



Conflict of Interest Policy

California Nonprofit Public Benefit Corporation

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About This Form: Public Counsel’s Community Development Project has designed the attached form of Conflict of Interest Policy for a California Nonprofit Public Benefit Corporation to assist nonprofit organizations seeking to adopt or amend such a governance policy and the *pro bono* attorneys who represent them.

This form is annotated with explanatory endnotes, including citations to applicable laws, alternatives and recommended practices. For further instructions on how to use this form, how to create a policy that will allow a corporation to answer “yes” to Section VI, Questions 12a-c on the revised Form 990, and how to implement this governance policy, please see the endnotes. Public Counsel will update this form periodically for changes in law, recommended practices and available resources. For the latest version, see www.publiccounsel.org/practice_areas/community_development.

Important Notes: In creating any governance policy, it is very important that a nonprofit corporation institute procedures that the corporation is likely to be able to comply with consistently in the long term. Therefore, this sample should be used only after carefully considering every provision, and a corporation should not adopt any provisions that will be too burdensome for the corporation to follow given its circumstances. A governance policy will not protect a corporation from liability if it is not followed, and in some cases, a failure to consistently follow a written policy may more likely result in a finding of liability for the corporation than if no written policy existed. Please see the first endnote for more information.

This form should not be construed as legal advice. Please contact an attorney for legal advice about your organization’s specific situation. This sample should not be used “as is” but should be modified after careful consideration of the explanations in the endnotes. Some corporations may need to include additional provisions not discussed in this form to qualify for certain funding or comply with laws applicable to specific types of organizations.

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Public Counsel’s Community Development Project provides free legal assistance to qualifying nonprofit organizations that share our mission of serving low-income communities and addressing issues of poverty within Los Angeles County. If your organization needs legal assistance, or to provide comments on this form, visit www.publiccounsel.org/practice_areas/community_development or call (213) 385-2977, extension 200.

**FORM OF CONFLICT OF INTEREST AND ETHICS POLICY FOR A
CALIFORNIA PUBLIC BENEFIT NONPROFIT CORPORATION**

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CONFLICT OF INTEREST [AND ETHICS] POLICY¹

OF

[NAME OF CORPORATION]

A California Nonprofit Public Benefit Corporation

ARTICLE I. INTRODUCTION AND PURPOSE²

[Name of Corporation] (the “Corporation”) requires its directors, officers, employees and volunteers to observe high standards of business and personal ethics in the conduct of their duties and responsibilities. The Board of Directors (the “Board”) of the Corporation, recognizing that it is entrusted with resources devoted to charitable purposes, has adopted this Conflict of Interest [*and Ethics*³] Policy (the “Policy”). The purpose of this Policy is to protect the Corporation’s interest when it is contemplating entering into a transaction or arrangement that might benefit the private interest of a director, officer or other person in a position of authority within the Corporation. The Corporation strives to avoid conflicts of interest to ensure that it continues to operate in accordance with its tax-exempt purpose. This Policy is intended to supplement but not replace any state and federal laws governing conflicts of interest applicable to nonprofit and charitable organizations.⁴

ARTICLE II. DEFINITIONS

Section 1. Duty of Loyalty of Interested Persons.⁵ Conflicts of interest can place personal interests at odds with the fiduciary “duty of loyalty” owed to the Corporation. The duty of loyalty requires that a director, manager, principal, officer, or member of a committee with governing board-delegated powers (each, an “Interested Person”), refrain from using his or her position for personal gain, and avoid acting on issues in which his or her personal or financial interests could conflict with the interests of the Corporation.

Section 2. Direct and Indirect Conflicts of Interest. Conflicts of interest arise from personal relationships or from a financial interest. Conflicts can arise either directly or indirectly. A direct conflict can arise where an Interested Person has a personal or financial interest in any matter involving the Corporation or has a financial or agency relationship (i.e., is a director, officer, manager, partner, associate, trustee or has a similar agency relationship) with

an entity involved in a transaction or other business with the Corporation. An indirect conflict can arise where someone related to an Interested Person by business affiliation, or a “Family Member” (spouse, parents-in-law, ancestors, brothers and sisters (whether whole or half blood), children (whether natural or adopted), grandchildren, great-grandchildren, and spouses of brothers, sisters, children, grandchildren, and great-grandchildren) of the Interested Person has dealings with the Corporation. By way of example, an Interested Person has a financial interest if such person has, directly or indirectly, through business, investment or a Family Member:

- (a) an ownership or investment interest in any entity with which the Corporation has a transaction or arrangement;
- (b) a compensation arrangement with the Corporation or with any entity or individual with which the Corporation has a transaction or arrangement; or
- (c) a potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which the Corporation is negotiating a transaction or arrangement.

Compensation includes direct and indirect remuneration as well as gifts or favors that are not insubstantial.

Section 3. Potential and Actual Conflicts of Interest. Acts that mix the personal or financial interests of an Interested Person with the interests of the Corporation are indicative of a conflict of interest. Not every potential conflict is an actual conflict, however. An Interested Person who has a financial interest in a matter involving the Corporation may have a conflict of interest requiring application of the mitigating procedures described in this Policy only if the appropriate party designated in Article III, Section 3 decides that such a potential conflict of interest is actual or material. However, acts that even have the appearance of a conflict of interest can be damaging to the reputation of the Corporation. Consequently, the Corporation seeks to avoid potential and actual conflicts of interest, as well as the appearance of conflicts.

Section 4. Activities that May Present a Conflict of Interest. The following is a non-exclusive list of the types of activities that may present a conflict of interest and should be disclosed in accordance with Article III.

- (a) **Adverse Interest.** Participation by an Interested Person in decisions or negotiations related to a contract, transaction or other matter between the Corporation and: (i) the Interested Person; (ii) an entity in which the Interested Person or a Family Member of such person has financial interest; or (iii) an entity with which the Interested Person has an agency relationship.
- (b) **Competing Interests.** Competition by an Interested Person, either directly or indirectly, with the Corporation in the purchase or sale of property or property

rights, interests, or services, or, in some instances, competition directly for the same donor or external resources.

- (c) **Use of Resources.** Use of the Corporation's resources (for example, staff, contracts, donor lists, or name) for personal purposes of the Interested Person or a Family Member of such person.
- (d) **Inside Information.** Disclosure or exploitation by an Interested Person of information pertaining to the Corporation's business for the personal profit or advantage of such person or a Family Member of such person or a person/entity with whom the Interested Person has an agency relationship.

Section 5. Disclosure. The primary obligation of any person subject to this Policy who may be involved in a conflict of interest situation is to bring it to the attention of those designated under the disclosure procedures in Article III so that the potential conflict can be evaluated and addressed. An Interested Person should not make the decision about whether a conflict of interest exists unilaterally.

ARTICLE III. PROCEDURES TO DISCLOSE AND RESOLVE CONFLICTS⁶

Section 1. Duty to Self-Disclose.

- (a) An Interested Person shall make an appropriate disclosure of all material facts, including the existence of any financial interest, at any time that any actual or potential conflict of interest [*or ethical question*] arises. This disclosure obligation includes instances in which an Interested Person who is a director knows of the potential for a self dealing transaction as described in Section 4, or a transaction involving common directorship as described in Section 7, related to his or her interests. It also includes instances in which the Interested Person plans not to attend a meeting of the Board or a Board committee with governing board-delegated powers (a "Committee") at which he or she has reason to believe that the Board or Committee will act regarding a matter about which he or she may have a conflict. Depending on the circumstances, this disclosure may be made to [designate the appropriate persons to receive disclosure such as the Chairperson of the Board or the Chairperson of the Audit Committee or other], or, if the potential conflict of interest first arises in the context of a Board or Committee meeting, the entire Board or the members of the Committee considering the proposed transaction or arrangement that relates to the actual or possible conflict of interest [*or ethical question*].⁷
- (b) In addition, Interested Persons shall, in accordance with Article VI, make an annual disclosure of on-going relationships and interests that may present a conflict of interest.

Section 2. Disclosure of Conflicts of Others. If an Interested Person becomes aware of any potential self dealing or common directorship transaction or other conflict of interest involving another Interested Person, he or she should report it in accordance with the requirements of this Article III.

Section 3. Evaluation of Potential Conflict.⁸

- (a) After disclosure of all material facts and any follow-up discussion with the Interested Person with a potential conflict of interest, a determination must be made about whether a material financial interest, self dealing transaction or other kind of actual conflict exists. If the potential conflict is first disclosed during a Board or Committee meeting at which the Interested Person with the potential conflict is in attendance, the Interested Person shall leave the meeting while the determination of whether a conflict of interest exists is either discussed and voted upon or referred to Committee for further consideration. In either event, the decision-making body will evaluate the disclosures by the Interested Person, and will determine on a case-by-case basis whether the disclosed activities constitute an actual conflict of interest. If the disclosure is made outside of the context of a meeting, then the determination of whether a conflict exists will be referred to *[designate the decision-making body such as the Audit Committee, the Executive Committee, the Governance Committee or other]* for decision and action. Factors the decision-making body may consider when determining whether an actual conflict exists include (i) the proximity of the Interested Person to the decision-making authority of the other entity involved in the transaction, (ii) whether the amount of the financial interest or investment is *de minimis*⁹ relative to the overall financial situation of the Corporation, and (iii) the degree to which the Interested Person might benefit personally if a particular transaction were approved.
- (b) If it is determined that an actual conflict of interest exists which also constitutes a “self dealing” transaction as described in Section 4, then the transaction or matter in question can only be authorized if approved by the vote described in Section 6(a) after the Corporation has followed the procedures set forth in Section 5.
- (c) If it is determined that an actual conflict of interest exists which is not a “self dealing” transaction, but involves participation by the Interested Person in decisions or negotiations related to a material contract, transaction or other matter between the Corporation on the one hand and (i) the Interested Person, (ii) an entity in which the Interested Person or a Family Member of such person has financial interest, or (iii) an entity with which the Interested Person has an agency relationship on the other hand, then the matter in question can only be authorized if approved by the vote described in Section 6(b) after the Corporation has followed the procedures set forth in Section 5.

- (d) In all other circumstances where it is determined that an actual conflict of interest exists, the decision-making body will recommend an appropriate course of action to protect the interests of the Corporation. All disclosures and the outcome of the deliberation about whether a conflict of interest exists will be recorded in the minutes of the appropriate deliberative meeting.

Section 4. “Self Dealing” Transactions of Directors.¹⁰

- (a) Section 5233 of the California Corporations Code requires that certain procedures be followed in order for the Board to approve any specific transaction that involves “self dealing” on the part of a director. Section 5233 defines self dealing as a transaction in which a director has a material financial interest (an “interested director”). Section 5233 requires that self dealing transactions be approved by a greater vote than other Board actions, as described in Section 6(a).
- (b) The following are exempt from the approval requirements of section 5233 (and therefore the Corporation need not obtain the vote described in Section 6(a)): (i) approval of an action fixing the compensation of a director as a director or officer; (ii) good faith approval, without unjustified favoritism, of a charitable program of which a director or a director’s Family Member(s) are among the intended beneficiaries; and (iii) a transaction about which an interested director had no actual knowledge involving an amount that does not exceed the lesser of one percent of the gross receipts of the Corporation for the preceding fiscal year or \$100,000.

Section 5. Procedures for Addressing a Conflict of Interest. Prior to voting on a contract, transaction or matter in which an actual conflict of interest is found to exist, the Board or Committee will follow the procedures described in this Section 5.

- (a) The Interested Person may make a presentation at the Board or Committee meeting at which such transaction is being considered, but after the presentation, he or she shall leave the meeting during the discussion of, and the vote on, the transaction or arrangement involving the possible conflict of interest.
- (b) The Chairperson of the Board or Committee shall, if appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.
- (c) After exercising due diligence, the Board or Committee shall determine whether the Corporation could obtain with reasonable efforts a more advantageous transaction or arrangement from a person or entity that would not give rise to a conflict of interest.
- (d) If a more advantageous transaction or arrangement is not reasonably possible under circumstances not producing a conflict of interest, the Board or Committee

shall determine whether the transaction or arrangement is in the Corporation's best interest, for its own benefit, and whether it is fair and reasonable. In conformity with the above determination, the Board shall make its decision as to whether to enter into the transaction or arrangement by the vote described in Section 6.

Section 6. Vote Required for Approval of Conflict Transaction.

- (a) A self dealing transaction must receive prior approval by a vote of a majority of the directors in office, without counting the vote of any interested director, and with knowledge of the material facts of the transaction and the involved director's interest.
- (b) A transaction in which an actual conflict of interest exists but is not a self dealing transaction must receive prior approval by a majority vote of the disinterested directors or Committee members present at a meeting at which a quorum is present.

Section 7. Interlocking Directorships.

Section 5234 of the California Corporations Code permits transactions between corporations having common directors so long as all material facts regarding the transaction and the relevant directorships are known to the respective boards of directors, and the matters are approved in good faith by a vote sufficient without counting the vote of the common director(s). Such transactions are not self dealing transactions subject to Section 4.

Section 8. Violations of the Conflict of Interest Policy.

- (a) If the Board has reasonable cause to believe that an Interested Person has failed to disclose actual or possible conflicts of interest, it shall inform the Interested Person of the basis for such belief and afford the Interested Person an opportunity to explain the alleged failure to disclose.
- (b) If, after hearing the Interested Person's response and after making further investigation as warranted by the circumstances, the Board determines the Interested Person has failed to disclose an actual or possible conflict of interest, it shall take appropriate disciplinary and corrective action.

ARTICLE IV. RECORDS OF PROCEEDINGS

The minutes of the Board or Committee meeting convened to consider a transaction subject to the mitigating procedures described in Article III shall contain:

- (a) The names of the Interested Persons who disclosed or whom otherwise were found to have a financial or other interest in connection with an actual or possible conflict of interest, the nature of the financial or other interest, any action taken to determine whether a conflict of interest was present, and the Board's or Committee's decision as to whether a conflict of interest in fact existed.
- (b) The names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection with the proceedings.

ARTICLE V. COMPENSATION¹¹

Section 1. A voting member of the Board who receives compensation, directly or indirectly, from the Corporation for services is precluded from voting on matters pertaining to that member's compensation.

Section 2. A voting member of any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Corporation for services is precluded from voting on matters pertaining to that member's compensation.

Section 3. No voting member of the Board or any Committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly from the Corporation, either individually or collectively, is prohibited from providing information to any Committee regarding compensation.

ARTICLE VI. ANNUAL STATEMENTS

Each person subject to this Policy shall annually sign a statement on the conflict of interest disclosure form ("Conflict of Interest Disclosure Form," attached as **Schedule 1**) or such other form as the Board adopts, which at a minimum affirms that such person:

- (a) has received a copy of the Policy;
- (b) has read and understands the Policy;
- (c) has agreed to comply with the Policy; and
- (d) understands the Corporation is charitable and in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes.

In addition, Interested Persons shall make an annual disclosure of on-going relationships and interests that may present a conflict of interest. Disclosures should address current affiliations, as well as past affiliations for the prior two years. Conflict of interest disclosure forms will be

submitted to the *[designate recipient of disclosure forms such as the Chairperson of the Audit Committee, Chairperson of the Board, Chairperson of the Executive Committee, Chairperson of the Governance Committee or other]* annually, and when appropriate, at or prior to action on relevant business transactions.

ARTICLE VII. PERIODIC REVIEWS

To ensure the Corporation operates in a manner consistent with charitable purposes and does not engage in activities that could jeopardize its tax-exempt status, periodic reviews shall be conducted. The periodic reviews shall, at a minimum, include the following subjects:

- (a) Whether compensation arrangements and benefits are reasonable, based on competent survey information, and the result of arm's length bargaining; and
- (b) Whether partnerships, joint ventures and arrangements with management companies conform to the Corporation's written policies, are properly recorded, reflect reasonable investment or payments for goods and services, further charitable purposes and do not result in [inurement, impermissible private benefit or in an excess benefit transaction](#).¹²

This periodic compensation review shall be in addition to the [Board's statutory obligation to periodically review the fairness of compensation](#), including benefits, paid to the President and Chief Financial Officer of the Corporation (i) once such officer is hired; (ii) upon any extension or renewal of the officer's term of employment; and (iii) when the officer's compensation is modified (unless all employees are subject to the same general modification of compensation).¹³

ARTICLE VIII. USE OF OUTSIDE EXPERTS

When conducting the periodic reviews as provided for in Article VII, the Corporation may, but need not, use outside advisors. If outside experts are used, their use shall not relieve the Board of the responsibilities for ensuring periodic reviews are conducted.

[ARTICLE IX. [CODE OF ETHICS](#)¹⁴

Section 1. [Code of Ethics.](#) *In conducting business and activities which are connected with the Corporation, an Interested Person shall follow these guidelines:*

- (a) ***[Ethical Conduct.](#)*** *Be honest and ethical in his or her conduct, including ethical handling of actual or apparent conflicts of interest between personal and professional relationships. An Interested Person should not engage in activities which have or may have the appearance of impropriety or conflict of interest, or that may call into question the actions or integrity of the Corporation, or of the Interested Person as he or she relates to the Corporation.*

- (b) **Legal Compliance.** *Comply with applicable laws and regulations, including the California Nonprofit Integrity Act of 2004, and report his or her concerns to the appropriate person listed in Article III if it appears that any other director, officer, employee or contractor of the Corporation is not complying with applicable laws or regulations with respect to the Corporation's business.*
- (c) **Confidentiality.** *Maintain the confidentiality of all internal information about the Corporation, including its donors, clients and beneficiaries, except when authorized or otherwise legally obligated to disclose such information.*
- (d) **Fair Dealing.** *Deal fairly with the Corporation's staff, donors, volunteers, beneficiaries and suppliers.*
- (e) **Protect Assets.** *Protect and ensure the proper use of the Corporation's assets, including, its name, goodwill, donor community and reputation.*
- (f) **Personal Influence.** *Be mindful of the interaction between his or her relationships inside and outside of the Corporation, and not allow inappropriate personal influence over the affairs of the Corporation.*
- (g) **Commitments.** *Do not "speak for" the Corporation or make or imply commitments by the Corporation without proper internal authorization and communication.*
- (h) **Loans.** *The Corporation should not make loans to Interested Persons except to induce persons who have been offered a position to join the Corporation, as approved by the Board.^{15]}*

CONFLICT OF INTEREST [AND ETHICS] POLICY

SCHEDULE 1: CONFLICT OF INTEREST DISCLOSURE FORM¹⁶

The undersigned, as a director, manager, principal, officer, or member of a committee with governing board-delegated powers, of [Name of Corporation] (the “Corporation”), acknowledges that:

1. he or she has received a copy of the Corporation’s Conflict of Interest Policy (the “Policy”);
2. he or she has read and understands the Policy;
3. he or she has agreed to comply with the Policy;
4. he or she understands the Corporation is charitable and in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes; and
5. the following on-going relationships and interests may present a conflict of interest: *(disclosures should address current affiliations, as well as past affiliations for the prior two years, and should include all of the following: the undersigned’s employer, all corporations (nonprofit and for-profit) of which the undersigned is a board member or officer, and the names of such of the undersigned’s Family Members¹⁷ or business affiliates or any other relationships the undersigned has which the undersigned believes may present a potential conflict)*

Name: _____

Title: _____

Signature: _____

Date: _____

«¹ **HOW TO USE THIS FORM:** This sample conflict of interest policy, which includes an optional code of ethics component, has been developed for use by small and mid-sized California nonprofits for educational purposes only. The endnotes discuss the applicable law, recommended practices, and why we have included certain language. **Bold** and ***bold italicized*** bracketed language in this form indicates that information specific to the corporation adopting the conflict of interest policy must be inserted. *Italicized* bracketed language in this form indicates optional language that should be included only if the corporation is also adopting a code of ethics as a component of its conflict of interest policy.

Important Note: In order for a corporation to make a truly informed choice about the procedures that will govern its corporate operations, this sample should not be used “as is.” Rather, it should be used as a starting point and be modified after consideration of the explanations in the endnotes and after review of and reconciliation with any conflict of interest provisions that may be contained in the corporation’s bylaws, personnel policies, vendor policies, volunteer policies, grant contracts or the contractor prerequisites of governmental agencies. **It is very important that anyone creating a conflict of interest policy for a nonprofit corporation fully understand the mechanics of such a policy, and choose provisions that fit the scope of the corporation’s specific operations. Therefore, each user of this form should think through every provision carefully, and should not draft any provisions that will be too burdensome for the corporation to follow under its circumstances.** Further, all directors and officers should be provided with a copy of the policy, and should be fully oriented as to its content in order to understand their respective rights and responsibilities.

The endnotes discuss relevant provisions of law, in effect as of July 2009. The primary sources of law described in these endnotes are (a) the California Nonprofit Corporation Law (California Corporations Code sections 5000 *et seq.*) which is sometimes referred to in these endnotes as “the law,” and (b) the Internal Revenue Code of 1986, as amended (U.S. Code Title 26), which is referred to in these endnotes as the “Code.”

Occasionally the endnotes refer to annotated bylaws. This resource, also created by Public Counsel’s Community Development Project with the support of the Annenberg Foundation, can be found on the Public Counsel website at www.publiccounsel.org/tools/publications/files/Annotated_Bylaws.pdf.

Defined terms:

The following terms are defined in these endnotes:

“Code” – Note 1

“interested person” – Note 10 (Cal. Corp. Code § 5227(a) definition)

“Interested Person” – Note 5 (conflict of interest policy definition)

“IRS” – Note 2

“the law” – Note 1

«² While acknowledging that it cannot enforce governance practices, the Internal Revenue Service (IRS) has for many years taken the position that adoption of a conflict of interest policy is an indication of good governance practices and correlates positively with the likelihood that a §501(c)(3) organization will comply with the requirements necessary to maintain tax exempt status. IRS encouragement to adopt a conflict of interest policy begins when a nonprofit corporation first applies for recognition of tax exempt status under §501(c)(3) of the Code. The IRS strongly suggests that a corporation adopt a conflict of interest policy to make sure that any transactions where a director or officer has a material financial interest will be approved by the disinterested directors. IRS Form 1023 asks whether the applicant nonprofit has adopted a conflict of interest policy that is similar to the sample policy the IRS includes in the form’s instructions. If the corporation does not adopt the sample language, it will

either have to adopt its own separate conflict of interest policy, add conflict of interest provisions to its bylaws, or explain in detail why it has not done any of these three options.

Public Counsel's annotated bylaws for public benefit nonprofit corporations and many other form bylaws utilized by California public benefit nonprofit corporations include language that models the provision in the California Corporations Code that addresses director self dealing transactions [*Cal. Corp. Code § 5233*] and can serve as a conflict of interest policy for IRS purposes. However, more comprehensive resolution of potential conflict of interest issues is often better handled in a stand-alone policy, particularly if the organization seeks to address conflicts that are not only financial in nature. Adopting a stand-alone policy also has another practical benefit. A §501(c)(3) organization has a continuing obligation to report significant changes to its organizing documents, including its bylaws, to the IRS. If the conflict of interest policy is contained in the organization's bylaws and is subsequently amended, such a change would need to be reported. If the organization decided to amend a stand-alone conflict of interest policy not contained in the bylaws by board resolution, such an amendment would not need to be reported (see instructions to Form 990, Part VI, Line 4, available at www.irs.gov/pub/irs-pdf/i990.pdf#page=18).

Form 990: Section 501(c)(3) organizations that are required to file the annual informational tax return Form 990 will also be confronted with the question of whether, as of the end of the organization's tax year, the organization has adopted a conflict of interest policy (Form 990, Part VI, Line 12a, available at www.irs.gov/pub/irs-pdf/f990.pdf#page=6).

The instructions to Form 990 describe a conflict of interest policy as:

A policy that defines conflict of interest, identifies the classes of individuals within the organization covered by the policy, facilitates disclosure of information that may help identify conflicts of interest, and specifies procedures to be followed in managing conflicts of interest. A conflict of interest arises when a person in a position of authority over an organization, such as an **officer**, **director**, or manager, may benefit financially from a decision he or she could make in such capacity, including indirect benefits such as to **family members** or businesses with which the person is closely associated. For this purpose, a conflict of interest does not include questions involving a person's competing or respective duties to the organization and to another organization, such as by serving on the boards of both organizations, that do not involve a material financial interest of, or benefit to, such person.

Thus, if an organization decides to edit this form policy or use another form, the organization should make sure that the policy it ultimately adopts at a minimum addresses all of the issues outlined in the IRS definition. It should be noted, however, that this form addresses issues of potential conflict in addition to those involving a material financial interest.

⌞³ This form policy includes an optional code of ethics. According to the Panel on the Nonprofit Sector's *Principles for Good Governance and Ethical Practices*, www.nonprofitpanel.org/report/principles/Principles_Guide.pdf, a charitable organization should have a formally adopted, written code of ethics with which all of its directors or trustees, staff and volunteers are familiar and to which they adhere:

Adherence to the law provides a minimum standard for an organization's behavior. Each organization should also have a code of ethics that outlines the practices and behaviors that its staff, board, and volunteers agree to follow. The adoption of such a code, though not required by law, helps demonstrate the organization's commitment to carry out its responsibilities ethically

and effectively. The code should be built on the values that the organization embraces, and should highlight expectations of how those who work with the organization will conduct themselves in a number of areas, such as the confidentiality and respect that should be accorded to clients, consumers, donors, and fellow volunteers and board and staff members.

As stated by the Nonprofit Sector, the process by which a code of ethics is adopted and implemented can be just as important as the code itself. The board and staff should be active participants in developing, drafting, adopting, and implementing a code that fits the organization's characteristics. It should then be complemented by policies and procedures that describe how the principles in the code will be put into practice. For that reason, the code contained in Article IX of this form is included by way of example only and should not automatically be adopted as a component of a corporation's conflict of interest policy without appropriate board and staff review. This section and all internal references to an ethics policy are optional and can be deleted.

«⁴ As alluded to in Note 1, this policy may not be the only expression of the corporation's procedure for dealing with conflicts of interest. In addition to statutes that govern conflict of interest issues, it is not unusual for conflict of interest provisions to be contained in a corporation's bylaws, personnel policies, vendor policies, volunteer policies, grant contracts or in the contractor prerequisites of governmental agencies. This sentence serves as a reminder that potentially incompatible conflict of interest provisions must be reconciled in some manner, either by a provision such as this one or through the adoption of a more comprehensive policy that attempts to address all of the potential sources of conflict in a single document.

«⁵ The duty of loyalty requires a director to act in the interest of the corporation, rather than in the personal interest of the director or some other person or organization. In particular, the duty of loyalty requires a director to avoid conflicts of interest that are detrimental to the corporation. The IRS recommends that organizations adopt a written conflict of interest policy to address potential conflicts of interest involving their directors, officers, and other employees. The IRS defines a conflict of interest as arising when a person in a position of authority over an organization, such as an officer, director, or manager, may benefit financially from a decision he or she could make in such capacity, including indirect benefits such as to family members or businesses with which the person is closely associated. This policy defines a potentially Interested Person as a "director, manager, principal, officer, or member of a committee with governing board-delegated powers." This policy may be modified to apply in a more comprehensive manner, and if so, the corporation will need to determine the appropriate scope of coverage intended by this policy and amend this definition accordingly. If the policy is intended to cover persons who are also employees of the corporation, it will be necessary to determine whether they are subject to conflict of interest procedures described in the corporation's personnel policy, and to reconcile any incompatible provisions or reporting procedures.

«⁶ A conflict of interest policy must describe the corporation's procedure for managing a disclosed potential conflict of interest. The procedure begins with identification of the party to whom a potential conflict is reported, and the party that will determine if a conflict of interest requiring further management exists. This "screening" decision could be made by any individual or group of individuals that the corporation determines can render a disinterested opinion as to whether an actual conflict of interest exists, such as the Audit Committee, the Governance Committee, a sub-committee of the full board, members of the Executive Committee, or specific officers or committee chairs.

«⁷ This section identifies possible persons to whom a disclosure of a potential conflict of interest can be made. Each corporation adopting a conflict of interest policy will need to determine whether the persons named in this section are the appropriate parties to receive such disclosures. The person receiving disclosure of a potential conflict of interest need not be the person who will decide in the first instance whether an actual conflict exists.

«⁸ This section describes a procedure for evaluating whether a potential conflict is actual or material. Relevant factors might include:

- (a) the proximity of the person to the decision-making authority of the other entity involved in the transaction;
- (b) the amount of the financial interest or investment (i.e., is it truly *de minimis*?); and
- (c) the degree to which the person might benefit personally if a particular transaction were approved.

Additional guidance for the decision-makers may be added to this section, such as a dollar-based definition of materiality. If the corporation decides to include a code of ethics with this policy, then the provisions of the code will also serve to inform the decision-makers about whether the potential conflict is consistent with the ethical principles that serve as a framework for persons governed by this policy to measure their business conduct.

«⁹ Consider whether to include a specified dollar amount that will be considered *de minimis*.

«¹⁰ The statutory procedure for addressing a self dealing transaction of a director is separately stated in this policy because the margin for approval, the positive “vote of a majority of the directors in office,” is a higher standard than may otherwise be required in other conflict of interest contexts. (Compare with Section 5, where approval of a transaction between the corporation and an Interested Person can occur “by a majority vote of its disinterested members present at the meeting.”) If the corporation is willing to apply the higher standard to all transactions implicating a conflict of interest, then Sections 4 and 5 could be redrafted as a single procedure.

«¹¹ This provision may need to be modified to reflect the actual compensation policy of the corporation with respect to its directors. Many §501(c)(3) corporations make the policy determination that directors will not be compensated for services rendered to the corporation as directors, except that directors may be reimbursed for expenses incurred in the performance of their duties to the corporation, in reasonable amounts as approved by the board.

If directors are to be compensated for rendering services to the corporation in a capacity other than as directors, remember that not more than 49% of the persons serving as directors may be “interested persons” which, for this purpose only, means:

- (a) any person currently being compensated by the corporation for services rendered to it within the previous 12 months, whether as a full or part-time officer or other employee, independent contractor, or otherwise, excluding any reasonable compensation paid to a director as director; or
- (b) any brother, sister, ancestor, descendant, spouse, brother-in-law, sister-in-law, son-in-law, daughter-in-law, mother-in-law, or father-in-law of any such person.

[*Cal. Corp. Code § 5227(a)*]

«¹² To maintain its tax exemption under §501(c)(3) of the Code, the corporation must ensure that all compensation paid to any person, especially officers and other insiders, is reasonable and does not constitute a private benefit. Thus, as a best practice the board should establish procedures to ensure that all salaries paid are reasonable, such as setting salary ranges, or requiring the chief executive to set salaries based on comparable salaries paid by other corporations and share those comparables with the board.

⌞¹³ California charitable corporations must have their board (or an authorized board committee) review and approve the compensation of the chief executive officer or president, and the compensation of the chief financial officer or treasurer, to ensure that the payment is “just and reasonable.” [*Cal. Gov. Code § 12586(g)*]

⌞¹⁴ If the corporation decides not to include a code of ethics within its conflict of interest policy, this Article IX should be deleted in its entirety. References to “ethics,” “ethics policy,” “Code of Ethics” and “ethical question” will also need to be identified and deleted throughout the document.

⌞¹⁵ The law prohibits loans to directors and officers unless approved by the California Attorney General. There are a few limited exceptions to this rule, including for advancement of expenses, payment of life insurance premiums or a secured loan to help the director or officer finance the purchase of a principal residence (only if this is necessary to retain the director or officer’s services). [*Cal. Corp. Code § 5236(a)*]

⌞¹⁶ The format of this sample annual disclosure questionnaire is very short and simple, but squarely places the burden of understanding the nuances of the policy and appropriately disclosing potential conflicts of interest on the person who fills out the form. Some corporations trade brevity for the hope of a greater likelihood of relevant disclosure by leading the director, officer or other person with disclosure obligations through a long series of fill-in questions, such as “name any corporations (nonprofit and for-profit) of which you are a board member or officer,” “name any family members you believe present the potential for conflict of interest,” “identify persons with whom you have a business relationship who also transact business with this corporation.” The decision about which approach to follow often depends on the culture of the corporation and on which form most likely will be timely completed and turned in.

In addition to conflict of interest policy expectations for annual disclosure, the IRS Form 990 requires filing organizations to disclose certain relationships, arrangements and transactions involving conflicts of interest and independent decision-making by their governing bodies. Some nonprofit corporations view the annual conflict of interest questionnaire as an opportunity to gather required Form 990 information as well. The Form 990 disclosure requirements focus on the following three categories:

- (a) interested persons (i.e., those who may possess conflicts of interest);
- (b) independent directors (i.e., those who are independent of the corporation); and
- (c) relationships among directors, officers and key employees (i.e., transactions or relationships between two persons, rather than relationships with the corporation).

For more information, please refer to the Form 990 instructions, available at www.irs.gov/pub/irs-pdf/i990.pdf.

⌞¹⁷ “Family Member” is defined for the purpose of this disclosure questionnaire in Article II, Section 2 of the policy as “spouse, parent-in-law, ancestors, brothers and sisters (whether whole or half blood), children (whether natural or adopted), grandchildren, great-grandchildren, and spouses of brothers, sisters, children, grandchildren, and great-grandchildren.” This list is derived from the definition of “family member” referenced throughout the instructions to the IRS Form 990 in the context of questions about (i) whether an organization has made loans, grants or other financial assistance to certain “interested persons” directly or through family members, (ii) whether a director cannot be considered “independent” because of a family relationship and (iii) whether the organization has engaged in certain direct or indirect business transactions involving current or former directors, officers, managers or their family members.

ADDITIONAL MATERIALS AND INFORMATION

Public Counsel

- Conflict of Interest Policy (text): www.publiccounsel.org/tools/assets/files/Form-COI_policy.doc
- Form 990 Resources
 - o Annotated Form 990: www.publiccounsel.org/tools/publications/files/annotated990.pdf
 - o Whistleblower Policy: www.publiccounsel.org/tools/publications/files/wb_policy.pdf
 - o Records Management and Retention Policy:
www.publiccounsel.org/tools/publications/files/records_policy.pdf
- Annotated Form of Bylaws: www.publiccounsel.org/tools/publications/files/Annotated_Bylaws.pdf
- Turning The Tide: Public Counsel's Response to the Economic Crisis
 - o Information and Resources for Nonprofits:
www.publiccounsel.org/tools/materials/files/nonprofit.pdf
 - o Why Your Nonprofit May Need Legal Assistance:
www.publiccounsel.org/tools/materials/files/np_legal.pdf

Internal Revenue Service

- Form 990 (including filing tips and other resources): www.irs.gov/charities/article/0,,id=201398,00.html
- Mini-courses About the New Form 990: www.irs.gov/charities/article/0,,id=166625,00.html
- Tax Information for Charities: www.irs.gov/charities

California Attorney General

- Guide to Charities: <http://ag.ca.gov/charities/publications.php>
- Nonprofit Integrity Act FAQ: <http://ag.ca.gov/charities/faq.php#nonprofit>

FREE LEGAL ASSISTANCE

Public Counsel's Community Development Project provides free legal assistance to qualifying nonprofit organizations that share our mission of serving low-income communities and addressing issues of poverty within Los Angeles County. If your organization needs legal assistance, or to provide comments on this form, visit www.publiccounsel.org/practice_areas/community_development or call (213) 385-2977, extension 200.