

NDC Audit Committee / Conflict of Interest Report

New Deal Café
Audit Committee
July, 2013

CONTEXT

Following the 2013 NDC membership meeting some members expressed concern that there is the *appearance of conflict of interest* (Appendix 1a) on the current board of directors (BOD) because of a relationship between one board member and a paid staff member. The Audit Committee volunteered to investigate the issue. In interviews with concerned members we learned that the primary concern is that the *appearance of conflict of interest* could lead to an *actual conflict of interest* if the board member was involved in the development of personnel policies and/or the board member made decision regarding the employed relative's performance. There was also concern expressed that the BOD member's participation in any employee's performance evaluation could be considered a *conflict of interest* if decisions made furthered the concerns of the related employee. The Audit Committee considered member comments, researched state and federal laws, and looked at best practices to come up with findings and recommendations to present to the NDC BOD for consideration. The Audit Committee also specifically addressed the *New Deal Café Cooperative Employee Manual and Performance Review 2008, Section 1.11* (Appendix 2), which has been referenced as a guiding document for the BOD by NDC members and past board members in response to concern about *conflict of interest* between members of the BOD and paid employees.

FINDINGS

- 1) The *appearance of conflict of interest* currently exists, and has existed historically, within the NDC organization. It involves and has involved members of the BOD, members of the Audit Committee, employees, and volunteers. The Audit Committee has identified three instances in the current organization where the appearance of conflict of interest exists:
 - One member of the BOD is related to one paid employee (the Bar Manager). Both have significant decision-making responsibility and since they are married (a legal relationship) they could give preference to their *Family Interests* (Appendix 1a) when considering NDC policy.
 - It is unclear what level of participation and/or influence the current general manager had in developing requirements for, screening applicants for, and filling the position she now holds. If as a board member the current general manager was involved in establishing the need for the position, establishing position qualifications, creating a position description, soliciting and interviewing candidates, and/or deciding to hire/or not hire one candidate over another, that could reasonably be viewed as *Self-Dealing* (Appendix 1a).
 - One member of the current Audit Committee is engaged to (has an emotional relationship) a non-paid NDC employee. Neither has significant decision-making responsibility but there is an *appearance of conflict of interest*.

- 2) Comments on the use of the *New Deal Café Cooperative Employee Manual and Performance Review 2008*, specifically Section 1.11 (Appendix 2) as a BOD guide for dealing with *conflict of interest* related to BOD Member/Paid Employee relationship:
 - This is an employee policy guide it may or may not pertain to actions of the BOD or the membership.
 - The Policy explicitly states (page 1, paragraph 2): “The policies and procedures contained in this handbook are not all inclusive and are only a set of guidelines. They do not give rise to any contractual rights enforceable by you. The Café has the right to modify, suspend, revoke, terminate, or change any policies and procedures set forth in the manual at any time with or without notice.”
 - *Audit Committee Opinion: in terms of the current situation the NDC membership effectively “modified”, “suspended”, “revoked”, and/or “changed” this policy by electing the board member in question even after full disclosure that they were related to a current employee. And by agreeing to the results of the election of that board member the BOD implicitly agreed to those changes.*
 - *Audit Committee Opinion: it was suggested that the clause in the New Deal Café Cooperative Employee Manual and Performance Review 2008 (Section 1.11) may have been copied from the GHI employee manual. The NDC may want to consider revising that manual to reflect the realities of a smaller organization.*

RECOMMENDATIONS

The NDC has a long history of people related to each other (legally or emotionally) working together, either as board members, audit committee members, paid employees, or volunteers. The results have been mixed! Because it is a small community based organization it seems reasonable that members and whole families who enjoy the benefits of the café would want to contribute at all levels (volunteer, employment, leadership) and that multiple members of a single family would be interested in contributing at the same time.

The audit committee’s interest is to address member concerns about *appearance of conflict of interest* and *actual conflict of interest* that could degrade member, employee, or customer trust in the organization.

Recommendations 1), 2), and 3) are based on an analysis of laws and best practices (Appendix 1b, c, d). Recommendations 4), 5), and 6) are intended to address current *appearance of conflict* situation and are consistent with the recommendations made in the 2013 *Audit Report* (submitted at the NDC annual membership meeting on May 19, 2013).

- 1) The BOD should establish a *Conflict of Interest Policy* that addresses the *appearance of conflict of interest*, and *actual conflict of interest* should it occur. The policy should address self-dealing, outside employment, family interests, gifts, and other common threats (Appendix 1a). The *Conflict of Interest Policy* should cover definitions, responsibilities, actions and remedies, and consequences.
- 2) All BOD members and employees with decision-making responsibility should read and sign a copy of the *Conflict of Interest Policy* acknowledging their agreement to abide by the policy. Signed copies should be kept in the BOD records.

- 3) The BOD should consistently apply the *Conflict of Interest Policy* to any/all BOD members, employees, and volunteers with decision-making power over NDC business and/or NDC employees or volunteers.
- 4) The NDC BOD should form a Human Resource Committee (HRC) that is independent of the BOD. Ideally the HRC would consist of two or more individuals who have experience with human resources policy. Members of the HRC do not have to be members of the BOD, but at least one member of the BOD should be a part of the HRC or the official liaison to the HRC.

Notes: This could be BOD members working apart from the BOD who make recommendations to the full BOD. This could be members/volunteers – a great opportunity to reach out to members who might want to get involved with the café on an organizational level, not on an operations level. This could be a willing Audit Committee task.

- 5) The HRC should review all human resources documents including but not limited to: Café HR policies, position descriptions, performance reviews, and employee manual to recommend modifications based on HR best practices – at a minimum the responsibilities outlined in job descriptions should be aligned with performance metrics in performance evaluations.

Note: the HRC could be the implementing body for recommendations made by the Audit Committee at the NDC annual meeting, May 19, 2013, and would be an expert resource for the BOD when dealing with HR issues.

- 6) All recommendations, changes, documents, etc. made by the HRC should be considered and voted on by the BOD (the implementers of Café policy). Where appropriate BOD members with *apparent conflict of interest* should be excluded.

Appendix 1

a. DEFINITIONS

http://en.wikipedia.org/wiki/Conflict_of_interest

A **conflict of interest (COI)** occurs when an individual or organization is involved in multiple interests, one of which could possibly corrupt the motivation for an act in another.

The presence of a conflict of interest is independent from the execution of impropriety. Therefore, a conflict of interest can be discovered and voluntarily defused before any corruption occurs. A widely used definition is: "A conflict of interest is a set of circumstances that creates a risk that professional judgement or actions regarding a primary interest will be unduly influenced by a secondary interest."¹¹ Primary interest refers to the principal goals of the profession or activity, such as the protection of clients, the health of patients, the integrity of research, and the duties of public office. Secondary interest includes not only financial gain but also such motives as the desire for professional advancement and the wish to do favours for family and friends, but conflict of interest rules usually focus on financial relationships because they are relatively more objective, fungible, and quantifiable. The secondary interests are not treated as wrong in themselves, but become objectionable when they are believed to have greater weight than the primary interests. The conflict in a conflict of interest exists whether or not a particular individual is actually influenced by the secondary interest. It exists if the circumstances are reasonably believed (on the basis of past experience and objective evidence) to create a risk that decisions may be unduly influenced by secondary interests.

The following are the most common forms of conflicts of interests:

- **Self-dealing**, in which an official who controls an organization causes it to enter into a transaction with the official, or with another organization that benefits the official. The official is on both sides of the "deal."
- **Outside employment**, in which the interests of one job contradict another.
- **Family interests**, in which a spouse, child, or other close relative is employed (or applies for employment) or where goods or services are purchased from such a relative or a firm controlled by a relative. For this reason, many employment applications ask if one is related to a current employee. If this is the case, the relative could then recuse from any hiring decisions. Abuse of this type of conflict of interest is called nepotism.
- **Gifts** from friends who also do business with the person receiving the gifts. (Such gifts may include non-tangible things of value such as transportation and lodging.)
- **Pump and dump**, in which a stock broker who owns a security artificially inflates the price by "upgrading" it or spreading rumors, sells the security and adds short position, then "downgrades" the security or spreads negative rumors to push the price down.

b. LAW

Concerned members have suggested that even though the NDC operates as a for-profit corporation, its governance has been conducted with an eye towards the non-profit sector – perhaps in case some day the café would like to convert to a non-profit status (conjecture). Much of the information found regarding conflict of interest on Board's of Directors is focused on non-profit boards. It seems that there is a higher standard for non-profit boards than for corporate (for-profit) boards. But there are some general patterns in both cases that:

- 1) Members of boards with decision-making responsibility have an obligation to act in the best interest of the organization over and above their own personal interests.

- 2) *Conflict of interest* occurs when a decision-maker's personal interests are affected positively by actions taken by that decision-maker to the detriment of the organization that they have an obligation to act in the best interest of.
- 3) The *appearance of conflict of interest* exists when someone in a decision-making position has interests outside of the organization which could influence his/her decision making.
- 4) Conflict of interest (acting to enhance one's own interests over the interest of the organization) is at least unethical and possibly illegal.
- 5) It is important wherever possible to eliminate the *appearance of conflict of interest*.

Maryland – *The Standards for Excellence Code (Non-Profits) regarding Conflict of Interest:*

<http://marylandnonprofits.org/dnn/Strengthen/StandardsforExcellence/ExploretheCode.aspx>

Conflict of Interest

Nonprofit board and staff members should act in the best interest of the organization, rather than in furtherance of personal interests or the interests of third parties. A nonprofit should have policies in place, and should routinely and systematically implement those policies, to prevent actual, potential, or perceived conflicts of interest.

A. Conflict of Interest Policy

(1) Nonprofits should have a written conflict of interest policy. The policy should be applicable to board members and staff, and volunteers who have significant independent decision making authority regarding the resources of the organization. The policy should identify the types of conduct or transactions that raise conflict of interest concerns, should set forth procedures for disclosure of actual or potential conflicts, and should provide for review of individual transactions by the uninvolved members of the board of directors.

B. Conflict of Interest Statements

(1) Nonprofits should provide board members, staff and volunteers with a conflict of interest statement that summarizes the key elements of the organization's conflict of interest policy. The conflict of interest statement should provide space for the board member, employee or volunteer to disclose any known financial interest that the individual, or a member of the individual's immediate family, has in any business entity which transacts business with the organization. The statement should be provided to and signed by board members, staff, and volunteers, both at the time of the individual's initial affiliation with the organization and at least annually thereafter.

c. BEST PRACTICES

Article

Conflict-of-Interest: What Non-Profit Organizations Need to Know

<http://www.nonprofitlawreport.com/guide/conflict-of-interest/>

The laws of most states require officers and directors of non-profit organization to discharge their duties in accordance with his good faith belief that they are acting in the best interests of the organization. Doing so protects them from liability acts or omissions in connection with their responsibilities. But, as a general rule, officers and directors that consent to distributions in involving conflicts of interest are personally liable to the organization for the amount of the distribution. To mitigate this significant risk, officers and directors should be well-versed in the procedures for handling conflict-of-interest transactions.

An officer or director could have a conflict-of-interest in any transaction with its non-profit organization in which the director personally profits or has a personal interest. The transaction is then “tainted” and may usually be set aside unless (a) full disclosure is made and authorization, approval, or ratification is obtained or (b) the transaction is otherwise fair to the organization. Full disclosure and approval may be obtained by either the board of directors or members of the board of directors, or, in the case of a membership non-profit, by the members entitled to vote. A conflict-of-interest transaction is considered authorized, ratified, or approved if it receives the affirmative vote of a majority of disinterested directors or members.

Some individuals serve as directors of more than one non-profit organization. If two organizations with the same director engage in transactions, the interlocking directorate may taint the transaction with conflict-of-interest and create a presumption that the transaction is unfair. A director is considered to have an indirect interest in a transaction if (a) another entity in which he or she has a material financial interest or in which he or she is a general partner is a party to the transaction or (b) another entity of which he or she is an officer, director, or trustee is a party to the transaction and the transaction is or should be considered by the board of directors of the organization. In this situation, the director should make the disclosure to each organization and obtain the authorization, approval, or ratification described above.

A strong conflict-of-interest policy is quickly becoming an essential document for non-profit organizations. Although the IRS does not formally require a conflict-of-interest policy (yet), it has taken steps to “encourage” organizations to adopt them. These policies can protect the interest of the exempt organization when it enters into transactions that could potentially benefit an officer or director. And as importantly, a good conflict-of-interest policy (if followed) can protect officers and directors from personal liability for decisions in transactions in which they have an interest.

Most conflict-of-interest policies define who is considered to have a conflict and then provide procedures for making decisions in transactions involving that person or persons. The policies typically require the tainted person or persons to make full disclosure of the conflict-of-interest to the board of directors of any actual or potential conflict. The board then follows a procedure for determining if a conflict actually exists and, if so, how or whether to proceed with the transaction. Directors, officers, and others who exercise control over a non-profit organization should sign a statement every year to acknowledge their awareness of the organization’s conflict of interest policy. The IRS has promulgated a Sample Conflict-of-Interest Policy that should be adopted by organizations that do not have a substantially equivalent policy of their own.

U.S Government (USG)

USG on Organizational Conflict of Interest within USG:

U.S. Government Accountability Office, Federal Acquisition Regulation (FAR) - <http://www.gao.gov/products/GAO-10-693>

- 1) A firm in one contract establishes requirements for competition in another contract for which the firm seeks to compete. It occurs where a firm, as part of its performance of a government contract, has in some sense set the ground rules for another government contract by, for example, writing SOW or specification.
- 2) A competing firm has possession of (a) proprietary information of other firms obtained from a Government official or (b) relevant source selection information not available to all competitors. It can also occur where a firm has access to nonpublic information as part of its

- performance of a government contract that leads to a competitive advantage in a later competition for a government contract.
- 3) A firm evaluates proposals or contract performance for its own products or services or the products or services of competitors. It can exist where a contract requires the exercise of judgment, and the economic interests of the firm — broadly defined — may be harmed through the free and unbiased exercise of that judgment.

d. COMMON MITIGATION

There are numerous resources that suggest remedies for conflict of interest. Although not directly applicable to the NDC case this list of options from New Zealand's Auditor General is representative of the range of options: <http://www.oag.govt.nz/2007/conflicts-public-entities/part4.htm>

There is a broad range of options for avoiding or mitigating a conflict of interest. The options (listed roughly in order of lowest to highest severity) include:

- taking no action;
- enquiring as to whether all affected parties will consent to the member's or official's involvement;
- seeking a formal exemption to allow participation (if such a legal power applies);
- imposing additional oversight or review over the official;
- withdrawing from discussing or voting on a particular item of business at a meeting;
- exclusion from a committee or working group dealing with the issue;
- re-assigning certain tasks or duties to another person;
- agreement or direction not to do something;
- withholding certain confidential information, or placing restrictions on access to information;⁴
- transferring the official (temporarily or permanently) to another position or project;
- relinquishing the private interest; or
- resignation or dismissal from one or other position or entity.

A common thread among various resources is that organizations should begin with a comprehensive *conflict of interest policy*. Another common thread is; when dealing with *conflict of interest*, or the *appearance of conflict of interest*, the governing body should evaluate the potential for conflict and the potential for damage when considering mitigation (or - what is the nature of the conflict and how damaging can it be).

Considerations may include the type of conflict (personal gain, financial gain, self-promotion, etc.), and the possible damages (financial loss to the organization, damage to reputation, etc.). Mitigation options range widely and include: doing nothing, requiring formal statements by those involved to act only in the best interest of the organization (and not their own best interest), individual acknowledgement of conflict of interest and recusal, formal recusal and/or removal from discussion, and – in cases where no other remedy is sufficient – removal of the individual from the organization.

Appendix 2

New Deal Café Cooperative Employee Manual and Performance Review 2008, Section 1.11 EMPLOYMENT OF RELATIVES

“Because of the possibility that actual or potential conflicts of interest may arise when relatives of the Board are employed, the Café does not permit the employment of relatives of the board.

For purposes of this policy, “relative” is defined as a spouse, child, parent, sibling, grandparent, grandchild, aunt, uncle, first cousin, or corresponding in-laws or “step” relation.

In situations where a conflict or the appearance of a conflict of interest arises involving non-relatives, such as a “domestic partner”, or “significant others”, the Café will take whatever action it deems appropriate to minimize such conflicts and charges of favoritism and to decrease the likelihood of sexual harassment in the workplace.

Employees who marry while employed are treated in accordance with these guidelines. That is, if in the opinion of the Café Board a conflict or apparent conflict arises as a result of marriage, the Café Board will take whatever action it deems appropriate to minimize such conflict and charges of favoritism.”