

Handling Conflicts of Interest

... Practical approaches for boards



by Dan Busby, *President, ECFA*

Understanding real or perceived conflicts of interest goes right to the heart of one of the most important issues of properly governing a ministry—independence. Diligent board members must examine their independence and their need to disclose to interested parties information about matters that may undermine that independence.

Understanding conflicts of interest is important because these real or perceived conflicts color independence. Someone with close ties to a ministry may be the most diligent and independent acting individual on the board. But in these times of heightened charity scrutiny, a ministry can ill afford to have its board members subject to negative attention because of suspicion about their motives.

For too long, many ministries have relied on the conflicted board member to proactively take steps to protect the ministry—a self-policing by individual board members. The basic flaw in this approach is that if a board member doesn't see the conflict, they can't or won't declare it or avoid it.

We are not the best judges of our own conflicts of interest. We need someone else to be the judge and tell us how our relationships appear to others. To tell us, someone has to know about the relationships that may create conflicts of interest.

The principles embodied in

Matthew 7 seem to apply to the difficulty with which we recognize our own conflict of interest. It's much easier to see the "speck" of conflict in the eye of another board member when all the time there is a "plank" in our own eye.

Shades of conflict. ECFA member organizations are to avoid conflicts of interest in their financial transactions. However, related-party transactions may be allowed if they meet certain minimum criteria.

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A conflict usually occurs when the personal relationships, objectives, or benefits of a board member make it virtually impossible for him or her to put the interest of the ministry above personal interests. The board member is trying to serve two masters—an untenable situation.

There may be degrees of conflict, from a very serious offense, such as a board member receiving fees from the ministry for a contract that was not disclosed to the board, to one of less significance: a board member's son and two daughters work for a subsidiary of the ministry. But, the effect is the same—others have ammunition to question your motives or decisions.

Impact of conflict. In what ways can a board member's conflict of interest harm a ministry? It may harm your peers by exposing the entire board to liability or negative publicity. It may harm the ministry and its employees by requiring them to respond to attacks—a diversion of board and staff resources. It may harm the ministry's reputation. One negative press story may decrease donor confidence and thereby reduce gift income.

Conflict examples. It's one thing to talk about conflicts of interest in theory. However, looking at a few examples brings it to life:

- A board member receives a consulting contract from a charity at a rate higher than comparable consultants. The contract is negotiated between the board member and the CEO. The contract was not placed on the board agenda for consideration. This qualifies as an actual conflict of interest under nearly any definition.

The board member has a vested interest in continuing the consulting arrangement and therefore cannot independently evaluate the performance of the CEO. This would still be true even if the consulting contract was beneficial to the charity and it was approved by the board.

- An organization's board member also acts as legal counsel for the organization, recommending legal courses of action that will generate fees to the benefit of the board member's firm without the challenge of a competitive bid or second opinion. Even if the organization prohibits the board member from voting on or approving such engagements, the difficulty in managing and controlling attorneys' time

charges still presents the organization a major challenge in removing a conflict of interest.

- A related-party transaction might occur if an organization purchased insurance coverage through a board member's brokerage firm. If the purchase was not disclosed, was not approved appropriately, was not made at the best possible price or in the best interests of the organization, the transaction would also constitute a conflict of interest.

A sixth-sense of awareness. Avoiding conflicts of interest and even excessive related-party transactions occurs best when an entire board has developed a mindset—a sensitivity, a keen sixth-sense awareness—enabling the board to readily identify potential minefields.

How can you tell if your board possesses that special sensitivity to conflicts of interest? The answer to these questions may provide some clues:

- Has your board adopted a comprehensive conflicts of interest policy that encompasses not only the board but also key staff?
- Does each board and key staff member annually complete a questionnaire to document potential conflicts of interest? Is this documentation reviewed by and disclosed to the board chair, CEO, and other appropriate individuals?
- Do board members involved in related-party transactions not only recuse themselves from voting but also leave the board room during the discussion and the vote?
- Is conflict of interest leadership provided by the board chair? Is he or she quick to point out potential conflicts when certain agenda items come to your

board? Does the board chair practice recusal when the conflict relates to the chair?

- Is the CEO considered “above the law”? Does your conflict of interest policy apply to all board members and key staff except the CEO?

Five steps to clarity. Consider following this five-step process for dealing with conflicts of interest:

- **Full disclosure.** Disclose all conflicts to the ministry and the other board members, no matter how minimal they may seem (including business or family interests which might be a real or perceived conflict). This should be documented in the annual conflict of interest questionnaire

“The distinction between an active conflict of interest and the appearance of one is often unclear.”

completed by each board member and verbally reinforced during board meetings (“As just a reminder, my wife is employed by the real estate firm the ministry is considering using as a broker.”)

- **Continually raise the topic.** Regularly discuss the topic of conflicts of interest in board meetings. What may not be a conflict today may become a conflict later on (“My son is considering a job offer from the outside fundraising firm that our charity uses. If that happens, I want the board to determine if my independence has been comprised. If so, I will resign.”)

- **Establish a board policy.** While policies do not always prevent conflicts of interest, they are a good start. A policy should

establish a process to review and discuss conflicts. An annual report by the board chairman or secretary summarizing potential conflicts of interest reported by the board members on the annual conflicts of interest questionnaire may be very effective. (Contact ECFA at info@ecfa.org for sample conflict of interest policies and questionnaire.)

- **Related-party transactions v. actual conflict of interest.** Many routine related-party transactions may be beneficial and at the same time pose very low risk to the charity. However, if a conflict is disabling, the board must make a decision about the conflicted board member's continuing status.

- **Consider how those outside the board will view the conflict.** Will the transaction, when disclosed, raise more questions that the board can adequately answer? Does the transaction have the best long-term interests of the ministry at heart? Pretend for a moment that you are an investigative reporter. How would he or she characterize the situation?

Boards should take note. Conflicts of interest are messy and make good front-page news. When spread out in the media, they are probably easier to understand than your ministry programs. That is why they may become the news about your ministry, instead of the wonderful work your ministry is accomplishing with God's help. ☺

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