

## ***Form 990 Policy Series***

The attached Memorandum is a part of the *Form 990 Policy Series*, developed by a group of lawyers, all members of the California bar and practicing nonprofit law (the “Form 990 Policy Series Group”). The *Form 990 Policy Series* includes Memoranda containing rationales and procedures for legal counsel to use in advising their clients on drafting and adopting appropriate policies responding to the new Form 990 as well as form policies and/or questionnaires.

The members of the Form 990 Policy Series Group with respect to the attached Memorandum (posted July, 2011) were as follows: Joel S. Corwin, Co-Chair; Barbara Rosen, Co-Chair; Elizabeth Bluestein; Lani Meanley Collins; the late Gerald A. Laster; Henry Lesser; Nancy McGlamery; Louis Michelson; Joy P. Paeske; Alicia Plerhoples; Lisa A. Runquist; Robert Siemer; Myron Steeves; Patrick Sternal; and Martin J. Trupiano. The views expressed in the Memoranda do not necessarily reflect the views of the law firms or employers at which these lawyers practice or any individual member of the Group.

The date at the top of the attached Memorandum is the date that the Memorandum was finalized, and the Memorandum may not reflect changes in law or practice since that date.

**FORM 990 POLICY SERIES  
MEMORANDUM**

**Re: Conflict of Interest Policy and Procedure – Part VI, Section B, Lines 12a, 12b, and 12c (Form 990 Policy Series Memo #2.1)**

**Date: January 16, 2011**

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**NOTE ON THE SCOPE OF THIS MATERIAL**

This material is designed to provide general guidance about an aspect of nonprofit corporate governance in the specific and limited context of the governance questions contained in the new IRS Form 990 (published by the IRS in 2008 and applicable to 990 filers based on a 2009-2011 filing year phase-in period depending on the size of the nonprofit). It is intended to provide some general guidance on the establishment of processes and/or policies to address a specific governance question in the Form. The subject matter of that question implicates a broad array of legal and practical issues ranging far beyond the immediate subject matter of the question itself. This material may address some of those issues but does NOT attempt to review them comprehensively and is NOT intended to be relied on for guidance on how they should be addressed in any specific situation.

Whether or not a nonprofit organization adopts a specific governance process or policy (or modifies an existing one), either in response to the disclosure requirements of the new IRS Form 990 or to change its governance practices for other reasons is a matter to be carefully considered by that organization, with input from its board and advisors and evaluation of its specific circumstances. The IRS has explicitly stated that adoption of the policies and practices about which the new Form 990 asks is not mandatory, although the IRS has also indicated that it attaches significance to the manner in which all tax-exempt nonprofit organizations govern themselves. The inclusion of a sample policy in this material is not intended to suggest that the policy is appropriate for every nonprofit organization nor that, if a policy on that topic is determined to be appropriate, the formulation in the sample necessarily fits the needs of an individual nonprofit organization. A customized approach, with outside professional advice, is recommended. Accordingly, this material is intended as general information for legal practitioners advising nonprofit organizations as to their governance and does not constitute legal advice for any particular nonprofit organization.

Although the subject matter of this material may have relevance to nonprofit organizations that are not required to file informational tax returns with the IRS or are permitted to file on an IRS form other than Form 990, the focus of this material is 990 filers. While this material is meant to apply to Form 990 filers who are exempt under Section 501(c) of the Internal Revenue Code, certain portions of this material may be applicable only to Section 501(c)(3) organizations. In addition, although this material may be of assistance with respect to nonprofit organizations that are not subject to oversight under California law, there may be portions of this material that are relevant only to nonprofits organized under, or (by reason of their California-related activities) otherwise subject to, California law and, except as specifically discussed in this material, the laws of other States are not addressed.

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**1. Summary**

A conflict of interest policy that is appropriately attentive to the new Form 990, federal and state law, and the needs of an organization, will permit the organization to answer “Yes” to the relevant questions in the new form. It can also, if consistently applied, prevent potential violations of federal tax and state corporate law and inspire public, donor, and member confidence in the organization.

## 2. Rationale for Adoption of the Policy

There are practical and legal reasons for adopting a conflict of interest policy. Prior to the revision of the Form 990, organizations had written conflict of interest policies in order to preserve the confidence of the public, their members (if any), and both existing and potential donors (if any), provide a road map to directors and officers regarding the relevant law governing insider transactions, and alert those covered by the policy that their dealings with the organization were subject to internal scrutiny. To these reasons, which continue to be valid, the Service has added another: The new Form 990 now asks in Part VI.B, Line 12, whether the organization has a written conflict of interest policy (Line 12a), whether officers, directors, and key employees<sup>1</sup> are required to disclose annually interests that could give rise to conflicts (Line 12b), and whether the organization regularly and consistently monitors and enforces compliance with the policy (Line 12c). The Service has stated that the absence of a conflict of interest policy will not by itself place an organization at risk for audit; however, an answer of “No” on any of Lines 12a, b, and c, if coincident with other evidence of insider transactions (*e.g.*, leases between the organization and one or more of its disqualified persons) may increase an organization’s audit risk.

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<sup>1</sup> The new Form 990 introduced the concept of “key employee.” A key employee is defined in the Glossary in the Instructions to Form 990 as follows:

For purposes of Form 990 reporting, an employee of the organization (other than an officer, director, or trustee) who meets **all three** of the following tests:

1. \$150,000 Test. Receives reportable compensation from the organization and all related organizations in excess of \$150,000 for the calendar year ending with or within the organization’s tax year.

2. Responsibility Test. The employee:

a. has responsibilities, powers or influence over the organization as a whole similar to those of officers, directors, or trustees;

b. manages a discrete segment or activity of the organization that represents 10% or more of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole;

c. or has or shares authority to control or determine 10% or more of the organization’s capital expenditures, operating budget, or compensation for employees.

3. Top 20 Test. Is one of the 20 employees (that satisfy the \$150,000 Test and Responsibility Test) with the highest reportable compensation from the organization and related organizations for the calendar year ending with or within the organization’s tax year.

A “related organization” as used in the definition of “key employee” is an organization with one or more of the following relationships to the organization filing the return:

- Parent: an organization that controls...the filing organization.
- Subsidiary: an organization controlled...by the filing organization.
- Brother/Sister: an organization controlled...by the same person or persons that control the filing organization.
- Supporting/Supported: an organization that is (or claims to be) at any time during the organization’s tax year (i) a supporting organization of the filing organization within the meaning of section 509(a)(3), if the filing organization is a supported

A 2005 Urban Institute Center on Nonprofits and Philanthropy Study, quoted by the Service in a May 2009 training session for Exempt Organizations agents and managers,<sup>2</sup> indicated that half of the 5,100 nonprofits surveyed had a conflict of interest policy; 29% required disclosure of financial interests. The June 2007 Nonprofit Governance Index from BoardSource, quoted in the same CPE training materials, found that 88% of the 2,152 public charities and private foundations surveyed (80% of which were public charities) had a conflict of interest policy. These two data points suggest that adoption and maintenance of conflict of interest policies were on the rise before the Service revised the new Form 990.

The Form 990 glossary defines “conflict of interest policy” as follows:

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.<sup>3</sup>

### **3. Background of Requirements/Sources for the Policy**

#### *A. All Form 990 Filers.*

The Service has acknowledged frequently and publicly that it has no statutory or regulatory authority to require an exempt organization to adopt a written conflict of interest policy. In its 2009 Continuing Professional Education training on Governance and Exempt Organizations, the Service articulated its interest in conflict of interest and other governance policies as follows:

If Governance Policies Are Not Required, Why Do We Ask About Them?

- Does the existence of a policy assure good behavior and compliance? Of course not.

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organization within the meaning of section 509(f)(3); (ii) or a supported organization, if the filing organization is a supporting organization.

<sup>2</sup> 2009 CPE Training on Governance and Tax-Exempt Organizations (hereinafter “2009 CPE Training”), slide 53.

<sup>3</sup> 2008 Form 990, Instructions, 43 (“Conflict of interest policy”).

- But having policies in place should provide the framework which an organization’s directors, officers, employees and volunteers may use to address issues that arise
- Written policies generally clearer than verbal
- But policies are not enough: they are only effective if they are used and followed<sup>4</sup>

*B. All Code Section 501(c)(3) Public Charities*

Though the Service had not, prior to the revised Form 990, asked organizations to declare on their annual returns whether they had a written conflict of interest policy, the question is neither new nor of recent interest to the Service. Since its revision in 2004, the Form 1023 Application for Recognition of Exemption has asked applicants for exemption under Code Section 501(c)(3) to disclose both (1) if their compensation arrangements will follow a conflict of interest policy and (2) if they have adopted a conflict of interest policy consistent with the sample policy included in the instructions to the Form 1023 (also included in Section 5 of this memorandum). In addition, the Service has historically encouraged organizations to adopt conflict of interest policies in less formal guidance. In a subsection of its online resource, “Life Cycle of a Public Charity,” first published in 2004, the Service offers this exegesis on conflicts of interest:

The directors of a charity owe it a duty of loyalty. The duty of loyalty requires a director to act in the interest of the charity 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 charity. . . . The Internal Revenue Service encourages a charity’s board of directors to adopt and regularly evaluate a written conflict of interest policy that requires directors and staff to act solely in the interests of the charity without regard for personal interests; includes written procedures for determining whether a relationship, financial interest, or business affiliation results in a conflict of interest; and prescribes a course of action in the event a conflict of interest is identified. The Internal Revenue Service encourages organizations to require its directors, trustees, officers, and others covered by the policy to disclose, in writing, on a periodic basis any known financial interest that the individual, or a member of the individual’s family, has in any business entity that transacts business with the charity. The organization should regularly and consistently monitor and enforce compliance with the conflict of interest policy.<sup>5</sup>

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<sup>4</sup> 2009 CPE Training.

<sup>5</sup> *Life Cycle of a Public Charity*, Starting Out / Organizing Documents / Sample Organizing Documents / Governance and related topics / “Governance and Management Policies” (posted February 4, 2008), at [http://www.irs.gov/pub/irs-tege/governance\\_practices.pdf](http://www.irs.gov/pub/irs-tege/governance_practices.pdf) (Section 4.B), last visited August 30, 2009.

Although the Service has no authority to require an organization to adopt a written conflict of interest policy or to require its officers, directors, and key employees to submit annual written disclosure of potential conflicts, there are several legal obligations imposed by both federal tax and state corporate statutes that a well-crafted conflict of interest policy may address.

*C. Code Section 501(c)(3) Public Charities and 501(c)(4) Social Welfare Organizations: Internal Revenue Code Section 4958.* Code Section 4958 is applicable to Code Section 501(c)(3) public charities and 501(c)(4) social welfare organizations; it does not apply to other exempt entities. Code Section 4958 imposes an excise tax on “excess benefit transactions” between an applicable tax-exempt organization and “disqualified persons” to the exempt organization. Excess benefit transactions are defined as transactions in which an excess economic benefit is provided by the exempt organization to a disqualified person. “Excess benefit” means a benefit provided by an applicable tax-exempt organization “directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.”<sup>6</sup> Disqualified persons who receive the benefit, as well as the officers and directors (and persons with duties similar to that of officers and directors) who knowingly participated in the transaction, may be liable for excise taxes: 25% on the benefiting disqualified persons and 10% on the organization managers (there are additional penalties of 200% of the excess benefit on the disqualified person if the transaction is not corrected within a specified period).

“Disqualified person” is defined in Code Section 4958(f)(1) and related Treasury Regulations; this definition is unique to Code Section 4958 and differs from the definition of “disqualified person” in other sections of the Code. Disqualified persons are persons who are, or in the previous five years have been, in a position to exercise substantial influence over the organization’s affairs. The following persons are deemed to have substantial influence: each member of the board of directors; the president, chief executive officer, chief operating officer, treasurer, and chief financial officer, regardless of title (directors and such officers, “Insiders”); the spouses, ancestors, children, grandchildren, great-grandchildren, brothers, and sisters (whether by whole or half blood) of Insiders, and the spouses of any of the foregoing relatives of Insiders (collectively, “Family Members”); and any entity in which Insiders and Family Members hold more than 35 percent of the control (“Controlled Entities”). For a corporation, control means more than 35 percent of the total combined voting power; for a partnership it means more than 35 percent of the profits interest; and for a trust it means more than 35 percent of the beneficial interest. In addition, the Board may determine that other persons are Insiders because they exercise substantial influence over the charity’s activities based on facts and circumstances described in Treasury Regulations. Such persons could include the founder of the organization, a substantial contributor to the organization, a person with managerial authority over the organization, or a person with control over a significant portion of the organization’s budget. In addition to the disqualified persons described above, a charity supported by a Code Section 509(a)(3) supporting organization will have

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<sup>6</sup> Code §4958(c)(1)(B).

additional disqualified persons under Code Section 4958. All Code Section 501(c)(3) entities and certain Code Section 501(c)(4) organizations are excluded from the definition of disqualified persons.

Section 4958 and the applicable Treasury Regulations set forth procedures an organization can employ in order to reduce the likelihood that a transaction between the organization and a disqualified person will be considered an excess benefit transaction. These procedures, if followed correctly, in advance of entering into a transaction with a disqualified person, secure a rebuttable presumption that the transaction is reasonable and therefore not an excess benefit transaction.

A conflict of interest policy does not have to address excess benefit transactions and rebuttable presumption procedures, but many Code Section 501(c)(3) and 501(c)(4) organizations choose to incorporate these concepts into their conflict of interest policies in order to identify and deal with transactions that could result in Code Section 4958 excise taxes – and those transactions that must be reported on Form 990, regardless of whether the benefits are reasonable or excessive. Form 990, Part IV, Lines 25a and 25b, ask organizations to state whether they have entered into any excess benefit transaction within the tax year (or within prior years). Other questions (including Lines 26 (regarding loans), 27 (grants), 28 (business relationships)) ask whether the organization has entered into certain types of transactions with Insiders and Family Members, regardless of whether such transactions provided excess benefits to a disqualified person. If an organization answers Yes to any of these questions, it must complete Schedule L. In addition, Part IX, Line 6, asks organizations to separately state compensation paid to disqualified persons (as defined in Code Section 4958) other than directors, officers, and key employees. A conflict of interest policy that flags all of these types of transactions as they arise will permit the organization to answer these Form 990 questions fully and truthfully.

*D. California Public Benefit Corporations and Mutual Benefit Corporations Holding Assets in Charitable Trust: California Corporations Code Section 5233.* In California, Section 5233 of the Corporations Code (“CCC”) governs financial conflict of interest transactions of nonprofit public benefit corporations, and by virtue of CCC Section 7238, mutual benefit corporations holding assets in charitable trust. CCC Section 5233 prescribes a very specific set of procedures which must be followed if a director has a material financial interest in a transaction of a charity. This law only applies to transactions with directors, while federal tax law also addresses transactions with other insiders. Both California law and federal law reach direct transactions, such as when a charity employs one of its directors, and also indirect transactions, such as the charity’s purchase of goods or services from a firm partially owned by a director. Such transactions are termed *self-dealing transactions*.

A self-dealing transaction, under California law, is a transaction to which the public benefit corporation is a party and in which one or more directors has a material financial interest. The Attorney General and certain other persons are authorized to bring suit under CCC Section 5233 alleging a self-dealing transaction, but a director will not be

liable if *all* of the following conditions can be proved; such proof is generally dependent upon contemporary written documentation of the following facts:

- The charity entered into the transaction for its own benefit; and
- The transaction was fair and reasonable to the charity at the time it entered into the transaction; and
- *Before* consummating the transaction or any part of it, all material facts regarding the transaction and the director's interest in it were disclosed to the board of directors; and
- Prior to authorizing or approving the transaction, a majority of the disinterested directors then in office (without counting the vote of the financially interested director(s)) determined, after reasonable inquiry in the circumstances, that the charity could not have obtained a better arrangement with reasonable effort, and formally approved the transaction in good faith.<sup>7</sup>

An organization's conflict of interest policy can incorporate these procedures for transactions with directors in order to avoid director liability for self-dealing transactions.

*E. California Mutual Benefit Corporations: California Corporations Code Section 7233(a).* In California, CCC Section 7233(a) governs financial conflict of interest transactions of nonprofit mutual benefit corporations. A contract or other transaction between a mutual benefit corporation and one or more of its directors (or entities in which one or more of its directors has a material financial interest), will not be void or voidable as long as at least one of the following is true:

- All material facts regarding the transaction and the director's interest in it are disclosed to the members and the transaction is approved by the members in good faith, with any membership owned by any interested director not being entitled to vote on the transaction; or
- All material facts regarding the transaction and the director's interest in it are disclosed to the board or committee approving the transaction, and the board or committee authorizes, approves or ratifies the transaction in good faith by a vote sufficient without counting the vote of the interested director(s), and the transaction was just and reasonable as to the corporation at the time it was authorized, approved, or ratified; or
- The person asserting the validity of the transaction sustains the burden of proving that the transaction was just and reasonable as to the corporation at the time it was authorized, approved, or ratified.

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<sup>7</sup> The statute also provides for approval by the Attorney General or by a committee of the Board as an alternative procedure. Cal. Corp. Code §5233(d)(3).



An organization's conflict of interest policy can incorporate these procedures for transactions with directors in order to help avoid director liability for transactions with interested directors.

*F. California Religious Corporations: California Corporations Code Section 9243.* In California, CCC Section 9243 governs financial conflict of interest transactions of nonprofit religious corporations. CCC Section 9243 is very similar to Section 5233 and prescribes a very specific set of procedures which must be followed if a director has a material financial interest in a transaction of the religious corporation. One distinction between CCC Sections 5233 and 9243 is that the religious corporation may take into account its religious purposes when determining the fairness and reasonableness of the transaction. As with Section 5233, Section 9243 only applies to transactions with directors, while federal tax law also addresses transactions with other insiders. Both California law and federal law reach direct transactions, such as when a corporation employs one of its directors, and also indirect transactions, such as the religious corporation's purchase of goods or services from a firm partially owned by a director.

A California religious corporation's members, directors, officers, and certain other persons are authorized to bring suit under CCC Section 9243 (but notably *not* the Attorney General; see also CCC Section 9230 regarding the Attorney General's limited enforcement powers with regard to religious corporations) alleging a self-dealing transaction, but a director will not be liable if *all* of the following conditions referred to in CCC Section 9243 can be proved (such proof is generally dependent upon contemporary written documentation):

- The corporation entered into the transaction for its own benefit or for the benefit of the religious organization; and
- The transaction was fair and reasonable to the corporation, or was in furtherance of its religious purposes, at the time the corporation entered into the transaction; and
- *Before* consummating the transaction or any part of it, all material facts regarding the transaction and the director's interest in it were disclosed to the board of directors; and
- Prior to authorizing or approving the transaction, a majority of the disinterested directors then in office (without counting the vote of the financially interested director(s)) determined, after reasonable inquiry in the circumstances, that the corporation could not have obtained a better arrangement with reasonable effort, and formally approved the transaction in good faith.<sup>8</sup>

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<sup>8</sup> The statute also provides for approval by the Attorney General or by a committee of the Board as an alternative procedure. Cal. Corp. Code §5233(d)(3) and §9243(d). With respect to the first bullet above, it is not clear what "religious organization" is being referenced in the statute. It may, for example, refer to a larger religious organization with which the corporation is affiliated. If there is another such organization, counsel should consider whether the conflict of interest policy should specifically refer to such religious organization whose benefit may also be taken into account in the policy.

An organization's conflict of interest policy can incorporate these procedures for transactions with directors in order to help avoid director liability for potential self-dealing transactions.

*G. California Public Benefit, Mutual Benefit, and Religious Corporations: California Corporations Code Sections 5234, 7233(b), and 9244.* In California, CCC Section 5234 governs transactions between a nonprofit public benefit corporation and another organization with which it has an overlapping director or directors. CCC Section 7233(b) governs such transactions between a mutual benefit corporation and another organization with which it has an overlapping director or directors. CCC Section 9244 governs such transactions between religious corporations and another organization with which it shares one or more directors. Under CCC Sections 5234, 7233(b), and 9244, the transaction between the nonprofit corporation and the other entity will not be void or voidable because the overlapping director or directors are present at the approval, authorization, or ratification of the transaction, as long as one of the following is true:

- The material facts as to the transaction and the director's other directorship were fully disclosed or known to the board or committee, and the board or committee authorized, approved, or ratified the transaction in good faith by a vote sufficient without counting the vote of the overlapping director(s) (or, as to a mutual benefit corporation, alternatively, if approved by the members under CCC Section 5034); or
- The transaction was just and reasonable to the nonprofit corporation at the time it was authorized, approved, or ratified. In determining whether the transaction is just and reasonable, Section 9244(a)(2) provides that a religious corporation may take into account its religious purposes.

#### **4. Considerations and Procedures for Implementation of the Policy**

In addition to consideration of the statutory provisions discussed above in Section 3, an organization should consider many variables when reviewing its existing policy or drafting a new one. Each of the three primary sources for crafting a conflict of interest policy that we have identified above – the Form 990, Internal Revenue Code Section 4958, and CCC Sections 5233, 5234, 7233, 9243, and 9244 – defines the relevant insiders, insider transactions, and arbiters differently from one another. We have summarized these differences in the following table:

	<u>Form 990</u>	<u>Internal Revenue Code</u>	<u>California Corporations Code</u>	
<i>Source</i>	<ul style="list-style-type: none"> <li>Part VI, Lines 12a-c</li> <li>Instructions to Part VI, Lines 12a-c</li> <li>Glossary to Instructions</li> </ul>	Section 4958 and related Treasury Regulations	Section 5233 (public benefit) Section 7233(a) (mutual benefit) Section 9243 (religious)	Section 5234 (public benefit) Section 7233(b) (mutual benefit) Section 9244 (religious)
<i>Relevant Parties</i>	<ul style="list-style-type: none"> <li>Scope of policy not specified.</li> <li>Definition of “conflict of interest policy” suggests that policies should cover conflicts with any “person in a position of authority over an organization, such as an <b>officer, director, or manager,</b>” and “<b>family members or businesses with which the person is closely associated.</b>”</li> <li>Part VI, Line 12b asks about annual disclosure of potential conflicts from “<b>officers, directors, trustees, and key employees, and those of family members.</b>”</li> </ul>	“Disqualified persons” (i.e., “Insiders” and “Family Members” as defined in Section 2, above)	Directors only (Section 5233)  Directors and related corporations (Section 7233(a))  Directors only (Section 9243)	Directors and related corporations
<i>Type of Interest/ Transaction</i>	Definition of conflict of interest policy suggests that only “material financial interest[s]” are relevant.	“Economic benefit” (which may or may not be an excess benefit)	Transaction in which director has a “material financial interest” (Section 5233 and Section 9243)  Transaction between corporation and director <u>OR</u> between corporation and entity in which director has a material financial interest (Section 7233)	Transactions between corporations with common directors
<i>Arbiter of Conflicts</i>	<ul style="list-style-type: none"> <li>None specified.</li> <li>Lines 12a and 12c ask about the policy and procedures of “the organization.”</li> </ul>	“Authorized body,” which may be the board of directors (minus the disqualified persons) or a body designated by the board that can (under applicable state law) act with the power of the board of directors	The board of directors (minus the interested directors) for public benefit, religious, and mutual benefit corporations <u>OR</u> the members or a committee for mutual benefit corporations (minus the interested directors or membership owned by interested directors)  Alternatively, for public benefit and religious corporations, a committee or person authorized by the board of directors may approve the transaction in advance if it was not reasonably practicable for the board to approve prior to the transaction, subject to the board’s later ratification of the transaction. (5233(d)(3), 9243(d)(4))  In part because of the limited oversight by the Attorney General, for religious corporations, approval or ratification may also be by the members (9243(d)(2)).	The board of directors or committee (minus the overlapping directors) for public benefit, religious, and mutual benefit corporations (or the members, for mutual benefit corporations)
<i>Penalty for Engaging in Conflict of Interest Transaction</i>	None specified; also no stated penalty for “No” answers to Lines 12a-c.	<ul style="list-style-type: none"> <li>On disqualified person: 25% of excess benefit</li> <li>On organization managers who knowingly participated in transaction: 10% of excess benefit</li> <li>On disqualified</li> </ul>	Interested director may be liable to corporation for damages.  Contract or transaction may be void or voidable if procedures not followed.	Contract or transaction may be void or voidable if procedures not followed.

		person who fails to correct transaction within specified period: additional 200% of excess benefit		
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In each of these categories – persons covered, types of interest and transactions covered, and the arbiter of conflicts – an organization may make choices in crafting its conflict of interest policy in order to make its internal policy broader or more narrow than the requirements set forth in the Form 990, the Internal Revenue Code, and the California Corporations Code.

Persons Covered. It is difficult to imagine an effective conflict of interest policy that does not cover directors (or persons meeting the definition of “director” under state corporate law, regardless of title). A conflict of interest policy that addresses only California state law requirements might limit its scope to directors, but most conflict of interest policies for public charities and social welfare organizations will cover at least those persons considered disqualified persons under Code Section 4958.

Beyond these basic categories, there are several different possibilities. The new Part VI, Line 12b, which asks whether the organization obtains annual disclosures of potential interests from officers, directors, trustees, and *key employees*, has created a new category of “key employees.” Although Line 12b only addresses annual disclosures of potential interests, an organization may wish for its conflict of interest policy to cover key employees on par with directors and officers. Alternatively, the conflict of interest policy could include an annual disclosure requirement for key employees but not include key employees within the scope of the entire policy (*e.g.*, only include current key employees and not those within the five year look back period).

An organization may wish not to address categories of persons whose conflicts of interest are not addressed in state corporate or federal tax law, or the organization may wish to impose different procedures for some such persons. For example, employees who are not disqualified persons under Code Section 4958, and are not “key employees” under the definition in Form 990, may have conflicts that, if not managed, could undermine public confidence in the organization. A school may wish to impose special conflict of interest rules on its teachers; a hospital on its doctors, etc. There is no statutory guidance for appropriate rules and procedures for such categories of persons; an organization will be guided by its individual circumstances and its board’s tolerance for risk and complexity.

Types of Interests and Transactions Covered. The definition of conflict of interest in the Instructions to Form 990 specifies that “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.” Indeed, many conflict of interest policies limit their scope only to material financial interests. The scope of an organization’s policy will depend only in part on the legal obligations applicable to it.

Other organizations wish to go beyond their legal obligations and address other types of conflicts that could impact the fiduciary duties of care and loyalty of their directors, officers, and employees, or that could undermine public confidence in the organization, such as conflicting corporate opportunities, service on the boards of directors of grantees and affiliated organizations, significant investments (not otherwise rising to the 35% threshold), etc.

When considering how broad the policy should be, one must consider how the conflict of interest policy intersects with the organization's compensation policy (if any) and with the Form 990 questions and definitions concerning independence of the governing body and business and family relationships. Some organizations may combine these issues into one policy. However, even though the review and approval of compensation can give rise to conflicts of interest and questions of independence of the governing body and business and family relationships, in some organizations there may be no risk of such conflicts, for example because the person whose compensation is being determined (such as the Executive Director) is not on the Board and does not have a family or business relationship with any Board member. While the purpose of a compensation policy is to create a process to set reasonable compensation for insiders, the purpose of a conflict of interest policy is to address conflicts arising from transactions between the organization and both insiders and persons related to insiders by family or business relationships. The independent governing body and business and family relationships questions on the Form 990 are intended to assist the organization to identify the relationships that could affect the decision making process of members of the governing body and other insiders. Accordingly, when working in any one or more of these areas – compensation, conflict of interest, independent members of the governing body, and business and family relationships – an organization should consider its exposures in the other areas as well. The Form 990 Policy Series, of which this Memorandum is a part, has memoranda addressing each perspective. Before finalizing a policy or questionnaire that addresses compensation, conflicts of interest, independence of the governing body and business and family relationships, it is recommended that the memorandum for each topic be carefully reviewed.

Arbiter of Conflicts. The organization's board of directors may be a suitable arbiter of potential conflicts for many organizations. Organizations may wish to vest the authority to investigate and review potential conflicts in a committee or a staff person. Ultimate review and approval of potential transactions should ideally be accomplished by the board of directors (minus the interested directors). However, in Code Section 501(c)(3) and 501(c)(4) organizations, if convening the board is not practicable, a committee that meets the definition of "authorized body" under Code Section 4958 may review and approve the transaction pursuant to the policy's procedures. If the intent of the policy is to follow the procedures outlined in CCC Section 5233 (applicable to nonprofit public benefit corporations and mutual benefit corporations holding assets in charitable trust), or Section 9243 (applicable to religious corporations), such committee approval must be followed by ratification of the board at its next meeting. As discussed above, a conflict of interest policy may cover more types of conflicts and categories of persons than are addressed in federal tax and state corporate law. A nonprofit

organization, whether public, mutual benefit or religious, and whether charitable or otherwise, may wish to delegate to a committee (composed of directors or non-directors) or one or more staff persons the review and assessment of potential conflicts of interest with individuals who are not necessarily disqualified persons under Code Section 4958.

## 5. Sample Policies

A. *Sample Policy A: California Public Benefit or Religious Corporations; Narrow Range of Covered Persons; Broad Range of Covered Interests; Annual Disclosure of Potential Conflicts of Interest.* The following policy includes a conflict of interest policy intended for a California nonprofit public benefit or religious corporation exempt from federal income tax under Code Section 501(c)(3), an annual acknowledgment form, and an annual disclosure of interests that could give rise to a conflict of interest. The policy reflects the following choices:

1. Narrow Range of Covered Persons. The policy is **narrow** in terms of covered persons; it applies to officers, directors, and key employees **ONLY**. It does not cover all insiders that are disqualified persons under Code Section 4958, and it does cover key employees using the definition from the Form 990 Instructions (which is not part of Code Section 4958). This range of coverage may be appropriate for an organization that wishes to have in place a conflict of policy that meets the minimum requirements necessary to answer “Yes” to Lines 12a-c of Part VI.B, or an organization that wishes to have a separate conflict of interest policy that meets allows it to answer “Yes” to these questions, and separate policies that set forth the policy and procedure for dealing with the conflicts of interests of other persons.

2. Broad Range of Covered Interests. The policy is broad in scope; it applies broadly to all interests potentially affecting a person’s judgment, not just financial and not just those regulated by federal tax law or state corporate law. Some organizations will prefer a narrower scope, focusing only on interests and transactions that are regulated by law.

3. Covered Transactions and Relationships. While the policy is designed to pick up many transactions and relationships to be disclosed on Form 990, it may not reach all of them. An organization may need a more detailed disclosure form to collect all the information requested on other parts of current or future versions of Form 990.

4. Disclosure of Family Relationships. The form limits disclosure of family members to those presenting a specific potential conflict. Please be aware that the IRS **may** want names of all listed relatives. Be aware that, pending clarification by the IRS, not listing all relatives may not be sufficient disclosure to answer “Yes” to Part VI.B, Line12c.

5. Prior Transactions Not Addressed. This policy does not address the approval process for past transactions that have already occurred or commenced.

6. Statutory Compliance Not Guaranteed. Compliance with this sample policy *does not guarantee compliance* with Code Section 4958 or other applicable rules of law, including California state corporate law.

7. The Board of Directors as Arbiter of Conflicts. This sample policy assumes that the Board of Directors will be the arbiter of conflicts, and not a committee of the Board or, in the case of religious corporations, the members.

*(Sample Policy A continued on next page)*

## [NAME OF ORGANIZATION]

### CONFLICT OF INTEREST POLICY<sup>9</sup>

#### Article I: Purpose

This conflict of interest policy is designed to foster public confidence in the integrity of [Name of Organization] (the “Organization”) and to protect the Organization’s interest when it is contemplating entering a transaction (defined below) that might benefit the private interest of a director, a corporate officer, the top management or top financial official, or a key employee (defined below). [Note to Organization: Compliance with this Sample Policy A will not insure compliance with Code Section 4958 or CCC Section 5233 or 9243. Although the range of interests covered by this policy may be broader than those covered by law, the range of covered persons is more narrow. Additional procedures may apply to transactions covered by Code Section 4958 or CCC Section 5233 or 9243.]

#### Article II: Definitions

The following are considered *insiders* for the purposes of this policy:

1. Each member of the Board of Directors or other governing body.
2. The president, chief executive officer, chief operating officer, treasurer and chief financial officer, executive director, or any person with the responsibilities of any of these positions (whether or not the person is an officer of the Organization under the Organization’s Bylaws and the California Corporations Code).
3. Any *key employee*, meaning an employee whose total annual compensation (including benefits) from the organization and its affiliates is more than \$150,000 **and** who (a) has responsibilities or influence over the organization similar to that of officers, directors, or trustees; **or** (b) manages a program that represents 10% or more of the activities, assets, income, or expenses of the organization; **or** (c) has or shares authority to control 10% or more of the organization’s capital expenditures, operating budget, or compensation for employees.

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<sup>9</sup> Note that this Conflict of Interest Policy does not assume the existence of a separate Compensation Policy. Compensation paid to insiders, including for their service as directors, officers, and key employees, should be evaluated under this Policy in its current form. If an organization has a separate Compensation Policy that addresses such compensation decisions, this sample policy may be modified accordingly.



*Interest* means any commitment, investment, relationship, obligation, or involvement, financial or otherwise, direct or indirect, that may influence a person's judgment, including receipt of compensation from the Organization, a sale, loan, or exchange transaction with the Organization.

A *conflict of interest* is present when, in the judgment of the Board of Directors, an insider's stake in the transaction is such that it reduces the likelihood that an insider's influence can be exercised impartially in the best interests of the Organization.

*Transaction* means any transaction, agreement, or arrangement between an insider and the Organization, or between the Organization and any third party where an insider has an interest in the transaction or any party to it. **[Note to Organization: If the Organization has a separate Compensation Policy that addresses the receipt of compensation by an insider in his or her capacity as an insider (e.g., compensation paid to the President for her services to the Organization as its President), please include the following sentence: "*Transaction* does not include compensation arrangements between the Organization and a director, officer, or other insider that are wholly addressed under the Organization's Compensation Policy."]**

### **Article III: Procedures**

#### *1. Duty to Disclose*

Each insider shall disclose to the Board all material facts regarding his or her interest in the transaction, promptly upon learning of the proposed transaction.

#### *2. Determining Whether a Conflict of Interest Exists*

With regard to an insider, the Board shall determine if a conflict of interest exists. The insider(s) and any other interested person(s) involved with the transaction shall not be present during the Board's discussion or determination of whether a conflict of interest exists, except as provided in Article IV below.

#### *3. Procedures for Addressing a Conflict of Interest*

The Board shall follow the procedures set forth in Article IV in order to decide what measures are needed to protect the Organization's interests in light of the nature and seriousness of the conflict, to decide whether to enter into the transaction and, if so, to ensure that the terms of the transaction are appropriate.

#### **Article IV: Review by the Board**

The Board may ask questions of and receive presentation(s) from the insider(s) and any other interested person(s), but shall deliberate and vote on the transaction in their absence. The Board shall ascertain that all material facts regarding the transaction and the insider's conflict of interest have been disclosed to the Board and shall compile appropriate data, such as comparability studies, to determine fair market value for the transaction.

After exercising due diligence, which may include investigating alternatives that present no conflict, the Board shall determine whether the transaction is in the Organization's best interest, for its own benefit, and whether it is fair and reasonable to the Organization; the majority of disinterested members of the Board then in office may approve the transaction.

#### **Article V: Records of Proceedings**

The minutes of any meeting of the Board pursuant to this policy shall contain the name of each insider who disclosed or was otherwise determined to have an interest in a transaction; the nature of the interest and whether it was determined to constitute a conflict of interest; any alternative transactions considered; the members of the Board who were present during the deliberations on the transaction, those who voted on it, and to what extent interested persons were excluded from the deliberations; any comparability data or other information obtained and relied upon by the Board and how the information was obtained; and the result of the vote, including, if applicable, the terms of the transaction that was approved and the date it was approved.

#### **Article VI: Annual Disclosure and Compliance Statements**

Each director, each corporate officer, the top management official, the top financial official, and each key employee of the Organization, shall annually sign a statement on the form attached, that:

- affirms that the person has received a copy of this conflict of interest policy, has read and understood the policy, and has agreed to comply with the policy; and
- discloses the person's financial interests and family relationships that could give rise to conflicts of interest.

#### **Article VII: Violations**

If the Board has reasonable cause to believe that an insider of the Organization has failed to disclose actual or possible conflicts of interest, including those arising from a transaction with a related interested person, it shall

inform such insider of the basis for this belief and afford the insider an opportunity to explain the alleged failure to disclose. If, after hearing the insider's response and making further investigation as warranted by the circumstances, the Board determines that the insider has failed to disclose an actual or possible conflict of interest, the Board shall take appropriate disciplinary and corrective action.

### **Article VIII: Annual Reviews**

To ensure that the Organization operates in a manner consistent with its status as an organization exempt from federal income tax, the Board shall authorize and oversee an annual review of the administration of this conflict of interest policy. The review may be written or oral. The review shall consider the level of compliance with the policy, the continuing suitability of the policy, and whether the policy should be modified and improved.

*(Sample Policy A continued on next page)*

**[NAME OF ORGANIZATION]**

**CONFLICT OF INTEREST POLICY:  
ACKNOWLEDGMENT AND FINANCIAL INTEREST DISCLOSURE  
STATEMENT**

[Name of Organization] (the “Organization”) follows a conflict of interest policy designed to foster public confidence in our integrity and to protect our interest when we are contemplating entering a transaction or arrangement that might benefit the private interest of a director, a corporate officer, our top management official and top financial official, or any of our key employees.

**Part I. Acknowledgment of Receipt**

I hereby acknowledge that I have received a copy of the conflict of interest policy of [Name], have read and understood it, and agree to comply with its terms.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Printed Name

*(Sample Policy A continued on next page)*

**Part II. Disclosure of Financial Interests**

We are required annually to file Form 990 with the Internal Revenue Service, and the form we file is available to the public. To complete Form 990 fully and accurately, we need each officer, director and key employee to disclose the information requested in this Part II.

A “conflict of interest,” for purposes of Form 990, arises when a person in a position of authority over an organization, such as an officer, director, or key employee, 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.

**Part II** Please check ONE of the following boxes:

My interests and relationships have not changed since my last disclosure of interests. [Proceed to signature block below. Do not complete the tables.]

**OR**

I hereby disclose or update my interests and relationships that could give rise to a conflict of interest: [Complete the table below. Use additional pages as needed.]

Family Relationships	Names of those presenting a potential conflict of interest
Include spouse/domestic partner, living ancestors, brothers and sisters (whether whole or half blood), children (whether natural or adopted), grandchildren, great grand-children, and spouses/ domestic partners of brothers, sisters, children, grandchildren, and great grandchildren	

Type of interest	Description of interest that could lead to a conflict of interest
Transactions or arrangements with the Organization	
Transactions or affiliations with other nonprofit organizations	
Substantial business or investment holdings	
Transactions or affiliations with businesses not listed above	

I am not aware of any financial interest involving me or a family member that could present a conflict of interest that I have not disclosed either above or in a previous disclosure statement.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Printed Name

B. *Sample Policy B: California Mutual Benefit Corporations; Narrow Range of Covered Persons; Narrow Range of Covered Interests; Annual Disclosure of Potential Conflicts of Interest.* The following policy includes a conflict of interest policy intended for a California nonprofit mutual benefit corporation exempt under Code Section 501(c)(5), (6), or (7), an annual acknowledgment form, and an annual disclosure of interests that could give rise to a conflict of interest. The policy reflects the following choices:

1. Narrow Range of Covered Persons. Like Sample Policy A, Sample Policy B is **narrow** in terms of covered persons; it applies to officers, directors, and key employees **ONLY**. Because Code Section 4958 does not apply to Code Section 501(c)(5), (6), or (7) organizations, no attempt is made to address persons who would be “disqualified persons” under Code Section 4958. Sample Policy B covers key employees using the definition from the Form 990 Instructions. This range of coverage may be appropriate for an organization that wishes to have in place a conflict of interest policy that meets the minimum requirements necessary to answer “Yes” to Lines 12a-c of Part VI.B, or an organization that wishes to have a separate conflict of interest policy that allows it to answer “Yes” to these questions, and separate policies that set forth the policy and procedure for dealing with the conflicts of interests of other persons (such as employees who are not key employees).

2. Narrow Range of Covered Interests. The policy is narrow in scope; it applies to material financial interests potentially affecting a person’s judgment. Compliance with this Sample Policy B will not insure compliance with CCC Section 7233. The interests covered by this policy are potentially more narrow. Some organizations may prefer a broader scope, focusing on all of the interests and transactions that are regulated by law.

3. Covered Transactions and Relationships. While the policy is designed to pick up many transactions and relationships to be disclosed on Form 990, it may not reach all of them. An organization may need a more detailed disclosure form to collect all the information requested on other parts of current or future versions of Form 990.

4. Disclosure of Family Relationships. The form limits disclosure of family members to those presenting a specific potential conflict. Please be aware that the IRS *may* want names of all listed relatives. Be aware that, pending clarification by the IRS, not listing all relatives may not be sufficient disclosure to answer “Yes” to Part VI.B, Line 12c.

5. Statutory Compliance Not Guaranteed. Compliance with this sample policy ***does not guarantee compliance*** with all rules of law.

6. The Board of Directors as Arbiter of Conflicts. This sample policy assumes that the Board of Directors will be the arbiter of conflicts, and not a committee of the Board.

*(Sample Policy B continued on next page)*

## [NAME OF ORGANIZATION]

### CONFLICT OF INTEREST POLICY<sup>10</sup>

#### Article I: Purpose

This conflict of interest policy is designed to foster public confidence in the integrity of **[Name of Organization]** (the “Organization”) and to protect the Organization’s interest when it is contemplating entering a transaction (defined below) that might benefit the private interest of a director, a corporate officer, the top management or top financial official, a key employee (defined below). [Note to Organization: Compliance with this Sample Policy B will not insure compliance with CCC Section 7233. The interests covered by this policy are potentially more narrow.]

#### Article II: Definitions

The following are considered *insiders* for the purposes of this policy:

1. Each member of the Board of Directors or other governing body.
2. The president, chief executive officer, chief operating officer, treasurer and chief financial officer, executive director, or any person with the responsibilities of any of these positions (whether or not the person is an officer of the Organization under the Organization’s Bylaws and the California Corporations Code).
3. Any *key employee*, meaning an employee whose total annual compensation (including benefits) from the organization and its affiliates is more than \$150,000 **and** who (a) has responsibilities or influence over the organization similar to that of officers, directors, or trustees; **or** (b) manages a program that represents 10% or more of the activities, assets, income, or expenses of the organization; **or** (c) has or shares authority to control 10% or more of the organization’s capital expenditures, operating budget, or compensation for employees.

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<sup>10</sup> Note that this Conflict of Interest Policy does not assume the existence of a separate Compensation Policy. Compensation paid to insiders, including for their service as directors, officers, and key employees, should be evaluated under this Policy in its current form. If an organization has a separate Compensation Policy that addresses such compensation decisions, this sample policy may be modified accordingly.

*Interest* means any material financial interest, whether through commitment, investment, relationship, obligation, involvement or otherwise, direct or indirect, that may influence a person's judgment, including receipt of compensation from the Organization, a sale, loan, or exchange transaction with the Organization.

A *conflict of interest* is present when, in the judgment of the body or individual determining whether a conflict exists, an insider or person related to the insider by family or business relationship ("interested person") has a material financial interest in the transaction such that it reduces the likelihood that an insider's influence can be exercised impartially in the best interests of the Organization.

*Transaction* means any transaction, agreement, or arrangement between an interested person and the Organization, or between the Organization and any third party where an interested person has a material financial interest in the transaction or any party to it. [Note to Organization: If the Organization has a separate Compensation Policy that addresses the receipt of compensation by an insider in his or her capacity as an insider (e.g., compensation paid to the President for her services to the Organization as its President), please include the following sentence: "*Transaction* does not include compensation arrangements between the Organization and a director, officer, or other insider that are wholly addressed under the Organization's Compensation Policy."]

### **Article III: Procedures**

#### *1. Duty to Disclose*

Each interested person shall disclose to the Board all material facts regarding his, her, or its interest (including relevant affiliations) in the transaction. The interested person shall make that disclosure promptly upon learning of the proposed transaction.

#### *2. Determining Whether a Conflict of Interest Exists*

With regard to an interested person, the Board shall determine if a conflict of interest exists.

#### *3. Procedures for Addressing a Conflict of Interest*

The Board shall follow the procedures set forth in Article IV in order to decide what measures are needed to protect the Organization's interests in light of the nature and seriousness of the conflict, to decide whether to enter into the transaction and, if so, to ensure that the terms of the transaction are appropriate. In the case of an insider who is a director, the director shall not vote



on any transaction in which the director has an interest, and the remaining Board members shall decide the matter.

#### **Article IV: Review by the Board**

The Board may ask questions of and receive presentation(s) from the insider(s) and any other interested person(s), and may deliberate and vote on the transaction in their presence. The Board shall ascertain that all material facts regarding the transaction and the interested person's conflict of interest have been disclosed to the Board and shall compile appropriate data to ascertain whether the proposed transaction is just and reasonable to the Organization.

After exercising due diligence, which may include investigating alternatives that present no conflict, the Board shall determine whether the transaction is in the Organization's best interest, for its own benefit, and whether it is just and reasonable to the Organization; the transaction can be approved by the Board by majority vote of those present at a meeting for which quorum requirements have been met, without counting the vote of any interested directors. Interested or common directors may be counted in determining the presence of a quorum at such meeting.

#### **Article V: Records of Proceedings**

The minutes of any meeting of the Board pursuant to this policy shall contain the name of each interested person who disclosed or was otherwise determined to have an interest in a transaction; the nature of the interest and whether it was determined to constitute a conflict of interest; any alternative transactions considered; the members of the Board who were present during the debate on the transaction, those who voted on it, and to what extent interested persons were excluded from the deliberations; any comparability data or other information obtained and relied upon by the Board and how the information was obtained; and the result of the vote, including, if applicable, the terms of the transaction that was approved and the date it was approved.

#### **Article VI: Annual Disclosure and Compliance Statements**

Each director, each corporate officer, the top management official, the top financial official, and each key employee of the Organization, shall annually sign a statement on the form attached, that:

- affirms that the person has received a copy of this conflict of interest policy, has read and understood the policy, and has agreed to comply with the policy; and
- discloses the person's financial interests and family relationships that could give rise to conflicts of interest.

### **Article VII: Violations**

If the Board has reasonable cause to believe that an insider of the Organization has failed to disclose actual or possible conflicts of interest, including those arising from a transaction with a related interested person, it shall inform such insider of the basis for this belief and afford the insider an opportunity to explain the alleged failure to disclose. If, after hearing the insider's response and making further investigation as warranted by the circumstances, the Board determines that the insider has failed to disclose an actual or possible conflict of interest, the Board shall take appropriate disciplinary and corrective action.

### **Article VIII: Annual Reviews**

To ensure that the Organization operates in a manner consistent with its status as an organization exempt from federal income tax, the Board shall authorize and oversee an annual review of the administration of this conflict of interest policy. The review may be written or oral. The review shall consider the level of compliance with the policy, the continuing suitability of the policy, and whether the policy should be modified and improved.

*(Sample Policy B continued on next page)*

[NAME OF ORGANIZATION]

**CONFLICT OF INTEREST POLICY:  
ACKNOWLEDGMENT AND FINANCIAL INTEREST DISCLOSURE  
STATEMENT**

Our organization follows a conflict of interest policy designed to foster public confidence in our integrity and to protect our interest when we are contemplating entering a transaction or arrangement that might benefit the private interest of a director, a corporate officer, our top management official and top financial official, any of our key employees, or other interested persons.

**Part I. Acknowledgment of Receipt**

I hereby acknowledge that I have received a copy of the conflict of interest policy of **[NAME OF ORGANIZATION]**, have read and understood it, and agree to comply with its terms.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Printed Name

*(Sample Policy B continued on next page)*

**Part II. Disclosure of Financial Interests**

We are required annually to file Form 990 with the Internal Revenue Service, and the form we file is available to the public. To complete Form 990 fully and accurately, we need each officer, director and key employee to disclose the information requested in this Part II.

A “conflict of interest,” for purposes of Form 990, arises when a person in a position of authority over an organization, such as an officer, director, or key employee, 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.

**Part II** Please check ONE of the following boxes:

- My interests and relationships have not changed since my last disclosure of interests. [Proceed to signature block below. Do not complete the tables.]

**OR**

- I hereby disclose or update my interests and relationships that could give rise to a conflict of interest: [Complete the table below. Use additional pages as needed.]

Family Relationships	Names of those presenting a potential conflict of interest
Include spouse/domestic partner, living ancestors, brothers and sisters (whether whole or half blood), children (whether natural or adopted), grandchildren, great grand-children, and spouses/ domestic partners of brothers, sisters, children, grandchildren, and great grandchildren	

Type of interest	Description of interest that could lead to a conflict of interest
Transactions or arrangements with the Organization	
Transactions or affiliations with other nonprofit organizations	
Substantial business or investment holdings	
Transactions or affiliations with businesses not listed above	

I am not aware of any financial interest involving me or a family member that could present a conflict of interest that I have not disclosed either above or in a previous disclosure statement.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Printed Name

C. *Sample Policy C: Code Section 501(c)(3) Organizations; Form 1023, Appendix A: Sample Conflict of Interest Policy.* The sample conflict of interest policy contained in Appendix A to the Instructions to the Form 1023 is flawed for many reasons, but because it was drafted by the Service and is included in the Form 1023 as a model policy, organizations should at least be familiar with its contents. The Instructions to Form 1023 were last updated in June 2006, prior to the revision of the new Form 990, so it is not clear that the Service considers the Appendix A policy to be sufficiently comprehensive to permit an organization to answer “Yes” to Lines 12a-c, for the reasons identified below. Note that Form 1023 and its sample Conflict of Interest Policy are only relevant to Code Section 501(c)(3) organizations.

1. No Annual Disclosure of Potential Conflicts of Interest. Line 12b of Part VI.B of the Form 990 asks if the organization requires “directors, officers, trustees, and key employees” to disclose annually any interests that good give rise to potential conflicts, including indirect conflicts created through family and business relationships. The Form 1023 sample Conflict of Interest Policy requires only that the directors, principal officers, and members of board committees annual acknowledge that they have read the organization’s Conflict of Interest Policy and agreed to comply with it.

2. No Coverage of Key Employees. The Form 990 extends disclosure obligations to Key Employees, a concept that did not exist in the Form 990 when the sample policy in the Form 1023 was drafted. Therefore, in addition to not requiring annual disclosure of potential conflicts, the Form 1023 sample would not permit an organization to answer “Yes” to Line 12b of Part VI.B of the Form 990 because Line 12b asks about requirements for Key Employees.

3. Narrow Range of Covered Interests. The policy is narrow in scope, applying only to financial interests. Other types of interests that could give rise to conflicts are not covered.

4. Federal and State Statutory Compliance Not Guaranteed. Compliance with the Form 1023 sample policy *does not guarantee compliance* with Code Section 4958, Code Section 4941, or other applicable rules of law, including California state corporate law.

5. Disclosure of Family Relationships. The form does not require prior disclosure of business, investment, or family relationships, although it does treat as “financial interests” any interest created “directly or indirectly” through “business, investment, or family.”

6. Prior Transactions Not Addressed. This policy does not address the approval process for past transactions that have already occurred or commenced.

*(Sample Policy C continued on next page)*

**Note:** Items marked *Hospital insert – for hospitals that complete Schedule C* are intended to be adopted by hospitals.

## **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. This policy is intended to supplement but not replace any applicable state and federal laws governing conflict of interest applicable to nonprofit and charitable organizations.

## **Article II Definitions**

### **1. Interested Person**

Any director, principal officer, or member of a committee with governing board delegated powers, who has a direct or indirect financial interest, as defined below, is an interested person.

#### ***[Hospital Insert – for hospitals that complete Schedule C***

If a person is an interested person with respect to any entity in the health care system of which the organization is a part, he or she is an interested person with respect to all entities in the health care system.]

### **2. Financial Interest**

A person has a financial interest if the person has, directly or indirectly, through business, investment, or family:

- a.** An ownership or investment interest in any entity with which the Organization has a transaction or arrangement,
- b.** A compensation arrangement with the Organization or with any entity or individual with which the Organization 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 Organization is negotiating a transaction or arrangement.

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

A financial interest is not necessarily a conflict of interest. Under Article III, Section 2, a person who has a financial interest may have a conflict of interest

only if the appropriate governing board or committee decides that a conflict of interest exists.

## **Article III Procedures**

### **1. Duty to Disclose**

In connection with any actual or possible conflict of interest, an interested person must disclose the existence of the financial interest and be given the opportunity to disclose all material facts to the directors and members of committees with governing board delegated powers considering the proposed transaction or arrangement.

### **2. Determining Whether a Conflict of Interest Exists**

After disclosure of the financial interest and all material facts, and after any discussion with the interested person, he/she shall leave the governing board or committee meeting while the determination of a conflict of interest is discussed and voted upon. The remaining board or committee members shall decide if a conflict of interest exists.

### **3. Procedures for Addressing the Conflict of Interest**

**a.** An interested person may make a presentation at the governing board or committee meeting, but after the presentation, he/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 governing 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 governing board or committee shall determine whether the Organization can 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 governing board or committee shall determine by a majority vote of the disinterested directors whether the transaction or arrangement is in the Organization's best interest, for its own benefit, and whether it is fair and reasonable. In conformity with the above determination it shall make its decision as to whether to enter into the transaction or arrangement.

#### **4. Violations of the Conflicts of Interest Policy**

**a.** If the governing board or committee has reasonable cause to believe a member has failed to disclose actual or possible conflicts of interest, it shall inform the member of the basis for such belief and afford the member an opportunity to explain the alleged failure to disclose.

**b.** If, after hearing the member's response and after making further investigation as warranted by the circumstances, the governing board or committee determines the member 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 governing board and all committees with board delegated powers shall contain:

**a.** The names of the persons who disclosed or otherwise were found to have a financial interest in connection with an actual or possible conflict of interest, the nature of the financial interest, any action taken to determine whether a conflict of interest was present, and the governing 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 Compensation**

**a.** A voting member of the governing board who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member's compensation.

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

**c.** No voting member of the governing board or any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization, either individually or collectively, is prohibited from providing information to any committee regarding compensation.

#### ***[Hospital Insert – for hospitals that complete Schedule C***

**d.** Physicians who receive compensation from the Organization, whether directly or indirectly or as employees or independent contractors, are precluded from membership on any committee whose jurisdiction includes



compensation matters. No physician, either individually or collectively, is prohibited from providing information to any committee regarding physician compensation.]

## **Article VI Annual Statements**

Each director, principal officer and member of a committee with governing board delegated powers shall annually sign a statement which affirms such person:

- a.** Has received a copy of the conflicts of interest policy,
- b.** Has read and understands the policy,
- c.** Has agreed to comply with the policy, and
- d.** Understands the Organization 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.

## **Article VII Periodic Reviews**

To ensure the Organization 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.
- b.** Whether partnerships, joint ventures, and arrangements with management organizations conform to the Organization'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.

## **Article VIII Use of Outside Experts**

When conducting the periodic reviews as provided for in Article VII, the Organization may, but need not, use outside advisors. If outside experts are used, their use shall not relieve the governing board of its responsibility for ensuring periodic reviews are conducted.