

Conflicts of Interest: Safeguarding Your Foundation



COUNCIL *on*
FOUNDATIONS

Building Strong and Ethical Foundations:
Doing It Right



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Introduction

INTRODUCTION

Grantmaking foundations in the United States have a strong history of being created with honorable motives and operated with unquestionably high standards—standards that reflect the honor, respect for society and philanthropic impulse of their founders. That foundations continue to adhere to these high standards has been borne out repeatedly by numerous studies by the Internal Revenue Service and thousands of anecdotal experiences in the Council’s more than 50 years of serving philanthropic institutions.

Today, however, foundations are being challenged to rebuild trust with the public and policymakers in an environment of increasingly negative public opinion and more aggressive legislation. To regain the long-standing public support of philanthropic traditions, the Council on Foundations, working with its philanthropic partners, has established a national ethics and standards program.

Building Strong and Ethical Foundations: Doing It Right is a two-year initiative designed to take the lessons of good philanthropy and moral suasion to grantmakers, their advisors, foundation executives and trustees across the country. The program also will build partnerships with state and federal regulators to halt bad practices through legal means while educating regulators about the appropriate role and functions of foundations.

Specifically, the Council will:

- Develop new guiding **principles and governance standards** that more specifically reflect the existing Principles and Practices for Effective Grantmaking to which all Council members currently subscribe.
- Increase **professional development materials and outreach** about strong legal and ethical governance practices to foundation professionals, foundation advisors, and state and federal charity officials.

The enclosed materials are designed to encourage greater compliance and adherence to legal and expected standards of accountability. Resources include articles by the Council on Foundations and sample conflict of interest policies for community foundations, private foundations and corporate giving programs.

The supplemental book contains the Council's **Principles and Practices for Effective Grantmaking**, with special sections on conflicts of interest and ethical behavior, and our recommendations for determining executive and trustee compensation.

Additional copies of the referenced materials can be obtained by sending an e-mail to strongfoundations@cof.org.

The Council on Foundations doesn't have all the answers, but the enclosed tools will enable us all to share the challenges before us, turn the tide of skepticism and encourage the field to establish accountability as a way of doing business.

Dorothy S. Ridings
President and CEO
Council on Foundations



ARTICLE

Conflicts of Interest

by Jane C. Nober
Foundation News & Commentary
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With Congress and the media focusing on corporate governance and foundation administration, it is a good time to make sure that all grantmakers have a strong conflict of interest policy in place. Both private foundations and public charities (such as community foundations) should have clear guidelines on financial or other interests that must be disclosed and transactions that must be scrutinized or avoided. The policy should cover both board members and foundation staff. A robust conflicts policy can not only help a grantmaker stay on the right side of the law but also keep the organization from engaging in behavior that gives even the appearance of conflict.

While the Tax Code does not require that a charitable organization have a conflicts policy in place, it would be difficult to achieve or demonstrate compliance with applicable provisions of the law without such a document. As the IRS moves forward with its plan to audit selected community foundations, it will no doubt look for evidence that an organization has a comprehensive policy—and that it is enforced.

THE LAW ON CONFLICTS

Board members or trustees of a charity have fiduciary duties to the organization. This means that they must be careful stewards of the charity's assets and must put the charity's interests first. On occasion, however, a board member's other involvements—business interests, family relationships or political or other charitable activities—may make it impossible for him or her to provide disinterested advice to the charity. Especially when the matter affects the financial interests of a board member, this duality of loyalties may become a conflict of interest.

In addition, for private foundations, Section 4941 of the Tax Code prohibits a variety of financial transactions between the foundation and “disqualified persons.” This category includes substantial contributors to the foundation and its managers, plus members of both those groups' families and businesses in which they have a large stake. Specifically barred transactions include rent payments to a disqualified person and loans from the foundation to a disqualified person—even when the terms of the deal would benefit the foundation substantially.

There's also a general prohibition on the use of a private foundation's income or assets “by or for the benefit of” a disqualified person. That means that a foundation's grants and other expenditures must not provide tangible economic benefits to disqualified persons. An exception to the bar on self-dealing allows foundations to pay disqualified persons reasonable compensation for very limited personal services that are necessary to the foundation's operation.

For public charities, such as community foundations, financial transactions between the charity and its board members—as well as other “insiders”—are covered by the intermediate sanctions rules in Section 4958 of the Tax Code. Insiders also include major donors, charity executives and their families. If any payments to such insiders—including salaries and payments for goods or services—exceed fair market value, the insiders, and possibly members of the organization's board, will be subject to penalty excise taxes.

In addition to those federal rules, some states have laws that regulate whether a board member or other charity official may participate in voting or other actions when the board member has a financial interest in the outcome.

GETTING INTO COMPLIANCE

Legal rules help shape the outlines of the conflicts policy that a charity should have. Both private foundations and public charities should have written rules—approved by the board—that require board members and executives to disclose business or other ties that may result in a conflict of interest or bias for or against making a particular grant or investment. Ideally, this disclosure happens on a regular basis—say, at the beginning of the year or when a director's term begins. At the very least, foundation managers must be required to make full disclosure when a relevant matter is under consideration by the foundation.

Depending on what the manager's conflict is, it may be appropriate for him or her to abstain from voting on or even discussing the matter. For example, if a partner in the foundation's investment management firm serves on the board, he or she should not vote on any resolution to retain or dismiss the firm. The minutes of the board or committee meeting should note this abstention.

Foundation staff, too, should be required to disclose positions or interests that may give rise to conflicts. Does the program officer have a spouse who works at a potential grantee? Does the program officer personally receive consulting fees from nonprofits that may apply for funds? Depending on the size and activities of the foundation, it may be wise to have a parallel conflicts policy for staff members.

In addition, foundations should prepare themselves for situations where there may be no legal conflict but there may be the *appearance* of conflict. A board member's printing firm, for example, might seek the contract to produce the community foundation's annual report. One approach is to bar board members from doing business with the foundation. Another approach is to mandate a rigorous bidding process so that foundation managers can be confident that the best bid—even if it comes from a foundation insider—will win.

The stronger and more comprehensive a foundation's conflict of interest policy is, the easier it should be to spot conflicts and address them before they become a problem. Furthermore, when a foundation has evidence that it has gone through the procedures required by its conflicts policy, it will more easily be able to defend its actions to the media or government authorities.

Some conflicts, once disclosed, turn out not to be conflicts at all. Where a foundation board member serves on the board of an organization seeking a foundation grant, the foundation may generally make the grant without penalty. Disclosing this tie provides other board members with an opportunity to learn about the applicant charity from their colleague. Foundation policy may require that the board member abstain from voting on the grant, although there is no federal legal requirement that he or she do so. Because the board member's dual role has been disclosed, other board members may weigh his or her comments appropriately.

But some conflicts cannot be cured by disclosure. Where a community foundation proposes to pay above-market rates to a fundraising firm operated by the executive's spouse, no amount of disclosure can make the problem go away. Where a private foundation's investment manager uses foundation assets to manipulate the price of a stock held by disqualified persons, there's a genuine conflict (and probably an act of self-dealing, too).



ARTICLE

Conflicts of Interest, Part II

May the foundation's lawyer serve as a trustee?

by Jane C. Nober

Foundation News & Commentary

January/February 2004 Vol. 45, No. 1



FOUNDATION LAWYER/TRUSTEE

Often, the lawyer who drafted a foundation's organizing documents stays on as counsel to the organization. He or she may be asked to serve on the grantmaker's board as well. Is this permissible? May he or she participate in all decisions the board makes? May the lawyer be paid for the time that he or she devotes to board meetings and other legal work for the foundation and, if so, may the compensation be at the rates customarily charged by his or her law firm? Does it matter whether the grantmaker is a private foundation or a public charity?

The foundation's lawyer may serve as a trustee or director of the organization—be it a public charity or a private foundation. However, a lawyer/board member should not participate in decisions relating to the retention or compensation of his or her law firm. The board should decide in advance whether the lawyer must recuse himself or herself from all discussion of those questions or only from the final vote. Otherwise, a lawyer/board member may participate in all of the board's decisions.

Like any other board member, the lawyer/trustee should disclose any outside involvements that may give rise to conflicts. For example, if he or she (or the law firm in which he or she is a partner) represents charities that are potential grantees of the foundation, this fact should be disclosed. There is no bar on the foundation making a grant to those organizations, but the lawyer/trustee should probably recuse himself or herself from any decisions related to those grants.

REASONABLE COMPENSATION

The rules on compensating a lawyer/trustee are the same as those applying to many individuals whom a grantmaker pays. If the entity is a private foundation, the lawyer/trustee is a “disqualified person”—the label the Tax Code uses to describe major donors to the foundation, foundation directors, family members of both of those groups and businesses in which they are large stakeholders.

Disqualified persons may be compensated only for *personal services* that are reasonable and *necessary* to the foundation’s work and the compensation may not be *excessive*. Legal services (along with investment management services) are expressly included in the definition of personal services in the Internal Revenue Service’s (IRS) private foundation regulations.

Assuming the lawyer’s services are *necessary*, what’s a rate of compensation that’s *not excessive*? The IRS’s position is that the amount similarly situated people are paid for similar work will be considered reasonable compensation. If the attorney’s law firm customarily bills clients similar to the foundation at the rates it proposes to charge the foundation, this may serve as evidence of the reasonableness of the rates. Ideally, a foundation would periodically compare the rates it pays with other similarly sized foundations or put its legal work out for bid.

If the trustees of a private foundation are compensated for their service, may the lawyer/trustee receive both legal fees and trustee fees? Strictly speaking, as long as all of the services are necessary and the total compensation package is reasonable, such payments will be permissible. However, if the lawyer is already charging the foundation for his or her time, foundation managers must ensure that legal fees are limited to services above and beyond those customarily performed by trustees to prevent double dipping.

RULES FOR PUBLIC CHARITIES

If the grantmaker is a public charity, such as a community foundation, the relevant legal rules on compensation for a lawyer/trustee come from the Tax Code’s intermediate sanctions provisions. For more information on intermediate sanctions, see Lloyd H. Mayer, Caplin & Drysdale, Intermediate Sanctions Checklist (5/31/2001), available for download (PDF) at: www.cof.org/files/documents/legal/checklist.PDF.

Intermediate sanctions rules penalize excess benefit transactions, in which charity insiders (such as directors) receive more value from an organization than they have provided to it. Charities must pay no more than fair market value for services provided by insiders. They may establish a rebuttable presumption that the lawyer/trustee’s compensation meets this standard by having an independent committee consider data on comparative rates and approve the compensation, being sure to fully document this determination. Some community foundations put their legal work out for competitive bids periodically as well.

OTHER CONFLICTS, OTHER RULES

Sometimes, the lawyer/trustee may face a conflict between his or her role as a trustee and as the counsel for the foundation. These situations often will be governed by the state's code of ethics for lawyers. If the board's actions are an issue in a lawsuit, for example, the lawyer/trustee may not be able to serve as counsel in the litigation. This might be the case if the state attorney general brings an action against the foundation's board for mismanagement of its assets or if a foundation employee sues the board for employment discrimination. A lawyer/trustee might also find himself unable to represent the foundation if one faction of board members takes another to court.

Particularly in the community foundation context, lawyer/trustees may find themselves on both sides of a gift. For example, a lawyer who serves as counsel and trustee of a local community foundation may have a client with a complicated asset that she wishes to give to a charity. If the client chooses the community foundation, the lawyer may have a conflict between his duty to help his client achieve her goals and his duty to help the community foundation consider fully the implications of accepting this particular gift. (Note that this conflict arises whether or not the community foundation's counsel sits on the charity's board; it's simply made more acute because the board is ultimately charged with accepting or rejecting gifts.) In this situation, the lawyer must disclose his dual loyalties. The wisest course for the board is to bring in another advisor to counsel them on the consequences of accepting the asset.

An attorney or law firm that has been with the foundation since its inception can be a marvelous resource—a repository of institutional memory, an ethical compass and a source of objective opinions. Having this voice of authority on the board can be enormously helpful. But foundation managers need to remember that their trusted attorney needs to be treated a little differently from other board members.

RESOURCES

John A. Edie. *Family Foundations and the Law*, 3rd ed. (Washington, DC: Council on Foundations, 2002). Item #805, \$30, Nonmembers \$55. To order call 888/239-5221.

John A. Edie & Janne Gallagher, "Memo to Community Foundations and Public Foundation Members of the Council on Foundations regarding Intermediate Sanctions Regulations" (May 31, 2001). Available at www.cof.org/files/documents/legal/checklist.pdf. (Contains a checklist for assessing compliance with the intermediate sanctions rules.)

Jane C. Nober. *Company Foundations and the Self-Dealing Rules*, 3rd Ed. (Washington, DC: Council on Foundations, 2002). Item #1013, \$20, Nonmembers \$35. To order call 888/239-5221.

Lawrence M. Brauer and Charles F. Kaiser III, "Tax-Exempt Health Care Organizations Revised Conflicts of Interest Policy." Available at www.irs.ustreas.gov/pub/irs-tege/topice00.pdf. (Contains a sample conflict of interest policy for a healthcare organization, not a grantmaker, but does provide insight into the IRS's thinking in this area.)



ARTICLE

Conflicts of Interest Part III

by Jane C. Nober

Foundation News & Commentary

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In previous articles (“Conflicts of Interest,” www.foundationnews.org/CME/article.cfm?ID=2561 and “Conflicts of Interest Part II,” www.foundationnews.org/CME/article.cfm?ID=2747), we’ve reviewed the importance of developing a conflicts of interest policy for board and staff members. We’ve also examined the issues that may arise when the foundation’s lawyer serves as a director or trustee. This column focuses on foundation investments. May foundation board members (or other closely affiliated individuals or businesses) manage foundation investments? May they be paid for this service? What factors should foundation managers consider before they select an investment manager who has a close relationship with the foundation? When is it a bad idea? What special procedures should be followed when a board member or other close affiliate is also an investment manager?

It is often tempting to look close to home for foundation investment expertise. Family foundations may wish to retain children of the charity’s founders to manage the foundation’s portfolio. Foundations sponsored by corporations, especially financial institutions, may consider putting their assets under the watchful eyes of corporate investment managers. Community foundations that work with local investment advisors may seek to tap the money management abilities of board members who are professional investors. While federal law is fairly permissive in that area, it is not always wise to mix investment management with those close relationships.

THE RULES

The Tax Code generally allows both public charities and private foundations to retain and compensate individuals and businesses with close connections to the charity that manage the charity’s investments. If the entity is a private foundation and the investment manager is a “disqualified person”—the label the Tax Code uses to describe major donors to the foundation, foundation directors, family members of both of those groups and businesses in which they are large stakeholders—the private foundation must avoid committing an act of self-dealing. To comply with the rules, the manager may be compensated only for *personal services* that are reasonable and *necessary* to the foundation’s work and the compensation may not be *excessive*.

Investment management services are expressly included in the definition of personal services in the Internal Revenue Service's (IRS) private foundation regulations. An example in the regulations discusses a private foundation manager who owns an investment counseling business and provides investment management services, for a fee that is not excessive, to the foundation. Under the relevant rules, the example concludes, the arrangement does not constitute an act of self-dealing.

Assuming the investment manager's services are *necessary*, what's a rate of compensation that's *not excessive*? The IRS's position is that the amount similarly situated people are paid for similar work will be considered reasonable compensation. If the investment manager customarily bills clients similar to the foundation at the rates it proposes to charge the foundation, this may serve as evidence of the reasonableness of the rates. Ideally, a foundation would periodically compare the rates it pays with other similarly sized foundations or put its investment management work out for bid.

If the grantmaker is a public charity, such as a community foundation, the relevant legal rules on compensation for an investment manager with close ties to the foundation come from the Tax Code's intermediate sanctions provisions. [For more information on intermediate sanctions, see Lloyd H. Mayer, Caplin & Drysdale, Intermediate Sanctions Checklist (5/31/2001), available for download (PDF) at: www.cof.org/files/documents/legal/checklist.PDF.]

Intermediate sanctions rules penalize excess benefit transactions, in which charity insiders (such as directors) receive more value from an organization than they have provided to it. Charities must pay no more than fair market value for services provided by insiders. They may establish a rebuttable presumption that the investment manager's compensation meets this standard by having an independent committee consider data on comparative rates and approve the compensation, being sure to fully document this determination. Ideally, community foundations would periodically put their investment management work out for competitive bids.

Community foundations face an additional requirement in connection with investment management. Compliance with Treasury Regulations requires that they establish a target standard for investment performance and that they retain the right to fire investment managers who do not meet these goals.

In all cases, an investment manager who is also a board member should not participate in decisions relating to the retention or compensation of his or her investment firm. The manager may participate briefly in the discussion leading up to the vote in order to answer any factual questions, but should then leave the room to allow the remaining board members to discuss and decide the issue. The investment manager should refrain from participating in board discussions of investment performance and should not be named to the investment committee if the board has one. The foundation should avoid having its investments managed and evaluated by the same individuals or firm.

Like any other foundation fiduciary, investment managers should disclose other potential conflicts of interest. For example, where a grantee requests an endowment grant and the foundation's investment manager/board member has a contract to manage the grantee's funds, this tie should be disclosed.

BEYOND THE LAW

Just because the Tax Code allows an action doesn't necessarily make it a good idea all the time. Before selecting a disqualified person to manage a foundation's portfolio, foundation managers should consider not only legal, but also ethical and other factors.

Having an investment manager with close ties to the foundation does present ethical challenges. Will foundation managers feel comfortable firing an investment manager whose performance is not satisfactory? Will they delay terminating a relationship—to the detriment of the foundation's finances—because of the investment manager's other work on behalf of the foundation or because of his or her relationship with other foundation managers? No one wants to be the private foundation CFO who has to tell a major donor that his child's investment performance is terrible. Similarly, if a community foundation's investment manager is also a big fundraiser for the organization, how likely is it that foundation executives will immediately pull the foundation's assets from her company when she fails to meet performance benchmarks?

Other conflicts can arise when foundation investment managers are also family members of a donor or hold positions in the donor's business. Loyalty to family or the family business could lead the investment managers to retain a foundation's large stake in an enterprise when a more objective investor might diversify.

Finally, a foundation should consider the public relations aspect of hiring a closely affiliated individual or firm as an investment manager. If the foundation's assets decline in value, it will be tempting for reporters and other commentators to assume that it was the investment manager's personal or other ties that earned her the privilege of mismanaging the charity's funds. Even when assets increase in value, reporters and others may try to argue that foundation insiders received excessive compensation for their work.

Despite those concerns, many foundations will still choose to select investment managers with close ties to the foundation. To ensure that those relationships are legal, ethical and publicly defensible, foundation managers should document:

- The selection process by which the manager is picked
- The professional skills and achievements on which the selection of the investment manager is based
- The benchmarks used to set the manager's compensation
- The performance standards used to evaluate the manager's work
- The contract or other agreement under which the manager can be fired
- The procedures, including policies and disclosure forms, that the foundation has adopted to avoid conflicts of interest

When a foundation's assets increase, the foundation's ability to effect positive change also increases. Good investment management can help this happen. But foundations need to ensure that the deals they make with money managers are wise investments as well.

Jane C. Nober is special counsel in the Legal Services and Ethical Standards Department at the Council on Foundations.

**Median Annual Investment Fees Paid in 2003, as a Percentage of Assets,
by Community Foundations, by Asset Group***

Asset Group (in millions)	Median Fees Paid (as a percent of assets)	Number of Respondents
\$250 or more	0.57	10
\$100 to \$249.9	0.49	15
\$50 to \$99.9	0.50	11
\$25 to \$49.9	0.50	22
\$5 to \$24.9	0.56	42
Total	0.52	100

*The survey instrument asks for an annual fee total which includes investment advisory, custodial and bank fees. This figure does not include brokerage commissions or investment consulting fees.

Note: These data are reported by each foundation and have not been verified for accuracy. For more information, contact Judith Kroll, director, Research, Council on Foundations.

Investment Consulting Fees Paid in 2001, by Private Foundations, by Asset Group

Asset Group (in millions)	Investment Consulting Fees as a Lump Sum			Investment Consulting Fees as a Percent of Assets				Number of Respondents
	Median	Mean	Range	Median	Mean	Range		
\$500 or more	135,800	416,931	25,000 to 5,337,343	0.0086	0.0334	0.0008	to 0.4063	23
\$250 to \$499.9	70,332	78,763	31,500 to 164,359	0.0175	0.0222	0.0068	to 0.0459	14
\$100 to \$249.9	52,084	75,632	15,000 to 548,394	0.0309	0.0478	0.0075	to 0.3740	31
\$50 to \$99.9	42,373	46,587	10,000 to 181,821	0.0588	0.0621	0.0124	to 0.1838	22
\$25 to \$49.9	25,000	37,546	9,000 to 142,165	0.0720	0.0923	0.0244	to 0.3575	9
\$10 to \$24.9	15,302	27,626	2,500 to 85,135	0.0947	0.1522	0.0131	to 0.3941	15
\$5 to \$9.9	10,000	17,003	2,400 to 42,000	0.1058	0.2651	0.0246	to 0.6532	5
Less than \$5	16,400	16,400	9,274 to 23,526	0.5191	0.5191	0.4895	to 0.5488	2
All	49,700	123,403	2,400 to 5,337,343	0.0363	0.0777	0.0008	to 0.6532	121

*Insufficient data. For more information, contact Judith Kroll, director, Research, Council on Foundations.



ARTICLE

Conflicts of Interest, Part IV

by Jane C. Nober

Foundation News & Commentary

January/February 2005 Vol. 46, No. 1



Ordinarily, established private foundations and public charity grantmakers would ignore the IRS's revision of Form 1023, Application for Recognition of Exemption from Federal Income Tax. After all, these groups have already received their determination letters. But the revised Form 1023 and the accompanying instructions that the IRS issued on November 1, 2004, merit grantmakers' attention.

The new Form 1023 is in the vanguard of IRS forms that are designed to educate tax-exempt organizations and help halt abusive transactions. In addition, the form and instructions contain questions and information about conflicts of interest that all grantmakers should consider.

The new Form 1023 focuses on policies and processes that charities can use to safeguard against abuses in areas such as compensation and self-dealing. Parts of the form set out a listing of what the IRS apparently deems best practices; if applicants indicate that they are not following these recommended steps, they must explain how they intend to achieve compliance with the law. The IRS has already stated that it

plans to incorporate questions like these into Form 990 and Form 990-PF, the annual information and tax forms that public charities and private foundations file.

Question 5 of Part V of the new Form 1023 focuses on conflicts of interest, a subject that this column has previously covered three times (www.foundationnews.org/CME/article.cfm?ID=2561, www.foundationnews.org/CME/article.cfm?ID=2747 and www.foundationnews.org/CME/article.cfm?ID=3006).

It asks applicants whether they have adopted a conflict of interest policy that is consistent with a sample included in the instructions. If the answer is “yes,” applicants must include a copy of the policy; if the answer is “no,” applicants must answer further questions on the subject: “What procedures will you follow to assure that persons who have a conflict of interest will not have influence over you for setting their own compensation?” and “What procedures will you follow to assure that persons who have a conflict of interest will not have influence over you regarding business deals with themselves?” The form notes that a conflict of interest policy is recommended but not required for exemption.

So what does the IRS think a conflict of interest policy should look like—and does the IRS model work for grantmakers? The IRS’s sample policy was drafted back in the late 1990s as a guide for healthcare organizations. It was developed with public charities in mind and with a particular focus on financial conflicts of interest between a charity and directors and officers. Private foundations may want to evaluate whether the sample policy is a good fit for them, and all grantmakers may wish to include statements about non-economic conflicts of interest. Following is a summary of some of the document’s provisions, with comments on how grantmakers might consider revising the policy.

PURPOSE

The IRS’s policy states that it is meant to protect a charity’s interests when it is contemplating transactions that may benefit the private interests of officers or directors or that might result in excess benefits to foundation insiders. *Comment: Public charity grantmakers’ conflicts policies often cite a desire to maintain public trust. Private foundations may cite the importance of exhibiting fairness or integrity or upholding the values of a founding family.*

DEFINITIONS

The policy defines an “interested person” as “any director, principal officer, or member of a committee with governing board delegated powers, who has a direct or indirect financial interest.” A person has a “financial interest,” directly or indirectly, through business, investment, or family, if the person has an actual or potential ownership or investment interest in any entity with which the charity has or is negotiating a transaction or arrangement, or has a compensation arrangement with the charity or with any entity or individual with which the charity has a transaction or arrangement. The policy clarifies that not every financial interest is a conflict of interest. *Comment: Grantmakers often have all manner of established advisory committees in operation; the policy should clearly show how it applies to members of those groups. Grantmakers’ policies may also cover staff members and should probably define who constitutes a member of an interested person’s family. Grantmakers may also wish to note that not every conflict of interest is financial; directors and staff members may have personal or political involvements that may cause them to have dual*

and conflicting loyalties in connection with a grant or other foundation expenditure. Private foundations must keep in mind that the definition of “interested persons” is different from—and less inclusive than—the tax code’s definition of “disqualified persons,” that group of donors, directors and their family members and business interests with which the foundation is barred from entering into an array of financial transactions.

PROCEDURES

The IRS’s sample policy provides that an interested person must disclose any actual or possible conflict of interest and all material facts relevant to the conflict. After disclosure to the board or appropriate committee, the interested person must leave the meeting room. The board or committee will then discuss the matter and vote on whether a conflict of interest exists. If a conflict of interest exists, the board or committee shall, if appropriate, determine whether the charity can obtain a more advantageous arrangement that would not pose a conflict of interest. If an alternative arrangement is not possible, the board or committee shall determine by a majority vote of disinterested directors whether the transaction is in the charity’s “best interest, for its own benefit, and whether it is fair and reasonable.” *Comment: This procedure tracks many states’ laws on how to deal with conflicts of interest. Where a vote of disinterested directors is not possible, an outside authority such as a court may validate a transaction if it can be shown to be fair and reasonable. No amount of disclosure or independent ratification can correct an act of self-dealing that occurs between a private foundation and a disqualified person.*

COMPENSATION

The sample policy also states that a voting member of a board or committee who receives compensation for services from the charity is prohibited from voting on matters related to his or her compensation arrangement. *Comment: Both private foundation and public charity grantmakers should exercise great caution when they hire foundation insiders—family members or board or committee members—to perform professional services. See www.foundationnews.org/CME/article.cfm?ID=2747 and www.foundationnews.org/CME/article.cfm?ID=3006.*

ANNUAL STATEMENTS AND PERIODIC REVIEWS

To ensure compliance, the conflicts policy requires that directors and officers annually sign a statement declaring that they have received, read, understood and intend to comply with the policy. The charity is obligated to carry out periodic reviews to ensure that the organization does not serve private interests at the expense of its charitable mission. The periodic compliance check will include, at a minimum, a review of whether “compensation arrangements and benefits are reasonable, based on competent survey information, and the result of arm’s length bargaining,” and whether transactions with management organizations are reasonable and do not result in impermissible private benefit. *Comment: This provision requires only an annual certification that the directors and officers have read and understood the policy and agree to comply with it; some foundations require periodic statements from individuals covered by conflicts of interest policies that disclose the financial, vocational and charitable ties that may give rise to conflicts.*

The key features that appear in most conflicts of interest policies can be reduced to a few simple (and alliterative) ideas: disclose, discuss, decide (by disinterested directors whenever possible) and document. The IRS's sample policy requires all of those actions. With a little tweaking, this policy can help grant-makers ensure that their assets are being used for charitable, not private, ends.

ADDITIONAL RESOURCES

The new 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 are available at www.irs.gov/pub/irs-pdf/i1023.pdf.

The IRS training material in which the model conflict of interest policy was originally presented can be found at www.irs.gov/pub/irs-tege/topic-c.pdf.

Updates to this article are at www.irs.gov/pub/irs-tege/topice00.pdf and www.irs.gov/pub/irs-tege/eotopic04.pdf.



	IRS Sample Conflict of Interest Policy	Additional Provisions to Consider
Purpose	<ul style="list-style-type: none"> ■ Prevent transactions that result in private benefit at the charity's expense 	<ul style="list-style-type: none"> ■ Maintain public trust, fairness and integrity
Definitions <i>Who does it apply to?</i> <i>What does it apply to?</i>	<ul style="list-style-type: none"> ■ Directors, officers, members of a committee with governing board delegated powers, who have a direct or indirect financial interest ■ Individuals with direct or indirect financial interest 	<ul style="list-style-type: none"> ■ Staff, advisory board or committee board members with no voting power, definition of family members ■ Non-financial interest, especially related to grantmaking practices
Procedures <i>What procedures are used to resolve conflicts?</i>	<ul style="list-style-type: none"> ■ Disclose, discuss, decide (by disinterested directors whenever possible) and document ■ Appropriate disciplinary and corrective actions are available for violations 	<ul style="list-style-type: none"> ■ No amount of disclosure can correct an act of self-dealing between a private foundation and a disqualified person
Compensation	<ul style="list-style-type: none"> ■ Board member does not vote on his or her compensation for services provided 	
Annual statements and periodic reviews	<ul style="list-style-type: none"> ■ Ensure that interested persons annually sign statement acknowledging receipt, knowledge of and compliance with policy ■ Review compensation and management services arrangements ■ Employ independent outside expert to assist with periodic review, if necessary 	<ul style="list-style-type: none"> ■ Interested persons periodically disclose relevant outside ties



RESEARCH

Conflicts of Interest Policies

by Judith Kroll

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Judith Kroll is the Council on Foundations director for Research.

The Council on Foundations' *2004 Grantmakers Salary and Benefits Report* includes four tables on staff conflict of interest policies. Sixty-five percent of foundation respondents reported that they have a written conflict of interest policy for staff. Family foundations were less likely to have a policy than community or public foundations.

Among foundations that have a written policy, 69.5 percent (316 of 455) prohibit or require the disclosure of gifts, remunerations or services from grantees or applicants. More than 85 percent prohibit or require the disclosure of service on the boards of grantees or applicants. Nearly four-fifths of foundations prohibit or require the disclosure of a staff or family member affiliation with grantees, applicants or vendors.

Seventy percent (328 of 470) of respondents with a written conflict of interest policy also require staff to sign disclosure statements. More than 70 percent of both community and public foundations reported this practice. Staff was most often (64.1 percent) required to sign such statements annually.

The Council's annual *Grantmakers Salary and Benefits Report* covers base compensation levels for 37 positions of four grantmaker types—community, corporate, private and public. Among the privates, family foundation data are separated from independents for ten of the 37 positions—CEO, program director, senior program officer, program officer, program associate, program assistant, grants manager/administrator, executive assistant, administrative assistant and secretary. The report also covers staff demographics, tenure and turnover, salary administration, bonuses and issues specific to the CEO.

Benefits information regularly covered includes costs, percentage of benefits costs covered by grantmakers, types of leave and voluntary benefits offered and retirement plans. In 2004, detailed information was collected on education benefits/tuition reimbursement, medical plan features and the cost of medical plan coverage.

Data in the report are presented by grantmaker type and asset group and by staff size for the benefits tables. To order, visit www.cof.org/publications. Book: Item #227, \$80, Nonmembers \$150. CD-ROM: Item #226, \$40, Nonmembers \$80.

**Grantmakers that Require Staff to Sign a Conflict of Interest Disclosure Statement,
by Grantmaker Type and by Asset Group, 2004**

	Grantmakers That Require Staff to Sign Conflict of Interest Disclosure		Grantmakers That Do Not Require Staff to Sign Conflict of Interest Disclosure		Number of Respondents
	Percent	Number	Percent	Number	
All	69.8	328	30.2	142	470
Grantmaker Type					
Community	74.8	157	25.2	53	210
Private	64.1	132	35.9	74	206
Family	60.8	48	39.2	31	79
Independent	66.1	84	33.9	43	127
Public	72.2	39	27.8	15	54
Asset Group (in millions)					
\$250 or more	72.0	77	28.0	30	107
\$100 to \$249.9	68.7	46	31.3	21	67
\$50 to \$99.9	70.3	52	29.7	22	74
\$25 to \$49.9	78.3	47	21.7	13	60
\$10 to \$24.9	66.7	50	33.3	25	75
\$5 to \$9.9	60.0	27	40.0	18	45
Less than \$5	69.0	29	31.0	13	42

Note: Does not include corporate grantmakers.



Sample Conflict of Interest Policies

SAMPLE ONE: FOR STAFF AND BOARD Code of Conduct

I. Introduction

The Foundation is a publicly supported charitable foundation serving the communities of [insert name of communities] and is dedicated to its mission of expanding private philanthropy in those communities. The Foundation operates within the public trust and strives to maintain the highest code of conduct in all of its operations.

The foundation recognizes that it can best accomplish its mission when the board of directors, volunteer committee members, staff and other groups associated with the foundation represent the diverse interests, cultures, occupations and expertise of the community. Thus, the foundation recognizes that members of the board of directors and others representing or affiliated with the foundation will from time to time face possible conflicts of interest or situations in which the appearance of conflict of interest could be detrimental to the foundation and the communities it serves. The foundation adopts this code of conduct in recognition of its responsibility to the public trust, in recognition of the importance of fairness and objectivity in its conduct of business, as a means of assuring that every decision of the foundation is made in the interest of the foundation and the communities it serves and as a means of publicly codifying its expectations of board, staff and volunteers, and others serving the foundation.

This code of conduct applies to all persons holding positions of responsibility and trust on behalf of the Foundation, including but not limited to members of the board of directors, volunteer committee members, members of the boards of supporting organizations to the foundation, and members of the foundation staff (hereinafter “members”). This code of conduct shall be provided to each member at the time that he or she is asked to serve the foundation.

II. General Policies and Expectations

Members of the foundation are expected to commit themselves to ethical and professional conduct. This includes the proper use of authority and appropriate decorum.

Members must represent unconflicted loyalty to the interest of the foundation. This accountability supersedes any conflicting loyalty such as that to advocacy or interest groups, business interests, personal interests or paid or volunteer service to other organizations. It also supersedes the personal interest of any staff or volunteer member acting as a consumer or client of the foundation's services.

It is the policy of the foundation that no member shall derive any personal profit or gain, directly or indirectly, by reason of his or her service to the Foundation.

There may be no self-dealing or any conduct of private business or personal services between any member and the foundation except those conducted in an open and objective manner to ensure equal competitive opportunity and equal access to information.

Board members or volunteer committee members must not use their positions to obtain employment in the Foundation for themselves, family members or close associates. Should a board or volunteer committee member desire employment, he or she must first resign.

Board and volunteer committee members may not attempt to exercise individual authority over the policies and operations of the foundation except through their roles as voting members of the board or volunteer committees. Staff members may not attempt to exercise individual authority over the policies and operations of the foundation except through their specific job responsibilities and established supervisory structure.

Board members and volunteer committee members in their interaction with the press and the public must recognize the inability of any individual member of the board or committee to speak for the foundation except as expressly authorized by the board chair. Staff members in their interactions with the press and the public must recognize the inability of any individual staff member to speak for the foundation except as expressly authorized by the executive director.

The Foundation will comply with both the letter and spirit of all public disclosure requirements, including the open availability of its Form 990 tax returns. However, all members must hold strictly confidential all issues of a private nature, including, but not limited to, issues related to private businesses, contributions from individuals, businesses and other private entities, and all personnel matters.

III. Policies on Conflict of Interest

In conducting the affairs of the foundation, duality or conflict of interest shall be presumed when a person to whom this policy applies or a member of his/her immediate family serves as a trustee, officer, staff member or holder of more than 10% of corporate stock of an affected organization or firm; has a formal affiliation or interest in an affected organization or firm; or could expect financial gain or loss from a particular decision.

Before a staff, board or volunteer committee member begins his or her service with the foundation, he or she shall file with the executive director of the foundation a list of his or her principal business activities, as well as involvement with other charitable and business organizations, vendors or business interests, or with any other associations that might produce a conflict of interest.

In addition to the disclosure required by the previous paragraph, each member is under an obligation to the foundation, to his or her fellow staff or volunteers, and to the community served by the Foundation to inform the foundation of any position he or she holds or of any business or a vocational activity that may result in a possible conflict of interest or bias for or against a particular grantee, action or policy, at the time such grant, action or policy is under consideration by the board or any volunteer committee of the foundation. Any duality or possible conflict of interest on the part of any member shall be disclosed to the chair of the board (in the case of volunteers) or the executive director (in the case of staff members) and made a matter of record as soon as the issue in question is raised and a possible conflict is known.

When the board, committee or staff is to decide upon an issue about which a member has an unavoidable conflict of interest, that member shall physically absent herself or himself without comment from not only the vote, but also from the deliberation, unless directly requested by the chair of the board or relevant committee to provide factual information or answer factual questions that may assist the board or committee in making a wise decision. In no case shall that Member vote on such matter or attempt to exert personal influence in connection therewith.

Disclosure and abstention shall be recorded in the minutes of the meeting(s) at which the issue is discussed and decided.

In any situation not specifically covered by the previous sections of this policy, members shall consider carefully any potential conflict of their personal interests with the interests of the foundation and refrain from any action that might be perceived as an actual or apparent conflict of interest.

IV. Examples of Appropriate Actions Under This Code of Conduct

Example 1. An officer or other paid employee of a bank or other financial institution who is also a board or finance committee member of the Foundation should inform the chair of the board of his or her potential conflict of interest and abstain from discussing or voting on the retaining, employing or dismissing of his or her financial institution as an investment manager of the foundation.

Example 2. A board or distributions committee member who is also a board, staff or committee member of a proposed grantee should inform the chair of his or her conflict of interest and abstain from voting on or discussing any motion for or against the proposed grant, except as expressly requested by the chair to provide factual information or answer factual questions that would be useful to the board or committee in its decisionmaking. If several grants are being voted upon concurrently, the Board or committee member must voice his or her conflict of interest to the chair before the vote so that a vote on the grant with which there is a conflict may be taken separately.

Example 3. A Board or Committee member whose personal financial interests could be positively or adversely affected by the Foundation's accepting, holding or disposing of a particular gift from a donor or by knowledge of the gift should inform the chair of his or her potential conflict of interest; refrain from seeking, obtaining or reviewing non-public information about the gift; and abstain from discussing or voting on acceptance of the gift.

V. Duties of the Board Chair and the Executive Director

The chair of the board shall be responsible for the application and interpretation of the code of conduct as they relate to board members, volunteer committee members or the executive director. The executive director shall be responsible for the application and interpretation of the above policies as they relate to members of the foundation's staff.

VI. Duties of Members

Each member has the affirmative responsibility to report to the board chair (in the case of concerns related to board or committee members or the executive director) or to the executive director (in the case of concerns related to members of the staff) any and all knowledge of any action or conduct that appears to be contrary to this code of conduct.

SAMPLE TWO: FOR STAFF

Policies and Procedures Regarding Conflict of Interest

Employees are required to conduct themselves at all times in accordance with good professional judgment for the sole benefit of the foundation and in such a manner as to not create a conflict of interest or appearance of such conflict.

A conflict of interest exists when an employee's duty to give individual loyalty to the foundation can be prejudiced by actual or potential benefit from another source. An employee should refrain from entering into any particular transaction or establishing any relationship with others if the employee's duty of loyalty and diligence to the foundation is or may be impaired.

Following are some examples of actions or activities that may create an actual conflict of interest, or give the appearance of a conflict:

- Engaging in any outside activity that detracts from the efficiency of your duties as an employee of the foundation. This includes serving on the board of organizations that are current or potential grantees of the foundation without the approval of the president and the board of directors;
- Engaging in any activity that conflicts with the interest or purpose of the foundation;
- Engaging in any financial, business or other relationships with current or potential grantees of the foundation;
- Accepting in any form whatsoever any remuneration, compensation or gift from current or potential grantees of the foundation. Likewise, no employee shall provide or give gifts or favors to others where these might appear designed to influence improperly others in their relations with the foundation;
- Failing to disclose to the President that an immediate family member is affiliated with a grantee or applicant.

All employees are under a continuing obligation to make full disclosure to the president of all situations involving either actual or potential conflicts of interest, whenever such situations may arise. If the foundation determines that a conflict of interest or appearance of such conflict exists, the employee may be asked to correct or remedy the situation immediately. Depending on the circumstances, an employee may be subject to discipline, up to and including termination, for having engaged in conduct that constitutes a conflict, or for failing to disclose promptly a situation involving an actual or potential conflict of interest.

Employee's Signature

Date

Employee's Name (typed or printed)

Received & Accepted By

Date

SAMPLE THREE: FOR STAFF AND BOARD

Conflict of Interest Disclosure and Confidentiality Statement

During the time that I serve on the board of directors, the employee review team or as an employee of [FOUNDATION], I realize that I will gain access to information that is considered to be confidential and/or proprietary. Such information relates to submitted proposals, criteria or decisions made with regard to the business of [FOUNDATION].

Since confidential and proprietary information is crucial to the operation of the foundation, and because the foundation in some instances has the obligation to protect such information, I agree that I will not use, publish or disclose such information during or subsequent to my employment or participation on the board of directors or the employee review team, and that I will preserve the restricted nature of this information except to the extent that it becomes publicly available, or is otherwise lawfully obtained outside the scope of this agreement from third parties.

Additionally, as an employee or member of the board of directors or the employee review team, I realize that I have an obligation to disclose and eliminate (if necessary) any potential or actual duality of interest or conflict of interest.

Below, I have listed all community organizations, nonprofit corporations or charitable programs that I or a member of my immediate family has a relationship with, that have sought or may in the future seek to do business with the foundation. The term “relationship” means any relation with a person or organization, whether financial (such as a significant donation of more than \$100), employment (such as a volunteer assignment, part-time job or as a consultant or independent contractor) or fiduciary (such as a board member or officer). The term “immediate family” means spouse, parent, child or other individual living in the same household.

I hereby certify that I have read, understand and agree to the foundation’s policies as described in this statement, with respect to confidential information and conflict of interest, and that the information given in this statement is complete and accurate to the best of my knowledge.

Date

Name (printed or typed)

Signature

SAMPLE FOUR: FOR STAFF AND BOARD

Purpose of the Statement of Policy

The foundation is committed to integrity and fairness in the conduct of all of its activities. Inevitably, the interests of directors and employees will involve them in organizations, causes and other endeavors that intersect with the affairs of the foundation. It would disadvantage the foundation to deprive it of the involvement of interested colleagues, but their participation in foundation decisionmaking cannot impair the fairness and integrity of foundation processes. This statement of principle is intended to further the work of the foundation by facilitating the substantive contributions of its employees and Directors through providing for disclosure of other interests and by requiring abstention from decisionmaking actions that affect non-foundation affiliations or interests. In addition, the foundation would suffer if there were any appearance of bias or self-interest in its activities. These principles are intended to preclude any such appearance.

This statement is not a codification of rules of conduct; rather it is an expression of intention and purpose which should be interpreted and applied to achieve its stated objective. Individuals worthy of affiliation with the foundation will govern themselves by that spirit.

Disclosure. Directors and employees of the foundation are committed to communicating fully with the foundation regarding any relationship or commitment that could affect the impartial fulfillment of their role in the affairs of the foundation. This policy refers to such a relationship or commitment as affiliation. Affiliation may be defined as the close involvement with a vendor, service provider or grantee on the part of (a) a director of the foundation, (b) a staff member of the foundation or (c) the spouse or equivalent, parents or children of a director or staff member. Affiliation includes, but is not limited to, serving as a board member, employee or consultant to a current or potential grantee, service provider or vendor, or doing business with the grantee, service provider or vendor. Antecedent affiliations and indirect associations also warrant disclosure. In principle, extra-foundation affiliations or interests should be disclosed to other participants in the foundation's decisionmaking process whenever there is any doubt about whether disclosure is required.

Disclosures ordinarily should be made to the president by members of the staff and to the chair of the board by other members of the board of directors. Formal notation of disclosures should be a part of the process.

Abstention from Foundation Decisionmaking. In all situations in which disclosure of affecting relationships should be made, the foundation-affiliated individual should abstain from decision-taking actions, and that abstention should be formally noted in the foundation's minutes. With disclosure to other participants, the work of the foundation is furthered by the willingness of its employees and Directors, however interested, to share information bearing upon the matter under consideration. Such participation is encouraged.

No Return Benefit. In considering any decision regarding an organization or person with which a foundation employee or director is affiliated, the foundation shall avoid any transaction that results in any direct or indirect economic benefit to the affiliated person or that would constitute self-dealing under Internal Revenue Code Section 4941. Incidental and tenuous benefits to affiliated persons, such as name recognition or public acknowledgment, are permitted.

Avoid the Appearance of Conflict. While the substance of integrity is the essence of the foundation's approach to these matters, avoiding the appearance of conflict is an important collateral objective. To that end, the foundation will not customarily make grants to, or contract with, organizations that employ affiliated persons. The president, with the concurrence of the chair of the board of directors, may approve exceptions to this policy when the work of the foundation will be furthered thereby or where the grant or contract will not affect the job or compensation of the affiliated person in question.

No significant personal benefit of any nature may be derived by any affiliated person from any such organization.

SAMPLE FIVE: FOR STAFF AND BOARD

Conflict of Interest Policy

The board and staff members of the foundation are encouraged to play active roles in their communities by serving as board members or otherwise being involved with a wide spectrum of nonprofit organizations. This means that, from time to time, potential conflicts of interest or the appearance of such conflicts will inevitably arise. It is the foundation's policy to deal with such conflicts in as open and appropriate a way as possible.

Conflicting involvements include but are not limited to the following: foundation board or staff members serving as board members of applicant organizations, immediate family members of foundation board or staff members serving as board members of applicant organizations, foundation board members or staff members or their immediate family members being employed by or doing business with applicant organizations.

In case of such conflicts or the appearance thereof, foundation board members and staff are expected to disclose the conflict before making any related grant decisions. Once such a disclosure has been made, the remaining board members will determine whether or not there is a potential conflict of interest. Should it be so considered, the board member involved shall abstain from voting and shall not participate in the discussion of the applicant organization other than to answer specific questions that may be raised by other board members.

In cases where the foundation's board of trustees decides to award a grant to an organization and one or more of the foundation's board members has abstained from voting as the result of a conflict or the appearance thereof or a staff member has a conflict or the appearance thereof, such grants and board or staff members shall be identified in the foundation's annual report.



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1828 L Street, NW, Suite 300, Washington DC 20036 • 202/466-6512 • fax 202/785-3926 • www.cof.org