13. Trouble Avoidance

Trusted ministries do not borrow trouble with related-party transactions. These transactions are minimized to avoid even the slightest appearance of impropriety.

"Commit a crime and the earth is made of glass."[1] Emerson might have said, "Engage in conflicts of interest, and sooner or later you'll be found out." Connecting the dots between family members and their businesses or their personal lives doesn't take much digging.[2]

Why does it matter if a transaction is made in the self-interest of a ministry leader or a board member versus the best interest of the ministry? It is the difference between right and wrong.

> A transaction that is not made in the best interest of the ministry is unethical at best and illegal at worst.

Fundamentally, it is doing what is right before God and man. "We don't want anyone suspecting us of taking one penny of this money for ourselves. We're being as careful in our reputation with the public as in our reputation with God" (2 Cor. 8:20–21).

What if the ministry's top leader wants to borrow $100,000 from the ministry? What if the ministry makes the loan with a long repayment period, a below-market interest rate, and a balloon payment—all inconsistent with good business practices? These are all examples of how a ministry can borrow trouble. Trouble. Trouble. Trouble.

A blind man on a galloping horse at midnight could see a related-party transaction problem. But we often can't see the problem ourselves when we are parties to the transaction. The intensely focused task of leading ministries can make us blind to the obvious and blind to our blindness.

Christopher Chabris and Daniel Simons constructed a short film of two teams passing basketballs, one team wearing white shirts, the other wearing black. Viewers of the film are instructed to count the number of passes made by the white team, ignoring the players with black shirts.

This task is difficult and completely absorbing. Halfway through the video, a person wearing a gorilla suit appears, crosses the court, does a chest thump, and moves on. The gorilla is in view for nine seconds.

Thousands of people have seen the video, and about half of them do not notice anything unusual. It is the counting task—and especially the instruction to ignore one of the teams—that causes the blindness. Without that task, no one would miss the gorilla. Viewers cannot imagine they missed the gorilla.[3]

Transactions that are not in the best interest of the ministry almost always occur between two or more parties with interlinking relationships. A related-party transaction is one in which a person (a board member or a ministry's top leader, for example) is responsible for promoting one interest at the same time he or she has a competing interest.

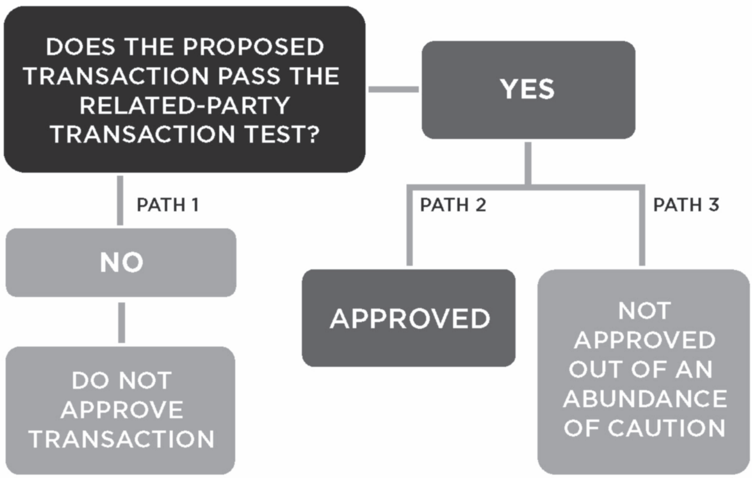
Board members are considered to be involved in a conflict of interest when

- they—or when members of their family, business partners, or close personal associates—could personally or professionally benefit, directly or indirectly, financially or otherwise, from their position on the board;
- they use their position on a board to the disadvantage or detriment of a third party;
- they solicit or obtain preferential treatment related to services received from, or rendered to, the ministry, including contracted work, employment, or honoraria;
- circumstances arise that compromise or appear to compromise, the ability of board members or staff to make unbiased decisions;
- they appropriate financial or other resources for personal use (e.g., information, property, equipment, supplies, transportation, training);
- they seek, accept, or receive material personal benefit from a supplier, vendor, individual, or organization doing or seeking business with the ministry;

> Worry is the interest paid by those who borrow trouble.
>
> George Washington

- they are involved in the contracting, employment, supervision, grievance, evaluation, promotion, remuneration, or firing of a family member, business associate, or friend of the board member.[4]

Related-party transactions take one of three paths:



PATH 1:
DO NOT APPROVE!
If the transaction is not in the best interest of the ministry, it should not be approved because it would inappropriately elevate a competing interest over the ministry's fiduciary interest.

PATH 2:
APPROVED!
A significant related-party transaction could be approved after disclosing it to the ministry's governing board who, after recusing related parties, determines the transaction is advantageous to the ministry, with a commitment to make appropriate disclosures.

PATH 3:
NOT APPROVED!
The ministry could decide not to approve the related-party transaction, perhaps out of an abundance of caution concerning the negative perception which could surround the transaction.

Want to avoid borrowing trouble? Start with a solid conflict of interest policy and avoid related-party transactions unless they meet strict guidelines.[5] Ministries should only enter into business transactions with an insider[6] if the following four steps are taken (see ECFA Standard 6)[7]:

Step 1: Exclude. All parties with a conflict of interest (direct or indirect) are excluded from the discussion and the vote that is related to the approval of the transaction.

Step 2: Compare. The ministry has reliable comparability information regarding the terms of the transaction from appropriate independent sources such as competitive bids, independent appraisals, or independent expert opinions.

Step 3: Determine. The ministry's board determines the transaction as being in the best interest of the ministry, including determining whether the transaction could be misperceived by givers, constituents, or the public—since the transaction will likely be publicly disclosed.

Step 4: Document. The ministry contemporaneously documents Steps 1, 2, and 3.

Even when all of the above precautions are observed, the ministry may be at risk to criticism from givers, staff, the media, or other members of the public (see also Perceptions chapter 3). This risk may be so significant that it overshadows all the benefits of the transaction.

Three examples illustrate these principles:

Example #1: A ministry purchases $5,000 of insurance coverage through a firm owned by a board member of the ministry. If the board member who owns the insurance firm is excluded from the discussion and vote, if the ministry obtains reliable comparability information on insurance coverage, if the ministry's board determines the purchase of the coverage is in the ministry's best interest and these steps are contemporaneously documented, the transaction meets the strict tests for approving conflict of interest transactions.

Let's say the insurance premiums are over $100,000. If the transaction is approved, try explaining to the media how you met the conflict of interest tests when the transaction is questioned. Your efforts to justify the transaction will be meaningless—the focus will be on the transaction instead of Christ.

> The perception of a conflict of interest can be just as damaging to a ministry's reputation as an actual conflict.

So, following the strict tests for conflict of interest transactions is important. But even if some pass these tests, it is wise to avoid them no matter how well you can justify it.

Example #2: A ministry board considers a $1 million software development contract. The wife of a board member owns a controlling interest in the software development company. Even if all four crucial related-party transaction steps are taken (exclude, compare, determine, and document), approval of this transaction opens the door to significant criticism, even if the software project is successful. And, just think of the precarious position the ministry would be placed in if the software project fails—not to mention the negative impression of followers of Christ.

Example #3: A ministry board considers a significant investment through a brokerage firm in which a ministry board member has a material ownership interest. If the ministry's board approves the investment as being in the ministry's best interest, and if it is consistent with its investment polices and meets its conflicts-of-interest policy, the investment passes the conflict of interest test.

It could be exceedingly difficult to justify this transaction to the public or the media because investment decisions with an insider are harder to explain than many other products. And, just think what will happen if the investment should turn sour and the ministry loses most of the investment—attacks in the media and perhaps even a lawsuit.

> You know you just borrowed trouble when a new board member says: "If I can't conduct business with the ministry, there is no reason for me to serve on the board."

Example #4: The majority of the board members are independent, but the CEO and several employees are members of the governing board. When the resolution on salary increases comes to the board, those affected by the resolution should not discuss or vote on the increases.

> The CEO and the affected employees should also recuse themselves from this portion of the meeting to avoid even the appearance of a conflict of interest. *Note:* In some cases, a board committee initially considers these compensation issues and brings a recommendation to the board. If so, the affected employees should be recused during the committee meetings.

Leaders and board members of trusted ministries think beyond self-interests to the interests of others. “Put yourself aside, and help others get ahead. Don’t be obsessed with getting your own advantage. Forget yourselves long enough to lend a helping hand” (Phil. 2:4).

Trusted ministries ensure that all transactions are in the best interest of the ministry. They minimize related-party transactions because they want to avoid even the slightest appearance of impropriety.

Questions for reflection

1. Does the ministry have a sound, comprehensive conflict of interest policy covering transactions between the ministry and board members and key staff members?

2. Does the board take adequate steps to ensure all transactions meet the conflict of interest policy?

3. Even if transactions meet the strict requirement of the conflict of interest policy, does the board avoid even the slightest appearance of impropriety in handling them?