



TAX-EXEMPT ORGANIZATIONS ALERT CONFLICT OF INTEREST POLICIES: DISCLOSURE, MONITORING, AND ENFORCEMENT

The IRS has redesigned the Form 990, the annual information return that most tax-exempt organizations file with the IRS, effective for tax years beginning on or after January 1, 2008. The revised form asks organizations if they meet certain best practices in nonprofit governance. Among the many changes to the revised Form is a new series of questions regarding the tax-exempt organization's conflict of interest policy.

These questions are found in Part VI of the redesigned Form 990, dealing with governance and disclosure policies and procedures. Although organizations may not be required to adopt these policies and procedures under the Internal Revenue Code, all organizations are required to answer each question in Part VI of the redesigned Form 990.

Question 12a of Part VI asks whether the organization has a written conflict of interest policy. If the organization answers "Yes," the organization is required to answer two additional questions.

- Question 12b, which asks whether officers, directors or key employees are required annually to disclose interests that could give rise to conflicts. The draft instructions to the redesigned

Form 990 explain that an organization should answer "Yes" to this question if the organization's officers, directors, trustees, and key employees are required to disclose at least annually their business interests that could give rise to conflicts of interest, such as any substantial business or investment interests held by them, their family or related entities; and

- Question 12c, which asks whether the organization regularly and consistently monitors and enforces compliance with the conflict of interest policy. If so, the organization is asked to describe, in narrative form, such monitoring and enforcement.

CONFLICT OF INTEREST POLICIES IN GENERAL

As the IRS explains, a conflict of interest policy should:

- define conflicts of interest,
- identify the classes of individuals within the organization covered by the policy,

- facilitate disclosure of information that may help identify conflicts of interest, and
- specify procedures to be followed in managing conflicts of interest.

The IRS also states that “a conflict of interest arises when a person in a position of authority over an organization, such as an officer, director, or manager, may benefit financially from a decision he or she could make in such capacity, including indirect benefits such as to family members or businesses with which the person is closely associated.”

A conflict of interest policy is not, strictly speaking, a requirement for federal tax exemption. However, the inclusion of questions about the adoption and enforcement of a written conflict of interest policy on the revised Form 990 is consistent with good governance practices that are being advocated by the IRS. Policies such as a conflict of interest policy, if maintained and followed, also help to ensure the organization, its officers, directors, and employees comply with applicable state or DC law.

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. The form should include certain basic information. Specifically, each officer, director or key employee 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 either:

- to certify that he or she has no actual or possible conflict of interest to report, or
- to 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, highlighting any changes and offering 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 POLICY

An important step in monitoring and enforcing a conflict of interest policy is for the organization to be diligent in its review of the annual disclosure forms submitted by covered persons, and to compile and maintain 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. This will assist the organization in monitoring compliance with the conflict of interest policy. In addition, the organization should undertake a periodic review of transactions involving the significant expenditure of the organization's 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. The organization must 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 redesigned Form 990 - "Does the organization regularly and consistently monitor and enforce compliance with the policy?" - the draft instructions provide that 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 persons 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 follow 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

The 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,

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it is in the best interests of the organization 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 revised Form 990. Therefore, 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 redesigned 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:

- Redesigned Form 990, Schedules and Instructions.
<http://www.irs.gov/charities>
- Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations (October 2007).
<http://www.nonprofitpanel.org/selfreg/PrinciplesGuide>
- Tax-Exempt Organizations Alert – Conflict of Interest Policies, Miller & Chevalier Chartered & DC Bar Pro Bono Program (July 2006)
<http://www.lawhelp.org/documents/315351Alert%20-%20Conflictof%20Interest%20Policy.pdf?stateabbrev=/DC/>

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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

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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

Name:

Position (e.g., employee/volunteer/trustee):

Date:

Certification

By signing this form below, I certify that:

1. I have received a copy of the organization's conflict of interest policy;
2. I have read and understand the policy;
3. I agree to comply with the policy; and
4. 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 no actual or possible conflict of interest to report, or describe below any relationships, transactions, positions you hold (volunteer or otherwise), or circumstances that you believe could contribute to an actual or possible conflict of interest between the organization and your personal interests, financial or otherwise:

____ I have no conflict of interest to report.

____ I have the following actual or possible conflict(s) of interest to report.

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1. Please specify below any actual transactions you are aware of between the organization and any entity or person with which you have a business, investment, or family relationship.

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

2. For the purposes of determining possible future conflicts of interest, please also specify other nonprofit and for-profit boards on which you and/or your spouse sit, any for-profit businesses for which you or an immediate family member are an officer or 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: _____