

# Don't Get Hoodwinked

## Safeguard your agency with vigilance around conflicts of interest

by Kathryn M. Vanden Berk

Any board, whether it is complacent or compliant, can be hoodwinked into approving transactions that are obviously conflicted, not recognizing that the board member sitting across the table is taking unfair advantage of the organization.

This is demonstrated through the four examples of conflicts of interest I have provided (see sidebar on page 24). They are actual examples, for which the names have been changed, that have either been reported in the press or have come before me in my practice. They occurred despite the fact that I'm sure that each of these organizations has a conflict of interest policy.

It makes sound business sense to be vigilant about conflicts of interest because the harm to an agency's reputation, if the story breaks in the press, can be enormous.

The Internal Revenue Service (IRS) has become so concerned about conflicts in tax exempt organizations that it now attaches a sample conflict of interest policy to the instruction booklet for exemption applicants.<sup>1</sup> Furthermore, an application will not be approved unless that policy—or some variant of it—is adopted by the applicant. I have developed a slightly modified format of that policy for my own clients, and it is available on the Alliance for Children and Families website.<sup>2</sup>

There are a few key actions your organization can take to protect itself:

**Update Your Conflict of Interest Policy.** The procedures for addressing potential conflicts of interest have not changed much in the last 50 years;



however, the specificity required in a good conflict of interest policy has changed greatly. Today, a good conflict of interest policy will be at least two pages long; it also will include very specific language about how to identify and manage potential conflicts of interest.

**Update Your Bylaws.** Because of the length of conflict of interest policies, I suggest that you should not include them within your bylaws in their entirety. However, a placeholder should be inserted into the bylaws, so it's clear that your organization does have a policy and that your board of directors is expected to follow it. My conflict of interest bylaw is

very simple and reads as follows:

*“Conflict of Interest. The board shall adopt a conflict of interest policy that is consistent with federal and state laws and guidelines, and such policy shall be amended as necessary to remain current with legal requirements for a tax-exempt organization.”*

**Require Term Limits.** If your bylaws don't provide term limits for service on the board and service as an officer, amend them so they do. Term limits prevent directors from becoming too chummy with one another, and too willing to engage in “you pat my back and I'll pat

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## Real Examples from the Field

### Board Director Profits by Edging out Competition

Harold Brown sits on the Hav-A-Kid Foundation Board of Directors as they discuss recent turnover problems. Everyone suspects the director of human resources is not performing effectively; however, the board wants to be sure before they act. Brown is a partner in his human resources consulting firm. So, the board naturally turns to him for advice.

Brown sees this as an opportunity to improve his firm's bottom line and offers to audit the department for \$75,000. This is vastly more than it will cost his company to do the audit, which is something that he knows but the rest of the board does not.

### CEO's Community Service Lacks Return on Investment

Sharon Simmons has been the CEO of Beyond Children for three years and enjoys the prestige that comes with the job. She is asked to become the paid director of several for-profit

companies and she snaps up the chance as a way to nicely supplement her already generous salary.

Simmons also serves on the board of the local arts council where she socializes extensively with the city's elites, often at Beyond Children's expense. An internal audit concludes that she has been away from the agency for more than 175 work days in the past two years—well over twice the number of her authorized vacation days.

### Board Chair Profits at Organization's Expense

Fred Land owns a racquetball club that he acquired in a real estate deal five years ago. The club is a dud; however, he plans to turn it into a gold mine. He is the chair of the Many Fine Youth Board of Directors. The organization keeps at-risk kids out of trouble by engaging them in gymnastics.

Land leases the building to Many Fine Youth for a modest rent and quickly begins leading the building's remodeling efforts. In five years,

the club is upgraded to Class A specifications—all at Many Fine Youth's expense. He then sells the building at a tidy profit and keeps 100 percent of the proceeds.

### Executive Charges Costs for Personal Ventures

Cynthia Janson is bored with her role as CEO of Families 2-Day, a small suburban agency. In addition, her husband recently lost his job. The couple decides they should embark on a new venture in internet sales of children's toys and books—a perfect extension of what the organization does every day.

They use the agency's attorney to incorporate and charge his fees to Families 2-Day. All of the company's startup costs, including developing a catalog and purchasing merchandise, are charged to the agency. By the time Janson leaves the organization, the unauthorized costs have hit six figures.

yours" activities. You will be amazed at how the regular infusion of new blood will strengthen your board and inoculate it against relationships that are too cozy.

**Manage Conflicts Wisely.** Make directors aware of your conflict of interest policy. If you have a policy that requires annual acknowledgment of the policy, honor this commitment. But, don't bury good board members in trifling conflicts. If you have someone from Kraft Foods on your board, it doesn't mean you have to stop serving Oreos in the dining room.

**Monitor both the Board and the Executive.** Assign someone the task of watching out for potential conflict situations at the board and staff levels. Be sure to document the process used when the board deals with potential conflicts, and ensure that dissenting votes are clearly marked in the minutes.

When it comes to executives, require that time spent away from the agency during office hours, excluding vacations, serves the agency in some capacity. This includes professional and community

involvement, as well as for-profit leadership. Make potential conflicts of interest a part of the executive's annual performance evaluation.

**Remember: Not Every Conflict is Prohibited.** The first step in analyzing disclosed conflicts is for your board to determine whether or not the reported activity actually constitutes a conflict. If it does, only then must your board decide whether or not it can be engaged in. A transaction that invokes the conflict of interest policy may, in fact, be the best one for the organization.

The sample conflict of interest policy I have provided gives organizations a clear process to follow. I urge you to review it carefully. ■

#### ENDNOTES:

1. The Form 1023 instructions can be found at the IRS website at [irs.gov/pub/irs-pdf/i1023.pdf](http://irs.gov/pub/irs-pdf/i1023.pdf)
2. View the sample conflict of interest policy at [alliance1.org/magazine/nonprofit-law](http://alliance1.org/magazine/nonprofit-law)



*Kathryn Vanden Berk practiced law for nine years before serving as the president of two residential treatment centers for children. Now practicing in Chicago, she focuses*

*on nonprofit start-ups, corporate and tax law, and employment issues. She serves as adjunct faculty at several Chicago universities, and is a member of the Advisory Board of the Axelson Center for Nonprofit Management at North Park University. She authored a handbook on starting nonprofits that is available from the Nonprofit Financial Center, Chicago, and a chapter in the Illinois attorney's handbook Not-for-Profit Corporations, 2004 Ed., Illinois Institute of Continuing Legal Education. In 2004 she authored Retooling Employment Standards for the Future, a publication of the First Nonprofit Educational Foundation, Chicago. She can be reached at 312-558-1690 or at [kvandenberk@nonprofitlawchicago.com](mailto:kvandenberk@nonprofitlawchicago.com).*