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Testimony for the Committee for Purchase From People Who Are Blind or Severely Disabled

Public Hearings Relating to Governance and Executive Compensation

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Phillip Burton Federal Building
California/Nevada Room
450 Golden Gate Ave.
San Francisco, CA 94102

Barbara Nurenberg
President and CEO
JVS
29699 Southfield Road
Southfield, MI 48076
248-233-4200
bnurenberg@jvsdet.org

We appreciate the opportunity to comment on the issues regarding the Committees' plan to reissue a proposed rule on Non-Profit Agencies (NPA) Governance and Executive Compensation.

JVS is a 501(3) not for profit organization established almost 65 years ago in Detroit, Michigan. The purpose was initially to provide employment services to those most in need. Over the years, JVS evolved into a broad spectrum human service organization, serving the elderly, people with disabilities, the homeless and youth, as well as the underemployed and unemployed. We have also grown from serving a few hundred people each year in the Jewish community, to over 25,000 people per year on a non-sectarian basis, from all walks of life and age groups.

As part of our vocational rehabilitation of people with disabilities, JVS has several JWOD contracts for services with the Army, IRS, V.A., and other governmental units. These contracts represent an approximate projected revenue of $2,395,400 for the 12 month period of July 1, 2005 – June 30, 2006. These contracts employ 66 individuals in total, 60 of whom have severe disabilities based on federal standards. This compares to ~~comprised with~~ total or projected revenue of $23,069,000 from over 300 different foundations, governmental entities, the United Way and private corporate and personal donors. We have received the highest level of accreditation by CARF for over 30 years. In the spirit of full disclosure and transparency, I wear many hats. I am the President & Chief Executive Officer, a consultant for CARF for the past 20 years and a NISH Board member representing the International Association for Jewish Associations.

Speaking on behalf of JVS, we understand and support the Committee's desire to address the executive compensation and governance issue. Like the Committee, our highest priority is to ensure the continued confidence of Congress, taxpayers, Federal agencies and the general public that the JWOD Program operates with integrity and efficiency.

Qualified Agencies Have Good Governance Practices

The Committee has requested further information and perspective in several areas related to governance practices. This statement is structured to address each of these areas. To avoid redundancy, in a few areas, the questions have been combined where the basic theme is the same.

(1) Are these criteria comprehensive and inclusive enough to effectively evaluate that a nonprofit agency demonstrates good governance practices and should be deemed qualified to participate in the JWOD Program?

The criteria stated in the Federal Register of December 16, 2005 provide a comprehensive template for good governance. They seem to basically follow recommendations in the report, <u>Strengthening Transparency, Governance, and Accountability of Charitable Organizations</u>, published by the Panel on the Nonprofit Sector convened by the Independent Sector in June of 2005. This report has benefited from input from the very broad participation of people from organizations of widely varying sizes, programs and sources of support, and it reflects the charitable community's long-standing commitment to accountability.

Although we are supportive of the above referenced criteria that you issued for comment, we have two concerns. The first relates to "board composition reflecting the diversity of the communities served by the organizations". This concept is supported to the extent that the board should represent all geographic locations and represent the service needs of the communities served. This support of the criteria is contingent on our understanding that this is not meant to discriminate against faith-based organizations where the board is generally all of the same faith.

The second concern relates to the definition of "highly compensated employees as compensation in excess of $90,000.00". In many large urban cities, given the cost of living, a very large not for profit organization will have employees such as Director of Information Systems, Psychologists and others who command such salaries and also benefits due to standard labor market rates. They are not executives by any definition. We would suggest substituting a considerably higher limit of $125,000.00, given the cost of living, life insurance and other fairly standard benefits or limiting the definition to coincide with the IRS, which constitutes the 5 most highly compensated employees who are required to be listed on the IRS 990. We would encourage that your standards and definitions remain consistent with the IRS and Form 990 reporting requirements. Going beyond this would create excessive burden for many organizations and on the other hand, require little accountability on the part of smaller and less urban organizations who are unlikely to have salaries reaching the $90,000.00 standard.

(2) Are there additional criteria that should be used, or substituted for the above, to evaluate evidence of good governance practices by nonprofit agencies in the Program?

As cited in number (1) above, we would encourage the revision of 2 definitions to be used in interpreting the list of good governance requirements. No additional criteria need to be used with or substituted for the published criteria. The criteria stated in the Federal Register notice of December 16, 2005, sufficiently addresses the standards of best practices in good governance. JVS believes that the JWOD Program should remain in step with the larger non-profit community thinking as it takes a proactive approach to following governance best practices. JWOD participating organizations have no unique characteristics that require special criteria or regulations of their governance and other business practices. Thus, it is recommended that the recommendations contained in the report, Strengthening Transparency, Governance, and Accountability of Charitable Organizations published by the Panel on the Nonprofit Sector, convened by the Independent Sector in June of 2005.

(3) Should accreditation by state or national organizations be recognized as evidence of a nonprofit adhering to good governance practices without review by the Committee?

(6) What is the best way to ensure that only qualified central nonprofit agencies and nonprofit agencies, with an internal structure that minimizes opportunities for impropriety, participate in the Program?

In reply to questions three and six, the Committee should recognize accreditation as evidence of a nonprofit agency adhering to good governance and business practices if the accreditation criteria used by the reviewing national, state, or local entity includes governance provisions that are similar to or exceed the criteria stated in the Federal Register of December 16, 2005. Since a high portion of organizations serving people with disabilities are already CARF accredited, and they have a strong section on business practices, including governance, input from people served, safety and other business practices appropriate to organizations serving people with disabilities, this would also avoid duplication, as in many states, this accrediting is required for state and local contracts and grants.

(4) Should different benchmarks be used for nonprofit agencies that are state, county, or local government agencies, or should they be exempt from Committee regulations in this area?

I have no comment.

(5) Should the size and/or the annual revenue of the nonprofit agency be a factor or factors in assessing appropriate governance practices?

Small organizations may have an inordinate burden in accreditation as the fees are costly. Specific thresholds could be determined; however, a proposed threshold might be $100,000 in total JWOD sales and total sales revenue from all sources of $500,000. This would provide some relief but governance practices would still apply to the vast majority of JWOD producing nonprofits. Additionally, a quality improvement system (plan of correction) is required of CARF for areas where they have recommendations. The CARF report along with the quality improvement plan should be submitted to the Committee, NISH or NIB to provide full disclosure and a basis for needed monitoring (if any).

(7) What if any enforcement mechanisms should be adopted to ensure only the qualified central nonprofit agencies and nonprofit agencies participate in the JWOD Program?

We recommend a continuation of the periodic compliance visits that are based upon generally accepted auditing standards utilizing committee staff and staff of the two central nonprofit agencies. However, the frequency and extent of compliance monitoring to ensure the NPA's are employing people with severe disabilities should also be reviewed. We recommend a shorter time between reviews, resource for more in-depth, random reviews, and an increase in mandatory training. Given the dynamic growth of the program in volume and complexity there should be an annual review of enforcement mechanisms processes to assure that the current depth and breadth is still adequate.

(8) What steps will the nonprofit agencies and central nonprofit agencies need to take to avoid conflicts of interest among its board members?

To avoid conflicts of interest among its board members, nonprofit agencies, as well as central nonprofit agencies should use the existing guidelines published by the IRS and the Independent Sector addressing disclosure, board member selection, and compensation. These guidelines involve having specific policies and training that relate to disclosure, conflict of interest, compensation, and related matters. This also provides guidance that outline actions to preclude conflict of interest. An annual certification or written statement could be executed and forward to the Committee annually. However, if CARF accreditation is one of the accepted sources of endorsements, CARF has specific standards that cover this area.

(9) What steps will the nonprofit agencies and central nonprofit agencies have to take to demonstrate financial responsibility?

An annual certified audit by a CPA for organizations with an annual budget of $250,000 or greater and a statement of certification of compliance with IRS requirements by the Chief Professional Officer and Chief Volunteer Officer should suffice. Additionally, this should add little or no extra burden for the not for profit organizations and central nonprofit agencies. These are requirements that already exist for most not for profit organizations.

Effect of Executive Compensation on Fair Market Price Determinations

(1) What is the threshold beyond which the compensation paid to the executives in a JWOD-participating nonprofit agency should be considered as influencing a proposed fair market price determination? For example, if the agency receives more than a certain percentage of its total revenue from sales through the JWOD Program, is there

a compensation level (total dollars paid or total dollars paid as a percentage of total revenue) at and above which fair market price impact would be deemed to occur?

(2) **Conversely, is there a point below which executive compensation, regardless of the dollar amount paid, would not be considered as influencing a recommended fair market price? Is such a *de minimis* test appropriate for large diversified nonprofits where total JWOD sales represent only a small percentage of total revenue?**

(3) **Without regard to any analysis of JWOD-related revenue, is there an established benchmark or absolute dollar threshold above which compensation would be deemed as influencing a proposed fair market price?**

In reply to these three related questions, JVS believes that there is no absolute dollar threshold that could equitably take into account the vast differences in scope and complexity of the organization, product and service mix, populations of people served, funding sources, community needs, geographic issues, cost of living and varying federal, state, and local regulatory requirements of all not for profit organizations.

While there may not be an absolute dollar value that can fairly be used to assess the reasonableness of compensation, there is an existing process or guidelines established by IRS that the not for profit organizations are already required to follow. The verification of the use of these guidelines through certification preferably by the Chief Professional Officer and Chief Volunteer Officer would be reasonable.

In regard to recent assertions and/or speculations that higher CEO compensation on the part of a producing JWOD Non-Profit Agency (NPA) has a direct effect on JWOD Fair Market Prices seems highly unlikely if not impossible.

For example, JWOD contract prices are tied to prices from the commercial market. The Committee's guidelines, Pricing Memorandum # 3 (PR3), require that prices proposed by NPAs be tied to actual prices paid in the commercial market for the same or similar services. In fact, two of the JWOD Program's largest federal customers, the Defense Commissary Agency (DeCA) and the General Services Administration Public Buildings Service (GSA/PBS) established Market Pricing agreements that explicitly tie agreed to prices to the commercial market. In the case of DeCA, NPA's must have prices in line with other small businesses for the same or similar services. GSA/PBS prices are benchmarked against a very in-depth commercial market pricing indicator that is calculated by an independent third party on a rolling quarterly basis.

Additionally, JWOD approved Fair Market Prices allows for a General and Administrative (G & A) plus overhead rate that is capped at a rate 9.5% calculated on the NPA's subtotal of all costs for a given contract. This overhead rate includes fee (profit). NPAs have the ability to have their G&A rate set higher if they can demonstrate that their rate is higher based on actual experience. To the best of my knowledge, the alternative requires extensive documentation and rarely occurs except under extraordinary circumstances.

Finally, JWOD contracts are fixed price contracts which differ significantly from other contract vehicles such as fixed price plus incentive fee, cost plus or time and material contracts. The NPA is not able to claim increases in any rates or costs associated with the contract unless expressly agreed to by the parties at the time the contract is initiated. The risk for increased costs not associated with increased labor or health and welfare rates is solely the responsibility of the NPA.

In other words, even if an NPA wanted to pay excessive salaries or bonuses, these costs can not be added to the pricing calculation because of the fixed price nature of the contract.

If the Committee is determined to have a "metric", we would recommend disregarding compensation for any organization where the JWOD revenue does not exceed 1/3 of the total revenue of the organization.

(4) Should receipt of documentation to support a "rebuttable presumption of reasonableness" serve to demonstrate that executive compensation does not by itself influence a proposed fair market price or any adjustment thereto?

As noted earlier, an annual written statement or certification should suffice, signed by the NPA's Chief Professional Officer or Chief Volunteer Officer certifying that the NPA is maintaining a board of independent members, that the Board of Directors approves compensation arrangements for highly paid executives and individuals using independent comparative salary data gathered from similar organizations for similar executive positions, and documents data used in decision making for compensation packages.

(5) To what extent should there be a relationship between the pay and compensation of line workers and highly compensated individuals?

There should be no ratio or formula as there is no rational basis or good business practice for doing so. To the maximum extent possible, existing law and regulation including Internal Revenue Service law and regulation, the Service Contract Act, and the Fair Labor Standards Act should govern this process. Federal law and regulation govern the determination of compensation for both line workers and highly compensated individuals. NPAs should be expected to follow the spirit and letter of all applicable laws and regulations regarding the determination of compensation for both line workers and highly compensated individuals so that they can hire and retain the most talented individuals throughout all levels of the enterprise.

(6) **At what point would it be appropriate to begin a review of an executive compensation package even if the proposed price for a product or service would fall within a range that it could be considered as a fair market price?**

To the maximum extent possible, existing Internal Revenue Service law and regulation should govern this process. A review of an executive compensation package should begin whenever there is an indication of a need. The IRS has procedures for determining compensation for a "highly compensated individual." If they deem that these procedures have not been followed, they can initiate a review and appropriate sanctions. From a Committee perspective, if an NPA either fails to submit a required declaration or certification (as noted in #4 above) or provide an incomplete certification, the Committee could conduct follow up queries. As explained in detail earlier, the assumption that price is influenced by excessive executive compensation is not the case when examining the facts in a market based system using fixed-priced contracts.

(7) **What approaches are available to identity and monitor nonprofit agencies executive compensation that would provide such information to the Committee routinely but without placing an undue burden on agencies?**

A written statement or declaration, or certification (mentioned above), signed by the NPA's Chief Professional Officer or Chief Volunteer Officer, certifying that the NPA is maintaining a board of independent members, that the Board of Directors approves compensation arrangements for highly paid executives and individuals using independent comparative data gathered from similar organizations for similar executive positions, and documents all data used in decision making for compensation packages. Alternately or in addition, a copy of the Form 990 could be submitted directly to the Committee.

Once again, JVS appreciates having this opportunity to comment on the proposed rule and would like to reserve the right to add further input on these issues in the future. We look forward to working with the Committee and NISH to ensure the continued success of the JWOD program.