Welcome

Our Presentation

Will Begin at 12pm

PRO BONO PARTNERSHIP / ATLANTA

Navigating Conflicts of Interest for Nonprofits

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Mission of
Pro Bono Partnership of Atlanta

To provide free legal assistance to community-based nonprofits that serve low-income or disadvantaged individuals.

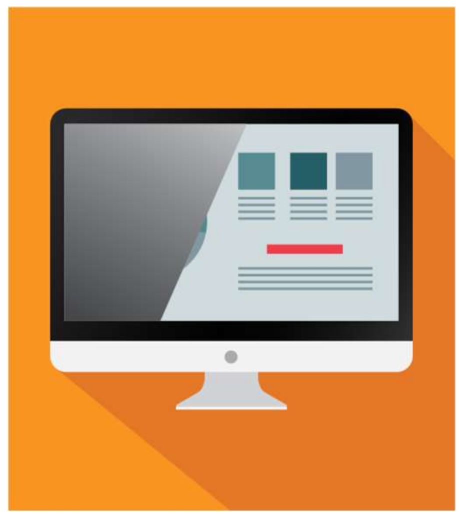
We match eligible organizations with volunteer lawyers from the leading corporations and law firms in Atlanta who can assist nonprofits with their business law matters.

PBPA Learning Center for Georgia Nonprofits

www.pbpatl.org/resources

ARTICLES

WORKSHOPS



WEBCASTS

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Client Criteria

In order to be a client of Pro Bono Partnership of Atlanta, an organization must:

- Be a 501(c)(3) nonprofit.
- Be located in or serve the greater Atlanta area.
- Serve low-income or disadvantaged individuals.
- Be unable to afford legal services.
- Employ at least one paid staff person.

Visit our website at www.pbpatl.org to apply.

Legal Information

This webcast presents general guidelines for Georgia nonprofit organizations and should not be construed as legal advice. Always consult an attorney to address your particular situation.

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Agenda

- What to look out for: recent examples of competing interests
- What is a conflict of interest and why should you care
- Conflict of interest policies
- Common conflicts of interest
- Hypotheticals

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Recent Examples of Competing Interests

- American Center for Law and Justice and Christian Advocates Serving Evangelism were run by the same family—the Sekulow family—with estimates being that the two organizations steered more than $60 million to the Sekulows and their for-profit businesses.
- Goodwill Industries Omaha, over a span of ten years, gave out more than $5 million in contracts to companies owned by board members, with employees specifically told not to “bid out” the contracts.
- Wreaths Across America, started by the Worcester family, paid approx. $20 million of its approx. $30 million of annual revenues to Worcester Resources, the for-profit company of the Worcester family, for wreaths laid on veterans’ graves. Wreaths Across America was run by the Worcester family matriarch and the wives of the two Worcester sons served on the board.

Recent Examples of Competing Interests (cont.)

- Baltimore mayor profited greatly by selling her self-published children's book to the University of Maryland Medical System, where she was a director.
- Eighteen National Rifle Association board members were paid commissions and fees, ranging from a few thousand dollars to over $3 million.
- Governor of West Virginia formed "Old White Charities" that paid salaries and other compensation to multiple members of the governor's family.

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 organizations include not only actual conflicts of interest but often the <u>perception</u> 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

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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

IRS & Conflicts of Interest (cont.)

- No excess economic benefit to a “disqualified person”—anyone who was in a position to exercise substantial influence over a tax-exempt organization (including entities and related people and entities)
- Penalty is “intermediate sanctions”: stops short of losing exemption, but includes significant economic penalties for the organization and the person receiving the excess benefit
- Safe harbor to avoid intermediate sanctions requires:
  - The terms of the deal are approved, in advance, by an authorized body of the organization made up of people with no conflict
  - That authorized body relied upon good and comparable data to make sure there was no excess benefit
  - That authorized body adequately documented its basis for that determination—when it made that determination

What do you think?

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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 an organization follows a good Conflict of Interest Policy and Procedure and documents 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

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.

Grows out of the duty of loyalty to the organization. A good conflict of interest policy helps directors and others carry out that important fiduciary duty.

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, and not participate or vote in, the decision about whether a conflict exists or how to proceed
  - How and when the above process is documented

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COI Policy (cont.)

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

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

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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.

Disclosure of Potential Conflicts

- Initial and periodic 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 he can complete the job before the annual meeting

COI - Hypothetical 1

Nonprofit for Success' 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 for Success.

Founder wants full copyright ownership of the book and all proceeds but does want to donate some of the proceeds to Nonprofit for Success.

COI - Hypothetical 1: Analysis

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

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?

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COI - 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?

COI - 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?

COI - 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

COI - Hypothetical 4

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

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

COI - Hypothetical 4: Analysis

- Clear separation of assets
- Make sure Making Money Corp. is not taking opportunities away from Helping People Corp.
- No promotion of Making Money Corp. by Helping People Corp.
- Helpful to have written distinction between functions of Helping People Corp. v. Making Money Corp.
- Significant board involvement in analysis of separation

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QUESTIONS

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