Agenda

- Why share services or merge?
- Considerations Before Moving Forward
- Key Points: Shared Services and Mergers
- Government Funding Issues
- Key Players and Their Roles
- Lessons Learned
Working Better Together: CAPLAW’s Guide to Shared Services and Mergers

Resource
http://www.caplaw.org/resources/PublicationDocuments/mergersandsharedservices/Introduction.html

Working Definitions

**Share Services**: Arrangements between multiple orgs to share administrative or programmatic functions or physical resources

**Merge**: General term used to describe a transaction in which two or more organizations become one

Ask “How do we best fulfill our org’s mission and strategy to be effective, and is [this] a better option than other alternatives?”

Thomas McLaughlin, Nonprofit Mergers & Acquisitions
Motivating Factors

- Cuts in government funding and intensified competition for funding
- Increased funding source expectation for effectiveness, efficiency and oversight
- Strengthen financial position
- Increase exposure within community
- Expand service programmatic offerings
- Executive/leadership transitions

Benefits

- **Efficiency**
  - Reduce duplication & operational $s
  - Standardize process

- **Economies of Specialization**
  - Access specialized services
  - Raise sophistication level

- **Sustainability & Investment**
  - Expand donor base
  - Preserve institutional knowledge

- **Purchasing Power**
  - Bulk purchasing discounts

- **If share services: keep identity & autonomy**
  - While minimizing costs
Case Study

Agency A
• Non-profit; $25M annual revenue
• 15 board members; 420 employees
• Serves 24 counties (mix urban/rural)
• Programs:
  – Head Start
  – Pre-kindergarten (State-funded)
  – Neighborhood service centers (CSBG)
  – WAP
  – LIHEAP
  – Long Term Care Ombudsman
  – Emergency Food and Shelter (FEMA)
  – Rural Housing Preservation (USDA)
  – Housing counseling/education (HUD)
  – 5311 Rural Transportation Program
  – Homelessness prevention

Agency B
• Non-profit; $4.5M annual revenue
• 18 board members; 20 employees
• Serves 9 counties (rural)
• Programs:
  – CSBG
  – WAP
  – Long-Term Care Ombudsman
  – 5311 Rural Transportation Program
  – Emergency Food and Shelter (FEMA)

Case Study

- Share services or merge?
- What are the benefits and drawbacks to each option?
- What are the issues to consider in entering into such an arrangement?
  - Structure
  - Governance
  - Staffing
  - Grants
  - Facilities and equipment
  - Financial management and oversight
  - Cost of each option
  - Culture and identity
Considerations Before Moving Forward

When Should We Start?

- Before it is necessary (i.e., before there is a crisis/before programs have been damaged)
- Often leadership transitions can be a good time to initiate conversations internally and externally
What is the First Step?

- Start with self-assessment
  - Motivations
  - Desired goals
  - Critical issues
  - Organizational obstacles and red flags
  - Financial position

Choosing Partners

- What are some ways of identifying potential partners?
  - Existing alliances and collaborations
  - Board or ED contacts/relationships
  - Working with a consultant
    - E.g., state CSBG office or CAA state/regional association
Choosing Partners

- What should we look for in a partner?
  - May, but need not necessarily be, another CAA or Head Start grantee
  - Both organizations bring strengths (e.g., resources, relationships, experience, skills) to the table
  - Compatible missions, services, organizational cultures
  - Strategic service fit
  - Geographic fit

Sharing Services: Key Points
Services That Can Be Shared

<table>
<thead>
<tr>
<th>Physical Resources <em>easier</em></th>
<th>Staffing</th>
<th>Programs <em>more difficult</em></th>
</tr>
</thead>
<tbody>
<tr>
<td>Workspaces, conference rooms</td>
<td>Financial &amp; administrative</td>
<td>Client intake</td>
</tr>
<tr>
<td>Copiers, printers</td>
<td>Data collection &amp; analysis</td>
<td>Program operation</td>
</tr>
<tr>
<td>IT, hardware, software, servers, cloud apps</td>
<td>HR</td>
<td>Curriculum research, development delivery</td>
</tr>
<tr>
<td>Communication systems, phones</td>
<td>Group purchasing</td>
<td>Community events</td>
</tr>
<tr>
<td></td>
<td>Fundraising</td>
<td>Advocacy campaigns</td>
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<tr>
<td></td>
<td>Facilities</td>
<td></td>
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<tr>
<td></td>
<td>Executive leadership</td>
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</tbody>
</table>

Structuring Arrangements

- **Program collaboration agreement**
  - Jointly applying to grants
  - Collaborating on aspects of implementing a project

- **Management/administrative services agreement**
  - Sharing staff or physical resources
  - Jointly operating a program

- **Fiscal sponsor agreement**
  - A nonprofit organization acts as a “fiscal sponsor” for another entity (typically one that does not have its own 501(c)(3) tax-exempt status)
UBIT Issues
Providing Administrative Services

- **Fees** generated from performing administrative services for other non-profit organizations are likely to be deemed to be unrelated business income (UBI)

- **Factors the IRS will consider:**
  - Relationship of service provider to the recipient
  - Fee charged for services
  - Nature of services (commercial?)
  - Recipients of the services

Mergers: Key Points
Preconditions for Success

- Trust
- Clear strategic planning and vision
- Merger champion
- Experienced leadership (executive director)
- Board and staff buy-in
- Thorough due diligence
- Attention to organizational culture and integration

Key Part of the Process

- Conduct due diligence
  - Each org conducts thorough investigation to ensure it understands the operations, assets, and liabilities (actual and potential) of other org
  - Satisfies directors’ fiduciary duties to respective orgs
  - Categories of info to inspect:
    - Corporate structure & records
    - Intellectual property
    - Contracts
    - Employment matters
    - Finances/debts
    - Compensation arrangements
    - Existing or threatened lawsuits
Structure
Acquisition Merger

Surviving corporation assumes assets and liabilities of one or more corporations, which then cease to exist (non-surviving corporations)

**BEFORE**

CAA #1 → CAA #2

**AFTER**

CAA #2

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**MERGER CASE STUDY**

Merger between People’s Regional Opportunity Program, Inc. and Youth Alternatives Ingraham to form the Opportunity Alliance

This case study is based on CAPLAW’s interview with Mike Trepka, Chief Executive Officer of the Opportunity Alliance. In Portland, Maine, about the merger of a Community Action Agency, People’s Regional Opportunity Program, Inc., with Youth Alternatives Ingraham to form the Opportunity Alliance.

**People’s Regional Opportunity Program, Inc.**

People’s Regional Opportunity Program, Inc. (PROP) was a 501(c)(3) Community Action Agency (CAA) with annual revenue of approximately $17 million and about 725 employees. PROP provided the following services to low-income people in Maine, particularly in the Portland area:

- Food pantry
- Meals on Wheels
- Fuel assistance
- Elderly services
- Child care services
- Home repair

**Youth Alternatives Ingraham**

Youth Alternatives Ingraham (YI) was a 501(c)(3) organization with annual revenue of approximately $19 million and about 260 employees. YI, based in South Portland, Maine, served children, youth, adults, seniors, families, and communities throughout Maine. YI provided the following:

- Youth services
- Grief counseling
- After school and community services
Structure
Consolidation
A new corporation is created, which assumes assets and liabilities of two or more other corporations, which cease to exist.

Structure
Asset Acquisition/Transfer
One corporation transfers all or a portion of its assets (but usually not liabilities) to another and then dissolves.
Structure
Asset Acquisition/Transfer

MERGER CASE STUDY

Merger between Mahube Community Council (Mahube) and Otter Tail Wadena Community Action Council (Otter Tail)

This case study is based on CAPLAW’s interview with Dr. Leah Plogot, executive director of Mahube-Ohio Community Action Partnership (Mahube-Ohio) in Minnesota, as well as a review of Mahube-Ohio’s website. This case study presents an example of the combination of a CAA experiencing financial difficulties with a larger and healthier CAA.

Mahube Community Council
Mahube Community Council (Mahube) was a 501(c)(2) Community Action Agency (CAA) that served three counties and that had an annual budget of approximately $12-$15 million and about 102 employees.

Otter Tail-Wadena Community Action Council
Otter Tail-Wadena Community Action Council (Otter Tail) was a 501(c)(3) CAA that served two counties and that had an annual budget of approximately $1 million and about 65 employees. Both run similar programs, including Head Start, energy assistance, and weatherization.

Structure
Parent-Subsidiary

One corporation becomes a subsidiary of another corporation (parent)

BEFORE
CAA #1

CAA #2

AFTER
CAA #2

Sole member
CAA #1
Changes in Control
Parent-Subsidiary

MERGER CASE STUDY

This case study is based on CAPLAW's interview with Kathy By Horst, Executive Director of MesaCAN, and Michael Hughes, CEO of A New Leaf. This case study presents an example of a parent-subsidiary merger between a small, non-profit CAA facing significant financial challenges and a larger, more financially robust non-profit organization providing overlapping social services in the same service area.

Mesa Community Action Network
At the time of the merger, MesaCAN was a 501(c)(3) non-profit community action agency (CAA) that provided a variety of anti-poverty services in Mesa, AZ, including homelessness prevention and emergency housing assistance, Low-Income Home Energy Assistance Program (LIHEAP), and a men’s shelter.

A New Leaf
At the time of the merger, A New Leaf was a 501(c)(3) nonprofit organization that provided a broad array of social services in Mesa, AZ, including affordable housing units, domestic violence shelters and services, family homeless shelters and services and youth and behavioral health services.

Government Funding Issues
**Funding Source Rules**

- **CSBG**
  - Get state CSBG office on board
  - Will new designation be required?
  - For mergers, be aware of tripartite board composition requirements

**Funding Source Rules**

- **Head Start**
  - Need OHS approval of change in:
    - Head Start Director and Executive Director/Chief Financial Officer (if >50% salary paid out of Head Start funds or listed in grant application as key personnel) (45 C.F.R. § 75.308(c)(ii))
    - Use of real property or facilities subject to a federal interest (45 C.F.R. § 1303.48(b))
Funding Source Rules

- **Head Start**
  - If Head Start grantee’s “legal status” changes, HHS will require recompetition (45 C.F.R. § 1304.5(a)(2)(ii))
    - **Recompetition not required** if Head Start grantee survives the merger
  - **Need to notify OHS** of name change

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Funding Source Rules

- **Cost Allocation**
  - Need to **properly allocate costs** of services performed under shared services arrangement
  - Determine impact on **indirect cost rate**, if applicable

- **Procurement**
  - Entity receiving services must follow its procurement policy and comply with the Uniform Guidance’s procurement standards (2 C.F.R. §§ 200.318 – 200.326)
Other Issues . . .

- Ability to transfer other government grants/contracts
- Merger costs likely to be unallowable charges to federal grants, except with prior approval
  - See Uniform Guidance, 2 C.F.R. § 200.455
- Keep your funding sources informed!
- Accreditation/licensing
- Union issues

Key Players and Their Roles
Board Members

Role

- Analyzes pros and cons of options, whether and how it will fulfill mission (especially for mergers)

- Board committee
  - Explores options and partners, including meeting with potential partners and overseeing negotiations
  - Oversees due diligence
  - Keeps full board informed
  - Makes recommendations to full board

Board Members

Votes

- Full board votes on:
  - Creating committee and scope of its authority
  - Whether to merge
  - Shared services or merger agreement
  - Corporate merger documents (plan of merger and articles of merger, etc.)
Board Members
Documenting the Decisions

- **Important to document board and committee discussions and votes in minutes**
  - Include the basis for board/committee decision(s)
  - Attach reports, other documents on which board/committee relied

Board Members
Fiduciary Duties

- **Duty of Care:** In overseeing the organization, nonprofit board members must act with “the care an ordinarily prudent person in a like position would exercise under similar circumstances”
  - Possible personal liability if board members don’t carefully examine potential merger partner
Board Members
Business Judgment Rule

- Under the “business judgment rule,” nonprofit board members who exercise good faith judgment will usually be protected from liability to the corporation
  - Even if the corporate action turns out to be unwise or unsuccessful

Board Members
Duty of Care

- Board members must make informed decisions
  - Obtain and consider written reports and professional advice before making important decisions
  - Ensure that a full, deliberative process is conducted and that directors are able to ask hard questions and get answers
Sample Merger Decision Matrix

<table>
<thead>
<tr>
<th>Variable</th>
<th>Value</th>
<th>Priority</th>
<th>Scores Based on 100 Total Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decisionmakers</td>
<td>Board leadership, Sr. Staff</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Timeframe</td>
<td>3-6 months</td>
<td>M</td>
<td></td>
</tr>
<tr>
<td>Program/Mission Fit</td>
<td>X100</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Operations Fit</td>
<td>X75</td>
<td>M</td>
<td></td>
</tr>
<tr>
<td>Culture</td>
<td>X75</td>
<td>M</td>
<td></td>
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<tr>
<td>Relative fit of Board</td>
<td>X55</td>
<td>M</td>
<td></td>
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<tr>
<td>Systems</td>
<td>X35</td>
<td>L</td>
<td></td>
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<tr>
<td>Public Relations/Fundraising</td>
<td>X95</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Is there a need?</td>
<td>X55</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Economically Feasible?</td>
<td>X100</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Impact on other programs?</td>
<td>X55</td>
<td>M</td>
<td></td>
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<tr>
<td>Can we provide a quality service?</td>
<td>X100</td>
<td>H</td>
<td></td>
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<tr>
<td>Assets</td>
<td>X90</td>
<td>M-H</td>
<td></td>
</tr>
<tr>
<td>Current Assets/Liabilities</td>
<td>X90</td>
<td>M-H</td>
<td></td>
</tr>
<tr>
<td>Leases Obligations</td>
<td>X50</td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Pending Litigation Issues</td>
<td>X100</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Other benefits the merger brings?</td>
<td></td>
<td>H</td>
<td></td>
</tr>
</tbody>
</table>

Management

Role

- The executive director or interim executive director, chief financial officer, chief operating officer (program or operations directors), other staff
- Due diligence
  - Programs and activities
  - Financial strength and viability
  - Sustainability
  - Staff culture and roles
- Plan for integration (merger)
Advisors
Role of Outside Professionals

- **Attorneys** – involve early in process; initially each partner should work with its own counsel
  - CAPLAW is available to consult with CAAs on CSBG-, Head Start- and other government-grant specific issues
- **Consultants** – help identify partners and facilitate merging or other partnership
- **Accountants** (especially for mergers) – tax filings, impact on financial statements, due diligence

Lessons Learned
Lessons Learned

- **Have a strong advocate for arrangement**
  - CEO, board/board chair

- **Build trust and familiarity with the other org**
  - Good relationship prior to sharing services or merging is essential

- **Be clear about how arrangement enables each org to achieve overall goals**

- **Conduct thorough due diligence**

- **Keep funding sources informed**
  - Involve major funding sources (government/private) early in process

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Lessons Learned

- **Communicate with and involve staff members**
  - Communicate early and often to get staff buy-in
  - Work to align organizational and staff interests
  - Clarify new roles

- **Don’t overlook organizational culture issues**
  - Address integration issues from the outset
  - Anticipate future issues and concerns

- **Engage outside experts**
  - 3rd parties offer outside perspective
  - Rely on experts who are familiar with the merger process