

# GOVERNANCE IN ACTION

## Handling Conflict of Interest for the Greater Interest

### What is Conflict of Interest?

Conflict of Interest (Col) happens “when ‘private interests’ of a board member or staff compete or conflict with the interests of the NGO, which may easily lead to a decision against the best interest of the organization.”<sup>1</sup> There is general impression on Col that it is associated with commercial crimes such as corruption or embezzlement, which mainly occur in the business sector. Actually, Col happens more often than expected in the nonprofit world. In reality, Col is much more complex and subtle. It may not only involve direct material gain, but also potentially non-tangible benefits that are not so obvious.

Private interests may come in forms of financial and personal benefits for the board members or staff, and people in their connections, such as family members, friends, etc.<sup>1</sup> An example of direct Col would simply be a procurement process that may favor a service provider where a board member may be its owner. In a more indirect or subtle situation, a board member, for example, may also be an employee of another organization of similar business nature. He/She needs to decide on the strategic plan of the agency governed that may conflict with his/her employer NGO. For a more sensitive situation, but rather common in the nonprofit sector (especially in self-help groups), a service user may sit on an agency's board where its activities may directly affect his/her own well-being.

### Types of Col

The Chartered Governance Institute (CGI) in the UK, formerly known as Institute of Chartered Secretaries and Administration, has categorized four common types of conflicts:<sup>2</sup>

#### Direct financial interest

the direct financial benefit that a board member may receive

#### Indirect financial interest

the financial interest that a close connection of the board member may receive

#### Non-financial or personal conflicts

other non-financial benefits that a board member may receive

#### Conflict of loyalties

conflicting duties that a board member may have in multiple charities or other organizations

### Why care about Col?

As NGOs are funded by public money and have multiple stakeholders that they are held accountable to, there are public expectations that board members, as governors of the organization, will ensure the objectives of the NGO are met and that money are well spent. All decisions made by the board should only be for the best interests of the NGO, not for any individual, even if it is for a particular beneficiary.

Mishandling or neglecting Col would lead to financial loss and other negative impacts to NGOs. It may also jeopardize the welfare of clients. If Col were inadvertently disclosed to the public, the reputation of the organization and the personnel involved will be imperiled. This will affect the NGO's credibility and donations in the long term. In extreme cases, mismanagement of Col may even be a gateway to fraudulent acts and bribery.

<sup>1</sup> Hong Kong Independent Commission Against Corruption. (2019). Tips for NGOs – Management of Conflict of Interest.

<sup>2</sup> The Chartered Governance Institute. (2014). Specimen conflict of interest policy, declaration form and register of interests for charity trustees.

# GOVERNANCE IN ACTION

## How to deal with Col?

It is essential for board members to recognize the Col, identify the risks associated, and handle with care. In some countries, it is legally required that charities have policies on Col. For instance, in the United States, it is compulsory for NGO boards to fill in a form annually to the Internal Revenue Service to acknowledge that they have a written Col policy. Organizations and board members failing to manage Col may be severely penalized.<sup>3</sup> While there is no such requirement in Hong Kong for nonprofit boards, directors should still take on such precautions as best practice. As individuals, board members have legal responsibilities and the duty of loyalty under the Companies Ordinance (for NGOs formed under this ordinance) and the common law to make decisions in the best interests of the agencies they serve. Various guidelines published by government departments and statutory bodies such as the Hong Kong Independent Commission Against Corruption (ICAC)<sup>4</sup>, the Social Welfare Department<sup>5</sup> and the Efficiency Unit<sup>6</sup> have all suggested that nonprofit boards should develop policies and protocols in handling Col.

The suggested protocol can be summarized into the following:



### Policy

NGOs should develop a policy with clear guidance on what happens when Col arises. There should be clear definitions and examples on the types of Col that board members and staff may face. In different situations, the policy should state the respective guideline in handling Col, that is, when Col should be declared, in what format, and the follow-up action required.

### Declaration

When Col arises, board members or staff involved should come to full disclosure as soon as possible. Depending on the nature of the Col and the policy of the organization, concerned parties (board, committee or staff members) may reveal relevant information verbally or in written format. The frequency of declaration can be determined by the organization internally.

### Record

Declaration is not sufficient for resolving Col. Once a Col is declared by a board member or staff, a designated person should have a proper record of the Col as well as the resolution to manage the Col. The board member may withdraw from all discussions and his/her voting right related to the subject matter. For instance, when a board member declares a Col during the board meeting, the board minutes should record this action. The organization may also keep a register of interests to document all potential and apparent Col declared.

Both the CGI<sup>2</sup> and the ICAC<sup>7</sup> have published templates on Col policies and declaration forms for NGOs' easy reference. Agencies may make reference to these materials in developing their own papers.

## Developing a positive culture towards Col

With the nonprofit sector being such a closely linked community, Cols are unavoidable and just happen naturally. Many board members are resourceful leaders who are well connected and "wear many hats" in different capacities. It is usually for this very reason that they become board members of their nonprofits. Just because Col happens so easily, it does not mean that NGOs should recruit board members who are less connected to avoid Col. Rather, if Col are managed properly, the networks associated with the board members can often bring in benefits to the NGOs, such as providing lower rates on services or linking up potential donors.

Board members should always reflect on themselves whether they face any Col. Directors disclosing Col frankly is crucial to developing an open and candid culture in the boardroom. It would always be a great virtue to serve on board selflessly with one's heart and soul. The rectitude of the board constitutes the cornerstone of the organization's integrity, which is essential to earning public trust for its sustainability.

<sup>3</sup> Internal Revenue Service, the United States Government. (2020). Intermediate Sanctions - Excess Benefit Transactions. URL: <https://www.irs.gov/charities-non-profits/charitable-organizations/intermediate-sanctions-excess-benefit-transactions>

<sup>4</sup> Hong Kong Independent Commission Against Corruption. (n.d.) Strengthening Integrity and Accountability - Government Funding Schemes Grantee's Guidebook.

<sup>5</sup> Social Welfare Department. (2002). Leading Your NGO - Corporate Governance - A Reference Guide for NGO Boards.

<sup>6</sup> Efficiency Unit. (2015). Guide to Corporate Governance for Subvented Organisations, 42-44.

<sup>7</sup> Hong Kong Independent Commission Against Corruption. (2015). Sample Code of Conduct for Board Members & Staff of Non-governmental Organisations in Social Welfare Sector (Full Version), Appendix 3 and Appendix 4.