

ISSUE BRIEF:

AUXILIARY ORGANIZATION OVERSIGHT – DIMENSIONS & DEPARTURES

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Abstract

Auxiliary organizations are subject to extensive and varied external oversight (Section II, *Oversight Dimensions*).

There is a critical intersection between auxiliary oversight and the proper role and responsibility of the organization’s governing board. The oversight function and board responsibilities need to be in balance: oversight structured around auxiliary compliance assurance -- not preempting appropriate governance; and auxiliary governance focused upon fulfilling the purpose of the organization in support of the university’s educational mission (Section III, *Oversight Features and Departures*).

There are practical ways to keep the oversight function and the board’s role in balance (Section IV, *Conclusion*).

I. Introduction

This Issue Brief surveys the major oversight legal requirements for auxiliary organizations operating within The California State University (CSU), including those applied to nonprofit public benefit corporations and tax-exempt organizations. It includes an assessment of those oversight functions, and draws distinctions that can avoid inappropriate departures from the scope or intent of those requirements.¹ The analysis and conclusions are those of the author.

II. Oversight Dimensions

Nonprofit Public Benefit Corporations. Auxiliary organizations are also nonprofit public benefit corporations, and therefore are held to applicable standards in the *California Corporations Code*.² This framework, together with other statutes and regulations identified below, empower the Attorney General with an extensive range of “oversight” functions. These functions are in addition to CSU or campus oversight functions, and are frequently referred to as exercising “supervision” over the affairs of such entities. The major ones are:

¹ The term “oversight” is frequently used to describe the role of the organization’s governing body. That *internal* role is not within the scope of this Issue Brief.

² Section 5110 *et seq.*

- Initial and annual filings with AG [Audit committee and audited financial statements also required if corporation has \$2M or more in gross revenue, the Board or board committee must review and approve compensation of CEO and CFO].³
- AG may examine corporation at any time to ascertain condition of its affairs, and compliance with its purposes and any trusts assumed.⁴
- AG may refuse to register or may revoke or suspend registration of corporation for violations of *Government Code* Sections 12580-12599.7, dealing with fundraising activities.⁵
- AG may bring or intervene in suit to correct departures from corporate purposes or failure to comply with trusts assumed by corporation;⁶ to appoint provisional directors;⁷ for failure to comply with statutes;⁸ to seek corporation's involuntary dissolution;⁹ or bring quo warranto action to challenge unlawful acts or usurpation of powers by corporation or its directors.¹⁰
- AG may intervene in suit challenging director's election or appointment.¹¹
- AG may initiate or intervene in action to remove director for breach of conduct standards.¹²
- AG may initiate or intervene in action to recover improper distributions.¹³
- Notice to or consent of AG required for change of corporate status,¹⁴ or disposition of substantially all assets.¹⁵
- Prior AG consent required for many types of mergers.¹⁶ Notice to AG in many cases of voluntary dissolution, or a waiver of dissolution objection from AG.¹⁷

³ *Ibid* Section 6324(a); *Government Code* Sections 12586(e), (g) & generally Sections 12580-12599.

⁴ *Corporations Code* Section 5250; *Government Code* Section 12588; *Bus & Profs Code* Sections 17510-17510.95

⁵ *Government Code* Section 12598(e). & *Code of Regs* Title 11 Sections 999.6 – 999.8.

⁶ *Corporations Code* Section 5250; *Government Code* Section 12951.

⁷ *Corporations Code* Section 5225.

⁸ *Ibid* at Section 6216.

⁹ *Ibid* at Sections 6510(a)(5), 6511.

¹⁰ *Code of Civil Procedure* Section 803.

¹¹ *Corporations Code* Section 5617.

¹² *Ibid* at Section 5223.

¹³ *Ibid* at Sections 5420, 6719 & 6721.

¹⁴ *Ibid* at Section 5813.5 & *Code of Regs* Sections 999.1 – 999.5.

¹⁵ *Ibid* at Section 5913.

¹⁶ *Ibid* at Section 6010.

¹⁷ *Ibid* at Sections 6611, 6616, 6617.

- AG must be given written notice of any proceedings in which AG may intervene or could have initiated.¹⁸

Note that these oversight functions deal either directly with compliance assurance or indirectly with processes to correct departures from applicable standards. **It is not the AG's oversight role to direct corporate affairs, but to protect the public and corporation assets when those affairs run afoul.**

For further details, see the California Attorney General's *Guide for Charities* at:

http://ag.ca.gov/charities/publications/guide_for_charities.pdf

Auxiliary Organizations. The statutory basis for auxiliary organizations is found in the *Education Code*.¹⁹ As presently structured, all student body organizations are recognized as auxiliary organizations.²⁰ Such organizations are established on CSU campuses "under the *supervision* of university officials."²¹ (Emphasis added.) The collection, deposit, investment or use of student body, building and operating fees are regulated by statute, trustee regulations, and system policies.²² The campus chief fiscal officer is the "...*custodian* of these moneys and provide(s) the necessary accounting records and controls thereof."²³

The statutory framework for auxiliary organizations includes provisions covering entities included in and excluded from the framework,²⁴ audit and financial reporting,²⁵ the role of a campus president over the propriety of expenditures and the integrity of financial reports,²⁶ compensation standards,²⁷ conflict of interest,²⁸ applicable construction project contract law,²⁹ tax-exempt financing,³⁰ board and sub-board meetings,³¹ and the election of officers and board members.³²

¹⁸ See, e.g., *Ibid* at Section 5223(b) & *Code of Regs* Sections 999.1 – 999.5.

¹⁹ *Education Code* Sections 89300, 89305 89900, 89920.

²⁰ *Ibid* at Section 89300 and 89901(b).

²¹ *Ibid* at Section 89300 (first paragraph).

²² *Ibid* at Sections 89301, 89302, 89304.

²³ *Ibid* at Section 89302(second paragraph).

²⁴ *Ibid* at Section 89901

²⁵ *Ibid* at Section 89900(a).

²⁶ *Ibid* at Section 89900(b). Also see 89756.

²⁷ *Ibid* Section 89900(c) & (d).

²⁸ *Ibid* at Sections 89906-9.

²⁹ *Ibid* at Section 89911.

³⁰ *Ibid* at Section 89912.

³¹ *Ibid* at Sections 89920-24 & 89927

³² *Ibid* at Section 89925.

“The operation of auxiliary organizations shall be conducted in conformity with regulations established by the trustees.”³³ By statute, the trustees set auxiliary organization governing board composition,³⁴ meeting frequency,³⁵ advice and counsel,³⁶ external relationship (including gift and grant acceptance),³⁷ accounting and reporting system,³⁸ mission-relevant transaction procedures,³⁹ earned overhead use policy,⁴⁰ financial standards,⁴¹ fiscal viability,⁴² and use of discretionary fund⁴³ requirements.

Trustee Regulations and Delegated Authority. As can be seen from the statutory framework summarized above, the CSU Board of Trustees has considerable delegated authority to establish regulations over auxiliary organizations operating within the system. That authority is typically expressed by trustees in the *California Code of Regulations* (commonly known as “Title 5”).⁴⁴ Trustee resolutions are another source of policy direction affecting auxiliary organizations. There are a number of provisions that relate either to a further delegation of authority from the trustees to the Chancellor and campus president, or to the oversight role of system and campus officials.

The campus president has the authority to call student member fee-setting elections, fix polling places, and designate faculty election supervision, under prescribed requirements.⁴⁵ Collected student membership fees are deposited in trust with the campus chief fiscal officer (or designee) and transmitted to the student body organization treasurer⁴⁶ under procedures approved by an appropriate student body organization officer. These funds, and all other funds for the student body organization, shall, subject to campus president (or designee) approval, be held or invested in a manner consistent with Education Code Section 89301.⁴⁷

The campus president “...shall require that each auxiliary organization submit its programs and budgets for review...” for conformity with system and campus policy. A planned program or appropriation found by the president to be inconsistent with such policy shall not be carried

³³ *Ibid* at Section 89900(c).

³⁴ *Ibid* at Section 89903(a). Also see *Code of Regs* at Section 42602.

³⁵ *Ibid* at Section 89903(b).

³⁶ *Ibid*.

³⁷ *Ibid* at Section 89903(c). Also see *Code of Regs* at Section 42500(b).

³⁸ *Ibid* at Section 89904(a).

³⁹ *Ibid* at Section 89904(c).

⁴⁰ *Ibid* at Section 89904(d).

⁴¹ *Ibid* at Section 89904(b).

⁴² *Ibid* at Section 89904.5.

⁴³ *Ibid* at Section 89904.6

⁴⁴ *Code of Regs* Title 5, Sections 41401-11; 42400-42667. See general authority under *Education Code* Section 89030.

⁴⁵ *Ibid* at Section 41405-6.

⁴⁶ *Ibid* at Section 41409

⁴⁷ *Ibid* at Section 42403(a).

out. An approved program or appropriation, later found by the president to be outside acceptable policy, shall be discontinued pending further review and appropriate adjustment.⁴⁸

All auxiliary organization records shall be open for audit to the trustees and Department of Finance.⁴⁹ The *Richard McKee Transparency Act of 2011*⁵⁰ prescribes a public records disclosure regime for auxiliary organizations.

The Chancellor has review and approval authority over the establishment of any new auxiliary organization,⁵¹ and shall maintain a list of auxiliary organizations in good standing (that is, in compliance with trustee rules and regulations), with the authority to remove any organization from the list, with appropriate reasonable notice, for grounds, and under a specified process.⁵² Only those functions prescribed by the trustees by regulation may be performed by auxiliary organizations,⁵³ and then (with the exception of student body organization activities) only after entering into an appropriate written agreement containing specified provisions.⁵⁴

The Chancellor has been delegated the authority to prescribe standard system-wide fiscal audit procedures.⁵⁵

Auxiliary organizations may issue debt instruments for prescribed purposes with prior campus president approval under trustee policy, as may be implemented by the Chancellor.⁵⁶

The auxiliary organizations classified as student body organizations are held to a list of “approved uses of funds” collected through mandatory fees.⁵⁷

To carry out delegated trustee authority,⁵⁸ the Chancellor, or designated staff, issue policy and practice statements by Executive Order, coded memoranda, or letters. Executive Orders dealing in part with oversight functions include:

⁴⁸ *Ibid* at Section 42404. Also see Executive Order 369 for resolving differences between campus president and student body organization board over budget/programs. EO 369 came on the heels of *Associated Student, San Jose State University. v. Trustees of Cal. St. U. & C* (1976), 56 Cal. App. 3d 667, and *Associated Student of San Diego State University v. Thomas B. Day, etc., et al*, (1980), (unpublished), both of which affirmed – but did not expand or narrow -- the prescribed regulatory authority of the campus president.

⁴⁹ *Ibid* at Section 42404(b).

⁵⁰ *Education Code* Section 89913-19, effective January 2012.

⁵¹ *Ibid* at Section 42407.

⁵² *Ibid* at Section 42406.

⁵³ *Ibid* at Section 42500(a) & (e).

⁵⁴ *Ibid* at Sections 42501-02.

⁵⁵ *Ibid* at Section 42408

⁵⁶ *Ibid* at Section 42500(c).

⁵⁷ *Ibid* at Section 42659.

⁵⁸ See *Standing Orders of the Board of Trustees* Section VI(d) & (h);

698 Board of Trustees Policy for the California State University Auxiliary Organizations;

731 Designation of Chief Financial Officer;

732 Compilation of Policies and Procedures Pertaining to California State University Auxiliary Organizations;

751 Centers, Institutes, and Similar Organizations on Campuses of the California State University;

849 California State University Insurance Requirements

1000 Delegation of Fiscal Authority and Responsibility – which is now supplemented and augmented by,

1059 Utilization of Campus Auxiliary Organizations.

Although EO 1059 opens with a section titled, “Campus Oversight of Auxiliary Organizations,” it does not define or add any additional meaning or context to the term “oversight.” The section does, however, restate explicit or long recognized policy:

- A. *Campus auxiliary organizations are California nonprofit corporations which are legally separate entities and are organized and operated solely for the benefit of the campus. The separate legal status of auxiliary organizations enables strategies that are important to the campus educational mission and provides capabilities essential to a comprehensive university.*
- B. *Campus auxiliary organizations shall not operate outside the regulation and oversight of the campus.*
- C. *The campus president is responsible and accountable for prudent judgment in the utilization of campus auxiliary organizations, for ensuring the fiscal viability of campus auxiliary organizations, and for compliance with applicable CSU policies.*
- D. *The campus chief financial officer (CFO) shall be the primary responsible campus official in respect to administrative compliance and fiscal oversight of campus auxiliary organizations.*

The laws, regulations and policy statements forming the auxiliary organization operational realm clearly express a preeminent system and campus oversight framework. **It is important to an understanding of this oversight framework to distinguish the specific approval authority exercised by a campus president (or by designees).** The president’s *approval authority* represents a proactive form of oversight, in contrast to the broader reactive oversight typology (audits, internal compliance reviews, and the president’s authority to halt existing programs or expenditures determined to be “outside campus policy”). Proactive oversight should not be viewed as a prerogative to decide Board actions by preempting the proper role of the Board (see Section III below for discussion of oversight features and departures).

U.S. Internal Revenue Oversight. The Internal Revenue Service (IRS) also has broad auxiliary organization oversight. Auxiliary organizations are all classified as tax-exempt organizations.⁵⁹ The IRS exercises its oversight function primarily through filings of the initial application (Form 1023) for an exempt status determination, annual tax information returns (Forms 990 and 990T), and audits/inquiries of various types. The new Form 990 includes expanded inquiry into governance and management areas that “cross-walk” to California nonprofit public benefit corporation standards.

None of the IRS oversight functions by the IRS attempts to direct organization affairs; only to help assure compliance with applicable statutory and regulatory requirements.

For additional details on IRS oversight of tax-exempt organizations, see:

<http://www.irs.gov/charities/charitable/index.html>

III. Oversight Features and Departures

The major oversight functions described above are all intended to monitor, evaluate and verify that auxiliary organizations affairs are in keeping with their corporate purpose(s), the prudent handling of assets, obligations and relationships, and responsive to officials and agencies charged with supervision responsibilities.

Nonprofit corporations and auxiliary organizations are required to be governed by a board of directors.⁶⁰ Operating within parameters described above, the board of directors is charged with conducting all organization activities and affairs. All corporate powers “... shall be exercised by or under the direction of the board.”⁶¹

The auxiliary organization oversight function at the campus level can be confusing or simply conflated in practice. It is important that the board, the president and staffs discern and respect these important features of the **oversight function**:

1. Recognition by all concerned that the auxiliary organization’s affairs must keep well within its corporate purpose (often expressed in general terms to “support and enhance the mission of the university” it supports).
2. Recognition by campus administration and agreement with each campus auxiliary organization that the **oversight** is a **compliance assurance** function.

⁵⁹ *Internal Revenue Code (IRC) Section 501(c)(3)*. There appears to be considerable variance in *IRC* provisions auxiliary organizations use to qualify as “supporting organizations.”

⁶⁰ *Corporations Code Section 5210 & Education Code Section 89903* (first paragraph). The name of the governing board may vary.

⁶¹ *Corporations Code Section 5210*.

3. Recognition that campus auxiliary organizations must be in compliance with Trustee policies, Executive Orders; campus policies; State, Federal and Local laws; the California Nonprofit Corporation Code; the Board governing documents and policies; the Education Code and Title 5 Regulations.
4. In order to execute the President's compliance authority, recognition that the campus president requires each auxiliary organization to submit its programs and budgets for review at a time and in a manner specified by the president. Should the president determine that any program or appropriation planned by an auxiliary organization is not consistent with policy of the Board of Trustees and the campus, the program or appropriation shall not be implemented.
5. Recognition by the board, the campus president and staffs, of the auxiliary organization's governing board authority to develop and adopt policy, make decisions on behalf of the organization, and set direction for the organization, consistent with applicable laws, regulations, and system/campus policies. This framework preserves the intended "separate, but related" precept, furthers the risk responsibility provisions of the operating agreements, and reinforces the statutory fiduciary duties to which individual board members are held.
6. University policy relating to campus auxiliary organization oversight functions, program/budget development and review, together with procedural aspects to implement that policy, should be in writing and demonstrate preservation of the above framework.

Some hypothetical examples of "departures" should bring home the distinction between oversight and control:

Departure Scenario A

The campus president is eager to employ a new CFO and plans to appoint him as a member of a campus auxiliary organization Board of Directors. To gain acceptance of an appointment offer, the president seeks a loan from the auxiliary organization Board for the new CFO to assist with housing costs. The president asserts his authority over auxiliary organization affairs in obtaining favorable Board action.

The president's approach to the Board would be a questionable exercise of his program/budget review and approval authority since the board had not established a housing loan program, and there is no appropriation for the president to review.

If the new CFO is on the Board at the time, such an action may also raise Education Code issues (director financial interest in Board loan approval action), as well as Corporations Code self-dealing issues (housing loans to directors are not permitted).

Departure Scenario B

The campus Associated Students (a student body organization) obtained the approval of the university president for partial support of a community-service program, together with funding, as part of its current year budget. Mid-year, the university determined that it could no longer fund the rest of the program, and the CFO declines to release AS funds for the program, asserting authority as the custodian of AS funds, coupled with the University's decision to withdraw its program support. What result and why?

There is a Title 5 process to resolve such post-program/budget approval situations which should be respected by CFO. Withholding AS support funds is beyond the CFO's custodial role over fee funds in this circumstance. If the university and the AS Board arrive at different positions on supporting the program with AS funds, the parties should engage in the Executive Order 369 process.

Departure Scenario C

The university solicited a major restricted charitable gift from a distinguished alumni member. As the university's designated recipient of gifts in support of the university, the campus Foundation (an auxiliary organization in good standing) Board of Directors declined to accept the gift on the grounds that the gift restrictions included provisions allowing the donor to keep too much control over how the gift proceeds would be utilized by the university. The president asserts his approval authority over Foundation affairs, and directs Foundation management to accept the gift. What result and why?

The president does not have a valid basis of authority to circumvent the governing board. There is no planned or existing program (gift acceptance) and no appropriation involved—certainly nothing at odds with system or campus policy. In fact, the reverse seems present, since, accepting the gift would arguably be counter to prudent gift management and system gift policy. The president seems to be placing both the donor and the institution in a dubious position. The interested parties need to rethink this donation.

IV. Conclusion

The central conclusion based on this analysis is that auxiliary boards and system/campus officials should operate in a way that allows the respective roles and responsibilities to be effectively played out (*modus vivendi*).

There are, of course, practical dimensions to a mutual effort by the auxiliary organization and campus administration to fulfill these respective roles and responsibilities. Here are a few:

- Meeting the requirement of having the campus president’s representative(s) serve on the auxiliary board, as well as ensuring that the representative provides the president with updates.
- Establish, at a minimum, a quarterly meeting between auxiliary management and the campus CFO to update the CFO on: budget vs. actual expenses; revenues; human resources policy and employee issues; risk management changes or issues and any changes in programs or services being contemplated by the organization.
- Periodic campus-based compliance reviews, organized and executed through the efforts of the campus CFO.
- Requiring proposed new or substantially changed programs and all auxiliary budgets to be routed through to the campus president before submission to the board for adoption, coupled with an internal process for resolving any differences.⁶²

⁶² Executive Order 369 is an example of a practical process for resolving budget and program issues between the university and an auxiliary organization. In this case, the process involves student body organizations. A campus written protocol could serve as a tool for achieving *modus vivendi*