

GOVERNANCE: CONTENDING WITH CONFLICTS OF INTEREST

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Seattle, WA

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Handouts:

1. PowerPoint Presentation
2. Sample Conflicts of Interest Policy

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OVERVIEW

- Why focus on conflicts?
- Separate board and administrative conflicts policies
- What rules apply?
- Drafting and implementing a board conflicts policy
- Using a lawyer

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WHY FOCUS ON CONFLICTS?

- Head Start reauthorization
- IRS Form 990
- Funding source scrutiny
- State law
- Governance best practices
- Public perception – public, press, donors

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EXAMPLES OF POSSIBLE CONFLICTS

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- Board member works for bank where CAA wants to get a loan
- CAA considering hiring executive director's daughter as a consultant
- Policy council member's aunt works for CAA
- CAA pays law firm of attorney on its board for legal services
- Many others...

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SEPARATE BOARD AND ADMINISTRATIVE POLICIES

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- Board – directors and officers
- Administrative – employees and agents
- Policy Council – for Head Start grantees

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ADMINISTRATIVE CONFLICTS POLICY

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- Sometimes called codes of conduct
- Concerned primarily with financial benefits or interests
- Employment of family members
- Procurement
- Gifts
- Policy in employee handbook

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WHAT RULES APPLY?

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- IRS "excess benefit" rules
- Government grant rules
 - OMB Circulars
 - Head Start, HUD
 - State grant rules
- State corporate law
- Ethics rules for gov't employees
- IRS Form 990
- Audited financial statements – FASB 57
- State reporting rules/forms

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IRS EXCESS BENEFIT RULES

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- Excise taxes on:
 - Insiders who get unreasonable compensation for services or more than FMV for property from 501(c)(3) and
 - Managers (including board members) who approve those transactions

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IRS RULES: REASONABLE COMPENSATION

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- Reasonable compensation = what like enterprises (nonprofit and for-profit) under like circumstances would ordinarily pay for like services

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IRS RULES: INSIDERS

- Insiders (“disqualified persons”) = anyone in a position to exercise substantial influence over the org’s affairs at any time during the 5 years ending on transaction date

IRS RULES: INSIDERS

- Disqualified persons include (among others):
 - Board members
 - Officers and key staff – e.g. president, CEO, treasurer, CFO, COO or equivalent
 - Certain of their family members: spouses; brothers/sisters; ancestors; children; grandchildren; great grandchildren; and their spouses
 - Certain entities controlled (35% or more) by board members, officers, key staff or family members

IRS REBUTTABLE PRESUMPTION

- If follow certain procedures, IRS has burden of showing 501(c)(3) paid unreasonable compensation or more than FMV for property

IRS REBUTTABLE PRESUMPTION PROCEDURES

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- Transaction must be approved by authorized body (board or board committee) composed of people who don't have a conflict of interest re: the transaction
- Before deciding whether to approve the transaction, board/committee must get and rely on appropriate data as to comparability
- Board/committee must adequately document the basis for its decision

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OMB CIRCULARS – A-122 AND A-87

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- May not use federal funds to pay for professional and consultant services provided by officers and employees (outside of regular employment) (A-122, Att. B, 37.a; A-87, Att. B, 32.a)
- Compensation paid to directors, officers, associates or their immediate family members must be reasonable for services rendered (A-122, Att. B, 8.d)
- Costs of goods/services for personal use of employees are unallowable (A-122, Att. B, 19; A-87, Att. B, 20)

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OMB CIRCULARS – A-110

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- Employees, officers or agents can't participate in selection, award, or administration of federally funded contract if real or apparent conflict of interest would be involved (2 CFR § 214.42)
- Officers, employees and agents may not solicit or accept gratuities, favors, or anything of monetary value from contractors, or parties to sub-agreements (2 CFR § 214.42)
- Similar rules for public CAAs

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HEAD START – BOARD

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- Members of governing body shall:
 - Not have a financial conflict of interest with the Head Start agency (including any delegate agency)
 - Not receive compensation for serving on the governing body or for providing services to the Head Start agency
 - Not be employed, nor shall members of their immediate family be employed, by the Head Start agency (including any delegate agency)
- Exception for public officials in certain cases

(42 USC §9837(c)(1))

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HEAD START – BOARD

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- Immediate Family Member
 - Spouse
 - Parents and grandparents
 - Children and grandchildren
 - Brothers and sisters
 - In-laws
 - Adopted and step family members

(Policy Clarification OHS-PC-E-029)

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HEAD START – POLICY COUNCIL

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- Members of policy council shall:
 - Not have a conflict of interest with the Head Start agency (including any delegate agency)
 - Not receive compensation for serving on the policy council or for providing services to the Head Start agency

(42 USC §9837(c)(2))

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HUD PROGRAMS

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- Check rules for your program(s)
- Who's covered?
 - Officers, employees, agents, consultants of CAAs, and CAA public official board members if their gov't agency makes grants of HUD funds to CAA
 - If they exercise functions or responsibilities with respect to HUD program run by CAA or are in a position to participate in a decision-making process or gain inside info re: that program

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HUD PROGRAMS

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- What's prohibited?
 - Covered persons can't:
 - Have a financial interest or benefit from the HUD-assisted activity
 - Have a financial interest (and, in some programs, a personal interest) in any contract, subcontract, or agreement re: the HUD-assisted activity or re: the proceeds of the HUD-assisted activity
 - Either for themselves or those with whom they have business or immediate family ties, during their tenure or for one year afterward

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HUD PROGRAMS

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- HUD may grant exceptions in certain cases
 - Disclosure of conflict to HUD and to public required
 - Must show certain factors
 - Where funds come through a state or local gov't, it must request the exception and provide an attorney's opinion that interest won't violate state or local law

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STATE GRANT RULES

- Check state grant rules re: conflicts of interest – for example:
 - Program-specific rules (e.g., CSBG)
 - Procurement rules for state contractors/grantees

STATE CORPORATE LAW

- Nonprofit corporate law in many states
 - Requires board to follow certain procedures when reviewing conflict-of-interest transactions
 - Prohibits loans to officers and directors

ETHICS RULES FOR GOV'T EMPLOYEES

- Federal employees can't act as agents or attorneys for anyone before any federal dep't or agency (18 USC §205)
- State and local ethics laws may prohibit public officials from:
 - Taking official acts that would benefit organizations (including nonprofits) with which they have personal connections
 - Participating in certain transactions with private organizations
 - Accepting gifts or payment of travel or entertainment expenses

DISCLOSURE

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- FASB 57 requires disclosure of material related-party transactions in audited financial statements
 - Excludes compensation
 - Includes no-cost or nominal cost transactions
- New IRS Form 990 – increased focus on conflicts
- Reports filed with state charity regulators may require disclosure of related-party transactions

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DRAFTING A BOARD CONFLICTS POLICY

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- Conflicts with conflicts
- Integration of different rules
- One source for the board
- Policy in board policy manual

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ANATOMY OF A BOARD CONFLICTS POLICY

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- Purpose
- Covered persons
- Conflict defined
- Prohibited conflicts
- Procedure for permissible conflicts
- Monitoring conflicts policy
- Disclosure/acknowledgement statement

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PURPOSE

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- Purpose of purpose
- Audience
 - Future board
 - Staff
 - Donors
 - Public/press
- Form 990 inquires about disclosure of conflicts policy

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COVERED PERSONS

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- Board vs. administrative policy
- Look to rules that apply
 - IRS “excess benefit” rules
 - Government grant rules
 - State corporate law
 - Ethics rules for gov’t employees
 - FASB 57
 - IRS Form 990
 - State reporting rules/forms

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CONFLICT DEFINED

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- Focus on financial interests
- Exclusions from conflicts
- Non-financial conflicts

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PROHIBITED BOARD CONFLICTS

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- Head Start – board members
- HUD – officers, and in some programs, board members
 - Employees, agents and consultants in administrative policy
- OMB Circulars – officers
 - Employees and agents in administrative policy

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PERMISSIBLE BOARD CONFLICTS – PROCEDURE

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- IRS excess benefits transactions rebuttable presumption
- Check state law for greater restrictions

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MONITORING

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- IRS Form 990
- Use of disclosure forms

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IRS FORM 990

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- Three sets of questions on conflicts
- Customizing the monitoring process to your organization
- Integrating monitoring into board policies that define duties

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USE OF DISCLOSURE FORMS

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- Three questionnaires on conflicts/independent and related directors
- Conflicts: detailed vs. minimal disclosure
- Use of disclosure forms for education
- Following through on disclosure forms

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USING A LAWYER

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- Why?
 - Conflicts policies are very engineered
 - Especially if multiple funders
- Avoid cut and paste
- Need lawyer familiar with state law
- Need lawyer familiar with funder requirements to work with local attorney
 - CAPLAW
 - CDLC in Oregon

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CERTIFICATION

- Congratulations!
You are now a Conflicts Wonk

ORGANIZATIONAL RESOURCES

- CAPLAW (www.capl原因.org)
- Community Development Law Center (www.cdlcweb.org)
- Technical Assistance for Community Services (www.tacs.org)
- Board Source (www.boardsource.org)
- Independent Sector (www.independentsector.org)
- IRS (www.irs.gov/charities)
- Guidestar (www.guidestar.org)

FEDERAL CITATIONS

- Federal Employees – 18 U.S.C. §205
- IRS Excess Benefits Transactions
 - 26 USC §4958
 - 26 CFR §53.458-0 through 53.4958-8
- IRS Form 990 (www.irs.gov/charities)
- Office of Management and Budget
 - OMB Circular A-110, §215.42
 - OMB Circular A-122, Attachment B.7.d and 37.a, 19

FEDERAL CITATIONS: HUD

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- Community Development Block Grants
– 24 CFR §570.611
- Home Investment Partnership Programs
– 24 CFR §92.356
- Emergency Shelter Grants
– 24 CFR §576.57(d)

**FEDERAL CITATIONS:
HEAD START**

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- 42 USC § 9837(c)(1) and (c)(2)
- 45 CFR §1304.50, 1304.52(i)(2)
- Policy Clarifications: HHS-PC-E-Program Governance Guidance

**CONFLICTS OF INTEREST POLICY
FOR
CAPLAW'S 2009 NATIONAL TRAINING CONFERENCE
SEATTLE, WASHINGTON**

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This is a sample policy to be used for educational purposes. A good conflicts policy is a very complex document that responds to IRS rules, federal and state funder requirements, and state nonprofit law. Please obtain legal help before you finalize your conflicts policy.

CONFLICTS OF INTEREST AND EXECUTIVE COMPENSATION POLICY FOR HEAD START PROGRAMS

Purpose

The Board of Directors shall monitor the transactions between the corporation and insiders to ensure that any transaction between the corporation and an insider that is a conflict of interest is fair to the corporation and does not grant excessive benefit to the insider. The purposes of this policy are to ensure that directors and officers act loyally to the corporation and that directors, officers and those who exercise substantial influence over the corporation do not use their influence to obtain benefits in excess of fair market value in transactions with the corporation. This policy seeks to ensure that the corporation observes state and federal taxation and funding laws concerning conflicts and excess benefits transactions.

SECTION 1: DEFINITION OF INSIDER

For purposes of this policy, “insider” has the same meaning as “disqualified person” under the Internal Revenue Code, 26 USC §4958. The current IRS definition is explained in §1.1 through 1.4 below and will need to be updated if the IRS definition changes. In addition, the individuals and entities described in §1.5 and 1.6 below are also considered insiders.

[IRS EXCESS BENEFIT TRANSACTION REGS]

1. An insider is any person who is in a position of authority over the corporation or who exerts substantial influence over the corporation, including directors, officers, the top management official, the top financial official, other key employees, the founders and major donors.
2. Family members of insiders are also insiders. Family members include the spouse or partner in a civil union recognized by state law; children, grandchildren, great-grandchildren, whole and half-blooded brothers and sisters, and spouses of any of these people; and any ancestors (parents, grandparents, etc.)
3. Corporations and limited liability companies in which an insider owns more than 35% of the voting power, partnerships in which the insider owns more than 35% of the profits and trusts or estates in which the insider owns more than 35% of the beneficial interest are insiders.
4. An insider who becomes an insider by virtue of #1 through #3 above remains an insider for five years after his or her influence over this corporation ends.

[OREGON NONPROFIT LAW]

5. An entity in which a director has a material interest or is a general partner, director, officer, top management official, top financial official or other key employee is an insider.
6. An insider is any other for-profit or nonprofit entity in which a director of this corporation is a

director or officer and the entity and this corporation are parties to a transaction that is or should be considered by the boards of both corporations.

SECTION 2: DEFINITION OF CONFLICTS OF INTEREST

For purposes of this policy, a “conflict of interest” arises when an insider described above may benefit financially from a decision he or she could make in his or her capacity as an insider, including indirect benefits to family members or businesses with which the insider is closely associated. A conflict of interest arises in any such transaction between the corporation and an insider, except for (1) transactions in the normal course of operations that are available to the general public under similar terms and circumstances, and (2) expense reimbursements to an insider made pursuant to an accountable plan under IRS Reg. 1.62-2(c)(2).

SECTION 3: PROCEDURE

[IRS EXCESS BENEFIT TRANSACTION REGS]

In order to ensure that transactions with insiders are fair to the corporation and comply with state and federal laws:

1. All insiders must promptly and fully disclose all material facts of every actual or potential conflict of interest to the Board of Directors at the time such conflict arises.

[HEAD START REGS]

2. If the insider is a director, the director may not:

(a) Engage in a conflict of interest with the corporation or any delegate agency;

(b) Receive compensation for serving on the Board or for providing services to the corporation or any delegate agency;

(c) Be employed by, nor shall members of the director’s immediate family be employed by the corporation or any delegate agency. Immediate family generally includes the spouse, parents and grandparents, children and grandchildren, brothers and sisters, mother-in-law and father-in-law, brothers-in-law and sisters-in-law, daughters-in-law and sons-in-law, and adopted and step family members.

If the director holds his or her position as a result of a public election or political appointment, that position carries with it the concurrent appointment to serve as a director of a Head Start agency, and the director has a conflict of interest as described in §3.2(b) or (c) above, the director may serve on the Board. The Board shall handle the conflict as described elsewhere in this policy. The corporation shall report the conflict to the Office of Head Start.

[IRS EXCESS BENEFIT TRANSACTION REGS]

3. When the corporation engages in a transaction with an insider that constitutes a conflict of interest not disallowed by §3.2 above, the Board shall handle the transaction as follows:

(a) The Board shall exclude any insider that has a conflict of interest with respect to the transaction from all discussion and from voting on the transaction. The Board may ask questions of the insider prior to beginning its discussion.

(b) The Board shall gather appropriate data to ensure that the compensation for each insider is reasonable. In the case of employee compensation packages, the Board shall utilize reliable surveys of compensation for comparable positions or shall utilize data for at least three similarly situated employees in comparable positions. The Board shall not use the employee whose compensation is under consideration to collect comparability data.

(c) The Board shall document its decision by keeping written records that state the terms of the transaction and date approved, the directors present and who voted on it, the comparability data and how the data was obtained, and any actions taken with respect to directors who had a conflict of interest with respect to the transaction. The records must be prepared before the latter of the next Board meeting or 60 days after the final action is taken. Once prepared, the records must be reviewed and approved by the Board within a reasonable time.

4. When employee compensation packages are established each year, the Board shall identify those employees who are insiders. The Board shall monitor the compensation packages of insiders in accordance with the procedure in §3.3 above.

5. When the corporation provides an economic benefit to an insider for the insider's services as an employee or an independent contractor, the corporation shall contemporaneously document the transaction as required by the IRS (generally on an original Form W-2, Form 1990, or Form 1099 or with a written employment contract).

SECTION 4: COMPLIANCE WITH THIS POLICY

[IRS FORM 990]

In order to ensure compliance with this policy:

1. On an annual basis, the Secretary of the corporation or the Secretary's designee shall develop and maintain a list of insiders who engage in or are reasonably likely to engage in transactions that constitute conflicts of interest with the corporation during the year.

2. The officers, directors and key employees shall each year disclose interests that could give rise to a conflict of interest under this policy. Such disclosure shall be made on a Disclosure and Acknowledgment form similar to the one attached to this policy and shall be filed with the Secretary or the Secretary's designee.

3. The Secretary or the Secretary's designee shall monitor and enforce compliance with this policy by reviewing the list of insiders and the Disclosure and Acknowledgment forms each year and by bringing potential or actual conflicts to the attention of the President of the Board. The President shall disclose conflicts to the Board as they arise and ensure that the procedures in this policy are followed.

4. The Secretary or the Secretary's designee shall convey the list of insiders identified above to the Executive Director and shall instruct the Executive Director to notify the Board if the Executive Director or any employee plans to engage in a transaction with an insider that constitutes a conflict of interest, including payment or reimbursement for business or travel expenses of the insider and/or members of the insider's family not made pursuant to an accountable plan under IRS Reg. 1.62-2(c)(2). If so, the Board shall monitor the transaction to ensure that it complies with the procedure in Section 3 above.

SECTION 5: DELEGATION TO COMMITTEE

The Board may delegate its responsibilities under this policy to a committee of the Board. The committee shall comply with this policy and shall report its decision to the Board in a timely fashion.

DATE ADOPTED: _____

SIGNATURE: _____

PRINTED NAME: _____

TITLE: _____

[IRS FORM 990]

ANNUAL QUESTIONNAIRE

**CONFLICTS OF INTEREST AND EXECUTIVE COMPENSATION POLICY
DISCLOSURE AND ACKNOWLEDGMENT STATEMENT**

[Each Director, Officer and Key Employee should sign and submit this form annually.]

Disclosure

Please report below any conflicts of interest or potential conflicts of interest between the corporation and you, a family member or a business or corporation with which you are connected within the meaning of the Conflicts of Interest and Executive Compensation Policy.

You have an ongoing obligation to notify the Board promptly of any such conflicts of interest that subsequently arise.

List of Conflicts or Potential Conflicts

Please list and explain any conflicts here:

Acknowledgment

I have received, read, understand and will comply with the Conflicts of Interest and Executive Compensation Policy of the corporation. I affirm that, other than the interests reported, I am aware of no conflicts of interest that I have or may have within the meaning of the Conflicts of Interest and Executive Compensation Policy.

Signature

Title

Print Name

DATE: _____

Please submit this form to the Secretary of the corporation and retain a copy for your records