Legal counsel

Navigating Tough Conflict of Interest Situations

Conflicts of interest are inevitable. Don't let them derail your organization.

Amy Coates Madsen

The term "conflict of interest" comes up more and more often these days. You can probably think of many times such conflicts have landed nonprofits in trouble.

Conflicts of interest may also be on your mind because the revised form 990 asks whether your organization has a written conflict of interest policy and whether you require officers, directors, and key employees to disclose potential conflicts of interest each year. The 990 even requests information on how you monitor and enforce your conflict of interest policy.

While the conflict of interest policy mentioned on the 990 isn't required under the Internal Revenue Code, it's one of the policies the IRS considers "generally to improve tax compliance…[and to help an organization avoid]…excess benefit transactions, inurement, operation for non-exempt purposes, or other activities inconsistent with exempt status." The current application for tax exempt status also requests that filers indicate whether their directors, officers, or trustees are related to one another through family or business relationships. A listing of a nonprofit's related-party transactions has been part of the 990 for years.

According to the IRS, "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." Some states have state-specific laws. Additional regulations are tied to certain funding sources.

> What if someone on your board recommends a family member for a position in your organization?

Because of the nature of nonprofit organizations, which attract like-minded people passionate about a cause, conflicts of interest are bound to arise. You can handle them gracefully if you're well prepared.

Your First Line of Defense: A Written Policy

The best armor against a conflict of interest disaster is a board-approved conflict of interest policy. At a minimum, this policy should include:

• a definition of a conflict of interest, with some examples clarifying what such a conflict might entail.

• a list of people covered by the policy. Exemplary conflict of interest policies cover all board members, all paid staff, and any volunteers with significant decision making authority.

• a process for dealing with conflict of interest situations. For example, you should require people to disclose any potential conflicts of interest when they join your organization and then every year thereafter. You should be sure decisions on conflicts of interest are made by those who don't have a vested interest in the situation. And you should note the documentation process you'll use when a conflict of interest takes place (such as using board minutes to detail the conflict, the people involved, and the resulting decision).

How to Handle Conflicts of Interest

Here are a few questions and answers about conflicts of interest you might face:

Should a nonprofit make a purchase from a board member?

There are often reasons to purchase goods or services from board members. For instance, a board member may have a skill set that's not readily found in the open market. Or, a board member may offer you a service for a mere fraction of the normal asking price. Whatever the reason behind considering payment to a board member, take great care to follow your conflict of interest policy to the letter and record all steps in the decision making process. You must avoid situations that make the organization look like a privately-held company.

Should a married couple serve on the board?

Sometimes both spouses of a couple might be good candidates for board positions. Whether this practice is appropriate depends on many factors, including: the size of the board (and corresponding size of the group's quorum), whether one or both of the board members in the couple serves in a leadership role, and whether there's a prohibition on the practice by local or state law (or funder).

For instance, suppose a nonprofit with a married couple on the board has a total of six board members, including the husband, who serves as treasurer, and the wife, who serves as president. That situation would look much worse to the outside world (including the IRS) than if the board has 30 members with one husband and wife team, neither of whom holds a leadership position. In the situation with six board members, a quorum is likely to consist of three or four members, which would allow the husband and wife to "carry the vote" in virtually any situation.

Even with a strong conflict of interest policy, you could still find yourself in hot water.

The best idea may be to allow one half of a couple to serve on the board and the other to serve as a committee member or direct service volunteer. Avoiding every appearance of a conflict of interest goes a long way to preserve the organization's public trust.

Should the executive director hire an employee who's related to a board member?

What if someone on your board recommends a family member for a position in your organization? Would it make a difference if it was a management job or an unpaid internship? What if the board member was the organization's biggest donor or the head of a local foundation?

The best armor is a board-approved conflict of interest policy.

First, it would be wise to check whether the family member would serve in a "key employee" role. If so, the potential conflict is much greater. The IRS, in form 990, defines a key employee as "any person having responsibilities, powers, or influence similar to those of officers, directors, or trustees. The term includes the chief management and administrative officials of an organization (such as an executive director or chancellor). A chief financial officer and the officer in charge of the administration or program operations are both key employees if they have the authority to control the organization's activities, its finances, or both."

In addition, it would be worthwhile to look at whether the board member is likely to move to a higher board position in the future. The conflict could be more pronounced if the person later becomes the board president.

The size of the board should be considered, too. The smaller the board, the greater impact each member has on a decision, raising the potential for a conflict of interest.

You should also check your organization's policies. Do they require board members to recuse themselves from votes that might cause conflicts of interest? If issues involving staff (benefits, layoffs, terminations, evaluations, and so on) arise frequently, it may be difficult to constantly recuse such a board member.

Hiring a family member may not be illegal, but is it wise? In most cases, no. The conflict will need to be reported on the form 990, which means it will be public, and may not stand up to scrutiny.

The Most Important Question to Ask

Even if you have a strong conflict of interest policy, and follow it carefully, you could still find yourself in hot water. For instance, one nonprofit made headlines because it had entered into contracts with many of its board members. While the organization had followed its conflict of interest policy, the sheer number of times it purchased services from board members raised red flags.

When deciding whether to enter into a transaction with a board member or other interested party, there's one common-sense question that can help: If the situation were described on the front page of the newspaper, would you be able to explain it to your mother or grandmother?

It all comes down to this: Keep the importance of preserving the public trust foremost in your mind. Then you'll most likely do the right thing. ■

Resources

Whitehouse, Sheldon, "The Sarbanes-Oxley Act & Nonprofits: But I Thought That Didn't Apply to Us," *Nonprofit World*, Vol. 22, No. 5.

Fram, Eugene & Judy Withers, "Conflict of Interest in the Board Room," *Nonprofit World,* Vol. 17, No. 2.

These resources are available at www.snpo.org.

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