AccountAble™

Conflict of Interest Provisions in Bylaws **Issue # 97; Dec 03** (Released: May-04)

In this issue

In an earlier issue of AccountAble[1], we discussed the reasons for including some important administrative provisions in the bylaws. We continue the discussion here, focusing on conflict-of-interest provisions.

Trustee or office-bearer?

We have used the terms 'trustee' and 'office-bearer' interchangeably. If your organisation is a trust, then you should use the word 'Trustee' while drafting the Trust Deed. If it is a society, then use the words 'office-bearer' or 'Governing Body member', or a similar word.

Conflict of Interest Provisions

In an NGO, decisions are taken by the Governing Body or by senior employees. These people or their relatives may also have other activities or firms. Sometimes, the NGO has to enter into a contract with such a firm. How to make sure that the NGO will not be at a loss in such a deal?

For this purpose, special provisions are inserted in the bylaws. These are called conflict-of-interest provisions. Conflict of interest provisions also help demonstrate to donors and general public that the NGO is

committed to transparency and accountability.

The bylaws do not lay down the detailed rules for managing the conflict of interest. This is left to the Trustees. However, the bylaws can say that what would the policy look like. Bylaws can also say that the Trustees have to design and enforce such a policy.

Conflict of Interest Policy:

> **The Trustees will design and ensure implementation of a conflict-of-interest policy based on principles outlined below:**

This means that the trustees are responsible for designing a conflict of interest policy. They should then also make sure that it is implemented. The principles to be used while designing the policy are given below[2].

1. Commitment to duties

- **The duty of undivided loyalty to the Trust**
- **The duty of care**
- **Prohibition against self-dealing**
- **Need for accountability and stewardship**

[1] AccountAble 85: Administrative Provisions in Bylaws

[2] These have been propounded by Herignton J. Bryce and have listed in AccountAble 53: Conflict of Interest. See also Financial & Strategic Management for Nonprofit Organizations, 3rd edition. Jossey-Bass Publishers, San Francisco, USA

This sub-clause lays down broad principles. Key persons should be committed to their duties. What does this include? Firstly, their loyalties should be undivided. They should take care of Trust's interests as they would take care of their own. They should avoid dealing out benefits to themselves at the cost of Trust's interests. They should see themselves as being accountable to the trust for their actions or inaction.

2. Prohibitions

- **The Trust will not loan money or property to a key-person.**
- **The Trust will not make a grant of funds (directly through itself, or indirectly through another organisation), to a key-person.**
- **The Trust will not sell or buy or lease land or buildings from a key-person without specific approval of the Board of Trustees and from the Charities Commissioner, where applicable.**
- **The Trust will not do business with a key person in a way that is unfair to itself.**

This sub-clause tells us what the Trust can not do, in respect of key-persons. It can not lend money to them. It can not make grants to them, directly or indirectly. If the Trust decides to sell or buy immovable property from a key person, then the decision must be approved by the Board of Trustees. The Trust should also avoid getting into business deals where it loses money or any other thing of value to a key person.

3. Disclosure of interest

- **Each trustee or manager (including, but not limited to, Chief Functionary, Executive Director, Director, Secretary, office bearers, etc.) must disclose possible points of conflict.**
- **Such trustees should not be present when the matter is discussed.**
- **Every transaction, having any monetary implication, during a year with a key person, will be reported in the audited annual financial statements of the Trust. All outstanding commitments to / dues from a key person at the end of the year will also be disclosed, along with the highest and lowest amounts of such commitments / dues being disclosed in the audited annual financial statements.**

This clause plans for disclosure at two levels: internal and external. The key persons should disclose the areas where their might be a possible conflict. This is normally done by preparing a list of organisations / persons which are related to a key person. This list is normally provided by each key person annually.

The third sub-clause also asks the Trust to disclose all transactions with key persons.

This disclosure is done through the annual accounts.

Why is this clause important? It brings in an important element of public scrutiny. In this *kaliyug*, it is not sufficient to be honest – you must also be *seen* to be honest.

4. Money Value

- **The conflict of interest policy will also consider the amount involved. For example, if the total value of all such transactions with a key-person in a year exceeds Rs.50,000, then:**
    - **The goods or services must be provided to the Trust at actual, reasonable or discounted value.**
    - **Details of the transaction must be disclosed to the Board. The concerned member can not participate in discussion or voting.**
    - **Detailed minutes of the transaction must be kept.**
    - **The transaction must be authorised by 2/3 of the voting board. Persons who have themselves sold services or goods to the Trust in last one year, can not vote on this transaction.**
- **If the transaction exceeds Rs.2 lakhs, then it must be published in a local newspaper.**
- **The above monetary limits are illustrative only. Trustees may lay down more realistic limits depending on the size and nature of the organisation.**

This clause suggests stricter provisions for larger transactions. If the annual transaction value is more than Rs. two lakhs, then it must be published in a local newspaper. If it is more than Rs.50,000, then it must be approved internally.

The limits can be laid down based on discretion of the trustees. While designing the limits, keep in mind that payment of salary to a key person will also be covered by this policy.

5. Corrective Action

- **The policy should also provide for corrective action, when unfair transactions are discovered later:**
- **A transaction showing conflict of interest can be voided later if it is seen to be in bad faith.**

What kind of corrective action is possible? For example, if amount paid for some goods is too high, then it may be possible to recover the excess from the concerned persons.

6. Audit confirmation

- **Each annual audit report of the Trust will include, in its main body, a specific confirmation by the auditors of the Trust, whether the conflict of interest policy has been implemented in full during the year, and whether there were any departures. In case of departures, the audit report will give sufficient details thereof.**

This policy shall apply to every key person and to all transactions with key persons.

The audit confirmation clause is included to send out a clear signal that the policy is being implemented seriously. The clause also helps reduce mutual back-scratching.

Definition of Key Person

For the purpose of this trust deed, 'key person' means any person listed in section 13(3) of the Income Tax Act, 1961.

Further, any concern, whether commercial or non-profit, in which a natural 'key person' holds a position as an employee, board member or ordinary member will also be included in the definition of 'key person' for the purpose of this Trust deed.

Any person associated in an honorary capacity with the Trust will also be considered a 'key person' if he or she is in a position to influence decision-making in the Trust.

Further, a person will continue to be deemed a 'key person' for a further period of two years from the date his or her relationship as an active 'key person' of the Trust comes to an end.

This clause links the definition of the 'key person' to the Income Tax Act. Thus, the definition will automatically change as the society evolves and the Income Tax Act is amended. This also helps make sure that the Trust's functioning is within the law, all the time.

Related AccountAble Issues:

52: Key Person Transactions and Income Tax

53: Conflict of Interest

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