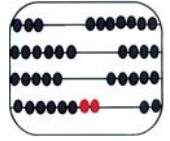


AccountAbleTM

ASIA

Bylaws: Conflict of Interest Provisions

Issue 9; Released Mar'08



AccountAid

IN THIS ISSUE

Trustee or office-bearer?	1
Conflict of Interest Provisions	1
Conflict of Interest Policy:	1
1. Commitment to duties	1
2. Prohibitions	1
3. Disclosure of interest	2
4. Money Value	2
5. Corrective Action	3
6. Audit confirmation	3
Definition of Key Person	3



Trustees. However, the bylaws can say what the policy would look like. Bylaws can also say that the Trustees have to design and enforce such a policy. Model provisions on conflict-of-interest are given below in italics lettering:

Conflict of Interest Policy:

The Trustees will design and ensure the 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 that can be used while designing the policy are given below².

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*

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.

In an earlier issue of AccountAble¹, we discussed conflict of interest and how it affects work of NPOs. We now take up a related issue: How can your trust deed or bylaws help manage conflict-of-interest effectively?

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 or corporation then use the words 'office-bearer' or 'Governing Body member', or a similar word.

Conflict of Interest Provisions

In an NPO, 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 NPO has to enter into a contract with such a firm. How to make sure that the NPO 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 NPO 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

¹ AccountAble 5: Conflict of Interest

² These have been propounded by Herignton J. Bryce and have been listed in AccountAble 5: Conflict of Interest. See also Financial & Strategic Management for Nonprofit Organizations, 3rd edition. Jossey-Bass Publishers, San Francisco, USA

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If the Trust decides to sell (or buy) immovable property to (or from) a key person, then the decision must be approved by the Board of Trustees.

2. Prohibitions

- The Trust will not lend 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 regulatory authority, 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 to (or 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 with a key person, having any monetary implication during a year 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 each 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 there 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.

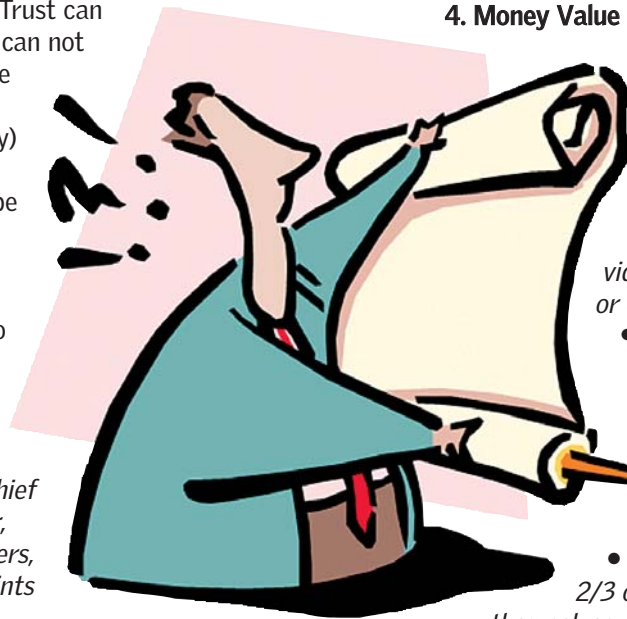
The third sub-clause also asks the Trust to disclose all transactions with key persons. This disclosure is done through the annual accounts.

Why is this important? It brings in an important element of public scrutiny. 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 [Rupees 50,000]³, 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 should not be present at the time of 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 [Rupees 2 lakhs]³, then it must be published in a local newspaper.
 - The above monetary limits are illustrative only. Trustees may lay down more realistic limits from time to time depending on the size and nature of the organisation.
- This clause suggests stricter provisions for larger transac-



³ Substitute with suitable amount in your currency



tions. If the annual transaction value is more than Rupees two lakhs, then it must be published in a local newspaper. If it is more than Rupees 50,000, then it must be approved internally.

The limits can be modified from time to time, 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.

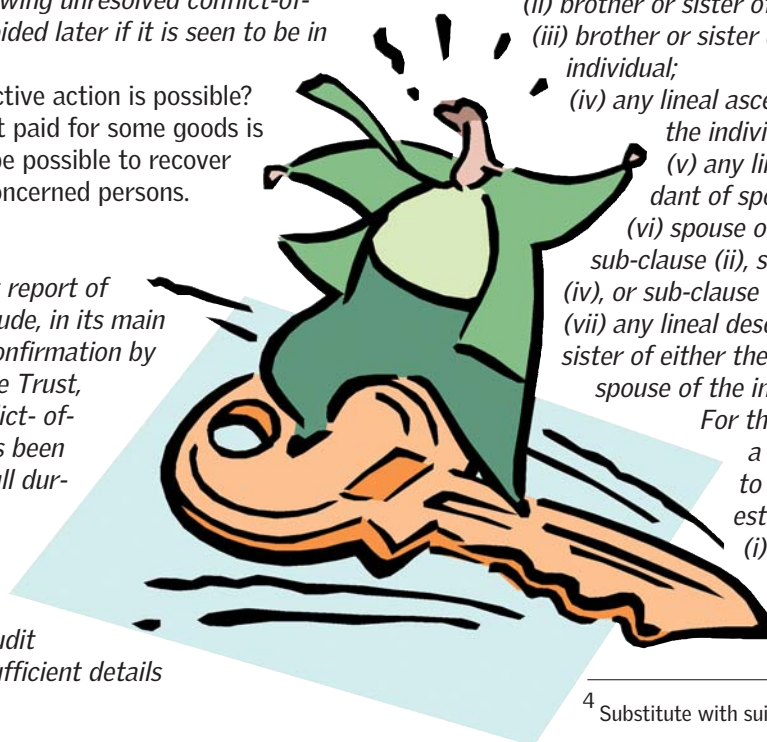
5. Corrective Action

- The policy should also provide for corrective action, when unfair transactions are discovered later.
- A transaction showing unresolved 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 of the following persons:

- a. the author/s of the trust or the founder/s of the institution;
- b. any person who has made a substantial contribution to the trust or institution, (that is to say, any person whose total contribution during the relevant financial year exceeds fifty thousand rupees)⁴;
- c. any trustee of the trust or manager (by whatever name called) of the institution;
- d. any relative of any such author, founder, person, member, trustee, or manager as aforesaid;
- e. any concern in which any of the persons (alone or together with other key person) referred to in clause a, b, c, and d has a substantial interest.

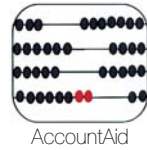
For the purpose of this clause "relative", in relation to an individual, means-

- (i) Spouse of the individual;
- (ii) brother or sister of the individual;
- (iii) brother or sister of the spouse of the individual;
- (iv) any lineal ascendant or descendant of the individual;
- (v) any lineal ascendant or descendant of spouse of the individual;
- (vi) spouse of a person referred to in sub-clause (ii), sub-clause (iii), sub-clause (iv), or sub-clause (v);
- (vii) any lineal descendant of a brother or sister of either the individual or of the spouse of the individual

For the purpose of this clause, a person shall be deemed to have a substantial interest in a concern:

- (i) in a case where the concern is a company, if its shares (not being shares entitled to a

⁴ Substitute with suitable amount in your currency



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.

fixed rate of dividend whether with or without a further right to participate in profit) carrying not less than twenty per cent of the voting power are, at any time during the financial year, owned beneficially by such person or partly by such person and partly by one or more of the other persons referred to at (a) to (e) above.

(ii) In the case of any other concern, if such person is entitled or such person and one or more of the other persons referred to at (a) to (e) above are entitled in the aggregate, at any time during the financial year, to not less than twenty per cent of the profits of such concern.

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 is critically important, as it defines the possible persons or organizations through whom a person may benefit, directly or indirectly. Therefore, care must be taken to ensure that this clause is not diluted.

Related AccountAble Issues:

5: Conflict of Interest

About AccountAid: AccountAid is a private consulting firm based in New Delhi. It works on accounting and regulatory issues concerning NPOs. For this purpose, it conducts research, workshops, and publishes reference material relevant for NPOs and grant-makers. It also provides advice to donor agencies on grant management systems.

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तत्सर्वं क्षम्यतां देवि प्रसीद परमेश्वरि ॥

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