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Now You See It, Now You Don’t: Conflict of Interest Demands More Than Just a Policy

By **Mel Gill (Synergy Management and Consulting Associates)** | March 21, 2007

This article addresses conflict of interest policies against the backdrop of experiences lived inside real nonprofits. In December 2006, *Nonprofit Quarterly* called on its readers to share both their policies and their encounters with such conflicts.

Dozens of readers responded with policies ranging from the most basic frameworks to the most detailed and legalistic prescriptions, laying out exactly what is expected from whom in what kind of situation. Several readers indicated they were starting to develop policies and looked forward to the results of this initiative. Surprisingly, but not re-assuringly, many stated that they had never

had occasion to use their policies. This, in and of itself, is cause to worry because even in the most squeaky clean nonprofit, opportunities for conflict are everywhere. A big “danger ahead” sign should flash when we do not recognize and resolve them.

Some conflicts are “easy” to spot in that they involve the most rudimentary question of individual vs corporate interest. That does not make them easy to handle. Ironically, just as I took on the task of putting *NPQ* reader responses together with my own experiences for this article, this e-mail request for help came to me from a distressed board member:

I am wondering if you have any articles that would specifically cover our conflict of interest situation. I’m on a board where the Chair has a proposal on the table for fundraising for the organization. This has the potential of making her a lot of money. She has not been asked to step down by the rest of the directors who seem to think I’m making a mountain out of a molehill.

I need something from a neutral party that they can read over and over again until they “get it” and understand that either the proposal must be taken off the table or the Chair needs to step down until the rest of the board members decide what they want to do with the project.

This request brought to mind another situation I encountered recently. I was consulting with a board whose chair had just completed an intensive training course for corporate directors. He was also a member of the organization’s foundation board. While serving in both capacities, he was actively lobbying the foundation to employ him as a fundraiser. The parent organization had a conflict of interest policy, but the chair played fast and loose with the rules, creating unnecessary turmoil in both boards. Despite his training, this chair just didn’t get it. Fortunately, the most influential of the other directors understood the seriousness of the situation and the chairman lost his position—and credibility—with both boards.

These two situations demonstrate that simply having a policy or offering board training won’t automatically eliminate conflicts of interest.

But conflicts of interest aren’t always crystal clear; they frequently arise from circumstances where ethical shades of gray may lead reasonable people to different judgements. This makes it essential not only to have clear policies and procedures, but to embed discussion of difficult topics into organizational culture. This has to be supported by a commitment to principles of integrity, transparency, predictability, and accountability.

Defining a Conflict of Interest

One *Nonprofit Quarterly* reader provided this definition of conflict of interest, which zeroes in on the concept with laser-like precision:

Conflict of interest means a conflict, or the appearance of a conflict, between the private interests and the official responsibilities of a person in a position of trust.

This is basically true, but with some caveats. Every organization should watch out for the standard warning signs that alert us to avoid business dealings, family influences, and financial

transactions that benefit board members directly. But it also includes more complicated issues that aren't so easy to identify or settle. In these situations, you may find these four tests helpful.

The Peer Standards Test

The peer standards test, or the community and industry standards test, asks whether the behavior or relationship in question is commonly acceptable within a given sector. In other words, the question is, "Would the community accept and approve of this person's or organization's actions?"

One of the letters to the Nonprofit Ethicist in this issue asks for guidance about a situation in which an organization holds an auction, and the son of one of the organization's executives wins a vacation for two as a prize. The executive's subsequent behavior to increase the value of the prize only makes this situation more complicated, but the Ethicist rightly notes that it is standard practice for family members of staff to be excluded from such contests precisely because it raises questions of fairness. Had this agency adhered to the standard, it would have prevented the issue from causing conflict within its board.

But be careful in using this test. The excuse "Everybody else is doing it"—whether it's padding expense accounts, contracting with board members to supply services in small communities, or hiring family members as staff—doesn't give you a free pass. Applying only the peer standard poses the danger of ignoring unethical activity simply because it's accepted by that community. (Consider some of the recent ethical breaches by legislators, for example.)

Public Disclosure: The Smell Test

With this test, the questions are, "How might key stakeholders, the public, or the media react if this activity were publicly disclosed?" and "What impact would this activity have on the credibility of the organization and its leadership?" You should engage an active imagination in this consideration, sometimes referred to as "the smell test." A perceived conflict of interest can be just as damaging to an organization's or a leader's reputation as an actual conflict.

Lots of problems are relatively invisible to those involved because they evolve into real conflicts over time. A homeless shelter that started without funding in a church basement, for example, was accustomed to checking with its board chair first when it was ready to place someone in permanent housing. It was understaffed, and the board chair, who had worked tirelessly to help establish the shelter, owned several rooming houses, which made the necessary transactions easy. For years the practice persisted until nearly all his rentals were filled with placements from the shelter. An informed organization would have understood that, if an enterprising reporter were to expose the practice, the "smell" of potential conflict of interest could further threaten the shelter's already tenuous relationship with the town in which it was located—never mind embarrassing its funding sources. In this case, a consultant alerted the board, which in turn took action and developed protocols. That reform required more work on the part of housing placement staff, but it also protected the agency from loss of credibility with its funders and community.

The Reasonable Person Test

With this test, the question is, "What would a reasonably prudent person or board do under the circumstances?" This is very important, since it goes directly to the heart of a director's legal duty

of care to “exercise the same degree of care, diligence, and skill that a reasonably prudent person would show in comparable circumstances.”

Admittedly, this can lead to murky waters. The daughter of a director of a local children’s services agency was planning a wedding and received a discount from a local hotel because the agency’s board had used the hotel in the past for its own events. The director asked the board to decide whether providing a discount should be treated as a conflict of interest. The board decided that it wasn’t for two reasons: first, the discount wasn’t solicited and second, the board routinely researched hotels in the area for the best rates. In this case, the board reasonably decided that there was no conflict of interest Another board, however, might have viewed the matter differently and asked the board member not to accept the favor to maintain a less potentially tainted relationship between the agency and the vendor.

The Best Interests Test

The requirement to “act honestly and in good faith in what the director considers to be the best interests of the corporation” is a “duty of loyalty’ that goes hand in hand with the “duty of care.” Board members often feel torn between their loyalties to a particular constituency and the nonprofit organization. Indeed, all boards have a “duty of due diligence” to seek as much information as possible before making a decision on a matter. Representatives of particular constituencies have an obligation to present both facts and perceptions on behalf of their constituencies and to declare which hat they’re wearing—as constituent representatives or as board members—when contributing to discussions. But when the hour of decision arrives, it’s a board member’s responsibility to cast his vote by determining the “best interests of the organization at hand,” regardless of the impact on his constituents. If a director can’t make this decision, then s/he is obliged to declare a conflict of interest and abstain from the discussion as well as the voting. This is a delicate balance that requires diplomacy and integrity.

If the interests of the organization and those of its primary constituencies are frequently in conflict, then the organization should step back and reflect on its focus, purpose, and priorities.

Boards of directors are made up of human beings who are presumably personally invested in the work being done by the organization. While representation of personal interests has no place in a board’s decision-making processes, it can be hard to know exactly what is at work in a particular situation. Lots of smaller organizations struggle with such situations. The example that follows from a reader allows us to look at the subtleties of some of the questions we face:

I serve on the board of a small nonprofit organization [with two employees]. One board member is hired every year as a short-term educator during the summer. Because the board member isn’t financially benefiting from any decision the board makes (after all, it’s the executive director who hires these educators), our policy doesn’t address this as a conflict of interest. But, I can’t understand how a board member can effectively oversee the work of our executive director and also be her employee. Is this the conflict of interest I see it as? If so, how can it be addressed in policy and practice?

This reader’s focus on the question of supervision may bring to light only one element of a potential problem as is revealed by an example posed to us by another reader:

An instructor for a school who also serves on the school's foundation board might have a conflict of interest when applying to the foundation for funds to help pay for supplies needed in his instructional program. Of course, he could abstain when the foundation board considered the request for funds for his program, but the other board members will know who requested the funding and will more than likely be in favor of supporting this person in return for his support of other requests of interest to them!

Still, even this reader, after identifying the slippery nature of such situations, cautions us not to be so rigid in our conflict of interest definitions and practices that they work to the disadvantage of nonprofits, their board members, and staff.

No Bright Line

"How about this one?" asks another respondent:
I sit on a board that is reviewing an array of programming that sometime in the near future I may have an interest in being a part of as a contracted consultant or possibly staff. Program planning is at an early stage, and I am not definite about my own thinking relative to being a part of the work. Still, my gut says I should minimally disclose and, if my (or the organization's) thinking is very seriously in that direction, then I should step down from the board of directors. What do you think?
Conflicts of interest are so difficult to weigh and balance because the relationships between board members and the community also are a part of the contribution that board members make to the agency. Take another example of an organization buying a new computer. If a board member owns a computer store, the organization may well benefit from discounts and extra service by buying the computer at her store. It would be a mistake to prohibit working with board members as vendors.

This may be particularly true in communities that have a limited pool of suppliers for a particular product or service. Social, business, religious, and service club networks are often the glue that hold these smaller communities together and that sustain the nonprofit agencies in their midst. We need to take care that our approach to conflicts of interest doesn't weaken that glue yet also maintains principles of fairness and transparency.

Still, without constant vigilance, situations can devolve into self-interested quicksand and remain there for far too long. Here are some examples from my own experience:

One-third of the board of a national organization with a mandate to support education, services, and research related to a specific disease comprised researchers seeking endorsement of their research proposals from this organization. The potential conflict of interest was repeatedly discussed by the board but remained chronically unresolved.

The members of a service organization within a narrow "community of interest" elected to its board a half-sibling of the executive director from whom he had long been alienated. He claimed the ability to separate the personal history from his judgments about her performance. Let the nightmare begin!

A local community arts organization—in essence a producers' co-op—owned a property that accommodated theater and musical productions and art shows. The board chair was the executive

director of one of the member arts organizations. He made arrangements for use of the facility for a theater production, assuming that his organization would have free use of the facility. When the executive director of the arts group questioned that assumption in the absence of a conflict of interest policy, sparks began to fly.

Encourage a Board Conversation!

Conflicts of interest are always personal and can be highly emotional. Some boards are willing to confront their issues directly, particularly with the aid of an independent facilitator. I've found that others need to be eased into confronting their issues by first discussing a hypothetical situation or another organization's experience. That helps to generate insight into their own circumstances in a less threatening way. In these situations, a case study may be helpful to facilitate a board's conversation on the issues. Managing conflict of interest will be challenging for any board, even one with the best policies and practices. But the more that board members openly discuss these issues, the better equipped the organization will be to deal with any conflicts of interest that may arise.

Conclusion

During my work with hundreds of organizations, I've found unresolved conflict of interest issues in about forty percent of these organizations. In many instances, volunteers encounter difficulty in challenging other volunteers. Many organizations draw board members from a network of personal and business associates who sometimes allow these relationships to cloud their judgment about what is best for the organization.

Most nonprofits would like to be known as rigorous in their approach to conflicts of interest but active vigilance is the price for this high regard. The first step is to recognize that conflicts of interest are inevitable at some time in most organizations and in most human interactions. Some organizations start every board meeting with a time for members to declare possible conflicts.

Constructive management of conflict of interest is an essential element of sound risk management practices.

In all fairness, many situations with potential for conflict present in various shades of gray, where personal judgments are required in the absence of obvious solutions. While conflict of interest policies are essential, so are clarity of roles and expectations with respect to standards of conduct based on organizational values, and principles of good governance—integrity, transparency, predictability and accountability.

Basic Conflict of Interest Guidelines

Here are some guidelines that can help organizations define conflict of interest and frame formal conflict of interest policies:

- A conflict of interest may be real, potential, or perceived.
- Board members are considered to be in a conflict of interest under the following circumstances:
- 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;
- when they use their position on a board to the disadvantage or detriment of a third party;
- when they solicit or obtain preferential treatment related to services received from or rendered to the corporation, including contracted work, employment, or honoraria;
- when circumstances arise that compromise, or appear to compromise, the ability of board members or staff to make unbiased decisions;
- when they appropriate financial or other resources for personal use (e.g., information, property, equipment, supplies, transportation, training);
- when they seek, accept, or receive material personal benefit from a supplier, vendor, individual, or organization doing or seeking business with the corporation;
- when they are involved in the contracting, employment, supervision, grievance, evaluation, promotion, remuneration, or firing of a family member, business associate, or friend of the director;
- non-precuniary interests may present a moral conflict of interest, if not a legal conflict.

Board members may create a moral conflict under these circumstances:

- when their personal interests conflict with the interests of members or clients or are otherwise adverse to the interests of the corporation;
- when their membership on the board or staff of another organization could create interests that conflict with the interests of the corporation or its clients and where their activities on one board might materially affect their capacity on another board.

Managing Conflict of Interest

Even with the best policies and practices, conflict of interest issues will arise and need to be managed. Below are some principles and procedures for managing conflicts of interest drawn from my own experience and reader responses:

- Board members should disclose conflicts of interests early and often.
- Conflict of interest should be a regular item on every board agenda and periodically discussed by the whole board.
- In cases where a board member may not perceive that a conflict of interest exists, it is the responsibility of other board members who are aware of a real, potential, or perceived conflict of interest on the part of a fellow board member to raise the issue.
- If the board is contemplating a financial transaction with a board member, the process should be conducted through a fair and open process in which board members who have no personal or business interests in the matter make the final decision about awarding contracts.
- Finally, the organization should report annually (for example, on its Web site or in its annual report) any conflict of interest disclosures and their disposition in relation to any financial transactions.

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