

# GOV



## GOVERNANCE SERIES

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# Identifying, Disclosing, and Managing Board Members' Conflicts of Interest

Board members make critical decisions that shape a health center's operations. For example, among other things, board members:

1. Approve the selection and dismissal of a health center's Executive Director or Chief Executive Officer.
2. Adopt policies for financial management practices as well as personnel policies.
3. Approve the annual budget.
4. Select services and where they are provided.
5. Determine the schedule of hours of operation.
6. Approve health center procurements if they are of "major" significance (*e.g.*, the procurement is above a significant dollar amount or is not included in the approved budget), as defined in the health center's relevant policies.

In making such decisions, every board member has a "duty of loyalty" to act in the best interest of the health center, and not in a manner that furthers personal interests at the health center's expense. The duty of loyalty is a duty to have undivided allegiance to the health center when making decisions or otherwise participating in governance of the health center. Impartial decision-making, un-"tainted" by board members' personal or other interests, protects the charitable organization's assets and reputation.

Frequently, board members have personal and professional affiliations that involve the health center's operations and may present actual or perceived *conflicts of interest*. This is particularly true in the health center setting because board members are often nominated due to their active community involvement. The presence of community leadership on the board is integral to the health center movement, and should be valued and encouraged.

This Information Bulletin provides general advice to board members regarding when actual or potential conflicts of interest may arise and what steps can be taken to ensure that the conflict does not taint board decision-making and expose the health center to potential risks and liabilities arising from such decision-making. In particular, this Information Bulletin explores:

- ◆ Identifying the “nature” of a conflict of interest -- when is an actual or potential conflict problematic,
- ◆ Preserving health center confidentiality in a conflict of interest scenario,
- ◆ Determining if a conflict of interest arises,
- ◆ Preventing and managing conflicts of interest,
- ◆ Establishing a conflict of interest policy for the health center.

Additionally, at the end of this Information Bulletin, readers are invited to “test” their conflicts of interest knowledge.

*It is the failure to disclose  
and manage the conflict  
that presents the problem.*

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## **IDENTIFYING THE “NATURE” OF A CONFLICT OF INTEREST**

Conflicts of interest are not inherently “evil.” Rather, the nature of a conflict of interest largely depends on how the conflict is managed. For example, a conflict of interest could arise if a board member is a professor at a local medical school that is negotiating with the health center to implement a training program. Assuming the board member discloses this potential conflict to the board and takes steps to ensure that the decision-making process related to the training program is untainted, the conflict of interest is not problematic. The board member's medical and educational expertise and involvement in the university is certainly beneficial to the health center, and should not be discouraged.

Suppose, however, that a conflict of interest arises because a board member is an owner of a company that contracts with the health center for the provision of a particular service. If this financial interest is not disclosed to the board and the board member participates in the decision-making related to the transaction, the failure to ensure that the conflict of interest did not taint the decision-making process presents a potential violation of the duty of loyalty. It is important to note that typically health centers and board members are permitted to do business – unless stated otherwise in the health center's policies or

prohibited by state law – as long as the transaction is fair to the health center and the conflict is disclosed and managed. In fact, such arrangements may prove to be beneficial for the health center. It is the failure to disclose and manage the conflict that presents the problem.

As key health center decision-makers, board members must identify when their personal and professional affiliations create an apparent or actual conflict of interest, and take steps to ensure that the conflicting interest does not influence the board's decision-making process.

## PRESERVING HEALTH CENTER CONFIDENTIALITY

The duty of loyalty to act in the best interest of the health center also prohibits board members from inappropriately disclosing information that the health center wants to remain confidential. This prohibition is particularly relevant in a conflict of interest scenario. For example, if a board member's brother submits a bid to the health center, he or she clearly cannot provide the brother with "inside" information on the bidding process or the other bidders. As a general rule, board members should be careful to not communicate (formally or informally) the health center's confidential information without board approval.

## DETERMINING IF A CONFLICT OF INTEREST EXISTS

A conflict of interest arises when a board member (or a board member's friend or family member) has a business, financial, fiduciary or personal interest that is, or appears to be, inconsistent or at odds with the interests of the health center. It is not necessary that a board member, in fact, be influenced by personal or other interests for a conflict of interest to arise. Conflicts of interest can be *apparent* – meaning that others could perceive there to be a conflict of interest.

Furthermore, even if a board member's business, financial, fiduciary or personal interest is consistent with the health center's interest, rather than at odds, it is important to disclose the nature of the interest to the board, as described below, so that the board may make an independent determination regarding whether a conflict of interest exists.

## Consult State Law

To determine whether an interest creates a conflict, it is advisable to consult state law governing nonprofit corporations. Such laws may specifically prohibit participation in transactions involving conflicts of interest unless the health center follows certain prescribed procedures.

Although some state laws only prohibit voting on transactions involving a conflict of interest, consider retaining the option of prohibiting board members from participating in any deliberations when there is a conflict. This option is desirable because the presence of the conflicted board member in related discussions may restrict the other board members' willingness and ability to freely deliberate.

## Consider Federal Law Requirements

Federal procurement standards prohibit board members, as well as employees and agents of the health center, from participating in the selection, award, or administration of a contract if there is a real or an apparent conflict of interest involved. Federal procurement standards state that a conflict arises when the board member, employee or agent or any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the individual or firm selected for the award.<sup>1</sup> This means that a board member with this type of real or apparent conflict of interest cannot participate in deliberations concerning selection among bidders or oversight of the contractor when the contract is federally-funded. Note that this restriction does not pertain to contracts that are paid for with non-federal funding (*i.e.*, expenses

1 Uniform Administrative Requirements for Awards and Sub-Awards to Institutions of Higher Education, Hospitals, Other Nonprofit Organizations, and Commercial Organizations, 45 C.F.R. § 74.42.

that are not charged directly to the grant award), unless the health center's policies state otherwise.

## Review the Health Center's Policies and Procedures

A health center's bylaws, policies, and procedures should define conflicts of interest, and stipulate how they are to be managed. If a health center does not have such standards, the board should establish a conflicts of interest policy, as described below. The health center's conflict of interest policy may be broader than required by state or federal law – that is, more protective of the health center – but not less restrictive.

## PREVENTING AND MANAGING CONFLICTS OF INTEREST

### Preventing Conflicts of Interest from the Outset

The process of preventing and managing conflicts of interest should begin with the selection of new board members. Specifically, nominees should be required to complete a disclosure form listing their personal and private affiliations, which should be reviewed by the full board. If the board identifies a conflict of

interest that greatly undermines the nominee's ability to have undivided allegiance to the health center, the board may conclude that nominee should not be selected to serve on the board.

In addition to preventing conflicts of interest, reviewing the affiliations of board member nominees also encourages current board members to monitor and disclose their own conflicts of interest. In order for board members to fulfill their duty of loyalty to the health center, it is critical that monitoring and managing conflicts of interest is in the board's culture of compliance.

### Steps to Manage Conflicts of Interest If and When They Arise

To identify and manage board members' conflicts of interest, there are several steps all boards should take, each of which is described in detail below:

- ◆ Disclosure
- ◆ Discussion and Consultation
- ◆ Management
- ◆ Documentation

#### Step One: Disclosure

Board members should:

- ◆ Disclose their potential conflicts of interest whenever a situation that may pose a conflict arises.
- ◆ Annually complete a disclosure form that lists personal and professional affiliations, thus ensuring that conflicts

of interest are assessed on a regular, periodic basis.

- ◆ Have disclosure forms reviewed by the Chairperson of the board, or another designated board member.

#### Step Two: Discussion and Consultation

If a potential conflict of interest is disclosed or discovered, the board should:

- ◆ Confer to understand the nature of the apparent or actual conflict, and whether and how it can be appropriately managed for guidance.
- ◆ Consult applicable federal procurement law, state law, and the health center's policies and procedures for guidance.
- ◆ If appropriate, permit the potentially conflicted board member to speak to the board regarding the potential situation, and may answer pertinent questions.

#### Step Three: Management

Depending on the circumstances, the board will determine one of two things:

- ◆ The board member does not have an actual or apparent conflict of interest, and may participate in the deliberations and/or vote regarding the matter. In order to make this determination, the board must conclude that the potentially conflicted board member's other interest is not, nor does it appear to be,

at odds with the interests of the health center, and that his or her participation in the deliberation and/or vote does not compromise the health center's reputation.

- ◆ The board member has an actual or apparent conflict of interest, and must abstain from voting on the matter. Further, the board may determine that the board member should abstain from participating in deliberations, or otherwise use personal influence to affect the decision.

#### Step Four: Documentation

- ◆ Any disclosed potential conflict of interest, and any subsequent board discussion and voting regarding the conflict and, thereafter, regarding the affected board member's involvement in the deliberations and/or vote, should be clearly described in the board minutes.
- ◆ The process of reviewing and managing conflicts of interest should be transparent and well-documented.

## ESTABLISHING A CONFLICT OF INTEREST POLICY

Establishing a conflict of interest policy is an important way for health centers to prevent tainted decision-making. A conflict of interest policy also informs board members of their disclosure obligations, and establishes the procedure that the board must follow when reviewing a potential conflict of interest. The conflict of interest policy should be covered in board training on a regular basis, as well as in new board member orientation. The consistent enforcement of such policies is critically important.

### Understand Conflict of Interest Requirements

The Health Center Program Expectations issued by the Bureau of Primary Health Care (BPHC) within the Health Resources and Service Administration (HRSA), which applies to all health centers,

states that the "organization's bylaws or written corporate board approved policy must include provisions that prohibit conflict of interest or the appearance of conflict of interest by board members, employees, consultants and those who furnish goods or services to the health center."<sup>2</sup>

Although the Program Expectations do not impose a requirement that health centers establish a policy to define and manage conflicts of interest, there is an increasing emphasis in the general charitable community that such policies are a key component of corporate compliance. For example:

- ◆ In February of 2008, the Internal Revenue Service (IRS) published guidance, *Governance and Related Topics - 501(c)(3) Organizations*, stating that it encourages a charity's board to adopt and regularly evaluate a written conflict of interest policy that:
  - Requires board members and staff to act solely in the interests of the charity without regard for personal interests;
  - Includes written procedures for determining whether a relationship, financial interest, or business affiliation results in a conflict of interest; and
  - Prescribes a course of action if a conflict of interest is identified.

#### Monitoring and managing conflicts of interest:

- ◆ Promotes compliance with federal and state laws including federal procurement standards, state corporation laws, and Internal Revenue Code.
- ◆ Promotes compliance with health center bylaws.
- ◆ Prevents misuse of health center resources.
- ◆ Preserves the integrity of the board's decision-making.
- ◆ Prevents the health center's loss of public confidence, trust, and reputation.

2 Policy Information Notice (PIN) # 98-23: *Health Center Program Expectations* (August 17, 1998) at pg. 23.

- ◆ The 2008 tax information return for charitable organizations, such as health centers (*i.e.*, Form 990), asks whether the charitable organization has a written conflict of interest policy. If the respondent answers yes, then the charitable organization must answer:
  - Whether officers, board members or trustees, and key employees are required to disclose annually interest that could give rise to conflicts; and
  - Whether the organization regularly and consistently monitors and enforces compliance with the policy.

If the respondent indicates that they monitor and enforce compliance, then they must explain how this is achieved. It is important to note that the IRS' inquiry regarding conflict of interest policies does not mean that charities are required to establish such policies. Nevertheless, health centers should consider that this additional question reflects the importance of conflicts of interest in the charitable organization setting.

## Draft Policies

For guidance on drafting a conflict of interest policy, see Information Bulletin #14 from the Risk Management Series, *Developing Comprehensive Standards of Conduct* (May 2006), at [www.nachc.com](http://www.nachc.com)

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## TESTING YOUR CONFLICTS OF INTEREST KNOWLEDGE<sup>3</sup>

Readers can test their ability to identify and manage potential conflicts of interest in the following scenarios involving Ben, a board member at his local community health center.

### #1: Question:

A candidate for the Chief Executive Officer position at The Health Center is Ben's close friend, Ned. Ben intends to vote for Ned because of Ned's experience in the health care industry and his commitment to the community. Ben believes that approving Ned for the Chief Executive Officer position is in The Health Center's best interests, and does not feel that he has a personal interest in Ned's appointment. Is Ben precluded from voting for the Chief Executive Officer position?

### Response:

Even though Ben does not have an actual conflict of interest, he may have an apparent conflict of interest because others may perceive that his support for Ned is influenced by their close friendship. Ben should disclose this potential conflict of interest, and the board should consider whether Ben should remove himself from any discussion and voting related to the Chief Executive Officer position. If appropriate, Ben may be provided the opportunity to speak with the board about why he believes he does not have an apparent or actual conflict of interest. If the board concludes (by vote that does not include Ben) that Ben has an actual or apparent conflict of interest, he should be required by the center's conflict of interest policies to recuse himself from relevant deliberations and the board's vote to select the Chief Executive Officer.

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<sup>3</sup> Testing Your Conflicts of Interest Knowledge is adapted from *Conflicts of Interest at Foundations: Avoiding the Bad and Managing the Good*, BoardSource 2005.

**#2: Question:**

Ben's son, Frank, owns a construction company and submitted a bid for a contract to renovate The Health Center's facility. The contract will be paid for using funds awarded under the health center's federal Section 330 grant. Is Ben permitted to participate in board decisions pertaining to the construction contract?

**Response:**

The transaction is for the procurement of services using federal funds, and is therefore governed by the federal government's procurement standards, as described above. Because Ben's immediate family member, Frank, has a financial interest in the construction company, Ben is prohibited from participating in the selection, award, or administration of the contract under the health center's standards of conduct.

**#3: Question:**

Ben is also on the board of a local nonprofit organization that provides counseling services to individuals living with HIV/AIDS. The state Department of Public Health announced a grant funding opportunity that both The Health Center and the local HIV/AIDS nonprofit organization are eligible to apply for. The other organization is unaware of the grant funding opportunity. May Ben participate in board matters related to the grant proposal?

**Response:**

Ben should disclose of this apparent conflict of interest. Because he will not have undivided allegiance to The Health Center in any deliberations or decision-making AND will be conflicted regarding the sharing of information gained in service to one board with the other organization, Ben should remove himself from participating in matters related to the grant proposal.

*The 2008 tax information return for charitable organizations, such as health centers (i.e., Form 990), asks whether the charitable organization has a written conflict of interest policy.*

**CONCLUSION**

In making decisions, every health center board member must uphold a "duty of loyalty" to act in the best interests of the health center and not in a manner that furthers personal interests at the health center's expense. Impartial decision-making is an integral component of the decision-making process of every health center board of directors, and identifying and managing actual and perceived conflicts of interest is a key to this process.

Identification and management of conflicts of interest can be achieved by implementing a few simple steps:

1. Require that perspective and present board members complete a conflicts of interest disclosure form at least annually; and
2. Establish policies and procedures to define and manage conflicts of interests.

These steps will not only assist board members to uphold their duty of loyalty, but ultimately should help prevent the health center's exposure to potential risks and liabilities arising from tainted decision-making.



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