COI: Candor Or Inhibition? Managing Conflicts Of Interest

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Hopefully gone are the days when nonprofit stakeholders might sweep potential conflicts of interest under the rug. Nonprofits are held to high standards of ethics, which call upon nonprofit leaders to candidly assess real or perceived conflicts of interest. As charitable enterprises continue to evolve in terms of complexity, performance, and notability, so must our approach to managing conflicts of interest. It's no longer surprising when nonprofit board members and other stakeholders are also involved in business relationships in support of a nonprofit's mission. How can we responsibly and rationally evaluate the need to address conflicts of interest?

What is a Conflict of Interest (COI)?

According to BoardSource's resource, *Managing Conflicts of Interest: A Primer for Nonprofit Boards,* "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."

In *Conflicts of Interest in Clinical Practice and Research*, a 1996 research paper published by Oxford University Press, the authors state that "A conflict of interest arises when individuals or organizations enter into a set of arrangements which under usual circumstances would lead to the reasonable presumption that they will be tempted to put aside their primary interests (such as advocacy for the patient and the public health) in favor of a secondary set of interests (the financial well-being of some commercial entity, or their own financial profit)."

A COI could potentially jeopardize an individual's loyalty to the nonprofit he or she serves. Nonprofit board members and executive officers are expected to fulfill the legal Duty of Loyalty to the nonprofits they serve. Duty of Loyalty is a legal obligation that requires nonprofit directors and key staff to prioritize the best interests of the nonprofit over their own personal interests and other business interests, whenever they make decisions on the organization's behalf.

Disloyalty can come in many forms including COIs, competition with the nonprofit, private inurement, and misuse of confidential information. Clearly, disloyalty acts against the founding reason any nonprofit exists: for public benefit rather than for the benefit of specific individuals. Disloyalty also risks a nonprofit's reputation and the trusting bond between the organization and its stakeholders.

Along with the legal Duty of Loyalty, nonprofit leaders are also expected to adhere to relevant state laws. Some states require that every nonprofit manage COIs in specific ways, or include specific content in an official COI policy. In addition to complying with legal requirements, nonprofit leaders should understand other expectations for managing conflicts of interest.

- The IRS Form 990 asks tax-exempt organizations whether or not: a written COI policy is in place; the organization monitors and enforces compliance with the policy; and, directors and key employees are asked annually to disclose interests that could give rise to conflicts.
- Charity watchdog groups report on how organizations answer COI-related questions on the Form 990. Some watchdog agencies, like BBB Wise Giving Alliance, require confirmation that a COI policy and management procedures exist in order for nonprofits to receive accreditation.

The Challenge to Disclose Conflicts of Interest

Defining conflicts of interest is simple enough, but when it's time to disclose real or perceived COIs, definitions leave some room for interpretation and inhibition. Disclosing a COI and discerning the appropriate way to address it both require multiple ethical considerations:

- **Moral awareness**: the ability to recognize that a relationship or situation potentially raises ethical issues
- **Moral intent**: the capacity to prioritize which value(s) should guide the decision
- **Moral decision-making**: the competence to determine a course of action that is ethically sound
- **Moral action**: the accountability to act on the ethical decision that was made

Empowering individuals and teams to apply these ethics filters in practice is far more challenging than simply implementing a COI policy. For example, even if an individual possesses moral awareness, he or she might not follow through with moral action after making a decision. Why not?

- **Sense of futility**: "My report probably won't do much good anyway," or "Even if I report this, there's plenty of other problems that won't be fixed."
- **Not my job**: "I'm sure the ethics team will figure this out at somepoint," or "I don't want to get involved, I'll just look the other way."
- **Fear of retaliation**: "If I report unethical conduct, I might lose my job or be cast out by my peers." The 2013 National Business Ethics Survey (NBES) (ethics.org/research/nbes/nbes-reports/nbes-2013) by Ethics & Compliance Initiative found that "one in five workers (21%) who reported misconduct said they suffered from retribution as a result."
- **Power dynamics**: "I can't report my own supervisor for ethical misconduct." The 2013 NBES found that managers are responsible for 60% of workplace misconduct, with senior leaders breaking the most ethical rules.
- **Personal gain**: "My relationship with the nonprofit is mutually beneficial; it's not really a conflict so it's not worth reporting." Of the barriers to moral action, personal gain is perhaps the most specific to conflicts of interest. An individual might rationalize the decision **not** to report a COI, in order to protect a personal business relationship or other personal gain.
- **Confusion or error**: "I'll hire my son's company to help design and carry out our next major fundraising campaign. They do great work and it's not a conflict because it doesn't benefit me personally." For the purpose of assessing a potential COI, transactions that benefit immediate family members (e.g., spouses, children, parents, siblings, individuals living in the same home, etc.), are usually considered benefits to the individual serving the nonprofit. This is but one example of an error a nonprofit leader could make in assessing a potential COI, which are sometimes complex and nuanced rather than black and white.

Are All COIs Material?

Most of us believe that all COIs are inherently material and negative, but every COI is different. Only context can tell us whether or not a COI poses a real risk of disloyalty or damage to a nonprofit. Transparent disclosure and candid dialogue enable a board to determine whether or not a COI poses risk, and if so, what action should be taken to manage the conflict.

Nonprofit board members are usually asked to disclose COIs annually for the duration of their terms, but also whenever they become aware that potential conflicts exist. When a COI is disclosed, people aware of the matter might presume that the individual with the conflict will act in a certain way because of that conflict. Though this is not necessarily true, this presumption should not be ignored; it should be discussed and assessed openly amongst members of the board.

Effective management of COIs rests *first* on disclosure and dialogue, as some COIs do not warrant any action other than awareness and understanding. When a COI potentially invites disloyalty or damage to the nonprofit, then the solution is to take *moral action*.

For example, after thorough discussion and analysis, a board might simply recognize that a conflict exists, and agree to remain aware and monitor it. In any case in which a conflict is deemed potentially damaging to the nonprofit, a board should take action to manage it. For example, the relevant board member might be prohibited from voting on any matters related to the conflict, or—if the conflict were very significant—the individual might be compelled to resign from board service or disengage in the conflicting conduct/business.

Nonprofit leaders must recognize that every individual likely has competing loyalties, so conflicts of interest are a normal and inevitable part of nonprofit service. The goal of managing COIs is not to eradicate all of them, but to effectively manage them in order to reduce risk to the nonprofit. A parallel goal is to ensure that the organization can manage COIs while still benefiting from the service of talented, dedicated individuals—even some who might have dual loyalties.

Types of COI and How to Manage Them

Conflicts of Interest can be broken down and described across three main criteria:

1. **Financial vs. Non-Financial**: Financial COIs have financial implications for the individual and the nonprofit. Financial COIs usually arise when an individual uses his or her status/role in the organization to obtain personal financial benefit, or when a person of authority is positioned to treat the nonprofit's assets as personal property.

Financial COIs are heavily emphasized in literature and discussion around COIs, but not all conflict situations are financial in nature. Non-financial conflicts can include dual loyalties or conflicting roles, which are often challenging to identify. *Example: An individual serves on the boards of two similar nonprofits, and both bid for the same federal contract. The board member is conflicted deciding which organization she will support with time, energy, and influence.*

2. **Individual vs. Organizational**: Individuals who serve nonprofits and nonprofit organizations themselves must both prepare to address COIs. Traditionally, COIs refer to situations in which an *individual's* interests create a conflict or pose risk to an organization. *Organizational* Conflicts of Interest (sometimes called OCIs) arise when an organization itself is conflicted in a way that could risk its credibility or objectivity.

Removing an individual from a discussion, project, or role can effectively resolve a COI, but it cannot resolve an OCI. *OCI Example: A health advocacy nonprofit favorably recommends a prescription drug after receiving a large contribution from the pharmaceutical company that manufactures the drug.*

3. **Inconsequential vs. Illegal/Unethical**: As explained in the discussion about material COIs above, COIs can fall anywhere on an ethics spectrum. At one end of the spectrum, COIs might be inconsequential or even beneficial to the nonprofit. In the middle of the spectrum, COIs warrant more careful consideration and management. At the other end of the spectrum, COIs are more clearly unethical and/or illegal. Unethical/illegal COIs garner the most attention, but they are clearly not the only COIs nonprofit leaders should prepare to disclose and address. An important goal of managing COIs is to assign the appropriate level of emphasis and consequence to every specific conflict that the board considers.

Aside from these categories of COI, recognize that COIs are nuanced in other ways:

- **Primary vs. secondary interests**: individuals with conflicts might not weigh conflicting interests equally
- **Real vs. perceived conflicts**: some conflicts could clearly compromise loyalty, but others create a perception of bias or compromise

After disclosure and discussion, various management actions are available to address COIs:

- **Do nothing** for inconsequential or beneficial conflicts
- **Recuse** the individual from voting on a policy or transaction related to the conflict
- **Prevent** the individual from participating in or being present for full discussion on a policy or transaction

related to the conflict
- **Restrict** the individual from creating a specified conflict of interest while serving in a key volunteer or staff role

Conflict of Interest Case Study & Resources

The NRMC team observed a nonprofit board work through a potential COI, using a simple disclosure form and discussion guide to facilitate *moral decision-making*. Learn from the experience and try this approach in your nonprofit.

Conflict of Interest Disclosure

ABC Nonprofit uses the following COI disclosure form to encourage thoughtful consideration and disclosure of potential individual conflicts

I have read ABC Nonprofit's Conflict of Interest Policy and I understand the application of the policy. To the best of my knowledge and belief:

_____ I have nothing to disclose.

_____ I have the following disclosure(s): (please circle or mark all relevant items and provide details below)

- I have a material financial interest in the following organization(s) doing business with ABC Nonprofit:
- I am an Officer, Trustee, or Director in the following organization(s) engaged (or soon to be engaged) in business transactions with ABC Nonprofit:
- I am an Officer, Trustee, or Director in the following nonprofit organization(s) with purposes directly or indirectly related to those of ABC Nonprofit:
- I am an Officer, Trustee, or Director in the following directly or indirectly related nonprofit organizations that receive financial support from ABC Nonprofit:
- I am performing (or bidding on) the following professional services for ABC Nonprofit, for which I will receive compensation:
- I have the following business relationships with other ABC Nonprofit stakeholders:
- I have the following family relationships with other ABC Nonprofit stakeholders:
- Other (please explain below):

Signature: ______________________________

Name: _________________________________ Date: ________

To guide their analysis of disclosed conflicts, board members collaborated to complete a simple worksheet (below) to stimulate candid dialogue and careful decision-making:

Board Member	No Conflicts to Report (Checkbox)	Potential Conflicts to Report (Summarize each Conflict)	Does a Conflict Exist?	Proposed Action
Jim Johnson	X	None	Yes/No	
Sally Smith	X	None	Yes/No	
Pat Patrick	X	None	Yes/No	

Leverage these tested resources to engage your board in a candid conversation of potential conflicts of interest. Effectively manage COIs to uphold the Duty of Loyalty, preserve public trust, and keep charity uncompromised.

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