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MANAGING
CONFLICTS
OF
INTEREST

THE BOARD'S GUIDE TO
UNBIASED DECISION MAKING

SECOND EDITION

BoardSource®

Library of Congress Cataloging-in-Publication Data

Kurtz, Daniel L.

Managing conflicts of interest : the board's guide to unbiased decision making / Sarah E. Paul and Daniel L. Kurtz. -- Third edition.
page cm.

Includes bibliographical references.

ISBN 1-58686-133-6

I. Nonprofit organizations--United States--Management. 2. Conflict of interests--United States. I. Paul, Sarah E. (Sarah Elizabeth), 1964- II. BoardSource (Organization) III. Title.

HD62.6.K87 2013

658.4'22--dc23

2012047461

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First Printing, December 2012

ISBN 1-58686-133-6

Published by BoardSource

750 9th Street, NW, Suite 650

Washington, DC 20001

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INTRODUCTION

Individuals who volunteer to serve on nonprofit boards tend to be actively engaged in their communities and have a myriad of professional, personal, and community relationships. Many serve on more than one nonprofit board at a time. The nonprofit sector depends on the spirit of volunteerism displayed by these engaged and capable individuals. However, these board members can also face challenges in carrying out their board responsibilities precisely because of the number and breadth of the associations and connections they have. Making unbiased, independent decisions on behalf of the organization can be difficult when a colleague, a friend, a family member, another organization, or a business relationship may be affected by or benefit from those decisions. The more connected a board member is, the more likely it is that such intertwining circumstances will arise, creating potential and sometimes problematic conflicts of interest.

This book seeks to demystify many of the legal rules relating to conflicts of interest that are applicable to nonprofit board members and executive staff, giving current and prospective board members the knowledge they need to serve with confidence. Because there are many legal definitions and nuances involved, this text seeks to create both a common understanding of conflicts of interest and a common vocabulary with which to discuss conflict issues.

The best approach to managing conflicts of interest may vary from one nonprofit organization to another, but all nonprofits share the fundamental need for impartial decision making. When making decisions, board members must set aside personal agendas and put the interests of the organization above all else. Conflicting interests will always be a key issue for nonprofit organizations, which require the care and attention of board members who are active and engaged.

WHAT IS A CONFLICT OF INTEREST?

A conflict of interest exists when a board member, officer, or management employee has a personal interest that is in conflict with the interests of the organization, such that he or she may be influenced by this personal interest when making a decision for the organization. Conflicting interests may include both financial and nonfinancial concerns, although the law is most often concerned with and focused on financial interests. While the term conflict of interest has taken on a negative

connotation, only some of the many different types of conflicts of interest may actually be harmful to an organization. How an organization manages conflicts of interest and ensures open and honest deliberation affects all aspects of its operations and is critical to avoiding legal problems and public scandals, making good decisions, and remaining focused on the organization's mission.

The key for nonprofit boards is not to try to avoid all possible conflict-of-interest situations, which would be impossible; rather, boards need to identify and follow a process for handling them effectively. There is no single solution to addressing conflicts that will best suit every nonprofit organization. It is essential to keep in mind the importance of disinterested decision making so that all board members can aid their organizations in determining how best to address conflict concerns, which helps to protect them and the organizations they serve. As board members and chief executives gain a greater understanding of the legal and organizational concerns surrounding conflicting interests, they will be able to help their organizations distinguish between situations in which conflicting interests can be beneficial to the organization and situations where a board member may be using his or her role to gain a personal advantage. Developing this ability enables board members to concentrate more on the challenges and psychic rewards that accompany nonprofit service.

The issue of conflicts of interest also relates to the more general subject of ethical conduct. Many organizations seek not simply to comply with legal regulations — which is required — but also to encourage the highest standards of behavior by its board and staff. This is not purely a concern for high-mindedness; donors and volunteers of nonprofit organizations trust organizations to be good stewards of their resources and to uphold rigorous standards of conduct and personal integrity.

OVERVIEW

The first chapter of this book describes the continuing scrutiny of nonprofit organizations by the Internal Revenue Service (IRS) and state attorneys general. The second chapter details the legal duties of board members, describes how conflicts of interest may arise, and explains that not all conflicts of interest are illegal or unacceptable. To help board members think through potential conflicts of interest, it acknowledges the difficulty of defining conflicts by illustrating them in terms of a continuum, with unacceptable (illegal) conflicts at one end and inconsequential conflicts at the other, with a range of situations in between.

The third chapter addresses legal considerations in detail, aiming to clarify the legal concepts and terms, and give nonprofit board members the knowledge they need to act in accordance with state and federal law. This chapter includes a discussion of the IRS intermediate sanctions rules applicable to public charities as well as

the stricter self-dealing rules that private foundations must follow. The material is intended as a basic guide and will also help board members recognize when they may need the advice of a legal professional.

Chapters 4 and 5 outline the steps a nonprofit board should take to ensure that it is prepared to handle conflicts of interest proactively and constructively. Chapter 4 discusses the conflict-of-interest policy and board member disclosure statement in detail. Chapter 5 provides guidelines for responding to conflicts of interest that have already become problematic.

Chapter 6 looks at the broader ethical context, seeking to provide guidance for board members as they consider the ramifications of their actions in terms of public perception and personal integrity, and discusses the increasing interest in having an organizational code of ethics.

Chapter 7 describes the requirement in the Sarbanes-Oxley Act that nonprofit organizations provide protection for whistleblowers and sets out some considerations when preparing a whistleblower policy.

The appendices include Q&As and sample policies and forms. A glossary of key terms follows the appendices.