



SECTION: FIVE

# Conflict of Interest and Procurement Policies



## Conflicts of Interest

When a director assumes office, the law requires that the best interest of the corporation prevail over the director's personal or business interests. A conflict of interest can arise in many situations including leasing property, buying goods and services, and borrowing or lending money. Conflicts can also arise with employees and family members of directors. Conflicts of interest have both legal consequences and public perception consequences. Nonprofits should adopt policies and procedures to ensure that those with decision-making power in the organization do not take actions that could benefit themselves, their families, or their business interests. For a sample conflicts of interests policy, see below.

### Prohibited Transactions

- **Loans to directors.** There is an absolute prohibition on paying dividends or lending the money of a nonprofit to a director. Directors who allow the making of a loan to a co-director will be personally liable for the full amount of the loan until it is repaid.
- **Private inurement.** There is also an absolute prohibition against "private inurement." In order for a corporation to be recognized as a public charity by the IRS, no part of the net earnings of the corporation may inure to the benefit of a private individual. Private benefits may occur when the nonprofit pays more for goods and services than they are worth. Violations of this restriction may result in severe penalties and substantial legal problems for the nonprofit and directors approving the transaction.

### Permitted Transactions

- **Reasonable compensation for services.** A nonprofit may pay reasonable compensation to a director for services the director provides on behalf of the nonprofit. The key qualification is "reasonable," which will be determined by the IRS, the Attorney General, donors, and the public on the basis of all the facts and circumstances of the situation.
- **Interested director transactions.** Texas law permits transactions with directors under certain circumstances. The three things to remember with regard to an interested director transaction are:
  - Disclose material facts;
  - Ensure that the transaction is fair to the nonprofit; and
  - Document the decision-making process.

The material facts of the director's interest in the transaction should be disclosed to the board before a vote on the transaction, and a majority of disinterested directors should

approve the transaction in good faith and with ordinary care. A transaction may be approved only if it is fair to the nonprofit when it is authorized. Any transaction with an interested director should be carefully documented in the minutes of a meeting at which the transaction is considered.

### **Sample Minutes for an Interested Director Transaction**

"A motion was made by Richard Nixon to rent an office from ABC Leasing. Board member, Spiro Agnew, stated that he owned the building in which the office was located. The board compared the rental rates with other comparable offices and determined that the rent was lower than other similar spaces. A second to the motion was made by Gerald Ford. The vote to approve the lease was 6-0 and Spiro Agnew did not participate in the vote."

## Sample Conflicts of Interest Policy

### I. Purpose

It is imperative to the success of the Corporation that there be a fully informed and responsive Executive Committee and Board. To accomplish this end, all Board members shall conduct themselves at all times in the best interest of the Corporation. In this regard, each Board member shall abide by the following "Code of Ethics." While no code or set of rules can be framed which will particularize all the duties of a Board member, the following code of ethics shall serve as a general guide.

### II. Code of Ethics

It is imperative to the success of the Corporation that there be a fully informed, responsive, and reasonable Executive Committee and Board. To accomplish this end, all Board members shall conduct themselves at all times in the best interest of the Corporation. In this regard, each Board member shall abide by the following "Code of Ethics." While no code or set of rules can be framed which will particularize all the duties of a Board member, the following code of ethics shall serve as a general guide. The enumeration of particular duties should not be construed as a denial of the existence of others equally imperative, though not specifically mentioned.

### III. Conflicts of Interest

- A. **Financial Interests.** Each Director, Officer, and committee member shall fully disclose any and all financial interests involving themselves or one of their family members in regard to any matter which is presented to the Board or a committee for a vote and shall abstain from voting on such matters. "Financial interests" include, but are not limited to:
1. An ownership, investment interest, or compensation arrangement with any entity with which the Corporation has a transaction or arrangement;
  2. A compensation arrangement with the Corporation or with any entity or individual with which the Corporation has a transaction or arrangement; or
  3. A potential ownership, investment interest, or compensation arrangement with any entity or individual with which the Corporation is negotiating a transaction or arrangement, including a commission or fee, share of the proceeds, the prospect of promotion or profit, or any other form of financial reward.
- B. **Family Relationships.** The term "family member" as used herein includes: parents, in-laws, children, siblings, spouses, aunts, uncles, nieces, and nephews.
- C. **Duty to Disclose.** In connection with the actual or potential conflict of interest, an interested person must disclose the existence of his financial interest and all material facts to the Directors and members of committees with board-delegated powers considering the proposed transaction or arrangement.
- D. **Determining Whether a Conflict if Interest Exists.** After disclosure of the financial interest and all material facts, and after any discussion with the interested person, the interested party shall leave the board or committee meeting while the determination of a conflict of interest is discussed and voted upon. The remaining board or committee members shall decide if a conflict of interest exists.

**E. Procedures for Addressing the Conflict of Interest**

1. An interested person may make a presentation at the board or committee meeting, but after such presentation, he shall leave the meeting during the discussion of, and the vote on, the transaction or arrangement that results in the conflict of interest.
2. The President or Chair of a committee shall, if appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.
3. After exercising due diligence, the board or committee shall determine whether the Corporation can obtain a more advantageous transaction or arrangement with reasonable efforts from a person or entity that would not give rise to a conflict of interest.
4. If a more advantageous transaction or arrangement is not reasonably attainable under circumstances that would not give rise to a conflict of interest, the board or committee shall determine by a majority vote of the disinterested Directors whether the transaction or arrangement is in the Corporation's best interest and for its own benefit and whether the transaction is fair and reasonable to the Corporation. The Corporation shall make its decision as to whether to enter into transaction or arrangement in conformity with such determination.

**F. Violations of the Conflict of Interest Policy**

1. If the board or committee has reasonable cause to believe that a person has failed to disclose actual or possible conflicts of interest, it shall inform the person of the basis for such belief and afford the member an opportunity to explain the alleged failure to disclose.
2. If, after hearing the response of the person and making such further investigation as may be warranted in the circumstances, the board or committee determines that the person has in fact failed to disclose an actual or possible conflict of interest, it shall take appropriate disciplinary and corrective action.

**G. Recordings and Proceedings.** The minutes of the board and committees with board-delegated powers shall contain:

1. The names of the persons who disclosed or otherwise were found to have a financial interest in connection with an actual or possible conflict of interest, the nature of the financial interest, any action taken to determine whether a conflict of interest was present, and the board's or committee's decision as to whether a conflict of interest in fact existed; and
2. The names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection therewith.

**IV. Gifts**

Directors and employees of the Corporation may not receive a gift, or a series of gifts, valued at more than \$25 from contractors or businesses who have performed services for the Corporation within the past 12 months without prior approval of a majority vote of disinterested Directors. Directors and employees of the Corporation shall also gain approval by majority vote of

disinterested Directors to personally employ contractors and businesses which have performed services for the Corporation within the past 12 months.

**V. Additional Provisions**

- A. Directors shall put forth their best effort to attend all meetings and constructively participate in the meetings.
- B. Directors shall be responsible for insuring that adequate and correct information is presented to their constituents and the public.
- C. Directors shall exercise good judgment in the control and use of confidential information that may from time to time come into their possession. No Director shall use confidential information gained by reason of being a member of the Board of Directors for personal gain to the detriment of the Corporation.
- D. Each Director shall serve as a public relations agent for the Corporation and therefore shall work diligently and properly to promote its goals and objectives while keeping abreast with its overall progress.
- E. Except for voting at properly called meetings of the Board of Directors, board members shall refrain from entering into the direct day-to-day administration of the program unless they are doing so upon express authority given to them by Resolution of the Board of Directors.
- F. The Executive Committee shall be charged with the responsibility of reviewing any allegations of Directors violating this code or acting in any way which is detrimental to the success of the Corporation and make recommendations to the full Board for final action.

**VI. Annual Statement**

Each Director, officer, and committee member with board-delegated powers shall annually sign a statement which affirms that such person:

- A. Has received a copy of the Code of Ethics/Conflicts of Interest policy;
- B. Has read and understands the policy;
- C. Has agreed to comply with the policy; and
- D. Understands that the Corporation is a charitable organization and that in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes.

## Sample Procurement Policy

The following policies and procedures shall be followed when the nonprofit purchases equipment, materials, supplies, property, or services from an outside source.

### A. General Policy

- ◆ **No Conflict of Interest.** All directors, employees, or agents who participate in the selection or acceptance of a contract for equipment, materials, supplies, or services must comply with the nonprofit's conflict of interest policy. No director, employee, or agent will participate in the selection or acceptance of a contract involving a conflict of interest without the approval of the board. "Conflict of interest" includes situations in which the employee, family member, or board member has a financial interest in the business or individual selected for the contract.
- ◆ **No Purchase of Items for Personal Use.** No director, employee, or agent who participates in the selection or acceptance of a contract for equipment, materials, supplies, or services shall use such items for personal use.
- ◆ **No Receipt of Gratuities.** No director, employee, or agent shall solicit or accept gratuities, favors, or anything of value from contractors, potential contractors, or parties to agreements with the nonprofit.
- ◆ **No Purchase of Items Not Approved in the Budget.** No director, employee, or agent shall solicit or accept any equipment, materials, supplies, or services that have not been approved by the Board of Directors in the annual budget without prior approval of the board.
- ◆ **Document Cost Analysis.** The nonprofit shall conduct a cost analysis and document the analysis in the procurement files in conjunction with every purchase. The procurement file should include a justification for the lack of competition if competitive bids or offers are not obtained.
- ◆ **Contract with Winning Bidder.** If a contract is competitively bid, the nonprofit will enter into a contract with the winning bidder that specifies the equipment, materials, supplies, property, or services to be purchased and the payment terms.
- ◆ **Evaluate Each Contractor.** The nonprofit will evaluate each contractor at the completion of each contract. The evaluation will be utilized to make decisions to award future contracts.

## B. Acquisition Procedure

The nonprofit will conduct all procurement transactions in a manner that maximizes opportunities, increases quality, and reduces the cost of purchase. The nonprofit reserves the right to reject any bids or offers, if deemed to be in its best interest.

- ◆ **Pricing Procedures.** One of the following procurement procedures shall be utilized for all purchases of equipment, materials, supplies, property, or services involving federal funds or involving amounts over \$500:
  - **Open Market Inquiry.** The nonprofit will inquire in the open market to ensure an advantageous price and quality. The file shall document the inquiries made and offers received.
  - **Request for Competitive Quotes.** The nonprofit will request competitive quotes, orally or in writing, from at least three different sources. The file shall document each invitation made and offer received.
  - **Formal Proposal Procedure.** The nonprofit will solicit competitive responses through a formal bid procedure. Bids will remain sealed until the time designated in the proposal. All requests for proposals shall contain the phrase “Equal Opportunity Employer.”
  
- ◆ **Document Prices.** The nonprofit shall maintain files on all quotations solicited and offers or bids received and any criteria for selection. In all instances in which the lowest bid is not awarded in the contract, justification for the selection must be contained in the file.
  
- ◆ **Purchases over \$\_\_\_\_\_.** The Board of Directors must approve purchases over \_\_\_\_\_ [*enter amount here*].
  
- ◆ **Two Signatories on Checks.** There must be two approved signatories on all checks for purchases over \$\_\_\_\_\_ [*enter amount here*].

## C. Property and Equipment Policy

When purchasing property (both real estate and equipment), the following procedures must be followed:

- ◆ **Title in the Name of the Nonprofit.** All property purchased belongs to the nonprofit and title vests with the nonprofit.
  
- ◆ **Property Inventory.** A list of all property owned by the nonprofit shall be kept showing the type of property, identification number, original cost, and depreciated

value. The inventory list must be completed at the time of purchase and annually at the end of the nonprofit's fiscal year.

- ◆ **Insurance Coverage.** The nonprofit will maintain insurance coverage for all property owned by the nonprofit and maintain documentation of each policy in a safe deposit box.

#### D. Additional Policies When Using Federal Funds to Purchase

- ◆ **Federal Debarment.** Before purchasing goods using federal funds, the nonprofit must review the Federal Government's General Services Administration's "List of Parties Excluded from Federal Procurement of Non-Procurement Programs" and document that the bidder is neither debarred or suspended from doing business with the federal government nor delinquent in a debt to the United States as defined in OMB Circular A 1-29.
- ◆ **Property of Federal Government.** Equipment purchased with federal funds that costs more than \$5,000 is generally considered the property of the federal government and must be disposed of through the applicable federal procedure.
- ◆ **Expanded restrictions on conflicts of interest.** Because specific federal programs, such as the HOME program, require approval from the federal government before engaging in a transaction in which a conflict of interest exists, the nonprofit shall check with the relevant federal agency before engaging in a transaction with a conflict of interest.