



## **CONFLICT OF INTEREST POLICIES: DISCLOSURE, MONITORING, AND ENFORCEMENT**

Under the Internal Revenue Code, a tax-exempt organization cannot use its assets for the private benefit of corporate insiders, such as the founder, officers and directors, other key employees and their family members (commonly known as the “private inurement rule”).

The Internal Revenue Service has long held that one of the best ways for an organization to ensure it is complying with the private inurement rule is to:

- Adopt a conflict-of-interest policy;
- Regularly monitor compliance with the policy; and
- Ask each individual covered by the policy to disclose, on an annual basis, any relationships with people doing business with the organization that could give rise to a conflict of interest.

Although nonprofit organizations are not required to have a conflict-of-interest policy in order to qualify for federal tax-exemption, the IRS considers having such a policy a good governance and accountability practice.

In fact, IRS Form 990, the annual information return form filed by public charities, asks organizations to provide information about their adoption and enforcement of conflict-of-interest policies.

### **What is a Conflict of Interest Policy?**

According to the IRS, a conflict of interest is present when a person in a position of authority over an organization, such as an officer, director, or manager, may enjoy a financial benefit from a decision he or she could make in his or her organizational capacity. This may include indirect benefits, such as to family members or businesses with which the person is closely associated.

An effective conflict-of-interest policy, therefore, should accomplish the following:

- define what constitutes a conflict of interest,
- identify the individuals within the organization covered by the conflict-of-interest policy,
- provide a means for the individuals to disclose information that may help identify conflicts of interest, and
- outline the procedures to be followed in managing conflicts of interest.

## **Disclosure of Conflicts**

At least once a year, the tax-exempt organization should distribute a certification and disclosure form to its officers, directors and key employees, in which each respondent should certify that he or she:

- has received a copy of the conflict-of-interest policy;
- has read and understands the policy;
- has agreed to comply with the policy; and
- understands that the organization is charitable and that in order to maintain its federal tax exemption it must engage primarily in activities that accomplish one or more of its exempt purposes and not engage in activities and transactions that provide impermissible benefits to individuals or entities.

In addition, the certification and disclosure form should also require each person to either:

- certify that he or she has no actual or possible conflict of interest to report, or
- describe any relationships, transactions, or other circumstances, including those of an immediate family member, that could result in a conflict between the organization's interests and his or her personal, financial or other interests.

As part of the annual process, the organization should provide each person covered by the conflict-of-interest policy with a copy of the policy and offer individuals the opportunity to ask

questions about the policy. The covered persons should then be required to complete and sign the certification and disclosure form, which should be retained in the organization's files.

## **Monitoring and Enforcing Conflict-of-Interest Policies**

To properly monitor and enforce a conflict-of-interest policy, an organization should be diligent in reviewing the annual disclosure forms submitted by covered persons, and in compiling and maintaining a list of potentially conflicted entities and individuals. Proposed transactions can then be matched against the list as a means of identifying possible conflicts. The organization should identify a person ultimately responsible for maintaining the list and screening for possible conflicts of interest.

When dealing with major vendors and service providers, the organization should consider asking the vendor or service provider to disclose any relationship - personal, financial, or otherwise - that the vendor or service provider has with any of the organization's directors, officers, employees or volunteers.

In addition, the organization should undertake a periodic review of transactions involving any significant expenditure of organizational funds to ensure any compensation paid continues to be reasonable.

If a possible conflict is identified with respect to a proposed transaction, the organization must be committed to following the procedures set out in its conflict-of-interest policy for

determining whether an actual conflict of interest exists, and the procedures for addressing the conflict of interest.

Among the steps the organization should take are the following:

1. The person with the potential conflict with respect to a transaction should disclose such conflict.
2. The person should not participate or be present at any meeting during which the discussion of the possible conflict of interest takes place.
3. The chair of the board should, if appropriate, appoint a committee of the board made up of disinterested directors to investigate alternatives to the proposed transaction.
4. If a more advantageous transaction is not reasonably available, the governing board or committee should determine, by a majority vote of the disinterested directors, whether the transaction is in the organization's best interest and is fair and reasonable.

The organization should also document, through well-kept minutes, any decisions related to transactions involving an actual or possible conflict of interest. Finally, the organization must be diligent in taking appropriate disciplinary and corrective action if a person who is covered by the conflict-of-interest policy fails to disclose an actual or possible conflict of interest.

When responding to Question 12c in Part VI of the Form 990 - "Does the organization regularly and consistently monitor and enforce compliance with the policy?" - the organization should describe its practices for monitoring proposed or ongoing transactions for

conflicts of interest and dealing with potential or actual conflicts, whether discovered before or after the transaction has occurred.

In addition, the organization should include an explanation of which class of people - such as officers, directors, and the CEO - are covered under the policy, the level at which determinations of whether a conflict exists are made, and the level at which actual conflicts are reviewed.

The organization should also discuss its commitment to following the procedures set out in the conflict-of-interest policy, and include and explain any restrictions imposed on persons with a conflict, such as prohibiting them from participating in the governing body's deliberations and decision in the transaction.

### **Reporting of Transactions with Interested Persons**

Members of an organization's governing board who are not involved with the potential conflict have the legal authority to determine that, notwithstanding the conflict of interest, it is in the organization's best interests to enter into a transaction involving a current or former officer, director, or key employee.

If an organization enters into such a transaction, it will be required to disclose the transaction on its Form 990. The organization may also be required to report details regarding the transaction on Schedule L of the Form 990. If the board carefully monitors compliance with the organization's conflict-of-interest policy, and interested persons annually certify whether or not they have

an actual or potential conflict, this will assist the organization in determining whether it needs to make disclosures concerning any transactions with interested persons on the Form 990.

### Sample Policies

The IRS has a sample conflict of interest policy that it recommends that a tax-exempt organization adopt. The IRS's sample policy (modified to remove certain language applicable to tax-exempt hospitals) is included at the end of this Alert as Attachment A.

The sample is generally worded so as to cover a wide range of organizations, but should only be used as a basis for drafting an individually designed policy.

**Any organization considering adopting a policy should meet with an appropriate advisor to tailor the policy to the organization's particular structure and activities.**

A sample Conflict of Interest Policy Certification and Disclosure Form is also included at the end of this alert as Attachment B.

### Additional Resources

You may also find the following information helpful in establishing your organization's conflict-of-interest policy and procedures:

- [Form 990, Schedules and Instructions.](#)
- [Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations \(October 2007\).](#)

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*The following is a sample document for a nonprofit organization seeking to qualify or maintain its status as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code. This sample is provided only for informational purposes and does not provide specific legal advice for any individual situation. Some or all of this document may not be appropriate for your organization. The sample reflects the provisions of the Internal Revenue Code as of the date it is written. However, laws change. Only an attorney with knowledge of your particular situation can provide the legal assistance you need.*

## **Attachment A**

### Sample Conflict of Interest Policy for Tax Exempt Organizations

#### Article I Purpose

The purpose of the conflict of interest policy is to protect this tax-exempt organization's (Organization) interest when it is contemplating entering into a transaction or arrangement that might benefit the private interest of an officer or director of the Organization or might result in a possible excess benefit transaction. This policy is intended to supplement but not replace any applicable state and federal laws governing conflict of interest applicable to nonprofit and charitable organizations.

#### Article II Definitions

1. Interested Person

Any director, principal officer, or member of a committee with board-delegated powers, who has a direct or indirect financial interest, as defined below, is an interested person.

2. Financial Interest

A person has a financial interest if the person has, directly or indirectly, through business, investment, or family:

a. An ownership or investment interest in any entity with which the Organization has a transaction or arrangement;

b. A compensation arrangement with the Organization or with any entity or individual with which the Organization has a transaction or arrangement; or

c. A potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which the Organization is negotiating a transaction or arrangement.

Compensation includes direct and indirect remuneration as well as gifts or favors that are not insubstantial.

A financial interest is not necessarily a conflict of interest. Under Article III, Section 2, a person who has a financial interest may have a conflict of interest only if the appropriate governing board or committee decides that a conflict of interest exists.

Article III  
Procedures

1. Duty to Disclose

In connection with any actual or possible conflict of interest, an interested person must disclose the existence of the financial interest and be given the opportunity to disclose all material facts to the directors and members of committees with board-delegated powers considering the proposed transaction or arrangement.

2. Determining Whether a Conflict of Interest Exists

After disclosure of the financial interest and all material facts, and after any discussion with the interested person, he/she shall leave the governing board or committee meeting while the determination of a conflict of interest is discussed and voted upon. The remaining board or committee members shall decide if a conflict of interest exists.

3. Procedures for Addressing the Conflict of Interest

a. An interested person may make a presentation at the governing board or committee meeting, but after the presentation, he/she shall leave the meeting during the discussion of, and the vote on, the transaction or arrangement involving the possible conflict of interest.

b. The chairperson of the governing board or committee shall, if appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.

c. After exercising due diligence, the governing board or committee shall determine whether the Organization can obtain with reasonable efforts a more advantageous transaction or arrangement from a person or entity that would not give rise to a conflict of interest.

d. If a more advantageous transaction or arrangement is not reasonably possible under circumstances not producing a conflict of interest, the governing board or committee shall determine by a majority vote of the disinterested directors whether the transaction or arrangement is in the Organization's best interest, for its own benefit, and whether it is fair and reasonable. In conformity with the above

determination it shall make its decision as to whether to enter into the transaction or arrangement.

4. Violations of the Conflicts of Interest Policy

a. If the governing board or committee has reasonable cause to believe a member has failed to disclose actual or possible conflicts of interest, it shall inform the member of the basis for such belief and afford the member an opportunity to explain the alleged failure to disclose.

b. If, after hearing the member's response and after making further investigation as warranted by the circumstances, the governing board or committee determines the member has failed to disclose an actual or possible conflict of interest, it shall take appropriate disciplinary and corrective action.

Article IV

Records of Proceedings

The minutes of the governing board and all committees with board-delegated powers shall contain:

a. The names of the persons who disclosed or otherwise were found to have a financial interest in connection with an actual or possible conflict of interest, the nature of the financial interest, any action taken to determine whether a conflict of interest was present, and the governing board's or committee's decision as to whether a conflict of interest in fact existed.

b. The names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection with the proceedings.

Article V

Compensation

A voting member of the governing board who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member's compensation.

A voting member of any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member's compensation.

No voting member of the governing board or any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization, either individually or collectively, is prohibited from providing information to any committee regarding compensation.

Article VI  
Annual Statements

Each director, principal officer and member of a committee with board-delegated powers shall annually sign a statement which affirms such person:

- a. Has received a copy of the conflicts of interest policy,
- b. Has read and understands the policy;
- c. Has agreed to comply with the policy; and
- d. Understands the Organization is charitable and in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes.

Article VII  
Periodic Reviews

To ensure the Organization operates in a manner consistent with its charitable purposes and does not engage in activities that could jeopardize its tax-exempt status, periodic reviews shall be conducted. The periodic reviews shall, at a minimum, include the following subjects:

- a. Whether compensation arrangements and benefits are reasonable, based on competent survey information, and the result of arm's length bargaining.
- b. Whether partnerships, joint ventures, and arrangements with management organizations conform to the Organization's written policies, are properly recorded, reflect reasonable investment or payments for goods and services, further charitable purposes, and do not result in inurement, impermissible private benefit, or in an excess benefit transaction.

Article VIII  
Use of Outside Experts

When conducting the periodic reviews as provided for in Article VII, the Organization may, but need not, use outside advisors. If outside experts are used, their use shall not relieve the governing board of its responsibility for ensuring periodic reviews are conducted.

## Attachment B

### Sample Conflict of Interest Certification and Disclosure Form

#### **Part I – Conflicts of Interest**

Name: \_\_\_\_\_

Position (e.g., employee/volunteer/director): \_\_\_\_\_

Date: \_\_\_\_\_

Note that the words in **bold** are defined in the appendix attached to the back of this questionnaire.

#### **Certification**

By signing this form below, I certify that:

1. I have received a copy of the organization's conflicts of interest policy;
2. I have read and understand the policy;
3. I agree to comply with the policy;
4. I agree to report promptly any changes in the information reported on this form, or any new information relevant to a conflict of interest; and
5. I understand that the organization is charitable and in order to maintain its federal tax exemption it must engage primarily in activities that accomplish one or more of its exempt purposes and not engage in activities and transactions that provide impermissible benefits to individuals or entities.

**Conflict of Interest Disclosure**

Please certify below that you either have nothing to report under the **Organization's** conflicts of interest policy, or describe below anything you believe could give rise to an actual or possible conflict of interest under the policy:

\_\_\_\_ I have nothing to report.

\_\_\_\_ I have the following matters to report.

1. Please specify below any matters you have to report.

(Please attach a supplemental statement if you have additional matters to disclose.)

2. For the purposes of determining possible future conflicts of interest, please specify other nonprofit and for-profit boards on which you and/or your spouse sit, any for-profit businesses for which you or a **family member** is an officer, a director, or a majority shareholder, and the name of your employer and any businesses you or a **family member** own).

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

(Please attach a supplemental statement if you have additional actual or possible conflicts of interest to disclose.)

I hereby certify that the information set forth above is true and complete to the best of my knowledge.

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

## PART II - Annual Independence Questionnaire

Name: \_\_\_\_\_

Position (e.g., employee/volunteer/director): \_\_\_\_\_

Date: \_\_\_\_\_

Note that the words in **bold** are defined in the appendix attached to the back of this questionnaire.

As you may be aware, the IRS Form 990's section on governance asks questions related to your independence.<sup>1</sup> In order to assist us in completing the Form 990, we ask that you please complete the following questionnaire. You may attach additional pages if necessary. We recognize that many of the questions below are technical and that they may overlap with information provided in response to the Conflicts of Interest Questionnaire. Please contact us if you are uncertain about any question or your response to such question and please answer every question (cross-references to prior responses are acceptable where appropriate).

1. **Payments by the Organization.** Have you been **compensated** as an **officer** or employee of this **Organization** since the beginning of the **Organization's** most recently completed tax year?

ANSWER:        YES                          NO

If you answered "Yes," please describe such **compensation**:

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<sup>1</sup> Note: A member of the governing body is not considered to lack independence merely because of the following circumstances:

- i) The member is a donor to the Organization, regardless of the amount of the contribution;
- ii) The member has taken a *bona fide* vow of poverty and either: (a) receives compensation as an agent of a religious order or a section 501(d) religious or apostolic organization, but only under circumstances in which the member does not receive taxable income or (b) belongs to a religious order that receives sponsorship or payments from the organization that do not constitute taxable income to the member; or
- iii) The member receives financial benefits from the Organization solely in the capacity of being a member of the charitable or other class served by the organization in the exercise of its exempt function, so long as the financial benefits comply with the organization's terms of membership.

2. **Payments by a Related Organization.** Have you been **compensated** as an **officer** or employee of a **Related Organization** since the beginning of the **Organization's** most recently completed tax year?

ANSWER:       YES                       NO

If you answered "Yes," please describe such **compensation**:

3. **Payments to Independent Contractors.** Have you received total **compensation** or other payments exceeding \$10,000 from the **Organization** or from a **Related Organization** as an **independent contractor**, other than reimbursement of expenses under an **accountable plan** or reasonable **compensation** for services provided in the capacity as a member of the **governing body**, since the beginning of the **Organization's** most recently completed tax year?

ANSWER:       YES                       NO

If you answered "Yes," please describe such **compensation**:

4. **Transactions with the Organization.** Have you, or any of your **family members**, been involved in a transaction with the **Organization** in one of the following threshold amounts (whether directly or indirectly through affiliation with another organization) since the beginning of the **Organization's** most recently completed tax year?

i) Greater than \$100,000 in the aggregate;

-OR-

ii) A single transaction in which the amount involved exceeded the greater of \$10,000 or 1% of the **Organization's** total revenue for the year.

ANSWER:       YES                       NO

If you answered "Yes," please describe such transaction(s):

5. **Family Relationship.** Have any of your **family members** been employed as an **officer, director, trustee** or **key employee** of the **Organization** since the beginning of the **Organization's** most recently completed tax year?

ANSWER:        YES                        NO

If you answered "Yes," please describe such **family members'** employment:

6. **Employment Business Relationship.** Have you, or any **family member**, been employed since the beginning of the **Organization's** most recently completed tax year by either a sole proprietorship or an organization with which an **officer, director, trustee, key employee** or greater-than-35% owner of the **Organization** is associated?

ANSWER:        YES                        NO

If you answered "Yes," please describe such business relationship:

7. **Transaction Business Relationship.** Have you, or any **family member**, directly or indirectly,<sup>2</sup> made one or more contracts of sale, lease, license, loan, performance of services or other transaction involving transfers of cash or property valued in excess of \$10,000 in the aggregate with an **officer, director, trustee** or **key employee** of the **Organization** since the beginning of the **Organization's** most recently completed tax year?

ANSWER:        YES                        NO

If you answered "Yes," please describe such business relationship:

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<sup>2</sup> For the purpose of question 7, "indirectly" means a transaction with an organization with which either you or the **officer, director, trustee** or **key employee** is associated as a **trustee, director, officer, key employee** or greater-than-35% owner.

**8. Investment Business Relationship.** Have you, or any **family member**, been a greater-than-10% owner<sup>3</sup> in the same business or investment entity as any **officer, director, trustee** or **key employee** of the **Organization** since the beginning of the **Organization's** most recently completed tax year?

ANSWER:        YES                          NO

If you answered "Yes," please describe such business relationship:

**9. Other Relationships.** Are there any other transactions or relationships that are not addressed elsewhere in this questionnaire, involving you or any **family member**, that could affect your ability to exercise independent judgment in making decisions as a member of the **Organization's** governing body?

Please sign, date and return this questionnaire as soon as possible. Responses may be sent to:

*[Include Contact Information]*

**By signing below, I affirm that my answers to the foregoing questions are true and accurate to the best of my knowledge. I understand that the Organization will rely on my answers in completing its Form 990.**

**I will promptly advise the Organization if, after the date hereof, I become aware of any information that would change my responses to this questionnaire.**

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

<sup>3</sup> Ownership is measured by stock ownership – either voting power or value – of a corporation, profits or capital interest in a partnership or limited liability company, membership interest in a nonprofit organization or beneficial interest in a trust. Note that ownership includes indirect ownership, for example, ownership in an entity that has ownership in the entity in question. There may be ownership through multiple tiers of entities.

### **Part III – Definitions**

“**Accountable Plan**” means a reimbursement or other expense allowance for business expenses incurred by the employee in connection with the performance of services as an employee which can be substantiated as bona fide expenses related to the employer’s business and which requires the employee to return any moneys paid by the employer which are in excess of the expenses substantiated.

“**Compensation**” (or being “**compensated**”) means all forms of cash and noncash payments or benefits provided in exchange for services, including salary and wages, bonuses, severance payments, deferred payments, retirement benefits, fringe benefits and other financial arrangements or transactions such as personal vehicles, meals, housing, personal and family educational benefits, below-market loans, payment of personal or family travel, entertainment and personal use of the organization’s property.

“**Control**” means:

(i) In the case of nonprofit organizations:

(a) In the case of a parent/subsidiary relationship: (1) the power to remove and replace a majority of the organization’s or other organization’s directors or trustees or (2) management or board overlap where a majority of the subsidiary organization’s directors or trustees are trustees, directors, officers, employees or agents of the parent organization.

(b) In the case of a brother/sister relationship: the same persons constitute a majority of the members of the governing body of both organizations.

(ii) In the case of stock corporations and other organizations with owners or persons having beneficial interests, whether such organization is taxable or tax-exempt: (1) ownership of more than 50% of the stock (by voting power or value) of a corporation; (2) ownership of more than 50% of the profits or capital interests in a partnership; (3) ownership of more than 50% of the profits or capital interest in a limited liability company treated as a partnership for federal income tax purposes, regardless of the designation under state law of the ownership interests as stock, membership interests, or otherwise; (4) being a managing partner or managing member in a partnership or limited liability company which has three or fewer managing partners or managing members (regardless of which partner or member has the most actual control); (5) being a general partner in a limited partnership which has three or fewer general partners (regardless of which partner has the most actual control); (6) being the sole member of a disregarded entity (an entity that is wholly owned by the organization that is not a separate entity for Federal tax purposes) or (7) ownership of more than 50% of the beneficial interest in a trust.

**“Director”** means a member of the organization’s governing body, but only if the member has any voting rights. A member of an advisory board that does not exercise any governance authority over the organization is not considered a director or a trustee.

**“Family Members”** means the family of an individual which only includes his or her spouse, ancestors, brothers and sisters (whether whole or half-blood), children (whether natural or adopted), grandchildren, great-grandchildren and spouses of ancestors, brothers, sisters, children grandchildren and great-grandchildren and any person residing in the same household as the individual.

**“Independent Contractor”** means a person who provides services to the Organization but who is not treated as an employee.

**“Key Employee”** means an employee of the Organization, other than an officer, director or trustee, who meets all three of the following tests:

(i) Receives reportable compensation from the Organization and all Related Organizations in excess of \$150,000 for the calendar year ending with or within the Organization’s tax year.

(ii) (a) has responsibilities, powers or influence over the organization as a whole similar to those of officers, directors or trustees; (b) manages a discrete segment or activity of the Organization that represents 10% or more of the activities, assets, income or expenses of the Organization, as compared to the Organization as a whole; or (c) has or shares authority to control or determine 10% or more of the Organization’s capital expenditures, operating budget or compensation for employees.

(iii) Is one of the 20 employees (which satisfy (i) and (ii) above) with the highest reportable compensation from the Organization and Related Organizations for the calendar year ending with or within the Organization’s most recent tax year.

**“Officer”** means a person elected or appointed to manage the Organization’s daily operations, such as president, vice-president, secretary or treasurer, as determined by the organizational documents and state law. For purposes of this questionnaire, an officer includes any top management official and top financial official.

**“Related Organization”** means any organization over which the Organization has **Control**.

Check which applies:

- The Organization has no Related Organizations.
- The following are Related Organizations: \_\_\_\_\_.