

CONVERSION FOUNDATIONS: DEFINING MISSION AND STRUCTURE

When a nonprofit health care corporation becomes a for-profit corporation through conversion, merger or acquisition, most state laws require that the full value of the nonprofit be preserved for public benefit purposes. The requirement may be met by transferring assets of the nonprofit to an existing charitable organization with the same or similar purposes. Most commonly it is met by establishing a new foundation.

Planning for the foundation should have the same level of regulatory and community oversight as the conversion transaction itself. Choices should be made through processes that encourage public dialogue, engage diverse elements of the community, and foster consensus about community health improvement goals. It is essential to include community members with unmet health needs in the foundation planning process. Active participation by advocates and community constituents can greatly improve how nonprofit assets are used in a philanthropic program.

The starting point is preservation of the nonprofit's historic purpose.

The most basic issue is to define the mission of the foundation to ensure that the funds are permanently dedicated to purposes consistent with those of the converting nonprofit. Foundations established from health organization conversions should be limited to accomplishing purposes related to health. Advocates should resist proposals to use funds for general charitable purposes, or to serve a broad range of community improvement goals. Such plans do not meet the legal requirement that charitable trust assets be used as nearly as possible to the purposes for which they were initially created. A broad charter will spread the new philanthropy across too wide an agenda and make it less effective in addressing community health needs.

At the same time, it is important that the mission not be so narrowly defined that the foundation cannot respond to health needs in its community as they arise and change over time. Plans that restrict funding to direct health services, purchasing health insurance, or continuing community benefit services of the converting nonprofit will limit the foundation's effectiveness. The foundation's ability to develop and lead health improvement

California Wellness Foundation

The California Wellness Foundation was established in 1992 following the conversion of Health Net, a major nonprofit health maintenance organization, to for-profit status. The Foundation's purpose clause reflects Health Net's focus on health promotion and disease prevention: *to improve the health of the people of California primarily through making grants for health promotion, wellness education and disease prevention programs.*

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initiatives important to the community will be curtailed if the mission is too specifically defined in advance.

Purpose language should be part of the foundation's governance documents, including the articles of incorporation and bylaws. A mission statement and/or a summary of key principles or values may also be adopted to more completely define how the foundation will do its work, and what issues it will address.

Dr. John T. McDonald Foundation, Coral Gables, FL

Doctor's Hospital serving Coral Gables Florida was supported by a charitable foundation named after its founder. Following sale of the hospital to Healthsouth, the foundation received nonprofit assets and retained the name of the community benefactor. Its purpose is: *to provide funding for programs and projects designed to improve, preserve or restore the health and health care of the people of Dade County, with priority given to projects in the Coral Gables community.*

Priority focus and geographic scope should be defined at the outset.

In shaping plans for new health foundations, communities recognize the need to focus philanthropic effort in order to have an impact and achieve results for those with the greatest need. Many mission statements indicate that the foundation has a priority interest in vulnerable populations - those who are at greatest risk for poor health and who face barriers to obtaining reliable, quality health care. Foundation priorities often specifically address the needs of people who are uninsured, underinsured, have disabilities or chronic illnesses, or are members of ethnic, language or other minority groups with disproportionate unmet health needs. Advocates should ensure that members of vulnerable groups in the community are involved throughout the foundation planning process.

The geographic area of the foundation is incorporated into the plan submitted for regulatory approval and into governance documents of the foundation. In most cases the foundation will operate in areas served by the converting nonprofit corporation. It is important to avoid too rigid definitions that could disenfranchise people in natural communities by strict reference to town or county boundaries. Conversion foundations should have sufficient flexibility to collaborate with other funders to address issues of statewide or regional significance. Wherever possible, language defining the foundation's geographic scope should indicate clearly the *primary* communities to benefit (as in the example above of the John T. McDonald Foundation in Coral Gables). The definition should not add barriers that will increase fragmentation of services, limit collaboration among funders, or prohibit the foundation from addressing areas of greatest need within its region.

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Sustainability and flexibility are key in mission definition.

A key goal in conversion planning is to ensure that community health assets are *permanently* protected and dedicated to health purposes. To preserve the asset base as enduring endowment, spending for grants and management of the foundation is generally limited to approximately 5% of the value of the asset base annually. Private foundations are *required* to make charitable distributions of 5% of their asset base annually, and may spend at slightly higher levels in some years. However distributions

significantly in excess of 5% annually cannot be sustained without using principal and thus reducing the value of the endowment over time. Thus a foundation with assets of \$100M will have an annual expenditure budget of approximately \$5M. To be effective, trustees of the foundation must be able to determine how to use the amount available annually in response to changing community health needs and opportunities.

Blue Cross and Blue Shield of Missouri

A 1994 restructuring of Blue Cross and Blue Shield of Missouri transferred 80% of its business to a for-profit subsidiary. The Attorney General and Commissioner of Insurance identified this as a conversion. Settlement of the suit brought by state regulators will create a foundation with assets between \$120 and \$140M. Though this will be the largest foundation in Missouri, its annual grant budget of \$6 to \$7M will not begin to cover costs of health insurance for the estimated 775,000 Missourians who are uninsured. Public officials and community advocates realized that restricting the foundation to this most direct transaction of the company's purpose would not meet a significant amount of the need and would not represent the best use of funds available. The foundation has a more flexible mandate to *identify and fill gaps in the myriad of public and private health care services already available to the uninsured and underinsured in the 85 counties (plus the City of St. Louis) comprising the former service area of Blue Cross and Blue Shield of Missouri; identify and address unmet health care needs...and identify and fund health care program opportunities...that can maximize the limited resources of the Corporation for the greatest possible effect upon the communities it serves.*

Under our current health delivery and insurance systems, many people lack access to reliable health care. The resources required to cover health care costs for those who are uninsured vastly exceeds what any foundation can provide. It is important that planning for conversion foundations not encourage the public sector or other health care institutions to reduce their commitment to addressing this issue. Agreements to continue essential services and community benefits must be negotiated with the successor for-profit as part of the transaction review. The foundation can play a role in addressing gaps in services and consider funding for urgent direct care needs. However, to fulfill their potential as effective

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community resources for health improvement, conversion foundations must be free to consider a range of grantmaking strategies.

Succeeding generations of trustees must balance direct service needs against opportunities to invest in prevention, public education, applied research, service evaluation and development of new delivery models. They should be able to consider funding documentation projects, advocacy, policy development and other initiatives directed at systems improvement and reform. Conversion foundation budgets should not be committed in advance to continuing particular services, or to funding priority needs defined at the point in time of their formation.

Community inclusive processes for program planning is critical.

As articulation of the foundation's public benefit purposes, the mission statement will guide subsequent program development and implementation. The mission statement forms the basis of the foundation's ongoing dialogue with its community and provides the framework for self-assessment and public accountability reporting. The foundation program plan and grantmaking criteria should result from more extended discussion, learning about philanthropic models, and meaningful engagement of the community in assessment of needs and opportunities.

Foundation planning processes should promote discussion of health goals and priorities *for the community*. The planning group or board should initiate an interactive community process to create wider opportunities for information gathering, dialogue and consensus building to inform foundation's grantmaking and program initiatives. In many cases, review of the conversion transaction itself will have included a health needs or community impact assessment and information from that review should also be incorporated in subsequent planning for the foundation.

Effective assessments use varied methods to gather information and to engage in consultation with the community: review of published reports and studies, data collection, surveys, focus groups, interviews with opinion leaders,

Mary Black Foundation, Spartanburg South Carolina

Established in 1996 following sale of a local hospital, the Mary Black Foundation committed resources early to a broad and inclusive health needs assessment. The study included focus groups, interviews and consultation with a wide array of community groups and agencies. Findings shaped the Foundation's priorities for a multi-year Healthy Spartanburg! initiative launched in collaboration with other local institutions. Through an active outreach and recruitment effort, community task forces were formed and provided with funding to plan activities in each of the Foundation's five priority areas. Together these working groups include representatives of close to 150 grassroots groups, churches, agencies, businesses and institutions serving Spartanburg County.

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invitational small group sessions and public meetings. It is important to solicit diverse points of view, and to use methods that encourage participation by people intended to benefit from the foundation's activities, generally those who are uninsured or underserved. Organizations that provide services to or advocate for disenfranchised and vulnerable groups in the community should be engaged as intermediaries to help with outreach, host or co-sponsor meetings, provide translation services, child care or other assistance to increase participation.

Planning leaders should commit to sharing reports and preliminary conclusions with informants throughout the process, and to circulating key documents in draft for comment to the widest extent possible.

How can a foundation planning process be organized?

Planning to shape the new health foundation can be initiated in several ways.

Regulators may appoint a foundation planning committee to oversee development of the foundation resulting from a conversion. Such a committee should include different elements of the community, diverse viewpoints, and the expertise required to guide

formation of a new philanthropic institution. In addition to civic, public sector, health industry and business leaders, foundation planning committees should include leaders from groups with unmet health needs, people with public health expertise and nonprofit, church and philanthropic leaders.

A community coalition formed in response to a conversion proposal may be designated to lead or participate in the foundation planning process, provided that it is broadly based in the community and has a sufficient management structure.

In cases where the board of the converting nonprofit takes the lead in mission definition and other foundation planning tasks, members should reach out to broaden participation and to include other elements of the community who are

Central Massachusetts Health Foundation, Worcester, MA

The 1995 sale of a nonprofit HMO, Central Massachusetts Corporation, was complicated by business and legal issues which took time to resolve. The Attorney General in Massachusetts approved the sale to protect the value of public benefit assets, but required a separate process for approval of the foundation plan. The HMO board was expanded by adding 6 new community members, including a representative of the broadly based community health coalition formed to monitor the conversion. With help from a philanthropic planning consultant, the expanded board initiated a widely publicized outreach effort and interviewed key informants in a community planning process. The community health coalition articulated standards for the new philanthropy. The coalition also reviewed the foundation bylaws, mission statement and guiding principles in draft and had input prior to completion of these key products of the planning process.

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not represented on the board. Community members may be added to the board, or invited to join ad hoc or special planning committees formed to help shape the foundation's activity.

However it is constituted, a group responsible for defining the mission of the foundation should have resources adequate to support an open, participatory process. The costs for skilled facilitation, engaging philanthropic expertise and conducting community assessment and planning should be covered from proceeds of the conversion under supervision of the relevant regulatory official(s).

In addition to determining the mission, priority focus and geographic scope of the resulting foundation, early planning will also determine how the foundation will be organized or structured.

There are several structural options for conversion foundations.

Most nonprofit health care organization conversions result in the formation of new, independent, private foundations, but there are alternatives that should be considered in many cases.

Private foundation¹

The most commonly selected form of organization, the independent private foundation, is governed by an autonomous board of directors. The endowment is invested to accomplish the charitable purposes, generally through grantmaking. If a private foundation form is selected, advocates should consider structural provisions to encourage ongoing community participation. Some alternatives include the use of outside appointing authorities to the governing board, community advisory committees and bodies of incorporators. (For additional information, please order the paper *Community Advisory Committees, A Structural Alternative for Conversion Foundations*. CHECK TITLE)

Private foundations are subject to an excise tax of up to 2% on investment income, are required to distribute 5% of the value of their endowment annually and are subject to other restrictions designed to protect the public interest.

Public foundation

Conversion foundations may elect to seek "public charity status" under the Internal Revenue Code (or to maintain that status previously granted to the hospital or health

¹ New independent foundations (both private and public foundations) may be established as either charitable corporations under Section 501(c)3 of the Internal Revenue Code, or as social welfare corporations under section 501(c)4. In general, 501(c)3 status is preferred for private foundations because it includes important public interest protections. For more information on the issues and choices involved in tax status designation, please order the paper on this subject, "Federal Tax Designation for Conversion Foundations".

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plan). Public foundations are not subject to an excise tax or a required annual distribution. Contributions to public foundations receive the most favorable treatment under the tax code. However to qualify as a public charity, a conversion foundation must meet an annual test for raising "public support" or donations from the public. The "public support test" is formulated in a ratio to the endowment. Since conversion foundations are generally formed with a large asset base, qualifying as a public foundation requires substantial fundraising on an ongoing basis. Few conversion foundations elect to undertake a development program on this scale.

Supporting organization

Foundations can achieve the benefits of public charity status without fundraising to meet the "public support test" if they are formed as a supporting organization to a qualified public charity. A number of conversion foundations have elected to do this, generally through affiliation with community foundations. Although some autonomy is relinquished, there are structural accommodations to the supporting organization form that can provide for community governance and participation. An advantage of the supporting organization option is efficiency as the conversion foundation can often make use of established staffing and philanthropic expertise. For additional information, please order the paper *Creating Supporting Organizations: An Option for Conversion Foundations* from the Community Health Assets Project.

Component fund in a community foundation

Community foundations are built through contributions from many donors, generally to serve charitable purposes in a defined geographic area. Thus they differ from private foundations which are typically created through donations from a single individual, family or corporation. Community foundations are public charities. They have ongoing programs to raise additional philanthropic gifts and are generally responsive and accountable to the public. Their governing boards are generally reflective of the community and may include members appointed by public officials or other outside authorities.

The endowment of community foundations is comprised of many component funds and grantmaking from these funds may be guided by advisory committees. In evaluating this option, advocates should consider the foundation's general record for accountability and responsiveness and what provisions can be made for community participation in management of the resulting health fund. Advantages to using a community foundation for conversion assets include the tax benefits of public charity status and the availability of existing staff, grantmaking and management expertise. This is an attractive option for conversions formed with a smaller capital base which would otherwise have to support the full costs of staff, office and investment management.

Transfer to another charitable organization Assets may be transferred to another charitable organization with purposes similar to those of the converting nonprofit. This option is sometimes selected because of a religious affiliation, or to preserve the

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educational and research functions of a health care organization which served these purposes. However if the purposes and geographic scope of the recipient nonprofit are not very closely aligned, this option will not adequately preserve the original purposes or provide for sufficient community oversight of conversion assets. It also may not meet requirements of charitable trust doctrine. Advocates should critically examine any proposal to transfer nonprofit assets to an existing organization.

Transfer to the public sector A few state governments have established publicly chartered vehicles to receive the assets from health care organization conversions, or have argued that part or all of conversion assets should be returned to public treasuries. Issues for consideration include: whether the assets will be used for health related purposes; whether they will be managed as permanent endowment or depleted for current use; and whether the governance plan recognizes the community stake in conversion assets. It is also unlikely that charitable trust issues will be met in a transfer of nonprofit assets to the public sector.

Conclusion

Foundations formed with assets of nonprofit health organizations differ from foundations created through private gifts to philanthropy. It is critical to ensure openness and public participation in the early planning for these foundations. Active regulatory oversight of the process and attention to defining the mission and structure are essential to forming new health foundations that are appropriate vehicles for public benefit assets and highly effective as philanthropic organizations.