NONPROFITS: BOARD GOVERNANCE

When the Revenue Agent Comes Calling: Conflict of Interest

09.14.16 | Linda J. Rosenthal, JD

The revenue agent who comes knocking at the door of a public charity will have at hand IRS Form 14114, Governance Check Sheet.

Issued in 2009, it's a 2-page audit guide divided into six separate sections, each focusing on a specific aspect of good governance.

We reviewed the first section, "Governing Body and Management," in "When the Revenue Agent Comes Calling: Part 1." The next post in our series on Form 14114 spotlights "Compensation," followed by one on "Organizational Control."

Conflict of Interest

Here, we turn our attention to the focus of the fourth section of Form 14114, IRS Governance Audit Checksheet, "Conflict of Interest."

Once again, there are multi-part questions, including drop-down menus for the agent to record detailed answers on these queries:

- If the organization has a written conflict of interest policy;
- If the policy addresses recusals;
- If the policy requires annual written disclosures of conflicts of interest; and
- (If any actual or potential conflicts of interest were disclosed), if the organization adhered to its written conflict of interest policy

In "The Conflict of Interest Policy: Why Is It Needed," we already discussed the importance of having this policy in place. According to the National Council of Nonprofits, "A policy governing conflicts of interest is perhaps the most important policy a nonprofit board can adopt…."

In this era of stepped-up scrutiny of 501(c)(3) organizations by regulators at all levels of government, charitable organizations are encouraged to develop "strategies that will help avoid the appearance or actuality of" wrongdoing, including "private benefit to individuals who are in a position of substantial authority."

The recommended preventive approach is development and adoption of a "conflict of interest policy." The Form 1023, for example, asks about it; in fact, the Instructions to the Application for Recognition of Exemption include a "Sample Conflict of Interest Policy" that new 501(c)(3)s are encouraged to approve right away.

The annual information return, Form 990, also asks pointed questions about conflict of interest policies and procedures.

What, exactly, is a conflict of interest in the context of tax-exempt charities?

> *A conflict of interest occurs where individuals' obligation to further the organization's charitable purposes is at odds with their own financial interests. For example, a conflict of interest would occur where an officer, director or trustee votes on a contract between the organization and a business that is owned by the officer, director or trustee. Conflicts of interest frequently arise when setting compensation or benefits for officers, directors or trustees.*

IRS officials believe that having a written policy in place from the beginning of the organization's corporate existence helps "ensure that when actual or potential conflicts of interest arise," there is a clear procedure "under which the affected individual will advise the governing body about all the relevant facts concerning the situation." Another benefit is that there will be a pre-established procedure by "which individuals who have a conflict of interest will be excused from voting on such matters."

Conclusion

The IRS takes seriously its role of continual oversight of organizations that have received the coveted 501(c)(3) tax-exempt status. "An important part of this oversight is providing organizations with strategies that will help avoid the appearance or actuality of private benefit to individuals in a position of substantial authority." Aside from the significant public relations damage from public allegations or proof of wrongdoing, the organization can face significant penalties along with possible revocation of tax-exempt status.

There's also a greater chance of being audited, if an organization fails to adopt any of" a number of written governance policies – including the conflict of interest policy – that have been "recommended … for consideration." That's because the IRS believes that "a well-governed charity

is more likely to obey the tax laws, safeguard charitable assets, and serve charitable interests more than one with poor or lax governance…."

The California Attorney General's Office, which has regulatory authority over charitable corporations and charitable assets in this state, also emphasizes the need for written governance policies like this.