

BUILDING STRONG FOUNDATIONS

Creating Community Responsive Philanthropy
in Nonprofit Conversions

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Foreword

More and more community groups, public policymakers, and foundation practitioners are becoming involved in shaping the new health philanthropy being created from the widespread reorganization of the nonprofit health sector. This handbook has been written for them and is unique in several ways.

First, it encourages all of these groups – but especially concerned community groups -- to continue stepping up their involvement, looking beyond the issue of asset preservation in nonprofit conversions and into the world of philanthropy. This is a world usually far-removed from influence by "non-experts." Yet, locally, it is not unusual for a single new foundation formed from a nonprofit hospital or health plan to dwarf all pre-existing philanthropy of any kind. The number of new health foundations, and the \$15 billion of charitable assets they now control, will only grow in the coming years as cost containment and other competitive pressures fuel further health industry restructuring. Over the last four years community groups have had an important impact on issues of asset and service preservation in nonprofit conversions. Now their concerns about the policies governing new health philanthropies are beginning to have a similar impact.

The focus on foundation design issues is also unique. Decisions regarding mission, governance, and operating principles are critical in setting the long term direction of any new institution. By the time a conversion is approved by regulators, fundamental decisions regarding the foundation's structure and orientation are complete. Community groups can have the greatest impact by becoming involved in these decisions during transaction negotiations and initial public review periods, rather than waiting until the foundation begins to operate.

The handbook recommends creating structural mechanisms that will enhance the openness and accountability of new health foundations, and thereby their long term public benefit impacts. This is in line with the thinking of a growing number of practitioners who believe that foundations are most relevant and, therefore, most effective when all of their elements – board, staff, and programs – are aligned with the constituencies and communities they intend to serve. Foundation financial resources then are able to leverage constituency leadership and grassroots participation as additional assets for community health improvement, including participation in shaping public policy to respond to priority community concerns.

The handbook combines in one set of recommendations best practices currently scattered among many different foundations, as well as innovative suggestions to increase programmatic effectiveness. These suggestions – and the growing experience of community advocates and new health foundations – offer models of accountability and community-responsiveness with promise for the wider field of philanthropy.

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Introduction

Background

Our nation has a proud history of communities and individuals coming together to create service organizations and resources to meet needs that businesses and government ignore. Private, non-governmental organizations such as churches, hospitals, museums, co-ops, food pantries, Scouts, health insurers, community clinics and credit unions are some of the wide variety of organizations that make up a vibrant third part of our society and economy, between business and government. These organizations are formed as nonprofits and are designed to help the community they serve, not to make profits for investors. They are controlled by boards of directors or trustees, who are usually volunteers.

The policies and laws which have been enacted to encourage and support nonprofits reflect the high value we place on the tradition of communities working together to meet their own needs. Nonprofits are private, not government organizations but because they receive government support, including tax-exemption, nonprofit charitable assets must be dedicated to public purposes. Boards of directors or trustees do not own the assets, but rather, they have the job of protecting the assets of the nonprofit, and seeing that they are used effectively to serve the needs of the community.

Nonprofit Service To Profit Making Business

Recently, all across the country, more and more nonprofit health organizations such as hospitals, HMOs, and insurance companies are becoming for-profit businesses. These transactions are called “conversions.” In these health conversions two extremely important community resources are at stake:

Health services such as indigent care, emergency room coverage, and other health services that are critical for maintaining healthy communities; and

Nonprofit assets that have been built by and on behalf of the public.

As conversions go forward, consumer and community advocates are working hard to see that the public interest in nonprofit organizations is well protected. The Community Health Assets Project, a partnership between Consumers Union and Community Catalyst, works to help community groups, state regulators, the media, and the public understand how to protect these essential health resources.

The Project provides technical assistance, strategic consultation, legal and policy analyses, and public education and training to organizations and individuals who are working to protect local health care assets. In many transactions community advocates have opened conversion proceedings to public scrutiny, participated in hearings, raised public awareness of conversions, and helped protect access to health care and health resources.

Among the most pressing issues facing advocates in a conversion is the determination of what will happen to the nonprofit assets after conversion. The sum of money at stake is enormous. In most cases the assets are preserved in a health related foundation in order to continue meeting community health needs. By the end of 1999 the amount of nonprofit assets set aside following conversion activity had reached more than \$15 billion, placed in over 122 healthcare foundations.¹

This handbook addresses how community and consumer advocates can get involved in the creation of new health care foundations in order to address the health needs of their community, state or region. It identifies the primary components of good conversion foundation practices, focusing on:

- ♦ A **planning process** that engages, in a substantial way, the perspective and expertise of consumers and health care advocates;
- ♦ A well formulated **mission statement** that dedicates the assets for purposes similar to the converting nonprofit;
- ♦ Criteria that ensure the **governing board** will have the appropriate expertise and experience and will be reflective and representative of the **diversity** of the community served;
- ♦ A **board selection process** that is deliberate, open, and accessible to health care consumers and the broader public, and is free of any conflict of interest;
- ♦ An **organizational structure** that is open to and accountable to the public, offers many opportunities for community input, and institutionalizes community involvement in a substantial way.

The Project believes that these recommendations are the best practices for building accountability into new foundations. This handbook also offers suggestions for involving philanthropic leaders in conversion proceedings to maximize the benefits for their communities.

While our discussion is focused on health care conversion foundations, these principles can be used just as effectively to build community accountability into the creation or restructuring of any foundation, not only conversion foundations. They also apply equally to foundations that may come from conversions in other industries as well, such as those in the student loan secondary market.

This handbook concludes with options which community groups and advocates can consider in working with conversion foundations after they are created. These same options can be considered as an effective way to hold any established foundation accountable in the public interest.

The ideas in this handbook are grounded in the collective experience of both Consumers Union and Community Catalyst who have worked with community partners on conversion transactions in more than twenty-five states. In some cases we identify alternatives and options that draw on the ideas of forward thinking established funders as well as advocates who are pushing beyond conventional practice, recognizing the uniquely public nature of conversion foundations.

We hope this handbook will provide you with the tools to get answers, get involved, and get results.

From Nonprofit Health Care Organization to Foundation: The Basics

Board members do not own the assets of a nonprofit health corporation. Rather, these individuals serve as stewards of the public trust, responsible for protecting assets that are permanently dedicated to public benefit purposes. The financial value of a nonprofit organization results from a pattern of broad community support, including the benefits of tax-exemption. Support for nonprofits also includes donations from individuals, government and charitable grants, and contributions of services, time and expertise, often over many years and from many sources. Because the public is the beneficiary and has participated in creating the value of a nonprofit health care institution, it has a significant stake in how its nonprofit assets are used following a health care conversion. This public interest creates an obligation on the part of the organization that receives the assets to ensure that there is community participation in all aspects of foundation planning, development, and operation.

When a nonprofit health care organization is sold to a for-profit purchaser or otherwise converts to for-profit status, the assets cannot transfer to the for-profit sector, but must remain dedicated for charitable health purposes. The charitable trust doctrine requires that a nonprofit corporation's assets, including donations, gifts, and all revenues generated by the organization, continue to be used to fulfill its original public benefit or charitable purposes. The obligation continues even if the nonprofit corporation changes its purposes, dissolves, or transfers its assets to another organization. When a nonprofit health care organization can no longer meet its charitable trust obligations, the cy pres doctrine² requires that the assets be used for another charitable health purpose that is as close to the original purpose as possible.

The solution most commonly selected to preserve nonprofit health assets consistently with the charitable trust and cy pres doctrines is to create a new foundation that will continue the charitable health purposes of the former nonprofit. Proceeds of conversion transactions are often used to establish a new nonprofit organized as a grantmaking foundation. As of 2000, more than 122 new health foundations had been created as a direct result of nonprofit to for-profit conversions.³

In some conversions, rather than form a new foundation, assets are transferred to an established community foundation or used to form a supporting organization of an existing public charity. In other instances, communities may determine that it is better to use conversion assets to directly fund needed health services, for example, funding a community clinic. Funding direct services eliminates the flexibility to meet the community's changing health care needs over time, but could ensure certainty and concrete results from the use of precious health dollars. Communities may want to

consider alternatives to foundations that address health needs. However, since most conversions currently result in the creation of new foundations, this handbook focuses on the critical components of these new health care foundations.

A health care foundation funded with assets from a nonprofit conversion has a unique public character and a resulting responsibility to ensure participation by the community it serves. Unlike foundations created from private wealth or corporate generosity, conversion foundations hold assets already dedicated to the broader public's benefit. Generally when foundations are created by private donors - individuals, families or corporations - the donors decide, on their own, how to distribute the funds for charitable purposes. In contrast, conversion foundation assets are not privately held, but are already dedicated to benefit the public. Thus the foundation is continuing a public trust. The board of trustees of a conversion foundation should determine how to spend the funds entrusted to it through meaningful consultation with the public. Foundations formed from nonprofit assets should represent and reflect the broader community and its health needs.

The argument for community engagement is reinforced by the experience of grantmaking foundations. Philanthropic organizations increasingly recognize the value of structures that enhance community empowerment and utilize community members' experience and expertise. Grantmakers seek to bring direct community experience and "voice" to bear in their decisionmaking because it strengthens the impact of their programs and more effectively addresses complex social concerns.

Early planning and decisions about structure and governance will determine many of the factors that influence how effectively a foundation engages its community and remains accountable to the public. Communities facing a sale or conversion of a nonprofit hospital or health plan that will result in creation of a new foundation should focus their efforts to require rigorous oversight, planning, and community involvement in that process.

Planning for New Health Care Foundations

Planning and forming a new health care foundation should be a public process. Regulator and consumer involvement strongly influence how effectively conversion assets are used and whether the resulting foundation will meet the highest standards for community engagement, accountability, and sound philanthropic practices. Planning for the foundation should have the same level of regulatory and community oversight as the conversion transaction itself does. The process should encourage public dialogue, engage diverse elements of the community, and foster consensus about community health improvement goals. Active participation by advocates and community groups, especially those representing people with unmet health needs, will greatly improve how nonprofit assets are used in a philanthropic program.

When a conversion transaction is first proposed, regulators immediately should begin planning for the subsequent use of charitable assets. The Attorney General (or other key regulator) can be actively involved throughout the planning, encouraging an open process and effective public participation. S/he should oversee selection of the initial governing board, review the proposed governance documents, and monitor the foundation program and operating plans. The formation of a foundation planning committee composed of community members can add capacity, skills, and credibility to the process

The Foundation Planning Committee

In order to gain the benefit of diverse community input, a regulator can convene a planning committee to make recommendations for establishment of the new foundation. A diverse planning committee is ideally suited to lead the public process for considering the important early decisions to be made about the foundation, including:

- ◆ Articulation of the public benefit purpose or mission of the foundation;
- ◆ Development of the criteria for board membership and a board selection process;
- ◆ Formulation of core values and principles;
- ◆ Determination of the structure of the new foundation;
- ◆ Establishment of the initial articles of incorporation and by-laws; and
- ◆ Incorporation of formal structures for community involvement and input throughout the life of the foundation.

Chaired by a highly respected community leader, the planning committee should include members representing a wide cross-section of opinions, backgrounds, and expertise. Including people who understand the concerns of vulnerable populations is critical. Individuals with expertise in public health, community development, and philanthropy will also provide beneficial input. A regulator may choose to designate a coalition of community groups to lead or participate in the foundation planning process, provided that

it is broadly based and has an adequate structure for decisionmaking. In some cases, regulators may elect to oversee and review a foundation planning process led by the board of the converting nonprofit. If the board is not broadly based and fully reflective of its community, regulators should require the addition of new members to gain more diverse perspective and expertise relevant to the planning task.

Other Avenues for Public Participation

Regardless of how the foundation planning process is organized, active community outreach to solicit a broad range of perspectives is essential. Regulators can achieve effective public process by overseeing the foundation planning and holding public hearings to gather community input and to review the foundation plan. For input to be meaningful, planners should commit to sharing their assumptions and preliminary findings throughout the process. Governance documents and the foundation plan should be made available in draft form for review and comment. At least one public hearing should seek comment on the foundation plan, articles of incorporation, and by-laws before they are finalized.

In order for the foundation planning to include meaningful public input, adequate resources should be allocated to support an open, participatory process. The costs for publicity and outreach, translation, skilled facilitation, recording, engaging philanthropic expertise, and conducting community assessment and planning should be paid by the converting nonprofit or covered from proceeds of the conversion under supervision of the relevant regulatory official(s).

Creating a formal foundation planning process geared toward openness and community participation can have a great impact on the outcome of a conversion. The planning sets the tone and provides a structural environment to involve communities and assure an open and public process.

Forming New Health Care Foundations: Issues & Standards

In some conversion transactions, the news that nonprofit assets of a health insurer, hospital or other provider will form a new health care foundation is not examined critically enough. Some community groups respond by positioning themselves to secure or qualify for grants. In either case, the opportunity to create a community-engaged foundation might be lost. Time and effort from consumers directed to planning the mission, governance, and structure of the foundation can ensure that it will allocate its resources effectively and be highly accountable to the public. By engaging in a process to carefully define the mission of the new foundation, to create standards for board membership and responsibility, and to choose the appropriate form and structure for the foundation, advocates can greatly improve the outcome of a conversion.

Purpose/Mission

The first task is to define the mission of the foundation to ensure that the assets are permanently dedicated to purposes consistent with those of the converting nonprofit. Foundations established from health conversions should be limited to health purposes. The purposes may be broadly defined but should be limited to health. Some health conversions have established foundations that support general community improvement projects and purposes completely unrelated to health. Advocates should resist attempts to use funds for general charitable purposes or to serve a broad range of community benefit purposes. Such plans do not meet the legal requirement that charitable trust assets be used as closely as possible to the purposes for which they were initially created.

The health mission of the foundation should be broad enough to allow grants to meet the community's needs as they evolve over time. The challenge is to draft a mission statement that focuses the foundation's work without too narrowly defining it. As the health care environment changes, the foundation must be able to refocus and respond to the community's needs. A foundation purpose that is clear enough to focus its efforts and enable it to achieve meaningful results must be balanced with the need to remain responsive and to address evolving community priorities and needs. It is also important to recognize that determining the health mission of the new foundation is an opportunity to set goals for enhancing access to health care and improving health in a community, rather than just maintaining the *status quo* before the conversion took place.

When crafting a mission statement, planners must balance direct service needs against opportunities to invest in prevention, public education, investigation, and the development of new delivery models. The mission statement should not limit the foundation strictly to providing or funding health care or insurance. The board's ability to consider funding policy development, data gathering projects, advocacy, and other

initiatives directed at systems improvement and reform is important if the foundation is to have a larger impact than the services its annual grant budget can support.

Equally important, foundation resources should not be used to supplant or replace governmental responsibilities. The resources required to cover health care costs for those who are uninsured vastly exceed what any foundation can provide. It is important that planning for new conversion foundations does not encourage the public sector or other health care institutions to reduce their commitment to addressing the ever-increasing health care crisis. A statement of intent that the foundation will seek to add value and leverage its funds may be included in the mission statement or foundation plan.

Similarly, making grants to nonprofit grantees that receive most of their operating funds from businesses may not be a good use of foundation resources. This is even more true of nonprofit health advocacy groups where business interests may conflict with the foundation's mission.

Conversion foundations are generally proposed as permanent endowments with a minimum spending of approximately 5% of the asset base annually. While this may be appropriate in many cases, it need not be a “given”. Advocates should weigh the potential community impact of spending out the capital and interest over five, ten or twenty years, for example, against what could be achieved with grants of 5% indefinitely from an endowment. Raising the question sharpens the focus on what will benefit the community's particular needs, the standard that should be used for all decisions about the foundation plan.

Who Will the Foundation Serve?

It is important for planners to consider the primary beneficiaries of the foundation's activities. Many incorporating documents articulate 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 missions may 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 disproportionately unmet health needs.

There has been much debate in conversion foundation planning about pre-defining the populations served. Advocates representing different constituencies have battled with one another in their attempts to have foundations focus on the people they serve, e.g., seniors, children, families, or the working poor. While these populations are those most often harmed by the fragmented health care system, they are not the only beneficiaries of nonprofit health providers. Even people with insurance living in affluent neighborhoods have contributed to the assets of nonprofit health providers and thus are the beneficiaries of a conversion. A challenge in foundation planning is to address the broad public's interest in conversion foundations. Communities have successfully argued that focusing

foundation resources on the uninsured and underinsured has a direct benefit to people with insurance, keeping their rates down and putting less stress on the entire health care system. A community may seek this more specific focus to guard against the foundation being so broadly committed that its grantmaking is diluted and ineffective.

Wherever possible, language defining the foundation's geographic scope should indicate the primary communities that will benefit. The definition should not be so restrictive as to increase barriers to health care, increase fragmentation of services, or prohibit the foundation from addressing areas of greatest need within its region.

Board Composition

Formation of the governing board is among the most important early decisions regarding the new foundation; both who will sit on the initial governing board and how board members will be qualified and selected in the future. Board selection should follow from an analysis of leadership needs, the development of criteria for individual board members and for the foundation as a whole, and a nominating and selection process designed to open the board to participation by diverse consumer constituencies.

The public's stake in conversion assets should be recognized and reflected explicitly at the level of the governing board. Creating governing boards that include people with diverse backgrounds, people from different areas of the community served, and people with a variety of philanthropic interests will enhance the strength and expertise of the foundation. It is important to seek representation from groups intended to benefit from the foundation's programs, including providers and advocates who have direct experience with target populations and consumers. The variety of ethnic, cultural, and linguistic groups represented in the community served should be reflected on the foundation's governing board. An ongoing commitment to maintain a diverse and broadly representative governing board should be stated in the foundation's by-laws.

To deliver the maximum benefit to its community, the new health foundation must act impartially. It must be viewed from the outset as making decisions fairly and without bias. It is essential, therefore, that the foundation neither carry nor assume obligations to fund services that the succeeding for-profit corporation will or should deliver. It must not favor (or disfavor) providers or other community partners on the basis of their alignment or competition with the converting nonprofit or its successor.

Therefore, board membership of the foundation should be completely independent from the for-profit successor company. No board member, officer, executive, or staff person from the for-profit should serve in any capacity with the foundation. However, if the foundation's endowment is primarily in the form of stock in the for-profit successor, a director or executive of the foundation may be named to the board of the for-profit company in order to represent the foundation's financial interests.

In some cases individuals formally associated with the converting nonprofit are excluded from sitting on the foundation board. In other instances members of the board of the converting nonprofit are considered, together with other candidates, for seats on the foundation board. Ideally, people affiliated with the former nonprofit should not receive priority consideration for board seats nor for any contract or staff position with the foundation. No paid or voluntary position with the foundation should be committed in advance to an executive or board member of the nonprofit that is the source of the endowment.

State, county, or municipal governments also should not control boards of conversion foundations. If they are to fully serve and add value to their communities, foundations cannot assume funding obligations of the public sector or displace government grants and programs. While a regulator may have a role in choosing the initial board of directors from a list of nominations supplied by an independent community advisory committee, public officials should have no ongoing role within the foundation. The assets of the nonprofit were created in the private nonprofit sector. Converting nonprofits originally were private organizations, not public entities; it would violate the charitable trust doctrine to allow those assets to come under government control.

Board Selection a Priority in California Conversion

The public prominence of the California Endowment*, as well as its mission, called for a broad-based inclusive recruitment process for its board. The process included both an outreach component to identify potential candidates and a point of access for interested individuals and groups who wanted to initiate consideration of themselves or other candidates for board membership.

A diverse blend of highly respected, seasoned search firms formed an executive search consortium to conduct outreach efforts throughout California. The search process sought to identify and recruit board candidates who represented the diversity of the state and the optimal skill mix from both corporate and nonprofit communities. The search consortium included a large international firm specializing in health care, a sole proprietorship focused on outreach to the Latino community, a mid-sized firm with a proven track record in diversity searches, and a 50% female-owned nonprofit search firm.

The search firms assembled a Search Advisory Group of health care and business leaders to provide strategic advice and counsel regarding the search project. The new board member recruitment, screening and final selection process included comment and approval by the California Department of Corporations. Eleven of the eighteen initial California Endowment Board members were newly selected for board service through the Search Advisory Group.

* The California Endowment was created in 1996 as a result of the conversion of Blue Cross of California from a nonprofit to a for-profit corporation

Attention to the size of the governing board is also relevant. While consumers and community interests should be well represented, concern for inclusiveness should not get in the way of a board's effectiveness. Boards of conversion foundations range considerably in size, with the median being twelve members.⁴ Larger bodies often assign significant authority to more limited executive committees. Thus, a very large board may not serve the goal of providing opportunities for broad participation and

representation of communities and interest groups. Consumers may be better served by more quantitatively limited participation on the board, together with membership on advisory committees to the foundation, rather than by making the board an unmanageable size.

Board Selection Process and Membership Criteria

Once the size of the board is determined, the planning committee is ready to define the process for selecting the first board of the new foundation and to establish the qualification criteria for board membership.

The process for selecting board members addresses two goals:

- ◆ Forming a governing board that is reflective of the community to be served by the new foundation; and
- ◆ Securing the leadership, skills, and connections needed for the foundation to be successful from the outset.

The foundation planning process should include a list of the types of expertise that should be represented on the governing board. This analysis will help shape the search for board member prospects, the selection process, and priorities for recruitment. Among the qualities to consider are sensitivity to community health needs, health policy or systems expertise, public health expertise, financial management, investment management, experience in philanthropy, nonprofit management, legal expertise, and board leadership skills. In addition to these qualities that are satisfied by the governing board as a whole, some communities have articulated criteria that every board member should meet, for example, that all board members show a demonstrated commitment to community health improvement, a record of voluntary service, or community leadership experience.

Foundations: Listening and Learning

The Kansas Health Foundation* conducts periodic "listening tours" across the state to assess the health needs of the Kansas community. The foundation's single agenda item is to listen to what Kansans have to say. Reliable and current information helps the foundation assess and respond to the health needs of the state. The foundation's "listening tours" have proven to be innovative, responsive, and appealing to many different groups of people.

An independent consultant hired by the foundation often arranges the "listening tour." The consultant is responsible for making contacts, sending out invitations, arranging for transportation, housing and meals. The consultant also assembles briefing books for the "listening tour" facilitators.

Foundation staff members travel all around the state, for a period of two weeks, meeting with various interested groups. For example, in 1995, the foundation visited seventeen cities and towns and met with a myriad of community groups including health care providers, teachers, entrepreneurs, public officials, historians, and health care consumers. Participants were asked a broad range of questions, including their perceptions on the major health issues in their communities, specific disease prevention issues, and barriers in addressing those issues. They were also asked to discuss the history of public/private partnerships in their communities, and to identify community leaders and resources. A typical meeting usually lasted for 1 1/2 hours.

The results of the initial tours were surprising. People were not as concerned with traditional medical issues (e.g., cancer and heart disease), as they were with greater societal problems such as keeping their communities free from drugs, violence, and crime. Specific urban issues included teen pregnancy, substance abuse, and violence inside and outside the home. Many of these problems affect a large spectrum of society, ranging from the very young to the very old.

Although not a scientific study, the "listening tours" facilitate discussion and public input and give the Kansas Health Foundation a way to assess general trends in its community. The foundation has used this information to create and fund grant initiatives and prioritize future health spending. A listening tour is one way the foundation practices good grantmaking.

* The Kansas Health Care Foundation was created in 1985 from the proceeds of the sale of nonprofit Wesley Medical Center to a for-profit company.

Once board membership criteria are established there should be a public and open process to search for qualified candidates. Planners (or the regulator) should disseminate the criteria for board membership, widely publicize the call for nominations, provide ample opportunity for many people to respond with suggestions, and be prepared with clear answers to any questions regarding how final selections are determined.

At the end of the outreach and nomination process, the initial board members must be selected. In some cases, the regulator acting alone picks the board. An alternative is the formation of a permanent community advisory committee to the foundation. Such a committee can be charged with recommending a slate of nominees to the appointing authority and can have an ongoing role in nominating members of the foundation's governing board in the future. (See page 19 for additional information about community advisory committees).

Community-Based Planning Should Shape Continuing Foundation Program

Once all regulatory and court approvals have been secured for the foundation plan and board members have been selected and seated, more specific planning is usually undertaken to shape the new foundation's grantmaking and program priorities. This phase may wait until staff is in place. Nonetheless, conversion foundation board members have an ongoing responsibility to see that the foundation is open and inclusive in all aspects of its operations.

Consultation with diverse elements of the community is essential for effective grantmaking by any locally focused foundation. It is especially important for health philanthropy because of the complex interaction of factors that influence health and well being. Some established conversion foundations are among the most successful of all philanthropies at using community engagement strategies. They adopt these practices in order to secure the involvement of key community leaders and constituencies and to collaborate with other institutions in the community. A broad base of participation enables foundations to engage in dialogue with others and to build consensus in order to set and achieve goals for health improvement.

Foundations that engage in effective community health assessments use varied methods to gather information and to work in consultation with the public. They review published reports and studies, collect data, conduct surveys, utilize focus groups, interview opinion leaders, convene small invitational group sessions, and hold public meetings.

For any conversion foundation, it is important to solicit diverse points of view and to use information gathering 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, to

host or co-sponsor meetings, or to provide translation services, child care, or other assistance in order to increase participation by their members and constituents.

One way to assure that community information flows to the new foundation is to require the foundation board and staff to attend an annual training hosted and conducted by representatives of the communities served. Required annual open meetings that invite community comment are another approach. Invitations for these events to broad sectors of the media, including ethnic media and other observers, can further open to healthy public scrutiny the foundation's processes for needs assessment, priority setting, and grantmaking.

Structure

It is important to consider the foundation legal structure in the context of how best to preserve and promote the values of openness, community engagement, and public accountability. There are two broad Internal Revenue Service (I.R.S.) categories that a foundation can be organized under, sections 501(c)(3) and 501(c)(4). While both of these forms are nonprofit, there are important distinctions between the two that should be considered when deciding on the form for a new conversion foundation.

To be an I.R.S. 501(c)(3) organization, a nonprofit must be “organized **and** operated exclusively for religious, charitable, scientific, ... literary, or educational purposes ... or for the prevention of cruelty to children or animals...”⁵ 501(c)(3) status recognizes that the organization is created for the public’s benefit. Some state laws actually classify 501(c)(3) organizations as public benefit organizations.⁶ Because there are limitations on a 501(c)(3) organization’s ability to engage in lobbying or political activity, the I.R.S. allows donations to them to be tax-deductible.

501(c)(4) organizations can also be organized for the public’s benefit. As described by the I.R.S., a 501(c)(4) is engaged in “promoting the common good and general welfare of the people of the community. . . operated primarily for the purpose of bringing about ‘civil betterments and social improvements.’”⁷ Yet, a 501(c)(4) receives less favorable treatment under Federal law than a 501(c)(3) in exchange for an enhanced ability to use its assets to engage in lobbying or other political activity. 501(c)(4) organizations include political or lobbying groups like Common Cause and the National Rifle Association. Donations to a 501(c)(4) are not tax-deductible.

Within the broad category of 501(c)(3) organizations, there are several choices for a conversion foundation. Private foundations and public charities are both classified as 501(c)(3) organizations, although they differ in the ongoing sources of their funding. If funding comes from a single corporation, an individual or family, the organization is generally classified as a private foundation. Most well known philanthropic foundations operate under this tax status. If an organization derives substantial support from the general public, it may qualify for status as a public charity.

Private foundations are subject to the most stringent I.R.S. rules. Many of the rules serve to assure public scrutiny and accountability, including the requirement to distribute at least a certain amount each year for charitable purposes, restrictions on board members’ ability to self-deal,⁸ and prohibitions against anyone privately gaining from the activity or business of the foundation. On the other hand, private foundations are subject to an excise tax on their net investment income.⁹

Like a 501(c)(4) organization, a public charity is subject to fewer Federal tax rules than a private foundation. This is because it must satisfy other requirements, the most important being the public support test. This test requires a public charity to receive more than one-

third of its funding from the public.¹⁰ Some of the private foundation restrictions apply to public charities, though a number of the important public accountability provisions do not. (See page 15 on private foundation restrictions.)

A third type of 501(c)(3) organization is known as a supporting organization. A supporting organization is a separate legal entity with a close relationship to at least one established public charity. Historically, supporting organizations have been created by families or individual donors who accept a less fully autonomous foundation in exchange for relief from the private foundation restrictions. In the case of a moderately sized endowment, a supporting organization may offer cost or management efficiencies while still providing a relatively high degree of community accountability.¹¹ Another option, generally appropriate for smaller endowments, is to create a fund within an established community foundation. If a determination is made to use a supporting organization or community foundation fund, community leaders should review and advocate for the public process and measures identified in this handbook that ensure community influence over the use of conversion assets. The concepts should be adapted and applied to any foundation vehicle selected.

An additional issue is whether the new foundation will function as a traditional grantmaking philanthropy or as an independent operator of programs and services. This second option is referred to as an “operating foundation” and it functions like a fully endowed nonprofit. Operating foundations decide on the work to be done and employ their own staff or contractors rather than granting funds to other organizations. They may operate health clinics, for example, or commission work by health policy analysts and researchers. Operating foundations may use advisory boards or other community guidance. They do not usually make grants to community groups or build capacity of nonprofit organizations within the communities served.

According to a 1998 Grantmakers in Health survey of health care conversion foundations, only three of the ninety-seven responding foundations were classified as 501(c)(4) social welfare corporations. The other ninety-four were all classified as 501(c)(3) organizations. Forty-two of the 501(c)(3) corporations were private foundations and fifty-two were public charities as of the survey date.¹² Many foundations initially qualify as public charities in the period immediately following the conversion. Subsequently the size of their endowments and the resulting levels of earned income make it difficult to raise enough funds to meet the public support test. In most cases, conversion foundations originally established as public charities ultimately become private foundations.

These are the basic structural choices available to communities that determine to form a foundation from assets of a converting nonprofit health care provider or insurer. Generally, private foundation status is preferable from the community’s perspective because of the greater public protections available. (See the discussion of private foundation restrictions on page 15.) Advocates and regulators should consider all options, however, and make their decisions considering the size of the assets, whether the

endowment is initially in the form of stock in the for-profit company, and how the foundation can best secure the kind of governance and linkage to its community that will make it accountable to the public.

Incorporating Documents

The principles guiding the ongoing work of the foundation rest in its governance documents: the articles of incorporation and the by-laws. The articles of incorporation include the basic information required under state law to form a charitable corporation. They limit the foundation to nonprofit purposes and usually articulate the specific mission, provide for the disposition of assets if the foundation is discontinued, and indicate how by-laws can be amended. The by-laws create the governance structure and formal guidelines under which the board, staff, and advisors must function. The initial foundation planning process should develop incorporating documents that clearly enunciate the mission of the foundation, establish board qualifications and the selection process, and formalize commitments to community engagement. If the foundation will be organized as a public charity, supporting organization, or a 501(c)(4) corporation, the by-laws can and should incorporate private foundation restrictions to protect the public interest.

Conflict of Interest Provisions

Among the most important elements to include in governing documents are conflict of interest provisions. These provisions serve to protect the community from any improper conduct by board members and staff that might put the charitable assets at risk. A provision should prohibit self-dealing and private gain on behalf of any parties associated with the foundation, including, but not limited to, the board members, staff, and advisory parties. It is also important to include language to ensure that funds are not distributed in a manner that benefits the succeeding for-profit.

By-laws should also include a clear conflict of interest policy appropriate to the needs of a grantmaking institution. The goal is not to prevent individuals who provide leadership for important communities from serving on the foundation board. Rather, the goal is to ensure that foundation decisions are not influenced by anyone with an interest at stake and that there is not the appearance of a conflict of interest, either of which could weaken public confidence in the foundation. Sound policies generally require board members to declare their affiliations (and those of close family members) with other nonprofits, including employment contracts, membership, or service on governing boards. By-law language should require that a board member leave the room prior to a vote on any business involving an organization with which s/he has a relationship. The member should not participate in the board discussion about that organization unless specifically questioned by another member of the board.

Private Foundation Restrictions

Incorporating I.R.S. private foundation restrictions into a foundation, regardless of its tax status, is the best way to ensure that the charitable assets of converting nonprofits are used solely to continue charitable health work. Adopting private foundation restrictions serves to protect a conversion foundation from the worst abuses found within philanthropy.

Private foundation restrictions include:

- ◆ A prohibition against holding more than 20% stock/interest in one corporation or partnership;
- ◆ The requirement that the foundation makes a minimum level of expenditures each year, defined as at least 5% of the average market value of the asset base;
- ◆ A prohibition against private inurement;
- ◆ Mandatory filing of a detailed tax return;
- ◆ A prohibition against engaging in any self-dealing transactions;
- ◆ A mandatory tax on investments that jeopardize the foundation's charitable purposes;
- ◆ A prohibition against grants for lobbying;
- ◆ Limitations on the foundation's ability to make grants to individuals and for-profit organizations; and
- ◆ A prohibition against certain types of loans.

Adoption of the private foundation rules ensures that the new foundation will meet at least minimal standards of public accountability. For example, the 5% minimum payout requirement results in a yearly guaranteed amount going to the community in support of the mission. The restrictions prevent the foundation from unduly delaying grantmaking to engage in extensive planning or for any other reason.

Spending Policy And Community Investment Strategies

Many foundation boards and managers believe that to preserve the asset base as an enduring endowment, spending for grants and management of the foundation should be limited to approximately 5% of the value of the asset base annually. Community advocates should understand that the private foundation restrictions are a floor, not a ceiling on spending. Depending on the earnings of the foundation's endowment, distributions significantly in excess of 5% annually cannot be sustained without using principal and thus reducing the value of the endowment over time. For some communities, increasing grants to meet urgent needs may be more important than preserving the endowment. It may be better for communities to distribute the endowment to achieve a major health impact rather than to spend the money slowly over time with less immediate effect. The tension between growing the endowment for the long term and improving current community health should be clearly addressed in the formation of the conversion foundation. Recent studies indicate that increasing the minimum payout by only one percent could magnify the yearly charitable contributions in the United States by at least \$4 billion dollars.¹³ Much higher payouts can benefit the community without jeopardizing the ability of the foundation to meet future needs.

Growing the endowment beyond increases in inflation is usually a board and staff priority, not a community priority.

When articulating a mission statement, advocates should consider incorporating language that provides opportunities for the foundation to expand its support to the community through investments in local projects, or by making loans at attractive terms. Equity capital for economic development or housing projects that benefit people with low to moderate incomes, loans for construction or acquisition of community health facilities, and low interest educational loans for professional development of health care workers are examples of such opportunities to use part of a foundation's asset base. These uses are referred to in the foundation world as program related investments, or PRI's. An established health care foundation can develop a PRI strategy at any point. By raising the issue early and by including in the foundation plan or by-laws the intent to make loans or other PRI's for community purposes, advocates can ensure this asset use is considered early.

Board And Staff Issues

It is preferable to frame requirements for board service in terms of background, skills, or expertise that should be represented on the board rather than to specify categories of people for particular seats (for example, reserving a certain number of seats for physicians). Limited terms of service and the requirement for rotation of new members onto the governing board are sound principles of nonprofit management. Limits on terms of service should be in the by-laws. Bringing on new board members nominated by a community advisory committee helps to bring current needs and thinking to the Board's decision making. Rotating terms so that no more than a minority of board members change at any one time will preserve the institutional memory and continuity of the Board. Advocates should be critical of any proposals for "life trustees," or by-laws that enable board members to serve for their lifetime.

Advocates should scrutinize any proposal that allows a conversion foundation to pay fees to its trustees or directors for board service, as this is not common practice among public and community foundations. Board members certainly may be compensated for the costs of travel and other expenses associated with their service on a foundation board. It may also be reasonable to provide the option for reimbursement for loss of income or childcare expenses or to offer an optional modest stipend in order to make board service feasible for low-income people.

Communities may also consider salary and experience requirements for staff. For example, the articles and by-laws might include a recommendation that all program staff have prior work experience with nonprofit organizations. They might also require that staff salaries be commensurate with the salaries of the foundation's grantees, e.g., for example that foundation staff salaries should not exceed by more than 10% the average salaries of grantee staff with similar responsibilities.¹⁴ A pay structure that rewards staff

for meeting defined goals may also be incorporated to assure staff accountability. This is common practice in the for-profit world. In order to assure that staff focuses on improving the health status of constituents rather than building an institutional power base, advocates may seek to limit the time of service for foundation staff, for example, to five years. Issues of institutional memory can be dealt with by staggering staff terms, with some flexibility of terms for initial hires. In addition, limits on overhead spending can be considered to minimize use of funds for foundation expenses and maximize the funds available to meet the foundation's goals.

Ongoing Commitment to Community Engagement

Many foundations adopt a variety of ongoing strategies to broaden participation and to practice more inclusive planning and decisionmaking. Foundations can seek active community consultation in setting grantmaking criteria, shaping program initiatives, and

<p>Foundation Institutionalizes Community Engagement</p> <p>The California HealthCare Foundation* uses community advisory committees to involve the larger community in the thinking, planning, and implementation of major initiatives. This process assures public involvement in the foundation's work.</p> <p>The Program for Elders in Managed Care, one of the first initiatives launched by the California HealthCare Foundation, uses a twelve-member advisory committee. Committee members represent diverse organizations, perspectives, and experiences in order to provide invaluable insight and guidance to the program. Members of the advisory committee include three geriatricians (one university-based, one from a staff model HMO, and one from an integrated health care system), four executive directors of community-based long-term care agencies, a representative of an area agency on aging, a representative of the American Association of Retired Persons (AARP), a California-based consumer advocate, a representative from the Federal Health Care Financing Administration, and a gerontologist and public policy expert from a major California university.</p> <p>The advisory committee played an active role in all aspects of the decision making process. The committee's involvement began by commenting on and reviewing drafts of the Request for Proposals that was used to solicit proposals under the Program for Elders in Managed Care. Committee members also reviewed all letters of intent and full proposals received by the foundation under the program.</p> <p>The California HealthCare Foundation now uses advisory committees in many of its programs. The foundation does not preclude advisory members from applying for the grants themselves, but advisory committee service is subject to the foundation's stringent conflict of interest policy.</p> <p><small>* The California HealthCare Foundation was established in 1996 as a result of the conversion of Blue Cross of California from a nonprofit to a for-profit corporation.</small></p>	<p>evaluating the impact of their work. Many use both standing and <i>ad hoc</i> advisory committees to gain the advantages of a wide spectrum of opinion, to secure particular expertise, and to learn from the viewpoints of those intended to benefit from a philanthropic program. Most grant making by United Way Programs is decided by a Community Advisory board of some form with the help of United Way staff. This direct form of community decision making may be</p>
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appropriate to meet local needs. At a minimum, by-laws should include provisions that encourage community involvement and public process in significant planning and program decisions of the foundation. Early assessment of community needs and interests should guide the establishment of foundation goals and priorities. Plans should be updated periodically using methods that seek input from the foundation's constituents.

Other requirements that preserve public accountability include open meetings, annual public meetings, appeal channels for decisions on grants, open nominating processes for board members, and regular reporting to the community on the foundation's goals and its progress in accomplishing key objectives.

Advisory Committees

Foundations can use both special as well as standing advisory committees for outreach, program design and development, grant application review, management of special program initiatives, periodic or ongoing evaluation, and for feedback on foundation activities and procedures. Advisory structures can significantly expand opportunities for community engagement and enrich and strengthen connections between a foundation and its constituents.

Meaningful and responsible use of advisors requires that the foundation make a realistic assessment of the resources required for the assigned task or responsibility. Advisory groups should be provided with staff assistance, financing, or other support adequate to their task. Clarity about the assignment, the extent of the advisory group's authority, its duration, and the terms and responsibilities of individual members is also critical. These issues should be covered in written materials and provided to new and prospective members of advisory groups.

While such advisory structures have been an effective means for making the work of foundations more inclusive, they seldom are required in conversion foundation structures or by-laws. To the extent that advisory structures and informal consultation rely on decisions of a foundation staff or board, they can be changed or discarded in the future. Providing in the by-laws for a permanent community advisory committee to the governing board addresses this concern.

Community Advisory Committees

Linking the foundation closely to the community it serves may best be accomplished by providing in the by-laws for a permanent Community Advisory Committee with at least these two important functions: 1) ongoing critical assessment of the foundation's interaction with the community it serves; and 2) serving as an outside

Community Advisory Committees in Action

The Colorado Commissioner of Insurance held a series of public hearings in 1997 on the proposed conversion of Blue Cross and Blue Shield of Colorado. There was considerable testimony before the Commissioner about the mission and governance of the foundation that would be created to hold charitable assets of the corporation, including calls for community representation on the foundation board of directors and public input into its funding priorities.

In response to testimony and a formal proposal from community groups, the Commissioner of Insurance established a Community Advisory Committee to serve as a nominating committee for the initial board of directors and to be a permanent intermediary between the foundation and local communities.

The Community Advisory Committee is a permanent committee of the foundation board. Its responsibilities are: 1) recommending to the Governor of Colorado a slate of nominees for the initial board of the new foundation; 2) subsequently recommending nominees as vacancies arise on the board; and 3) serving as an intermediary between the foundation and the community.

The Community Advisory Committee has thirteen members, two selected from each Congressional district, and one at-large member. The Governor of Colorado appointed initial members of the Community Advisory Committee following a statewide search for interested candidates and will fill vacancies on the Committee as they occur. Members serve for two years and may be appointed for one additional two-year term.

nominating committee to fill seats on the foundation board. In order to have adequate standing and a level of autonomy, it is important that the Community Advisory Committee report directly to the foundation governing board. Ideally, regulators should consider forming the Community Advisory Committee early in the foundation planning process so that it can play a meaningful role in selection of the initial foundation board. (See discussion on foundation planning on page 7.)

The Community Advisory Committee assists the foundation by suggesting methods to ensure public input in all facets of the foundation, identifying health needs, linking potential grantees to funding opportunities, and creating an information exchange between the community and the foundation.

Potential Constraints on a Foundation's Autonomy

In reviewing proposed conversions or sales of nonprofit health care organizations, advocates and regulators should be alert to constraints that could limit the foundation's autonomy, compromise its effectiveness, or prevent it from realizing the full value for the public assets.

Particular concerns arise when initial foundation assets are in the form of stock in the successor for-profit company. In order to ensure its financial strength over the long term, the foundation will need to sell this stock to diversify its investments. If the conversion involves a Blue Cross and Blue Shield (BCBS) plan, rules of the national BCBS Association require that the foundation complete the process within a limited time period. In order to realize the full value of its assets, the foundation must have the optimal ability to sell its stock. To the greatest extent possible, the foundation's board and management should control when and at what price it sells its shares. The foundation should have the full opportunity to participate when the company sells stock through an initial public offering and in all subsequent offerings. These rights – and any limitations on these rights – are generally spelled out in language that may be highly technical. The for-profit may seek to limit how, when, or to whom the foundation sells its stock, although the foundation has the same direct interest in maximizing the stock value. Advocates should work with regulators to be sure the foundation will have full control of decisions required to receive the maximum value of its endowment.

Some sales or conversion plans include “non-compete” provisions that improperly limit the foundation's options in serving its charitable mission. For example, foundations formed from a health insurer may be prevented from offering subsidized health insurance in cooperation with a competitor company of the for-profit successor. Or, companies that purchase a nonprofit hospital may seek to prevent the foundation from awarding grants to other hospitals in the community with which it competes, or even to nonprofit service organizations that are allied with competing hospitals. All such provisions represent a form of continuing control over charitable assets by the for-profit successor. They are an inappropriate constraint on the new health foundation and should be strongly resisted.

Non-compete clauses should not be included in the foundation plan or by-laws and advocates should press regulators to require removal of such clauses from the transaction documents as well.

Philanthropic Leadership

Advocates should seek to engage the leaders of established foundations as partners and supporters in the community response to health care conversions. Foundations and others with local expertise and strong records of working with communities may be particularly helpful. Established foundations have contributed to conversion transactions in the following ways:

- ◆ Sponsorship of community training about nonprofit conversions;
- ◆ Broadening participation in consumer coalitions through outreach to business, civic, government, and institutional leaders;
- ◆ Training and support to regulators about effective foundation structures and practices; and
- ◆ Funding or logistical support to strengthen community participation in the review of transactions and in planning for the new foundation.

North Carolina Coalition for the Public Trust

During the 1997 legislative session the North Carolina Health Access Coalition noted introduction of a bill that would enable nonprofit Blue Cross and Blue Shield of North Carolina (BCBSNC) to reorganize as a for-profit company without any set-aside of its public benefit assets. Understanding that passage of this bill would deprive the people of North Carolina of resources that should have been permanently dedicated to meeting health needs, the Health Access Coalition urged legislators to scrutinize and oppose the measure.

Within a few weeks, outreach to philanthropic leaders put the issue on the agenda of a meeting of North Carolina's community foundations. Participants at this meeting, which included staff and board members of the state's twelve community foundations, immediately issued a press release to highlight the philanthropic community's concerns about the BCBSNC proposal. They then circulated a statement of concern to board and staff colleagues at other foundations and major nonprofit institutions in North Carolina. Sixty-nine North Carolinians active in the state's nonprofit and philanthropic communities signed the letter of concern to key public officials. The letter called for creation of a charitable trust from the market value of BCBSNC in the event of a conversion. In response to the concerns raised, the legislature adopted a one-year moratorium preventing the conversion of BCBSNC and created a Legislative Study Commission to consider the issue further.

Nonprofit and philanthropic leaders stayed involved, organizing and recruiting others to join the broad-based Coalition for the Public Trust (CPT). Ultimately the Coalition had 424 individual and 111 organizational members. North Carolina community foundations jointly underwrote the budget for a two person staff, office, and legal expenses. CPT conducted an effective statewide public education initiative and worked with media contacts to raise awareness of the issues at stake. Within less than a year, in public testimony, BCBSNC finally agreed that it would form an independent charitable foundation with the full market value of its assets if it ever converts. The resulting bill (Senate Bill 993), adopted in May 1998, would protect 100% of the nonprofit assets should BCBSNC become a for-profit through a full conversion or acquisition by a for-profit. Philanthropic sector leadership was a key ingredient in this success.

The leaders of established foundations can strengthen the community response to conversion proposals and the planning for new health foundations. As institutional members of communities where conversions are underway or under discussion, foundation leaders understand the potential impact on health services and any reduction in capacity of the health and human services' safety net. Moreover, as stewards of limited philanthropic resources, foundation leaders can bring an informed perspective to

discussions about changes in local health care markets and expectations of what responsibilities can be transferred to nonprofit corporations and philanthropy.

Examples of specific affinity groups of private foundations which may have a natural interest in health care conversions would include: (1) Grantmakers in Health (GIH), whose mission is to “enhance the health and well-being of all people;” (2) Environmental Grantmakers Association, which is “a voluntary association of foundation and giving programs concerned with the protection of the natural environment;” (3) the National Network of Grantmakers, “an organization of individuals involved in funding social and economic justice;” (4) the National Committee for Responsive Philanthropy, whose mission is “to make philanthropy more responsive to people with the least wealth and opportunity, more relevant to critical public needs, and more open and accountable to all, in order to create a more just and democratic society;” and (5) local community foundations, which by definition “support charitable activities focused primarily on 'local' needs - those of a particular town, county or state.” In addition, Joint Affinity Groups (JAGs) and Regional Affinity Groups (RAGs) for staff and board members of private foundation may be able to provide meaningful input about the health concerns of vulnerable populations in communities across the U.S. Examples of JAGs include: the Association of Black Foundation Executives; Hispanics in Philanthropy; Native Americans in Philanthropy; Asian American/Pacific Islanders in Philanthropy; Jewish Funders Network; Disability Funders Network; Women in Philanthropy; Women’s Funding Network; and the Working Group on Funding Lesbian and Gay Issues.

Ensuring the Accountability of Health Care Conversion Foundations

Once a board of directors and organizational infrastructure (policies, procedures, priorities, staffing) are in place, community members will want to ensure that the public benefit responsibility is met throughout the life of the foundation. This section offers some options for holding conversion foundations accountable to the communities they serve, recognizing that the ultimate responsibility for accountability rests with the foundation's board of directors and with the state regulatory agency, usually the Attorney General's Office, that oversaw the creation of the conversion foundation.

The three sectors of our society – government, for-profit, and nonprofit sectors- are accountable for meeting their goals and missions with varying degrees of efficiency and effectiveness. Voters hold government accountable. Business corporations are answerable to shareholders and to customers. By granting and withholding support, the public and government determine the viability of nonprofit enterprises. Within the nonprofit sector, however, an endowed private foundation can do pretty much as it pleases as long as no laws are broken and its mission is followed. Although most foundation board members take their duties seriously, there is no clear standard of performance that they must satisfy. Foundation board members and staff have no outside authority that assures their effectiveness in meeting community health needs. Therefore, building accountability into a foundation from the start is essential.

Many accountability strategies have their beginnings in the thoughtful and vigilant planning that precedes the establishment of the conversion foundation. Some of these strategies are relatively common and well tested; others are more innovative and will require strong support from regulators and community members. Underlying all of these approaches is the fundamental principle that conversion foundations have a singular responsibility to benefit the public.

While there is no consensus within the field of philanthropy about whether – and how – foundations should be more accountable in serving their charitable missions, there is growing interest in the topic. Discussions of the issue involve leading foundations that resulted from health care conversions and some established from individual, private, or corporate donations. Community foundations, too, are beginning to look closely at what constitutes accountability in philanthropy and how to approach and measure it effectively. As evidence of the growing interest in philanthropic accountability, the Council on Foundations has established foundation accountability as one of its cornerstone priorities for the coming five years.

The absence of generally accepted performance standards complicates the accountability question but leaves room for thoughtfulness and creativity in approaching the issue. The

challenge in looking at foundation accountability is to establish the specific factors against which a charitable entity will be assessed. What does accountability mean? Does it mean the same thing to all stakeholders? Who are all the stakeholders? Are there process as well as outcome dimensions to the question? These questions merit considerable thought by any individual, group, or community seeking to assess the structure, behavior, practices or results of a conversion (or any other) foundation. There are no simple answers, but consensus among key members of the community, regulators and the conversion foundation board is essential to ensure that all parties are “on the same page” conceptually and technically.

Because the development of accountability standards is in its early stages, communities and foundations must discuss and apply their own best thinking and creativity to defining benchmarks and measures. Some process measures may be important to communities as indicators of clarity and objectivity in the foundation’s decision-making processes. For example, understanding how decisions about grants and programs are made, including the degree of public participation or the use of objective data, may be meaningful. Communities may ask foundations to demonstrate the value they place on broad consumer input and on objective empirical data and analysis by showing how such input is used in decision-making.

How the foundation works with the nonprofit organizations in the community it serves (collaborative partnering versus the more usual top-down planning model) also may be a measure of the foundation’s ability to implement its community and public obligations. The commitment of the foundation to objectively and constructively evaluate its grants (individually and collectively), and its willingness to adjust its grantmaking policies, priorities and procedures accordingly, are indicators of flexibility and commitment to producing tangible results. The involvement of constituents in program evaluation may be important. The inclusion of community health outcomes in the foundation’s goals and a commitment by the foundation to measure and report to the community on its own progress toward achieving goals may be significant. These imperfect measures of accountability offer a starting point for community members and foundations to begin a constructive dialogue to ensure the maximum community benefit from a conversion foundation’s work and resources.

As an overall strategy, community members should be aware of the specific governmental agency or unit responsible under the law for monitoring the philanthropic work of conversion foundations. Most often this is a division within the state Attorney General’s Office. Being familiar with the regulatory process and the opportunities for community input is a basic and essential first step toward ensuring long-term accountability of health conversion foundations. The opportunities for public input can be used to acknowledge the good work of the conversion foundation, as well as bring attention to activities or policies that are not fully consistent with the foundation’s public benefit obligations.

Community members always have at least two legally required sources of information about the conversion foundation's operations and philanthropic work. Regularly reviewing the foundation's Form 990 (the nonprofit equivalent of a tax return) provides considerable information about the foundation's finances, including its expenditures, grants and investments. These forms are available for public review in the offices of the state regulatory agency and many states have arranged for the 990 information to be available on-line. For example, the California Attorney General's office has recently added to its website a searchable database of Forms 990 filed by California nonprofits and it can be accessed by going to <http://www.caag.state.ca.us/charities>. In addition, most foundations are required to have 990s available for public review in their offices.

Many conversion foundations also issue annual reports that describe their activities and finances during the previous year. Along with the form 990, the annual report provides clear information by which community members can assess the foundation's work and its adherence to its public benefit obligations. Careful attention to information about overall payout (grants made during the previous year); expenditures for salaries, benefits and other overhead expenses; and investment returns will help community members better understand the operations of the conversion foundation and the strategies it employs to meet its mission and its public commitments.

Reviewing the foundation's form 990 and annual report will also provide community members with information about the specific grants made by the conversion foundation during the past year. Comparing the patterns of grants with the mission, principles, and priorities established by the conversion foundation will help community members develop their own understanding about how the foundation is meeting its mission in practical terms.

Increasingly, foundations are commissioning anonymous surveys of their applicants and grantees (they often refer to them as "customers") as one way to assess the foundation's accessibility and overall user-friendliness. This type of research, if used constructively by the foundation, regulators and community members, can help the foundation improve its organizational structure and its performance. It can enable the foundation to be more accessible and responsive to individuals and nonprofits in the community it serves. Such an approach works only if the results of these surveys are made public and if the foundation is committed to making changes from the resulting data.

The foundation can be required by its by-laws to host open, public, annual meetings and ensure public participation at these meetings. Community groups can request such meetings even if not required in the by-laws. Such meetings offer an opportunity for interaction and dialogue between the foundation and the public whose interest the foundation is entrusted to protect. Ideally, a neutral, trusted organization can be called upon to sponsor such a public meeting to help ensure that it is truly an interactive and substantive exchange, and not simply a public relations activity.

Other creative accountability strategies include periodic, independent evaluations of the conversion foundation. During the conversion process, provisions for regular evaluations of the foundation can be built into the new foundation's budget and charter. Such evaluations can be done every three to five years and can include assessments of the foundation's structure, expenditures, grants, and aggregate impact on community health. To ensure the independence of these evaluations, the process should be overseen by a trusted organization, paid for by the foundation, and administered in as "transparent" a manner as possible. Results of the evaluation need to be easily accessible to the public and any recommendations for changes or other corrective actions monitored by regulatory agencies and community members. These evaluations ought to ask the "so what?" questions that will document the extent to which the conversion foundation has been successful in meeting its community health mission and its public benefit obligation.

A less common and more creative set of strategies for ensuring the accountability of conversion foundations requires thoughtful planning, research, and organizing. Community groups can and should know what their foundation is doing, how it is operating and if the staff is accessible. If there is a serious question about whether the foundation is maximizing benefits to the community and meeting its mission and goals, some further work needs to be done. Information such as the Form 990s, annual reports, surveys by the community and evaluations by the foundation should be requested and reviewed. If the analysis of information raises questions, community groups can organize meetings, asking foundation representatives to attend and describe their process for priority setting and for measuring their accomplishments. Thorough, balanced research and analysis provide a credible basis for a community to ask questions and get respectful explanations. Foundations are not used to being held accountable and groups who are seeking grants may be wary of openly questioning a foundation's actions. But, in order to make sure that the foundation and community members work together, a new openness is necessary.

Some new thinking has emerged about the value of establishing an independent "ombudsman" function to provide a safe mechanism for community members, nonprofit organizations, and others to make complaints, suggestions, or recommendations about foundation practices and policies. Such an office could be funded by the conversion foundation's assets but should be administered by a trusted, independent organization in order to be truly effective in this sensitive role. Some conversion foundations have assigned the role of safe conduit for information – including critical information – to a permanent community advisory committee reporting directly to the foundation board (see page 19 for more on community advisory committees.)

These strategies for ensuring the accountability of conversion foundations come from the public's genuine interest in the health of its members. Conversion foundations should be strongly committed to their own ongoing public accountability and to a high degree of openness in their philanthropic work. Ideally, the public and the conversion foundation will find considerable common ground in developing a plan for ongoing accountability, rooted in a commitment to continuous improvement and public participation. This

avoids a polarization between the public's right to know and the foundation's legitimate responsibility to fulfill its mission and to pursue its community health goals and priorities.

Accountability for public benefit in conversion foundations is a complex issue that certainly does not end with the creation of the foundation. Rather accountability remains an important concern throughout the life of the foundation. Ensuring meaningful mechanisms for community evaluation and input begins during the foundation's initial planning and formation. Exercising those opportunities regularly on behalf of the public thereafter is a fundamental aspect of the public benefit doctrines governing the for-profit conversions of nonprofit health institutions.

Conclusion

An essential ingredient to a successful conversion transaction is the creation of a foundation that will have a long-lasting benefit to its community. With a strong foundation planning process in place, community advocates can influence the early stages of a foundation's creation. Board membership criteria that reflect the importance of community expertise, and a selection process that is open to the public, can go far in assuring a responsive and responsible board of directors. By incorporating structural provisions that institutionalize the role of the community and put into place important private foundation and conflict of interest provisions, advocates and regulators can provide for greater public accountability of the resulting foundation.

Advocates have many different tools that they can use to shape a foundation's mission, governance and structure in a direction that will benefit the community. Public pressure and involvement in this vital part of a conversion transaction is of utmost importance. With more than \$15 billion already in foundations created from health care conversions, the potential for improved community health is clear.

The Community Health Assets Project

The Community Health Assets Project is a national effort that seeks to protect nonprofit charitable assets and to ensure that health needs are addressed in the change of nonprofit health care institutions to for-profit status, transactions that are referred to as “conversions.” The project is a joint effort of the West Coast Regional Office of Consumers Union of U.S., Inc. and Community Catalyst in Boston, Massachusetts. Funded primarily by foundation grants, the project provides its assistance free of charge. A team of skilled attorneys, health policy analysts, and community education specialists with extensive experience in the full range of issues presented by conversions staffs the project. They provide assistance and technical advice to consumer groups, legal services organizations, philanthropic leaders, legislators, and regulators. They emphasize a collaborative approach in working with leaders from individual states and communities. The project staff have a unique ability to apply a broad base of experiences to the particular circumstances of a given state, community, and transaction. They can provide the following services:

Trainings

Trainings for local groups, policymakers and media familiarize participants with the full range of policy issues involved in conversions and lay the groundwork for participants to design a course of action most appropriate for their communities. Trainings provide accessible information, encourage active participation, and utilize local groups’ knowledge of community needs and unique circumstances.

Public Education

Written public education materials, both generic and situation-specific, are available for community groups, policymakers, philanthropic leaders, and the media. The project can sponsor or co-sponsor educational forums for these same audiences. Individually tailored materials specific to each community’s set of concerns cover a broad range of topics.

Legal and Policy Analyses

Legal and policy analyses of proposed laws and state statutes and regulations are available from project staff. Analyses of transactions identify specific public interest concerns ranging from health care delivery impacts, potential antitrust issues, valuation (how much a company is worth), protection of community benefits, and preservation of charitable assets.

Strategic Consultation

Strategic consultation involves ongoing advice and analysis of a conversion proposal and the conversion process as it unfolds. Project staff can assist by providing ideas for successful outreach and involvement, as well as advice about specific issues such as model

approaches for establishing mission and governance principles for foundations that might receive the assets. Consultation services also include facilitating discussion among diverse parties.

Information Clearinghouse

The project tracks regulatory, legislative, and market developments in the fast-evolving area of conversions. Staff generates public policy criteria and questions for review of proposed transactions through clearinghouse information. This service enables community groups, policymakers, and the media to access the most recent developments and models for handling the complex policy issues that arise in conversion transactions. Staff also publishes regular “FYI” updates that provide current information on conversion activity throughout the country. Additional information can be found at Consumers Union’s advocacy website at www.consumersunion.org.

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Notes

- ¹ "Philanthropy's Newest Members: Findings from the 1999 Survey of New Health Foundations", Grantmakers in Health, March 2000.
- ² "Cy pres" is from the French meaning "so nearly as, as nearly may be."
- ³ "Philanthropy's Newest Members: Findings from the 1999 Survey of New Health Foundations", *supra*.
- ⁴ Grantmakers in Health
- ⁵ Treasury Regulation § 1.501(c)(3).
- ⁶ For example, Missouri's nonprofit corporations law designates 501(c)(3) organizations as "public benefit" or "mutual benefit" corporations. R.S.Mo. § 355.881(3). California's Nonprofit Corporation Law also renders all charitable and public purpose nonprofits, which includes 501(c)(3)'s, as "public benefit" corporations. Cal. Corp. Code §§ 5111, 7111.
- ⁷ Treasury Regulation § 1.501(c)(4) – 1(a)(2)(i).
- ⁸ Under Federal Law, self-dealing refers to a wide variety of direct and indirect transactions between a private foundation and its "disqualified persons", i.e., those who are in a position to influence or control the charity's actions, as well as companies controlled by those persons.
- ⁹ Under 26 U.S.C. §4940, a private foundation pays a 2 percent (in some cases 1 percent) tax on its investment income each year.
- ¹⁰ Public support is defined as any combination of 1) qualifying gifts, grants, contributions from diverse sources, or membership fees, and 2) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in activities related to its exempt functions. See, "Coming of Age," *supra*.
- ¹¹ See, "Creating Supporting Organizations: An Option for Conversion Foundations," by Consumers Union of U.S., Inc., 1998.
- ¹² "Health Care Conversion Foundations: 1997 Status Report," *supra*.
- ¹³ "Spending Policies for Foundations: the Care for Increased Grants Payout," Study by Perry H. Mehrling, Chairman of Economics Department, Barnard College, Columbia University, National Network of Grantmakers, 1999.
- ¹⁴ Communities might also consider limiting grants to organizations whose highest staff salaries are no more than five times the salary of the lowest staff salaries.

Questions to Ask...

...about foundations formed as the result of nonprofit conversions.

As philanthropic organizations formed from assets held for public benefit, new health care foundations should be responsive to the communities they serve. They should also be highly accountable for their stewardship and effective use of these community assets. Here are some questions we believe any foundation should be willing and able to answer forthrightly. If your community is served by a foundation formed from assets of a nonprofit hospital or health plan, these questions might serve as the basis for discussion with the foundation about its work and its role in the community.

1. What is the foundation's statement of mission or purpose? How was the mission statement developed? Who participated, and what information about the community was considered? Is the mission reviewed periodically?
2. Who does the foundation intend to benefit? What will change for these people if the foundation is effective? How are the views and experiences of targeted beneficiaries represented in the ongoing work of the foundation?
3. What are the foundation's current goals? What does it seek to accomplish? Within what time period?
4. How does the foundation engage the community it serves in planning, implementation and evaluation of its work?
5. What is the review process and criteria for grantmaking? For foundation initiatives determined other than by reviewing proposals? How are funds allocated between grants and other funding commitments?
6. What non-grantmaking activities does the foundation pursue? How do these support the achievement of key strategic goals?
7. How does the board assess and measure its own progress toward organizational goals? How broadly are the results of self-assessment shared?
8. Who currently serves on the governing board? Does the foundation have goals related to board diversity and if so, what is the current status? What qualities are sought in recruiting board members?
9. What is the nominating process for board members? Do any non-board members participate? Are there opportunities to suggest people to be considered for service on the board?
10. What percentage of funds paid out each year go to grants, overhead expenses and contracts for foundation initiatives? What percentage of funds paid out each year goes to nonprofit organizations, community based organizations, general support grants, advocacy, direct services and research? What percentage goes to for-profit businesses?

Resources For Philanthropy Formation

OTHER MATERIALS AVAILABLE FROM THE COMMUNITY HEALTH ASSETS PROJECT

Please check the information you would like to receive and fax or mail with the order form on the next page. For more information regarding our conversion work visit the Consumers Union web site at www.consumersunion.org.

- ❑ *Selling Out? How to Protect Charitable Health Dollars and Services*, a basic manual published in 1998 by Consumers Union and Community Catalyst
- ❑ *The Public Interest in Conversions of Nonprofit Health Charities*, report co-published in 1997 by Consumers Union and the Milbank Memorial Fund
- ❑ Model Articles of Incorporation and By Laws for 501(c)(3) Foundations
- ❑ *Creating Supporting Organizations: An Option for Conversion Foundations*, by Julie Silas

Educational Resource Papers on Conversion Foundations

- ❑ Conversion Foundations: Defining Mission and Structure
- ❑ Conversion Foundations: Ensuring Community Participation
- ❑ Conversion Foundations: Standards for Governing Boards
- ❑ Federal Tax Designation for Foundations Created from Conversions
- ❑ Community Advisory Committees
- ❑ Questions to Ask About Conversion Foundations

Foundation Best Practices, one-sheets

- ❑ Community Advisory Committees, California HealthCare Foundation
- ❑ Board Recruitment, Caring for Colorado Foundation
- ❑ Board Recruitment, The California Endowment
- ❑ Community Involvement, Kansas Health Foundation
- ❑ Planning for Grantmaking, Mary Black Foundation
- ❑ Grantmaking, Williamsburg Community Health Foundation

Participation by Philanthropic Leaders: Why should established foundations be interested?

Case Studies: Effective Philanthropic Engagement

- ❑ Associated Grantmakers of Massachusetts
- ❑ North Carolina Coalition for the Public Trust
- ❑ Article, "The New Health Philanthropy: Ensuring the Effective Use of Conversion Foundation Assets," *States of Health*, November 1998.

- ❑ Mission Statement Examples

Resources Materials Order Form

Please complete the following information.

Name: _____

Organization: _____

Address: _____

City/State/Zip Code: _____

Phone/Fax: _____

Please return completed form to:

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