Conflict of Interest Policy Checklist for Nonprofits

A conflict-of-interest policy protects your nonprofit by ensuring that decisions are made in the organization's best interest rather than for the personal benefit of a director, officer or insider. The IRS does not require such a policy for 501(c)(3) tax-exemption, but adopting one helps directors recognise situations that could present a conflict and reduces the risk of inappropriate benefits. Kentucky's Principles and Practices for Nonprofit Excellence recommend an annual conflict-of-interest disclosure and emphasise that a majority of the board should be independent (not staff, not related to staff, and not paid contractors).

This checklist summarises key provisions to include in a conflict-of-interest policy and offers sample language adapted from the IRS-approved policy. Consult legal counsel to tailor the policy to your organization and comply with Kentucky statutes (e.g., KRS 273.215 on director duties).

Purpose and Key Definitions

1. Purpose

> **Sample language:**
>
> Purpose. The purpose of this conflict-of-interest policy is to protect the organization's interest when it contemplates entering into a transaction or arrangement that might benefit the private interest of an officer or director or result in an excess benefit transaction. The policy is intended to supplement but not replace any applicable state and federal laws governing conflict of interest.

Why it matters

- **Protects tax-exempt status.** Conflicts that are not managed can result in "intermediate sanctions" and jeopardize the organization's tax-exempt status.
- **Encourages disclosure and candour.** The policy should encourage directors to disclose potential conflicts and abstain from voting on matters in which they have an interest.

2. Definitions

Define key terms so everyone understands when the policy applies.

Interested person

Any director, principal officer, or member of a committee with board-delegated powers who has a direct or indirect financial interest.

Financial interest

An ownership or investment interest, compensation arrangement, or potential ownership or compensation interest with the organization or a third party. A financial interest is not necessarily a conflict; the board determines whether one exists.

Procedures and Documentation Requirements

3. Procedures

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Duty to disclose

Interested persons must disclose the existence and nature of their financial interest and all material facts before the board discusses a proposed transaction.

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Determination of conflict

After disclosure, the interested person leaves the meeting while disinterested directors discuss and vote on whether a conflict exists.

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Addressing the conflict

- The interested person may present information but must leave before discussion and vote.
- The committee or board should investigate alternatives that might avoid the conflict.
- If no better alternative exists, the disinterested directors decide whether the transaction is in the organization's best interest and fair and reasonable.

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Violations

If the board has reasonable cause to believe someone has failed to disclose a conflict, it should inform the person and provide an opportunity to explain. After investigation, the board may take appropriate corrective action.

4. Records of Proceedings

Meeting minutes should record:

- Names of persons who disclosed or were found to have a financial interest, the nature of the interest, and the board's determination whether a conflict existed.
- Names of persons present for discussions and votes, the content of the discussion (including alternatives considered), and how the board voted.

5. Compensation Restrictions

- A voting board member who receives compensation from the organization must not vote on matters relating to their compensation.
- Members of committees that oversee compensation who also receive compensation are likewise precluded from voting on those matters.

Annual Requirements and Periodic Reviews

6. Annual Statements

All directors, officers and committee members with delegated powers should annually sign a statement confirming that they:

- Received and read the conflict-of-interest policy.
- Understand and agree to comply with the policy.
- Recognize the organization's charitable status and its requirement to operate primarily for exempt purposes.

7. Periodic Reviews

The organization should conduct periodic reviews to ensure that transactions are fair and do not jeopardize tax-exempt status. These reviews should assess whether:

- [ ] **Compensation arrangements and benefits are reasonable**

  Based on competent survey information and arm's-length negotiation.

- [ ] **Transactions with vendors or partners are consistent**

  With policies, properly recorded and further charitable purposes.

- [ ] **Joint ventures and partnerships conform**

  To the organization's purposes and do not result in impermissible private benefit.

> Where appropriate, the board may engage outside experts to help with these reviews. Use of experts does not relieve the board of its responsibility to ensure reviews are conducted.

IRS Compliance and Kentucky-Specific Considerations

8. IRS Compliance Tips

The IRS encourages, but does not require, adoption of a conflict-of-interest policy for tax-exempt organizations. When applying for recognition of exemption (Form 1023), the IRS asks whether the organization has a written policy and how it manages conflicts. To demonstrate good governance:

Document arm's-length transactions

Use comparable data and reliable methods to ensure transactions (including compensation) are at fair market value. Arm's-length negotiations require parties to have adverse interests; related parties require additional precautions.

Recuse interested individuals

Ensure directors with a financial interest abstain from discussions and votes. The IRS looks for evidence that the board followed procedures when conflicts arose.

Maintain independence

Kentucky's Principles & Practices recommend that at least a majority of the board be independent and not compensated; this independence helps avoid excess benefit transactions.

Update disclosures annually

Collect conflict-of-interest questionnaires each year to identify potential conflicts and remind directors of their duty of loyalty.

9. Kentucky-Specific Considerations

Kentucky's KRS 273.215 codifies the duty of directors to act in good faith, on an informed basis and in the best interests of the corporation. Directors may rely on information from officers, employees or experts but must reasonably believe it to be reliable. Violations of the conflict-of-interest policy could be evidence of a breach of these fiduciary duties. The Kentucky Nonprofit Network urges nonprofits to:

- Adopt a written conflict-of-interest policy and require annual disclosures.
- Maintain a majority of independent directors (neither employees nor family members).
- Document decisions thoroughly in meeting minutes and retain records according to your document-retention policy.

Using this checklist will help your nonprofit create a robust conflict-of-interest policy that complies with IRS guidance and Kentucky best practices.