

*Drafting a Conflict of
Interest Policy:
A Guide to Key Provisions*



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Preface

A conflict of interest policy is one of the most important policies a foundation can have. A written, enforced conflict of interest policy helps a board spot conflict of interest transactions before they occur, ensures consistent decision-making about similar transactions and safeguards a foundation against transactions that may violate the law. Although a written conflict of interest policy is not required by law, federal and state charity regulators will ask to see such a policy if a foundation comes under investigation or audit. Many consider having a conflict of interest policy to be a best practice. It is a requirement for community foundations that seek to comply with the National Standards for U.S. Community Foundations and is a feature of the Council on Foundations' Stewardship Principles and Practices for family and independent foundations and corporate grantmakers.

This guide describes the key provisions that every conflict of interest policy should include. It can be used by boards to spot whether these provisions are included in their own policies. It is designed as a companion piece to the resources developed by the Council's legal staff on the topic of conflicts of interest. Extensive discussion of the issues covered in this guide and references to further resources can be found in *Conflict of Interest: Safeguarding Your Foundation* and *Conflict of Interest: IRS Sample Policy Annotated for Grantmakers* (both available on the Council's website, cof.org/strongfoundations).

Conflict of interest policies differ widely in form, style and substance, ranging in length from a couple of pages to more than ten. Don't be overly concerned about the form your policy takes. Some are organized based on the sections of the IRS sample conflict of interest policy or on the standard form used by a foundation's legal counsel, while others are arranged topically—for example, discussing conflicts of interest in grantmaking separately from conflicts of interest in business transactions.

Where can you find sample policies? A quick internet search will yield numerous sample conflict of interest policies that a foundation can adopt for its use. The Council encourages foundations to place their policies on their websites. An online documents database that includes sample policies from family, independent and community foundations and corporate grantmakers can be searched at cof.org/stewardship.

If you have questions about the information contained in this booklet, please e-mail strongfoundations@cof.org.



Key Provisions

I. Purpose

A written conflict of interest policy should identify and provide guidance on the most important and most common conflict of interest situations faced by a foundation, and set down general principles that can be applied to situations not covered in the policy. Thus a conflict of interest policy not only assists in resolving specific instances of conflict of interest, but also serves to guide decisionmaking in cases where the policy provides no clear answers.

- A. The key purposes of a conflict of interest policy are:
1. To help the foundation and its managers comply with the law and fulfill their fiduciary duty of loyalty.
 - It is important to avoid self-dealing, which may adversely affect the foundation and result in penalties on the foundation and/or its managers.
 2. To facilitate effective governance and maintain public trust.
 - Effective governance depends on decisionmaking by trustees and staff that is unbiased *and* that appears to be unbiased.
 - The appearance of a conflict of interest can damage a foundation's credibility and reputation and compromise its ability to fulfill its mission and programmatic goals.
 3. To facilitate the involvement of trustees with non-profits in their communities.
 - Many foundations encourage their board members to play an active role with nonprofits in their communities. A conflict of interest can arise, however, if foundation board members sit on the boards of nonprofits that are current or potential grantees. Whether or not to prohibit a grant in this situation is a choice for the foundation to make. Some foundations do prohibit these grants,

while others, especially in smaller, inter-connected communities, would be precluded from making any grants by such a prohibition. If these grants are allowed, it is especially important to draft procedures that guard against the perception of favored treatment.

II. Definitions

The scope of the policy is determined by to whom and to what it applies. A foundation does not have unlimited discretion in how it defines a conflict of interest; state and federal laws set the minimum standards. A conflict of interest policy should provide an overview of minimum legal requirements by including a brief summary of any state law requirements and, in the case of private foundations, the federal self-dealing rules, or, in the case of public charities, the federal intermediate sanctions rules (see Appendices I and II for a summary of the federal rules).

- A. Who does the policy cover?
 - 1. Directors/trustees
 - 2. Officers/senior executives
 - 3. Employees/staff (*Note: Some foundations have separate policies for staff in their employee handbooks.*)
 - 4. Board committee members who are not board members (as allowed by state law)
 - 5. Advisory committee members who are not board members
 - 6. Volunteers.

- B. What transactions does the policy cover?
 - 1. Conflicts of interest that occur:
 - Directly (between the individual and the foundation)
Example: Foundation pays board member for legal services.
 - Indirectly (through business, investment or family ties).
Example: Foundation hires an investment firm founded by a board member's sister to provide investment management services.
 - 2. Conflicts of interest that involve:
 - Financial interest (often referred to as “actual conflicts”)
Example: Board member is compensated for professional services.
 - Personal interest (often referred to as the “appearance of a conflict”)
Example: Foundation's board member is on the board of a public charity applying for a grant from the foundation.

- Gifts, gratuities, entertainment or honoraria from current or potential vendors or grantees.
Examples: Vendor sends holiday gift basket to foundation's procurement staff; foundation's CEO receives honorarium for speaking at the local chamber of commerce; foundation receives free tickets to events from current or potential grantees.

III. Disclosure/Annual Statement

The basic safeguard against entering into any actual or apparent conflict of interest transaction is disclosure. All too often foundations are caught in the public spotlight (and sometimes in the regulators' cross-hairs) for engaging in conflict of interest transactions that no one—or only a few insiders—at the foundation knew about. Not every decision needs to be made by the full board, but the full board should be aware of (and approve) all significant transactions. Board members should complete and sign an annual disclosure form and be reminded that they are under an obligation to disclose potential conflicts of interest whenever they arise.

- A. The policy should require everyone covered to:
 1. Complete an annual disclosure form
 2. Disclose potential conflicts of interest whenever they arise.

IV. Procedures

Clear instructions should be in place to help a foundation's board and staff to determine whether a conflict of interest exists and to guide the approval of a transaction that is not otherwise prohibited by state or federal law or by other provisions of the policy.

- A. There should be a clear procedure for determining whether a conflict of interest exists.
 1. An independent person or committee should determine whether an actual or potential conflict of interest does exist. In the case of staff, this person is usually a supervisor or CEO. In the case of the CEO or board members, the designated party is usually the board chair or a committee charged with overseeing conflict of interest transactions.
 2. Disclosures and decisions should be documented.
- B. The following procedures can be used for approving a conflict of interest transaction that is not otherwise prohibited by law or by other provisions of a foundation's policy:
 1. The conflicted person should abstain from discussion, except to provide factual information, and leave the room.
 2. The conflicted person should abstain from voting.
 3. A majority of disinterested directors (whenever possible) should approve the transaction.
(Note: If permitted by state law, interested persons can be counted for purposes of satisfying the requirement for a quorum.)

4. The decision to enter into a conflict of interest transaction should be based on whether:
 - The transaction is fair and reasonable (fair market value)
 - The transaction is in the organization's best interest
 - A more advantageous transaction or arrangement could reasonably be attained that would not give rise to a conflict.

(Note: These steps may be required as a matter of state law. In general, a competitive bid process protects the board member as well as the organization if the organization is considering entering into a business relationship with a board member.)
5. The discussion and the vote (including whether the conflicted individual left the room and/or refrained from voting) should be reflected in the minutes of the meeting.

Additional Provisions

I. Confidentiality

Some foundations include a confidentiality provision in their conflict of interest policies (others include this provision in personnel policies or in a separate confidentiality policy). The intent is to inform relevant individuals that confidential information acquired in connection with a person's role at the foundation should not be used for personal benefit.

Some foundations specifically address the use of information acquired with respect to the foundation's investments. The use of proprietary investment information for personal gain should be strictly prohibited. Private foundations that allow co-investing by trustees should be careful to avoid the potential for self-dealing.

II. Disciplinary Action for Violations

Some policies include procedures for handling investigations of alleged violations. Remedies for a violation may include termination of employment or removal from the board.





Private Foundation Self-Dealing Regulations Section 4941 of the IRS Code

The Internal Revenue Code and Treasury regulations prohibit private foundations from engaging in acts of self-dealing with disqualified persons.

Disqualified persons with respect to a private foundation include:

- foundation managers (officers, directors, trustees, or individuals with similar responsibilities).
- substantial contributors (defined as any person who has contributed an aggregate amount of more than \$5,000 to a private foundation, if such amount is more than two percent of the total contributions received by the foundation in the year in which the person makes a contribution).
- individuals who own more than 20 percent of a business enterprise that is a substantial contributor.
- family members of any person described above (spouse, ancestors, lineal descendants and spouses of lineal descendants).
- corporations, partnerships, trusts or estates in which a person described above owns more than 35 percent of the voting power, profits interest or beneficial interest.
- government officials.

Transactions that constitute self-dealing include:

- *sale, exchange or leasing of property* between a private foundation and a disqualified person.
- *lending of money or other extension of credit* between a private foundation and a disqualified person, other than the lending of money by a disqualified person to the foundation without interest or other charge, so long as the loan proceeds are used exclusively for charitable purposes.
- *furnishing of goods, services and facilities* between a private foundation and a disqualified person, other than the furnishing of goods, services or facilities by a disqualified person to the foundation without

charge so long as the goods, services or facilities are used exclusively for charitable purposes; the foundation may furnish goods, services and facilities to a disqualified person so long as they are furnished on a basis no more favorable than that on which they are made available to the general public.

- *payment of compensation (or payment or reimbursement of expenses) to a disqualified person, other than the payment of compensation and the payment or reimbursement of expenses by the foundation to a disqualified person for “personal services” that are reasonable and necessary to carry out the exempt purposes of the foundation, so long as the compensation, payment, or reimbursement is not excessive (“personal services” include foundation management by trustees, directors and officers, legal and accounting services and investment management; payment of directors’ and officers’ (D&O) liability insurance premiums on behalf of trustees and directors can be part of a reasonable (not excessive) compensation package).*
- *transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation, except when the benefit is incidental and tenuous, such as some public recognition for grants.*
- *payment to government officials.*
- *transactions involving corporate securities, except under narrow conditions (corporations that are disqualified persons generally may not purchase or exchange securities with their sponsored charitable foundations).*



Excess Benefit Transaction Regulations (“Intermediate Sanctions”) Section 4958 of the IRS Code

The Internal Revenue Code and Treasury regulations prohibit public charities from providing excessive (more than fair market value) economic benefits to disqualified persons. The regulations set forth procedures, or rebuttable presumption rules, that, if followed, provide a presumption of reasonableness for transactions between a public charity and a disqualified person.

Disqualified persons with respect to a public charity include:

- individuals who are currently, or within the last five years have been, in a position to exercise substantial influence over the affairs of the organization, including:
 - foundation managers (officers, directors, trustees, or individuals with similar responsibilities).
 - the founder of the organization.
 - substantial contributors (defined as any person who has contributed in the current fiscal year and the four preceding fiscal years more than \$5,000, if such amount is more than two percent of total contributions received during that five-year period by the organization).
 - other individuals based on a facts and circumstances test.
- family members of any person described above (spouses, siblings, spouses of siblings, lineal descendants and spouses of lineal descendants).
- corporations, partnerships, trusts or estates in which a person described above owns more than 35 percent of the voting power, profits interest or beneficial interest.

All transactions that provide an economic benefit to disqualified persons, such as compensation for services and purchases and sales of property, are subject to the intermediate sanctions rules, whether the transactions are conducted directly by the organization or indirectly through a controlled entity (taxable or tax-exempt) or an intermediary.

Under the regulations implementing the intermediate sanctions rules, to take advantage of the rebuttable presumption a public charity must have:

- Approval by a disinterested governing board (or committee) before the transaction is entered into.
- Comparable data showing that the economic benefit provided to a disqualified person for services or property does not exceed fair market value of the services or property.
- Concurrent and adequate documentation of the basis for making the determination that the transaction is reasonable (the regulations specifically state what information must be documented).





Resources

“Conflicts of Interest: Safeguarding Your Foundation,” a compilation of four articles written by the Council’s legal staff, and sample policies, 2005. www.cof.org/files/Documents/Building%20Strong%20Ethical%20Foundations/Conflicts_of_Interest.pdf.

Nober, Jane C., “Tread Carefully When Sharing Board Members with Grantseekers,” *Council Columns*, September 1997. www.cof.org/Content/General/Display.cfm?contentID=172.

Venkat, Sarita, “Director Independence and Charitable Contributions,” *Foundation News & Commentary*, May/June 2005. www.foundationnews.org/CME/article.cfm?id=3269&issueID=&authByte=60381&profileID=.

“Determining Reasonable Compensation for Foundation Directors and Trustees,” a guidance memorandum from the Board of Directors of the Council on Foundations, December 2002. www.cof.org/files/Documents/Governing_Boards/trusteecomp2003.pdf.

“Recommended Best Practices in Determining Reasonable Executive Compensation,” a guidance memorandum from the Board of Directors of the Council on Foundations, December 2002. www.cof.org/files/Documents/Governing_Boards/execcomp2003.pdf.

Resources and sample policies from the Council’s Standards and Effective Practices Database for:

- Community Foundations
- Corporate Grantmakers (COF members only)
- Family Foundations.

<http://bestpractices.cof.org>.

Other Resources

The new IRS Form 1023, Application for Recognition of Exemption, is available for download in pdf format at www.irs.gov/pub/irs-pdf/f1023.pdf. The instructions for the form, along with the IRS sample conflict of interest policy, are available at www.irs.gov/pub/irs-pdf/i1023.pdf.

“Conflicts of Interest at Foundations: Avoiding the Bad and Managing the Good,” BoardSource and the Council of Michigan Foundations, 2005. www.cmif.org/Documents/COI_Guide.pdf.





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