# Competing Professional or Personal Interests: When Somebody’s Gain is Your Organization’s Loss

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## Mission of
## Pro Bono Partnership of Atlanta:

To maximize the impact of pro bono engagement by connecting a network of attorneys with nonprofits in need of free business legal services.

# Pro Bono Partnership of Atlanta Eligibility & Other Information

- In order to be a client of Pro Bono Partnership of Atlanta, an organization must:
  - ✓ Be a 501(c)(3) nonprofit organization.
  - ✓ Be located in or serve the greater Atlanta area.
  - ✓ Serve low-income or disadvantaged individuals.
  - ✓ Be unable to afford legal services.
- *Visit us on the web at* www.pbpatl.org
- Host free monthly webinars on legal topics for nonprofits
  - ✓ To view upcoming webinars or workshops, visit the Workshops Page on our website

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# Recent Examples of Competing Interests

- Dartmouth – Trustees' investment firms managing endowment assets (May 2012)
- Greg Mortenson – founder of CAI, mixed his author/book activities with CAI activities, using charitable funds to pay for charter flights for book speaking engagements – Montana determined Mortenson must pay $1Million to CAI (April 2012)
- The Massachusetts State Ethics Commission has accused a former official at an agency for special needs children of violating state conflict-of-interest laws by voting to transfer $5.5 million to a another organization while he was trying to get a job there. (June 2012)

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# Recent Examples of Competing Interests (cont.)

- Since 2001, the South Shore YMCA has awarded more than $2 million in contracts to members of its own board. (May 2012)
- Two US Senators are investigating potential abuses of the Disabled Veterans National Foundation for questionable financial ties between it and Quadriga Art, a marketing firm that handles its direct mail (May 2012)

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# Somebody's Gain = Your Organization's Loss: Definition of a Conflict of Interest ("COI")

- A conflict between the private interests and the official responsibilities of a person in a position of trust
  - ✓ An individual has competing interests or loyalties.
  - ✓ The situation could undermine the impartiality of a person because of the possibility of a clash between the person's self-interest and professional interest or public interest.
  - ✓ Only the potential for bias is necessary not whether decisions are made based upon that bias.
  - ✓ The use of a person's authority for personal and/or financial gain.

## Perception is Reality

Conflict of interest issues for a tax-exempt organization not only include

actual conflicts of interest but often

the perception of a conflict of interest

## Reputation is Critical

# Potential Effects of a Competing Interest

- Potential state law violations – duty of loyalty, duty of care
- Potential IRS violations: private inurement & excess benefit transactions
- Loss of public confidence and a damaged reputation
- Loss of funding

# IRS & Conflicts of Interest

- No private Inurement
- Can lose exemption if have private inurement
- Examples of private inurement:
  - ✓ Unreasonable compensation and/or unreasonable fringe benefits.
  - ✓ Improper (personal) use of an organization's assets.
  - ✓ Forgiveness of debts owed by insiders.
  - ✓ Personal expenses being paid by the nonprofit.
  - ✓ Low-interest or unsecured loans to insiders.
  - ✓ Purchases, sales or property rental between the nonprofit and insiders that are not arms-length fair market value transactions.

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# A Conflict of Interest is Not Necessarily Bad

- A conflict may exist with a board member or key employee regarding a potential business arrangement but that doesn’t mean the business arrangement is not in the best interests of the organization
- If follow a good Conflict of Interest Policy and Procedure and document those steps, the arrangement may be the correct choice
- The key is to do the independent analysis and decision making and document the analysis and decision

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# Conflict of Interest Policy - Purpose

The purpose of a conflicts of interest policy is to protect an Organization's interest when it is contemplating entering into a transaction or arrangement that might benefit (or appear to benefit) the private interest of a director, officer or key employee of the Organization

# COI Policy

- The tool a tax-exempt organization’s board of directors’ uses to ensure private inurement or private benefit transactions do <u>not</u> occur.
- The policy and procedures should include:
  - ✓ When and how a person discloses a potential conflict of interest.
  - ✓ When, how and by whom the material facts are discussed.
  - ✓ The person who may have a conflict of interest should be excused before the decision about whether a conflict exists is made.
  - ✓ How and when the above process is documented.

# COI Policy (cont.)

- Definitions
  - ✓ Interested persons
  - ✓ Financial Interest
- Process
  - ✓ Disclosure
  - ✓ Withdrawal from promotion and voting
  - ✓ Independent analysis
  - ✓ Independent decision
  - ✓ Recordkeeping

# COI Definitions

- Interested Persons – may include
  - ✓ Director
  - ✓ Officer
  - ✓ Key Employee
  - ✓ Significant volunteer
  - ✓ OR family members of the above
  - ✓ Who has a direct or indirect financial interest
- Influence over the organization and a financial interest

# COI Definitions (cont.)

## Financial Interest

- A person has a financial interest if the person has, directly or indirectly, through business, investment or family –
  - ✓ an ownership or investment interest in any entity or
  - ✓ a compensation arrangement with organization or with any entity or individual, or
  - ✓ a potential ownership or investment interest in, or compensation arrangement with, any entity or individual
- with which the organization is negotiating or has a transaction or arrangement.

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# Disclosure of Potential Conflicts

- Signed disclosures
  - ✓ From: directors, officers and key employees
  - ✓ Asking: actual or potential conflicts of interest
  - ✓ Obtained: at time of election/appointment or being hired and on an annual basis.
- Signed disclosure should include
  - ✓ A declaration that the person has read, understood and intends to comply with the policy.
  - ✓ Asking the directors, officers and key employees to disclose their and their families' financial and business interests.

# Common Conflicts of Interest

- Improper (personal) use of an organization's assets.
  - ✓ Use of mailing lists by a related for profit entity
  - ✓ Use of equipment for personal use
- Personal expenses being paid by the nonprofit
  - ✓ Directors' Spouses travel for meetings
- Low-interest or unsecured loans to insiders and forgiveness of debts owed by insiders should be avoided.

# More Common Conflicts of Interest

- A board member performs professional services for an organization
- A board member proposes that a relative or friend be considered for a staff position.
- Donations by board members that are really benefiting the board member more than the nonprofit (e.g. – donation of house)

# More Common Conflicts of Interest

- Purchases, sales or rental of property & purchases or sales of goods or services between the nonprofit and insiders that are not arms-length fair market value transactions. Examples:
  - ✓ A board member may want to lease a building to the nonprofit.
  - ✓ A board member is a lawyer and the nonprofit wants to use these services for a fee.
  - ✓ A vendor who does landscaping for the nonprofit offers to landscape an employee’s yard free of charge.

# More Common Conflicts of Interest

- Purchases, sales or rental of property & purchases or sales of goods or services between the nonprofit and insiders that are not arms-length fair market value transactions. Examples: (cont.)
  - ✓ A nonprofit needs help to develop a website, but funds are limited. A board member arranges for her husband to provide this service to the nonprofit for a very low fee.
  - ✓ A key employee's daughter wants to sell medical insurance to the nonprofit and will receive a sizable commission if she is successful.
  - ✓ The executive director has her brother paint the nonprofit's facility because his schedule is free and can complete the job before the annual meeting

# COI: Hypothetical 1

Nonprofit A's founder writes a book about her life journey and experiences including how she overcame homelessness and a lack of education and includes stories of helping others to overcome these issues as part of her work through Nonprofit A. Founder wants full copyright ownership of the book and all proceeds but does want to donate some of the proceeds to Nonprofit A.

# Hypothetical 1 - Analysis

- Some of experiences learned were learned a result of being the Executive Director of Nonprofit A
- What belongs to the Founder and what belongs to Nonprofit A?
- Nonprofit A has an ownership interest in its works and stories
- COI Policy must be followed – arms-length transaction
  - ✓ Board Resolution
  - ✓ Contract with Founder

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# COI – Hypothetical 2

Executive Director Joan works for Healthy Living Nonprofit. Joan is an RN who spent 10 years specializing in nutrition and advising patients how to live healthier lives. As Executive Director of Healthy Living for the past 5 years, Joan has developed many innovative programs to teach parents and children how to live healthier lives and has even been recognized for these programs by the President of the United States.

Joan is approached by a Speakers Bureau to contract with the Bureau for speaking engagements. Joan's salary from Healthy Living is not much as she would rather help the organization thrive, so this contract would really help her out. Can Joan sign the contract and take the money from the speaking engagements?

# Hypothetical 2 - Analysis

- Critical Question: What is Joan being asked to speak about?
  - ✓ Her expertise gathered from her 10 years of experience as an RN addressing these issues?
  - ✓ The programs she developed as ED of Healthy Living?
- What knowledge is being leveraged through the speaking engagements and who owns that knowledge?

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# Hypothetical 2 – Analysis (cont.)

- Other Factors:
  - ✓ Will the speakers’ bureau contract with Healthy Living?
  - ✓ Can a contract be established between Healthy Living and Joan to pay Joan for these additional services?
- COI Policy must be followed – arms-length transaction
  - ✓ Board Resolution
  - ✓ Contract with ED – if appropriate

# COI – Hypothetical 3

Michael is on the Board of the Stop Cancer Foundation (“SCF”). SCF is currently looking to hire a products company to put its logo on a variety of items it plans to sell as part of its marketing and awareness efforts. Michael’s wife, Lisa, owns a company that produces such products. Michael believes Lisa’s company will be able to give SCF a great price and suggests SCF use her company. What should SCF do?

# Hypothetical 3 - Analysis

- SCF should follow it's COI policy
  - ✓ SCF consider Lisa's bid
  - ✓ SCF should gather other bids
  - ✓ Michael should identify the conflict and recuse himself from participating in the decision-making process
  - ✓ SCF should analyze all the options and make an independent decision
  - ✓ SCF should document the steps above

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# Hypothetical 4

Stephen is a mental health counselor who offers some of his services for free through the nonprofit he founded and some for a fee through the for-profit corporation he owns. In addition, the for-profit and nonprofit share office space and office supplies, and the websites link to one another.

- Is this permissible?
- What are the issues to consider?

# Hypothetical 4 - Analysis

- Clear separation of assets
- Make sure the for-profit is not taking opportunities away from nonprofit
- No promotion of for-profit by nonprofit
- Helpful to have written distinction between functions of nonprofit v. for-profit
- Significant board involvement in analysis of separation

# For More Information:

If you would like more information about the services of Pro Bono Partnership of Atlanta, contact us at:

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