

Conflict of Interest

It is a best practice for nonprofits to have a conflict of interest policy that provides guidance for how to approach conflict of interest transactions.

What is a conflict of interest transaction?

A conflict of interest transaction occurs when a director, officer or other person in a position of authority within the nonprofit (an "insider") has a personal or financial interest in a transaction involving the nonprofit or has a relationship with another entity that is involved in a transaction with the nonprofit. An indirect conflict may exist when an insider is related to an individual that has such an interest or relationship.

What is a conflict of interest policy?

A conflict of interest policy sets forth a nonprofit's procedure for the disclosure and review of potential conflict of interest transactions. The purpose of the policy is to protect the nonprofit's interest when it is contemplating entering into a transaction with an insider. It does this by describing such transactions and instructing both the insider and the board of directors on the process for reviewing the transaction.

Is a conflict of interest policy legally required?

While it is not legally required to have a conflict of interest policy, both state and federal laws regulate conflict of interest transactions. Thus, all nonprofits should have a conflict of interest policy that complies with these laws, and it is a standard practice to have one. Note that one of the questions on IRS Form 990 is: "Does the organization have a written conflict of interest policy?" It is generally agreed that the best answer to this question is "yes."

Why should our nonprofit have a conflict of interest policy?

Having a conflict of interest policy can help protect the board and other insiders. A good policy will clearly define what a conflict of interest is so that insiders know how and when to report potential conflicts of interest. Having this information may prevent insiders from using their position in the nonprofit for personal gain and acting on issues where their personal or financial interests could conflict with the interests of the nonprofit. Not only does this protect the interests of the nonprofit, but it will also help directors satisfy their fiduciary duties to the nonprofit.

What happens when a conflict of interest exists?

Insiders should be required to bring any conflict of interest, real or perceived, to the board's attention so that it can determine if an actual conflict exists and decide whether or not to proceed with the proposed transaction.

How does our nonprofit approve a transaction that is a conflict of interest?

While the specific procedure will vary based upon state law requirements, federal guidelines recommend the following steps to approve a conflict of interest transaction:

- The board must determine that:
 - A more advantageous arrangement not producing a conflict of interest is not reasonably possible under the circumstances;
 - The transaction is in the best interests of the nonprofit, and it is being entered into for the benefit of the nonprofit, not for the benefit of the insider; and
 - The transaction and the nonprofit's obligations in entering into the transaction are fair and reasonable to the nonprofit.
- The insider's interests in the transaction and all material facts related to the transaction must be fully disclosed to the board prior to approving the transaction.
- The board must approve the transaction by a majority vote of all directors that do not have an interest in the transaction.
- The minutes for the board meeting should document each of the above steps in detail and include all information and materials the directors relied upon in making their determinations.

Where can our nonprofit obtain a conflict of interest policy?

A conflict of interest policy should be drafted by an attorney who is familiar with the state and federal laws that regulate nonprofits and tax-exempt organizations. While the IRS has published a sample conflict of interest policy, each nonprofit should have its conflict of interest policy tailored to fit its particular needs and satisfy state laws.