

# Panel on the Nonprofit Sector

Convened by INDEPENDENT SECTOR

## Work Group Recommendations to the Panel on the Nonprofit Sector Posted for Public Comment January 24, 2005

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### #19: Conflict of Interest Policy Disclosure

#### I. Governance and Fiduciary Responsibility Work Group Recommendations

##### A. Statement of Problem

Many of the negative press reports concerning charitable organizations involve actual and/or apparent conflicts of interest. A fundamental step in preventing abuse in and protecting the reputation of charitable organizations is the identification and appropriate management of apparent and actual conflicts of interest. Many charitable organizations neither understand what a conflict of interest entails nor have policies to help guide managers in dealing with the apparent or actual conflicts that will inevitably arise.

##### B. Recommendations

Every organization ought to establish a conflict of interest policy. Charitable organizations should be required to report on the Form 990/Form 990-EZ/Form 990-PF whether they have a conflict of interest policy,<sup>1</sup> and the forms should be revised to enable this disclosure. All charitable organizations should be strongly encouraged to adopt and enforce a conflict of interest policy and to pay special attention to transactions between board members and organizations. Education initiatives and technical assistance should help organizations to accomplish this.

##### C. Rationale

Establishing and enforcing a conflict of interest policy is an important part of safeguarding charitable organizations against engaging in unethical or illegal practices. All organizations should implement conflict of interest policies tailored to their specific organizational needs and characteristics and should be required to disclose whether or not they have such a policy. A requirement to report annually whether or not an organization has adopted such a policy will remind organizations that have not yet done so that this is an important step to take and will likely result in more organizations adopting and enforcing such policies.

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<sup>1</sup> There is no need for legislation on the specifics of the policy, but rather only the existence or lack of a conflict of interest policy should be reported in the 990.

Note: These recommendations have not yet been reviewed by the Panel on the Nonprofit Sector. They will be part of the deliberations by the Panel as it prepares its interim report.

#### **D. Other Considerations**

None.

### **II. Expert Advisory Group Comments**

The Expert Advisory Group agreed with the Work Group's recommendations. It noted that the IRS has already added a question to the new Form 1023 asking organizations whether they have adopted a conflict of interest policy. Because organizations are not required to begin using the new Form 1023 until later this year, there is no information available as to whether the IRS will deny exemption to organizations that have not adopted a policy or whether disclosure will be sufficient.

The Expert Advisory Group observed that a conflict of interest policy helps to ensure that an organization and its officers and directors comply with federal and state legal obligations. Violations of section 4941 of the Internal Revenue Code (self-dealing transactions for private foundations) and section 4958 (excess benefit transactions for public charities) are triggered by transactions involving individuals who may have a conflict of interest with respect to the organization, as defined by the Code. All states mandate that directors and officers owe a duty of loyalty to the organization, and improperly benefiting from a transaction involving a conflict of interest more than likely involves a violation of the duty of loyalty. Some state statutes specifically penalize participation in transactions involving conflicts of interests unless the organization follows certain prescribed procedures.

The Expert Advisory Group noted with concern the fact that some board members are being advised by their employers not to sign conflict of interest policy disclosure statements because of liability concerns. If an organization has a policy requiring signatures and signed forms are missing, an outside auditor is required to report that fact in connection with its audit. Thus, there was some concern that requiring signatures on conflict disclosure statements might discourage board service in some instances. It was noted that some organizations have adopted narrow policies focused only on excess benefit transactions as defined by the Code rather than on a broader class of conflicted transactions.

The Expert Advisory Group recommends that, during Phase II, the Work Group develop model conflict of interest policy provisions to assist charitable organizations in crafting policies tailored to their specific organizational needs.