

The Conflict of Interest Policy: Why is it Needed?

09.15.15 | Linda J. Rosenthal, JD



“A policy governing conflicts of interest is perhaps the most important policy a nonprofit board can adopt....”

That’s advice from the [National Council of Nonprofits](#).

It mirrors the position of the Internal Revenue Service that this is a big deal. New organizations applying for tax exemption must indicate, on the [Form 1023](#), if they’ve adopted a conflict of interest policy.

Many of these startups use the Sample Conflict of Interest Policy in [Appendix A to the Instructions for Form 1023](#) as a template. They make a copy, vote on it, and put it in that fancy, gold-embossed binder that came with the incorporation packet – where it gathers dust.

Each year, these groups are asked about it on the [Form 990](#), but it’s a matter of checking a box: “Yes” (we have a written conflict of interest policy). The dust on the binder may not be disturbed at all.

This is a mistake.

Why Your Conflict of Interest Policy Matters

Why is it so important to have a comprehensive written policy on this subject?

Remarkably, the answer is found in that IRS Sample Conflict of Interest Policy: at the beginning and in (nearly) plain English:

”

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....

The federal tax agency, simply put, is trying to protect the 501(c)(3) organization from taking a giant leap into a pile of trouble; that is, violating the “[Private Benefit Rule](#)” or incurring “excess benefit transaction” sanctions. Either will cause great pain (in the organization’s coffers) or the possible loss of the tax exemption.

A Little Background

We explained in “[Written Policies: Which Ones Should Nonprofits Have?](#)” that the corporate corruption scandals of the early 2000’s – Enron and Worldcom, for example – freaked out government officials.

Although these were publicly traded, for-profit behemoths caught in the massive wrongdoing, the fallout spilled over into the nonprofit sector. Philanthropy leaders and regulators cooperated to create an entirely new paradigm that thrusts corporate governance into the spotlight.

State laws like California’s Nonprofit Integrity Act of 2004 were passed. The IRS revamped the Form 1023, and overhauled and expanded the Form 990 to ask probing questions about an organization’s leadership, governing practices, program operations, and financial systems and records.

The reason made sense: If a 501(c)(3) organization has a strong, independent governing body that adopts sound financial management techniques and safeguards, it’s more likely that the group will abide by the 501(c)(3) rules. It will be “organized and operated exclusively for charitable purposes,” and will carefully avoid the quicksand of “private benefit” and “inurement of net earnings” and other proscriptions in Internal Revenue Code section 501(c)(3).

The Framework of a Good Policy

Question 12 of Form 990, Part VI, Section B, “Governance, Management, & Disclosure, asks:

”

12a. Did the organization have a written conflict of interest policy? If “No,” go to line 13.

12b. Were officers, directors, or trustees, and key employees required to disclose annually interests that could give rise to conflicts?

12c. Did the organization regularly and consistently monitor and enforce compliance with the policy? If “Yes,” describe in Schedule O how this was done.

If your organization adopts a Conflict of Interest Policy along the lines of the IRS’s sample, you will have a document that not only explains what a conflict of interest is, but also mandates procedures for (a) avoiding and addressing a potential conflict, and (b) creating records to prove that you took the necessary steps to avoid trouble.

If not – (presumably) – you will be invited to explain yourself at some later date.

It’s just easier – and less anxiety-producing – to print out a copy of the Sample Conflict of Interest Policy, vote on it at the next meeting, and then scrupulously follow it, including the provisions of Article VII, “Periodic Reviews.”

Or, better yet, along with your professional advisors, draft a custom Conflict of Interest Policy that suits your particular circumstances, while including – at least – the general content of the IRS sample; that is:

- Definitions of “Interested person” and “financial interest”;
- Procedures;
- Records of Proceedings;
- Compensation Determinations;
- Annual Statements;
- Periodic Reviews; and
- Use of Outside Experts

Either way, make sure you “dust” this particular policy off on a regular basis.