Implementing and Utilizing a Conflict of Interest Policy

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Although a conflict of interest policy has always been an important part of good governance (for for-profits as well as not-for-profits), now may be a great time to reevaluate how well your organization integrates and confirms compliance with the conflict of interest policy throughout the organization. If your organization has not yet adopted a conflict of interest policy, now is the time to do so. Not only does the redesigned 990 incorporate more questions about transactions with interested persons and related organizations, but the IRS also has the authority to impose stiff intermediate sanctions penalties on any officer, director, or trustee (ODT) of the organization who receives an excess benefit and on any ODT of the organization if he or she approved an excess benefit transaction and was aware that the transaction provided an excess benefit to an ODT. A conflict of interest policy can protect the organization from encountering these troubling situations and protect it from loss of exempt status due to "private inurement."

A conflict of interest policy does not necessarily bar an organization from engaging in transactions with board members, officers, key employees and/or their families, or businesses; it provides an established procedure for dealing with those situations to ensure the transaction is in the organization's best interest.

If any interested person (defined as a director, principal officer, or someone with board-designated authority who has a financial interest) has a potential conflict of interest in a transaction, the policy should require that he or she discloses it to the board prior to a decision on the transaction. The interested party should not be present or have a vote when the board discusses the merits of the transaction or when it makes its decision. Minutes or other records should include analysis of the conflict of interest, who was present for the discussion, the comparability data considered by the board in making sure the transaction was "arm's length," and any votes taken.

Following these steps and exercising due diligence reduce the chances that a transaction benefits, or appears to benefit, the interested person to the disadvantage of the organization. The IRS is looking for boards of exempt organizations to avoid not only actual transactions between exempt organizations and insiders that provide excess benefits to insiders, but also the mere appearance of such transactions. Transparency requires full disclosure of the interests of insiders and full consideration of the transaction to ensure that it is in the best interest of the exempt organization.

The policy should also provide for periodic reviews of the organization's activities to ensure they are in compliance with its tax-exempt status. Such reviews should include analysis of compensation arrangements and associations with management organizations. Additionally, board members and principal officers should annually review the policy and sign off that they have read, understood, and complied with the policy. Even for long-time board members, annual review serves as a good reminder since their financial interests may change throughout the year.

Implementing the policy is the first step. Utilizing and adhering to the policy once in place can protect your organization from actual and perceived abuse.

Visit www.kynonprofits.org to learn more about conflicts of interest, including sample policies— simply click on the *Principles & Practices* tab.