

Conflict of Interest: A Matter of Integrity

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A conflict of interest occurs when a personal interest is at odds with the interest of one's position of trust. This article will address the dilemma of conflict of interest within the context of Christian charities.

The business world was shocked to learn that David Sokol, Warren Buffett's former heir apparent, misled his boss when he bought shares in a company (Lubrizol) and then recommended his employer, Berkshire Hathaway, buy the same company.¹ Berkshire's internal audit committee found that Sokol's activities violated company policies. Sokol benefited some three million dollars from the transaction, but he is now facing a lawsuit by a disgruntled shareholder for the return of the gain.² Berkshire Hathaway is also considering its own litigation and the Securities Exchange Commission is conducting an investigation. Buffett called Sokol's behaviour "inexcusable and incomprehensible."³

Conflict of interest has all the necessary drama for a scandalous headline and it remains a fertile breeding ground for corruption. The Christian community is not immune from similar incidents. We are just as vulnerable. As the example above shows, a conflict of interest occurs when a personal interest is at odds with the interest of one's position of trust. Charities are built upon public trust. The public expects charity leaders to put the interests of the charity first, above any personal gain or benefit. The courts hold directors of charities to an even higher standard of conduct – that of trustees.

Conflict of Interest Law in Canada

The law on conflict of interest is determined primarily in the common law (judicial decisions), though there are myriad pieces of legislation passed by the provincial and federal governments that deal with conflicts of interest in specific contexts (e.g., conflicts of interest of politicians, directors of corporations,⁴ charities,⁵ or trustees). Each jurisdiction has developed its own approach, yet the principles remain the same.

This area of law is rapidly evolving. For example, the new Canada Not-for-profit Corporations Act has an extensive requirement in s. 141 for disclosure of "the nature and extent of any interest that the director or officer has in a material contract or material transaction, whether made or proposed, with the corporation."

Since Canada Revenue Agency does not audit for conflicts of interest, some might be tempted to give this very little attention. However, that would be most unwise. Ontario's Office of Public Guardian and Trustee (OPGT) investigates charities operating in Ontario to ensure there is no conflict or appearance of conflicts of interest.⁶

The OPGT will investigate charities that have been the subject of a complaint (which can come from any source). Therefore it behoves us, as a Christian community, to be mindful of our roles

in working or volunteering for our charity and ensuring our personal interests are not at odds with the charity's best interests. Everyone has a stake in following the law. It does not take much for a disgruntled party, who may fall victim to a board action rife with conflicting interests, to file a complaint with the appropriate authorities and launch an investigation.

Having said all of that, there is a provision in section 13 of the Ontario Charities Accounting Act to obtain a court order, in rare occasions, granting authority to transact business with, or to be a client of, or to have an employee on the board of the charity.⁷

We will discuss five examples of conflict of interest in detail below. Before addressing those specific scenarios, we will discuss three legally and morally normative principles that are engaged when dealing with conflicts of interest. Once we understand those principles, we can then apply them to our scenarios.

Principles At Stake (Integrity, Loyalty, Disclosure (ILD))

The Principle of Integrity

"Judge me, O Lord, according to my righteousness, and according to my integrity within me" (Ps. 7:8, NKJV).

Conflict of interest is a matter of integrity. Integrity is defined as "adherence to moral and ethical principles; soundness of moral character; honesty."⁸ Integrity goes to the heart, and it is the conflicted heart that we are concerned with when we talk about a conflict of interest. The legal term would be "acting in good faith."

The Lord's search of the heart is a consistent theme in scripture. When the prophet Samuel was interviewing the sons of Jesse, one after the other, to determine whom the Lord had chosen as the next king of Israel, he thought he had found him but the Lord said, "No." The Lord was blunt: "For the Lord does not see as man sees; for man looks at the outward appearance, but the Lord looks at the heart" (I Samuel 16:7, NKJV).

The Principle of Loyalty

Christ taught us to recognize life's conflicting loyalties: "No one can serve two masters; for either he will hate the one and love the other, or else he will be loyal to the one and despise the other. You cannot serve God and mammon" (Matthew 6:23-25, NKJV).

When we accept positions of trust with a charity, we are called upon to put our loyalty to the charity above personal profit. That does not mean we "sell out" all of our higher responsibilities – to God or to family – in favour of the charity. In fact, if we were called upon to violate those responsibilities, it would be necessary, in good conscience, to step down from such a position. Personal gain is not to be had at the expense of the charity while serving as a fiduciary (a person of trust), whether as a board member or, I might add, its CEO and staff. The law speaks of the duty to act gratuitously and is very clear that no benefit is to be had from the charity unless there is a legal right to it (e.g., the reimbursement of expenses of a board member to attend a meeting).

The Principle of Disclosure

A conflict of interest is not necessarily evidence of impropriety, but rather it provides fertile ground for corruption to germinate and take root. It is a classic situation where one must be proactive early in eliminating even the appearance of evil. To linger could lead to compromise, bringing shame and breach of trust. That is why, for example, a judge will excuse himself from a trial in which he might have (or be seen to have) a personal interest in the outcome.

When we place ourselves in, or simply come to the realization that we are in, a conflict of interest in our roles vis-à-vis our charity, it is best that we deal with it expeditiously. Disclosure requires nothing less than an honest admission of our conflict to all parties concerned and an earnest effort to make good of the situation. That may require a stepping down; one interest or the other must usually give way.

Five Scenarios

There are any number of scenarios where a conflict of interest may arise. I will consider five.

Scenario #1: A charity is headquartered in a small urban setting. One of the directors on its board owns a local janitorial business. The janitorial firm is well-respected in the community as giving quality, efficient, and honest on-site service at a reasonable price. Any other janitorial firm is over two hours away and more expensive.

Is the director in a conflict of interest if the charity seeks to do business with his firm?

- The answer, of course, is yes. The director finds himself with two competing interests: personal profit from his business and his responsibility for looking after the best interests of the charity as a director.

What might be done to alleviate the concern?

- At a minimum, he should not attend any meeting where the issue of janitorial service is discussed. When the board is obtaining information on his company's services, another staff member should be the one who communicates with the board.
- Unfortunately, human nature being what it is, there will be a sentiment on the board that says, "If we do not give this contract to his company, he will think less of us." Here the remaining directors have to recognize their fiduciary roles and put the interests of the charity first and foremost over their own preconceptions of their relationship with the director who owns the janitorial firm.
- Should the director's janitorial firm be chosen to carry out the work, there will need to be adequate documentation to prove due diligence that the decision was motivated by the best interests of the charity.

- Some might suggest that the director's janitorial firm must never be hired by the charity because of the conflict. While there is no doubt that such a contract increases the complexity of the relationship, there has to be a balancing of risk. On the one hand, the conflict could lead to impropriety if not properly monitored, but on the other hand, the charity should not suffer loss by having to take a more expensive janitorial firm that would not meet its needs. If the charity has put safeguards in place to limit the risk, it could proceed with the contract.

Scenario #2: A director of a charity is the principal in an auto-leasing company. The charity staff has determined that the charity needs a vehicle for its work and leasing will make the most sense, so they make a deal with the auto-leasing company. The director does not get direct commission on the lease.

Is the director in a conflict of interest because the charity seeks to do business with his firm?

- It is tempting to suggest that there is no conflict here because the charity staff independently decided that it needed to lease a vehicle. Further, it is not a decision of the board but of the staff. However, there is a potential for conflict: the board will be approving the charity's budget for the coming year. Part of that budget will include the funding of the car lease. Therefore, a conflict of interest will be present or seen to be present.

What might be done to alleviate the concern?

- Our three principles, ILD, will assist. The principal, as soon as he is aware, must disclose the relationship to all members of the board. His first duty is to the charity, therefore, it must be clear that the arrangement is in its best interests. His forthrightness will go a long way to assist the board in its evaluation.
- There is also a responsibility for the charity staff to reveal all factors to its own board as it seeks to perform its due diligence.
- The fact that the director does not get direct commission on the lease is just one factor among many in the board's determination. There is certainly a perception here of conflict that must be addressed. There are many other ways that the director's interest could be in conflict besides the issue of direct funds (e.g., the public goodwill that occurs when a well-respected charity does business with his firm). That fact alone could prove more beneficial to his bottom line than the funding of one car lease.

Scenario #3: A small church employs a spouse of a church board member as its bookkeeper.

Is the board member in a potential conflict of interest?

- Yes, he is. There is a perception of a potential conflict. It would certainly manifest in the areas of finance. Take, for example, the effect of a board's decision to cut the budget, resulting in the removal of the bookkeeper position.

What might be done to alleviate the concern?

- If this were in Ontario, the OPGT would not permit this to remain. The only way it could remain is through a court order, as described above. Given the cost and aggravation, it would not be worth the trouble.
- The best option is for the board member to step aside because, undoubtedly, there will be confidential matters that the board will discuss, dramatically affecting the staff. A spousal relationship has proven to be more than most people can handle in keeping confidences and being impartial when making decisions in the best interests of the charity that may adversely affect their spouse. Such a situation challenges the ideal that all board members will unreservedly put the interests of the charity above their own.

Scenario #4: A charity director is an insurance representative for a large insurance company. The director persuades the charity to take a policy for which he gets a commission. Is the director in a conflict of interest if the charity seeks to do business with his firm?

- Yes, again. Even if we give the director the benefit of the doubt that his first concern was that of the charity in encouraging the policy, we are left with the reality that he personally benefited. It simply does not pass the "smell test." Appearances in such matters are not to be ignored. They are real and could cause the charity embarrassment.

What might be done to alleviate the concern?

- The board's duty requires it to ensure that such an insurance policy was necessary.
- The board must search the market to determine that this in fact was the best policy for its purposes and the cheapest.
- It would be wise for the director to donate the commission to the charity. That would take away any possible criticism that the director's duty to the charity was compromised.

Scenario #5: A church board director is an insurance agent and persuades the church to purchase a policy with his company, but in this case he does not get paid a commission for the policy.

Is the director in a conflict of interest if the church seeks to do business with his firm?

- Yes, the commission is but one factor of concern. Other benefits remain besides cash. As noted above, there is the matter of goodwill. A charity that does business with a company makes a statement that company is good to deal with. A director may end up getting a large number from the congregation to buy insurance through him just on the fact that the church bought insurance from him.

What might be done to alleviate the concern?

- The same as under number four above.

Board Agenda and Minutes

In the above scenarios it will be necessary to properly prepare the meeting minutes to show due diligence in addressing the conflict. At the beginning of each meeting, the board agenda ought to make time available for directors to declare any conflicts of interest on the proposed business of the day. If there is a declaration or a concern raised by another member, then it should be recorded in the minutes. The member with the perceived conflict of interest would be asked to address the board about the concern and be excused from the room to allow for proper deliberation. If the board finds a conflict of interest, then the board would follow its conflict of interest policies and take the appropriate action to meet the circumstance. A sample minute might look like this:

A conflict of interest was declared concerning the proposed agenda item addressing the bid of ABC Janitorial to perform janitorial services of our charity. Mr. X, a member of this board and the owner of the ABC Janitorial, declared the conflict of interest. He excused himself from the meeting. After some considerable discussion there was a consensus that the Board would not entertain ABC Janitorial's bid because it was not in the charity's best interest to do so.

Mr. X was informed of the board's decision and returned to the meeting for the remaining agenda items.

Depending on the circumstance, the meeting minutes may have to be curtailed because of the sensitivity of the subject matter. The bottom line is, you want to ensure that if a third party – such as a lawyer from a provincial Office of Public Guardian and Trustee – investigates a complaint, they will have the necessary information to determine whether due diligence was made to alleviate the concerns raised by the conflict of interest.

Conclusion: Things To Think About

The advice that I have given in this article can be summed up this way: conflicts of interest are common in all human relationships. The problem is not that they exist – the problem is how they are handled. Applying the principles of integrity, loyalty, and disclosure in a timely fashion to the conflict will save the charity and persons involved untold hours of grief.

Finally, here are some suggestions: First, review your current relationships and determine whether there exists a current or potential conflict of interest. Once the conflict has been declared, the options for appropriate action, as we have noted above, fall into three broad categories: (1) the person is permitted to stay in the position because of the circumstances; (2) the person must leave the meeting and is not permitted to vote; or (3) the person must step down. Remember, stepping down alone may not be enough in certain circumstances. Sometimes further action needs to be taken to void any contract or other relationship that gave rise to the conflict in the first place.

Second, ensure that your charity has a conflict of interest policy that clearly articulates the needs of your charity and has a well thought out approach to deal with conflicts as they arise. Each

individual holding a position of trust in your organization should be required to sign a declaration of conflicts on an annual basis. CCCC members may view a sample policy at http://www.cccc.org/members_sample_documents_view/html/7

Third, remember a conflict does not imply any wrongdoing – it raises a flag of warning that the relationship needs to be clarified to ensure nothing untoward happens that would put the individual and the charity in jeopardy.

Fourth, document all transactions that the charity has undertaken that give even an appearance of conflict. Full disclosure to the board and staff handling the financial transactions must be made. Disclosure before the transaction takes place is key. The minutes must accurately reflect what has been done to address the conflict.

Fifth, remember conflict of interest is a matter of integrity which in turn is a matter of our hearts. As Christians involved in the Gospel Commission, we can expect no less than the Lord to require our full loyalty and purpose.

¹ <http://www.berkshirehathaway.com/news/MAR3011.pdf>

² <http://www.forbes.com/sites/francinemckenna/2011/04/20/its-not-futile-shareholder-sues-sokol-buffett-and-berkshire-hathaway-board/>

³ <http://www.guardian.co.uk/business/2011/may/01/warren-buffett-accused-of-scapegoating>

⁴ The British Columbia (BC) Society Act, R.S.B.C. 1996, c. 433 in s. 25. Newfoundland and Labrador, Manitoba and Saskatchewan have codified an objective standard in Corporations Act, R.S.N.L. 1990, c. C-36; Corporations Act, C.C.S.M. c. C225; and Non-profit Corporations Act, 1995, S.S. c. N-4.2. While the old Ontario Corporations Act, R.S.O. 1990, c. C.38 does not – it will be replaced by the new Ontario Not-for-profit Corporations Act, S.C. 2009, c. 23. The new Canada Not-for-profit Corporations Act, S.C. 2009, c. 23, has an extensive requirement in s. 141.

⁵ Charities Accounting Act, R.S.O. 1990, c. C.10

⁶ <http://www.attorneygeneral.jus.gov.on.ca/english/family/pgt/charbullet/bullet3.asp>

⁷ <http://www.attorneygeneral.jus.gov.on.ca/english/family/pgt/proc4order-s13-CAA.pdf>

⁸ <http://dictionary.reference.com/browse/integrity>