

## ***ISSUE BRIEF:***

### **AUXILIARY ORGANIZATION GOVERNANCE: WHY THE ATTORNEY GENERAL CARES**

The Attorney General has jurisdiction to protect charitable assets (not just gift or trust funds), some under common law and others, like California, under additional statutory authority. Auxiliary organizations are chartered as nonprofit public benefit organizations and are considered charitable organizations.

The Charitable Trusts Section (CTS) of the California Attorney General's office carries out her mandate to protect charitable assets however they arise. Members of the board of directors of a nonprofit corporation are the stewards of those assets and responsible for maintaining their integrity and any restrictions on use placed upon them. When they do not, it is the CTS role to step in and restore those assets to their intended purpose.

Governance – or the failure to govern – is at the heart of all of the misapplication, waste and diversion of assets we see. It is for this reason that CTS now requires board training as a part of every settlement entered into. Below is a list of the top 10 issues investigated and prosecuted by CTS.

The policies and procedures that comprise good governance principles are key to a board's ability to manage – but having principles in place is meaningless unless the board adheres to them. In two recent exemplar cases, both sides can be seen (a complete lack of governance structure versus a sophisticated structure that was ignored). Both had the same result: misapplication and diversion of charitable assets.

The one complaint is also instructive for board members as it includes the primary causes of action asserted by CTS when the complaint cannot resolve a matter informally.

While the complexity of policies and procedures will be tailored to the size of the organization, the same elements are necessary in order to adequately manage an organization.

For instance, every organization must at all times be able to document all sources of revenue, including restrictions, and all expenditures. The initial audit letter sent by CTS to an organization will give a good idea about how CTS expects boards to document decisions. In general, the first things CTS want to see are:

1. Books and records documenting decisions – minutes, resolutions, compensation studies, etc;
2. Written policies and procedures for governance and internal controls;

3. Financial records that document revenue and disbursement of restricted funds – general ledgers, canceled checks, check registers, disposition of restricted assets, independent audits, and management letters;

4. Solicitation materials – which help determine if statements made in the course of solicitation place a restriction on how those donations can be used. [e.g., Noah’s Wish]

Boards may also be guided by the governance questions in Part VI of the new IRS Form 990 because each of those questions relate back to a duty under California law. On the AG’s Charitable Organizations website you can find guidance that cross-references each question to the relevant California statute.

In CTS view, because of the potential liability board members face in the event of misapplication and diversion of charitable assets, a well-structured organization would be wise to include a mechanism to educate incoming board members about their duties and familiarize them with the organizations policies and procedures – and provide a refresher to existing board members on a scheduled basis – because they are only effective if the board has the appropriate culture of oversight and awareness of its responsibilities.

#### TOP 10 ISSUES INVESTIGATED BY THE CALIFORNIA AGO

- Inadequate or thwarted board involvement
- Failure to follow mission
- Imprudent loans, investments, or transfer of assets
- Lack of documentation of important decisions
- Misuse/diversion of endowment funds/restricted assets
- Conflicts of interest
- Diversion to personal benefit
- Embezzlement (including failure to respond, reluctance to report, intentional misreporting and recover)

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