

Auxiliary Organizations Association
The California State University

**THE ROLE AND RESPONSIBILITIES OF
AUXILIARY GOVERNING BOARDS**

By

Robert E. Griffin

[CONFERENCE EDITION]

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I. Purpose and Background

For over two decades the *Auxiliary Organizations Association (AOA)*¹ has commissioned and published professional papers for its members on timely governance and management subjects.

AOA continues the series with this revision to the 2002 monograph.² Its primary purpose is to alert new governing board members and orient them to the board's role and responsibilities. The scope and detail of the paper should also provide a practical reference for more experienced board members, managers and staff, as well as university administrators charged with auxiliary organization oversight. This paper is not an in-depth treatise. Rather, it is a survey of selected, interwoven topics felt important to auxiliary organization governance.

The sections that follow address contemporary nonprofit governance concepts, legal and policy standards and requirements, and compliance approaches, coupled with valuable references and examples pertinent to auxiliary organizations operating within the California State University (CSU). Although board effectiveness and performance are important issues, they are beyond the scope of this monograph.

This paper does *not* constitute legal or compliance advice. Auxiliary organization governance issues follow patterns, but most are quite fact and circumstance sensitive, and should, therefore, be addressed and resolved in consultation with appropriate advisors. AOA will endeavor to keep this monograph up-to-date. The analysis, conclusions and approaches in this monograph are those of the author, not the AOA or its member organizations.

¹ The AOA, a California public benefit nonprofit corporation, is organized to develop and foster sound relationships between members and with their customers and clients; and to provide governance and management development programs, services and publications. AOA members are auxiliary organizations serving campuses within the California State University. The AOA is *not* an auxiliary organization.

² This revision includes changes in the law, regulations and system-wide policy, the addition of sections on fundraising, accountability, investing and debt instruments, and an expansion of information on meeting requirements.

II. The Governing Body and the Organization It Serves

There are well over one-half million charitable/educational nonprofit organizations across the United States.³ These entities include colleges and universities, religious groups, private foundations, symphonies, museums and other cultural organizations, hospitals, trade associations, consumer "watch-dog" and advocacy groups, social service agencies, and sports leagues. They run the gamut from substantial bodies and large private institutions of higher education, to a host of small, community-based, self-help development corporations.

"Nonprofit" corporations in California likewise host diverse services for the "public benefit" and are organized under the *California Nonprofit Corporation Law*.⁴ Nonprofits are the third major leg of the national economy, along with the private sector and government, and within the CSU, the auxiliary organizations play a critical support function to the campuses.⁵ There are at least 84 recognized auxiliary organizations operating in the CSU.⁶

The predominant feature of the nonprofit sector in the past decade has been explosive growth – not just in size – but in the *scope of services* and the demand for *competence*.⁷ Coping with this growth is the primary reason for this monograph: it falls principally to those who govern, manage and oversee the CSU auxiliary organizations to deliver effective campus support services with a high degree of competence and accountability. An array of statutes, standards, rules and regulations, as well as system, campus and internal policies and practices apply to auxiliary organizations. If auxiliary organization boards understand their role and responsibilities, and act constructively upon them, compliance with these requirements will be greatly improved, along with the quality of support services offered.

An online summary on the origin and nature of CSU auxiliary organizations may be found at: <http://www.calstate.edu/FT/AuxOrg/AOBackground.shtml>.

A. The Governing Board and its Authority

Governance Requirement

Every auxiliary organization operating on a CSU campus or for the CSU has been formed as a separate legal entity under California corporation law and

³ These are U.S. Internal Revenue Code Section 501(c)(3) organizations according to IRS records. Every auxiliary organization operating within the CSU also functions as a nonprofit corporation.

⁴ The Nonprofit Corporation Law is set out in California Corporations Code, Section 5200 *et seq.*

⁵ CSU Board of Trustees policy declares that auxiliary organizations are "essential to the educational program of a campus and shall be so operated." See *California Code of Regulations*, Section 42401 in Subchapter 6, Chapter 1, and Division 5 of Title 5.

⁶ The Chancellor's Office has an online list of the recognized auxiliary organizations operating within the CSU at <http://www.calstate.edu/FT/auxorg/AuxOrgList.shtml>.

⁷ Peter F. Drucker, *Managing for the Future: The 1990s and Beyond* (New York: Truman/Talley Books/Dutton, 1992).

authorized to function as an auxiliary under the *Education Code* and CSU regulations and policy. They are not campus departments, although they have a relationship with the institution under law, regulations, policies, and by agreement(s).

California Nonprofit Corporation Law⁸ requires each entity organizing under its provisions to be governed by a board of directors or an equivalent body called by another name. For example, some auxiliary organizations represent the campus student body, with an elected governance structure analogous more to a legislative body than a corporate board. These student body organizations are formed and operate as auxiliary organizations under separate statutory authority,⁹ but student body organizations are also nonprofit corporations subject to other laws and regulations discussed in more detail below. At present, all student body organizations are "membership organizations." All other auxiliary organizations are structured as "non-member organizations" – the governing board being considered the "membership."

No matter what they are called, the auxiliary organization's governing body has a common statutory governance role, like its counterpart in profit-oriented corporate enterprises: to operate a management structure in which all corporate powers are exercised by or under the board's direction.¹⁰

Board Powers

Directors on governing boards exercise plenary authority collectively, not individually, and are commonly referred to as "corporate powers." These powers repose under law and through the articles of incorporation and bylaws of the organization, and may often be delegated as long as the delegated duties and actions are subject to the board's review and control. Ultimate responsibility, however, resides with the board.¹¹

Matters ordinarily calling for board action or approval include:

- Adopting, amending, or repealing bylaws.¹²
- Amending the articles of incorporation.¹³
- Electing directors in some nonmember organizations.¹⁴
- Filling board vacancies and removing directors in some cases.¹⁵
- Electing officers.¹⁶

⁸ See footnote 3.

⁹ *California Education Code* Sections 89006, 89300 *et seq.*, and 89900 *et seq.*

¹⁰ *California Corporations Code* Section 5210.

¹¹ *Ibid.*

¹² *Ibid* at Section 5150(a).

¹³ *Ibid* at Section 5812.

¹⁴ *Ibid* at Section 5310(c).

¹⁵ *Ibid* at Sections 5221 and 5224.

¹⁶ *Ibid* at Section 5213(b).

- Employing the executive manager.
- Appointing and assigning duties to board committees.¹⁷
- Adopting annual budgets.
- Planning the year's programs and activities.
- Adopting corporate policies and long-terms plans.
- Investing corporate funds.
- Complying with governmental reporting and taxation laws.
- Issuing reports and financial statements.
- Calling and holding special membership or board meetings.
- Deciding to seek member approval through the voting process.
- Bringing and defending legal actions on behalf of organization.
- Approving corporate borrowing or loans.¹⁸
- Approving indemnification of corporate directors, officers, and other agents.¹⁹
- Approving the mortgage or other pledge of corporate assets to secure payment or performance of contracts or obligations.²⁰
- Approving the sale, lease, conveyance, exchange, transfer, or other disposition of corporate assets.²¹
- Approving mergers, reorganizations, and dissolutions.²²

The manner in which the board delegates or handles these matters is frequently spelled out in a series of policy statements, and these statements are often codified in a board policy manual or similar document.

B. Corporation Status

The auxiliary organizations within the CSU are all incorporated nonprofit entities. These entities fall within one of the three types of nonprofits contemplated by the Nonprofit Corporation Law: nonprofit public benefit.²³ To incorporate, the auxiliary organization files a charter with the Secretary of State known in California as *articles of incorporation*. The *Articles* recite the general governance features of the entity, including the intent to organize as a nonprofit, public benefit corporation.

Such corporations are formed exclusively for charitable or public purposes and its assets must be irrevocably dedicated to these purposes. If dissolved, they must distribute their assets to a similar entity.

The term "nonprofit" does *not* mean that the auxiliary organization cannot make money or a profit in the performance of its authorized functions.

¹⁷ Ibid at Sections 5210 and 5212(a).

¹⁸ Ibid at Section 5236.

¹⁹ Ibid at Section 5238(e).

²⁰ Ibid at Section 5910.

²¹ Ibid at Section 5911.

²² Ibid at Section 6011.

²³ Ibid at Sections 5100-6910. General provisions and definitions that apply to all California nonprofit corporations appear in Sections 5000-5080.

"Nonprofit" refers to the fact that there are no stockholders, and therefore no stocks and distribution of those profits to stockholders as dividends, etc. And, indeed, there are two statutory standards auxiliary organization function must meet: operations must be fiscally viable (with adequate reserves);²⁴ and commercial services, such as food services and bookstores, must be self-supporting.²⁵

As separate legal corporate entities, auxiliary organizations exist and operate permanently unless formally dissolved. The permanency is unique to corporations, unlike individuals or partnerships.

The persons who serve as directors make corporate decisions collectively as a board or as a committee of the board. Thus, with the possible exception of unanimous written consent actions, corporate decision-making is viewed as a collective and deliberative process, tempered by the obligations of good faith and prudent inquiry that are the cornerstones of the directors' fiduciary obligations to the entity they serve.

Corporate status then is one of the three structural footings of all auxiliary organizations in the CSU.

C. Status as Auxiliary Organization

The second structural footing common to these campus-support entities is that the California Legislature has given them a statutory basis distinct from, but in addition to their nonprofit corporate status.

The *California Education Code* identifies a narrow band of entities that have status as "auxiliary organizations."²⁶ These entities include: entities so designated by the Trustees; student body organizations operating under *Education Code* Section 89300; entities operating commercial services on a campus or other CSU property; and those entities with articles and bylaws expressing a purpose to support or benefit the CSU or one of its campuses, and with governing body members selected by either a CSU or campus official from students, faculty or staff, the Trustees or CSU staff.

This statutory framework for entities designated as "auxiliary organizations" gives to the CSU Board of Trustees the delegated authority to implement more detailed auxiliary organization regulations. The Trustees have adopted these implementing regulations in the *California Code of Regulations*, Sections 41401-41411 and 42400-42667, in Subchapters 4 and 6, Chapter 1, at Division 5 of Title 5 – popularly known as "Title 5." The Trustees have also adopted a number of resolutions that apply to auxiliary organizations.

²⁴ *Cal Ed Code* Section 89905.

²⁵ *Ibid* at Section 89904.5.

²⁶ *Ibid* at Section 89901(a) through (f).

Title 5 regulations, in turn, delegate to the Chancellor and campus presidents a considerable degree of authority to establish operational and oversight policies and practices that apply to auxiliary organizations through Executive Orders, coded memoranda, and campus policy statements. Title 5 also prescribes such things as: the process needed to establish a new auxiliary organization;²⁷ the functions that such entities may perform;²⁸ the affairs and fees of student body organizations;²⁹ operating agreement and lease requirements;³⁰ compensation standards;³¹ governing body composition requirements;³² and the authority of the campus president over entity programs.³³

The Chancellor's Office maintains a compilation of policies and procedures for auxiliary organizations. This document appears on the CSU website at this URL: <http://www.calstate.edu/FT/AuxOrg/PDF0800/Compilation.shtml>.

The "compilation" is updated from time to time, but its provisions should *not* necessarily be directly relied upon as the most current source, without checking the cited primary references.³⁴

D. Tax Exemption Status

Auxiliary organizations have a third common structural footing as "tax exempt organizations."

Just as most nonprofit organizations benefit from incorporation, auxiliary organizations benefit from the tax advantages of exempt status under California and federal law.

At present every auxiliary organization has qualified and maintains its status as a tax-exempt entity -- organized and operated for exempt purposes.³⁵ These entities are generally exempt from tax on the income and gifts they receive, and are able to offer their donors charitable tax deductions for their contributions. To maintain this status, auxiliary organizations must adhere closely to tax agencies regulations and file periodic reports much like tax returns. Activity unrelated to the entity's exempt purpose often requires special annual reports and can result in a liability for unrelated business income tax, and in cases where the unrelated activity is extensive, loss of tax-exempt status.

²⁷ Title 5 at Section 42407.

²⁸ Ibid at Section 42500 and 42659.

²⁹ Ibid at Section 41400 *et seq.*

³⁰ Ibid at Section 42501 and 42502.

³¹ Ibid at Section 42405.

³² Ibid at Section 42602.

³³ Ibid at Section 42402.

³⁴ See Executive Order No. 732, dated March 6, 2000. The "Compilation" was last updated in 2002, and is due to be revised.

³⁵ U.S. Internal Revenue Code, Section 501(c)(3) and California Revenue & Taxation Code Section 23701d.

E. Fundraising

There is an operational area related to exempt-status involving many auxiliary organizations: charitable solicitation and giving.

Each campus has established an auxiliary organization charged with seeking and securing private support (also known as friend and fundraising) for the university it serves. These auxiliary organizations operate under operating agreements and support service leases that authorize the fundraising function.³⁶

Even though only certain auxiliary organizations are authorized to perform fundraising functions, under California law, all auxiliary organizations are technically "charitable organizations" by virtue of their status as nonprofit, public benefit tax-exempt organizations. The *Nonprofit Integrity Act of 2004* (the Act)³⁷ set in place a number of operational requirements and financial standards, many of which extend to auxiliary organizations.

The Act includes provisions relating to organization filings, registration and reporting, compensation review, control over fundraising, including misrepresentations, commercial fundraisers, fundraising counsel and commercial co-venturers, prohibited solicitation and fundraising practices, and required contract cancellation provisions.

Here are key governance-related provisions affecting many auxiliary organizations:

- The governing board of organizations with \$2 Million or more in gross revenues (exclusive of audited governmental grants) must establish and maintain an audit committee, and, while non-board members may be included, staff and certain officers may not serve on this committee. This committee is responsible for: independent financial auditor engagement recommendations; conferring with the auditor on financial affairs; review of audit reports; and approval of any non-audit services by the financial audit firm.
- The governing board (or a designated board committee) must review and approve executive management compensation (including benefits) at hiring and when modified to determine that it is just and reasonable.
- Solicitation campaigns involving either a commercial fundraiser or a fundraising counsel require a written agreement meeting prescribed

³⁶ *California Code of Regulations* (Title 5), Section 42502 lists functions that may be performed by auxiliary organizations under appropriate agreements. Accepting donations is one of the listed functions.

³⁷ *California Government Code* Sections 12580-12599.7 and *Business and Professions Code* Section 17510.5.

standards and executed by an official authorized by the governing board.

- Such charitable solicitations must meet prescribed registration, management, representation and disclosure standards.

Irrespective of whether an auxiliary organization is a university's authorized fundraising arm, board members and management should be familiar and in compliance with the Act. The Chancellor's Office of Systemwide Advancement has posted a comprehensive compliance manual, online at: www.calstate.edu/UA.

* * *

For readers interested in exploring this broad topic further, Appendix A is a Suggested Reading list on nonprofit and auxiliary organization governance.

It should be evident that with these three organizational footings, auxiliary organization governance requires skill, diligence, and a keen sense of duty and stewardship.

III. Standards of Conduct, Conflicts of Interest and Related Topics

Board members are *individually* held to statutory requirements in the exercise of their duties. Since auxiliary organizations are also nonprofit corporations, auxiliary board members must follow applicable provisions of the *California Nonprofit Corporation Law*. They are also subject to conflict of interest standards expressed in the *California Education Code* for auxiliary organization governing bodies.

A. California Nonprofit Corporation Law

The "Fiduciary" Standard (Strict and Contemporary)

The term "fiduciary" refers to one who holds a position requiring trust, confidence, and scrupulous exercise of good faith and candor. Included are those with a duty, created by a particular undertaking, to act primarily for the benefit of others relating to the undertaking with trust and confidence exercised with fairness and good faith.³⁸ There is a strict, traditional interpretation of the term generally confined to trustees.³⁹ Then there is the less strict use of the term used to describe a nonprofit director's "fiduciary"

³⁸ *Black's Law Dictionary* (6th Ed 1990).

³⁹ See generally *California Probate Code* Sections 16000-16015.

duties of care, the duty of inquiry, the duty of loyalty, and the duty to comply with investment standards.⁴⁰

The strict trustee standard of duty is generally *not* imposed on directors of California nonprofit entities. In the case of auxiliary organizations serving as the trustee of charitable trusts, the traditional interpretation may well be applicable by extension to the governing board of that entity.⁴¹ Thus, the fiduciary duties of auxiliary organization governing directors are not only to the entity, but also to the institution it serves, to trustors, and the general public.⁴²

Duty Standards

Duty of Care: Directors owe a duty of due care in the performance of their governance functions.⁴³

"The duties of a director, including duties as a member of any committee of the board upon which the director may serve..." shall be performed "in good faith, in a manner such director believes to be in the *best interests of the corporation* and with such care, including reasonable inquiry, as an ordinary prudent person in a like position would use under similar circumstances." (*Emphasis added.*)

This standard is almost the same as that imposed on business corporations, but, unlike trustees under the strict fiduciary standard, nonprofit directors may delegate corporation management "to any person or persons, management company, or committee."⁴⁴

Duty of Inquiry: The director's obligation to make reasonable inquiry is triggered only when circumstances suggest that further inquiry is needed. Directors may rely on information, opinions, reports, or statements, including: financial statements prepared or presented by officers or employees believed to be reliable and competent in the matters presented; by counsel and independent accountants on matters believed to be within their professional competence; and by board committees on matters charged to that committee.

Duty of Loyalty: A director must act in a manner that the director believes to be in the best interest of the organization and all of its members,

⁴⁰ See *Guidebook for Directors of Nonprofit Corporations* (ABA, Nonprofit Corporations Committee, 1993).

⁴¹ *Cal Corps Code* Section 5250.

⁴² Auxiliary organizations are classified as "public benefit" nonprofit corporations. Citations to support this posture: *Holt v College of Osteopathic Physicians & Surgeons* (1964) 61 C2d 750, 754, 40 CR 244; *Queen of Angels Hosp. v Younger* (1977) 66 CA3d 359, 136 CR 36.

⁴³ *Cal Corps Code* Section 5231(a).

⁴⁴ *Ibid* at Section 5210.

including minority member factions, and to administer corporate powers for the common benefit – to advance and achieve the corporation's purposes.

Duty to Investments: In dealing with the organizations invested assets, directors must follow three statutory standards:

- Avoid speculation and look instead to permanent disposition of the funds, considering the probable income and the probable safety of the corporation's capital;⁴⁵
- Comply with any additional standards imposed by the corporation's articles or bylaws or by the express terms of an instrument or agreement under which the assets were contributed;⁴⁶ and
- Meet the general standard of care requirements applicable to directors of public benefit corporations.⁴⁷

Section IX below analyzes the management (including spending) of invested assets.

Self-Dealing Transactions

The "conflict of interest" law covering nonprofit directors does not use this term.⁴⁸ There are, nevertheless, strict sanctions imposed on auxiliary organization governing directors who engage in a self-dealing transaction involving the corporation the directors are serving.

"Self-dealing transactions" are any transactions to which the corporation is a party and in which one or more of its directors has a material financial interest, unless the transaction (1) is specifically excluded from coverage by statute⁴⁹ or (2) although otherwise covered by the prohibition, is approved or validated.⁵⁰

A director with a material financial interest in a transaction involving the corporation served is an "interested director." The law does not define "financial interest" or "material."

The statutory exclusions from the "self-dealing transactions" definition include:⁵¹

- Board actions fixing compensation for directors;

⁴⁵ Ibid at Section 5240(b)(1).

⁴⁶ Ibid at Section 5240(b)(2).

⁴⁷ Ibid at Section 5240(d).

⁴⁸ Ibid at Section 5233.

⁴⁹ Ibid Section 5233(b).

⁵⁰ Ibid Section 5233(d).

⁵¹ Ibid Section 5233(b).

- Transactions that are part of the corporation's public or charitable purpose and that the corporation approves in good faith and without unjustified favoritism, even if one or more directors or their families benefit as part of a class of persons intended to benefit from the program; and
- Transactions of which the interested director has no actual knowledge and which do not exceed the lesser of 1 percent of the gross receipts of the corporation for the preceding fiscal year, or \$100,000.

The organization can engage in a self-dealing transaction if it is approved or validated, either before or after the transaction is consummated, in any one of the following ways:⁵²

- Upon written and supported request to the Attorney General;
- Petition to the court;⁵³
- Validation by the corporation board under specified pre-conditions;⁵⁴ and
- Interim approval by other authorized persons under specified pre-conditions.⁵⁵

Also see Section III(B) below for parallel "self-dealing transactions" requirements specifically applicable to auxiliary organization governing directors found in the *California Education Code*. The *Education Code* requirements are stricter and, therefore, are considered to be the controlling standards for auxiliary board members.

Director Personal Liability

Given these standards, can a director avoid personal liability simply by disengaging – skip meetings, ignore reports and operations? If a director fails to take reasonable precautions that attend the duties of their corporate office, exposure to personal liability may result from injuries or losses caused by the organization.

On the other hand, so long as the director exercises reasonable diligence and care, he or she will be free from personal liability, even when poor judgment results in loss or injury to the corporation.

The relative freedom from personal liability enjoyed by nonprofit governing directors is reposed by statute:⁵⁶

⁵² Ibid at Section 5233(d).

⁵³ Ibid at Section 5233(d)(1).

⁵⁴ Ibid at Section 5233(d)(2).

⁵⁵ Ibid at Section 5233(d)(3).

⁵⁶ Ibid at Section 5239(a).

"There shall be no personal liability to a third party for monetary damages on the part of a volunteer director or volunteer executive officer of a nonprofit corporation...caused by the director's or officer's negligent act or omission in the performance of that person's duties as a director or officer, if all the following conditions are met:

- The act or omission was within the scope of the officer or director duties;
- The director or officer acted in good faith;
- The act or omission did not involve self-dealing; and
- The act or omission was not reckless, wanton, intentional, or grossly negligent."

Additional court procedural protections are also afforded nonprofit volunteer directors, but these have many exceptions.⁵⁷

Under the federal *Volunteer Protection Act of 1997*,⁵⁸ volunteers, including nonprofit entity directors, cannot be held liable for harm caused by the volunteer's act or omission on behalf of the nonprofit when specified circumstances are present.⁵⁹

Indemnification

Auxiliary organizations are permitted by law to indemnify directors and officers under a strict and technical framework⁶⁰ as long as the entity is financially viable. The indemnity scope includes "any threatened, pending or completed action or proceeding, whether civil, criminal, administrative or investigative,"⁶¹ and, although this appears to extend to all legal threats asserted against a director for which the director might be forced to retain counsel or otherwise incur personal expenses, this statutory indemnity power is dependent upon a number of factors, such as: the nature of the proceedings; their outcome; the director's conduct in the matter complained of; and approval of the indemnification by the corporation, the Attorney General, or the court or jurisdiction in the matter.

B. California Education Code

There are concomitant "self-dealing" requirements for auxiliary board members in the *Education Code*. These are stricter than the nonprofit corporation law standards and, therefore, typically apply to auxiliary board members. The *Education Code* (at Section 89006) also sets conflict-of-interest standards for auxiliary organization employees.

⁵⁷ *Cal Code of Civil Procedure* Section 425.15.

⁵⁸ 42 USC Sections 14501-05.

⁵⁹ *Ibid* at Section 14503(a): acting within duty scope; required license or certificate possessed; no willful or criminal misconduct, gross negligence, etc., and not caused by operated vehicle.

⁶⁰ *Cal Corps Code* Section 5238.

⁶¹ *Ibid* at Section 5238(a).

Financial Interest Conflicts

Except in certain circumstances, a director must avoid *transactions of the board* in which the director has a financial interest.⁶² The term includes contracts approved by the governing body. To do so is "misconduct in office" and the transaction breaching this prohibition is void, unless it meets a two-element circumstance test:⁶³

- Is the transaction just and reasonable as to the auxiliary *when approved*; and
- Was the financial interest disclosed or known to the board and noted in the meeting minutes, followed by a favorable, good faith board vote sufficient for the action without including the interested director(s)?

But wait! There are several *circumstance exceptions* to the application of the above test, any one of which revives the prohibition. Here they are:

- The transaction is directly between the interested director(s) and the auxiliary.⁶⁴
- The transaction is between the auxiliary and a partnership or unincorporated association in which a director(s) holds an ownership, partnership or other proprietary interest.⁶⁵
- The transaction is between the auxiliary and a corporation in which the interested director(s) owns or directly or indirectly holds more than a five percent (5%) of the outstanding common stock.⁶⁶
- The director(s) fails to disclose to the board the financial interest in the transaction at a public meeting, then influences or attempts to influence one or more board members in entering into the transaction.⁶⁷

Using Non-Public Board Information

It is also unlawful for a director to use *non-public* information obtained through board membership for personal pecuniary gain. It matters not if that gain happens after the director has left the board.⁶⁸

⁶² Cal Ed Code Section 89906.

⁶³ Ibid Section 89907.

⁶⁴ Ibid Section 89908(a).

⁶⁵ Ibid Section 89908(b).

⁶⁶ Ibid Section 89908(c).

⁶⁷ Ibid Section 89908(d).

⁶⁸ Ibid Section 89909. The term "non-public" refers to auxiliary or other information not generally available to the public.

IV. Meeting Requirements

A. Background on Open Meeting Laws

There are four major *Open Meeting* statutes in California. Only two are intended for auxiliary organizations: the *Gloria Romero Open Meetings Act of 2000*⁶⁹ or the so-called *Seymour Act*.⁷⁰ The *Ralph M. Brown Act 2001*⁷¹ and the *Bagley-Keene Open Meeting Act*⁷² are the other open meeting laws, but they are for state or local governing bodies, such as state or county boards, cities and special districts, and certain nonprofit entities created by public agencies – but, *not* auxiliary organizations. The next time some uninformed person berates your board at a meeting for violating the *Brown Act*, you should be clear on the open meeting law that does apply to your organization, and familiar with its main attributes. This section should help.

Between *Romero* and *Seymour*, which statute applies to which auxiliary? Here is the test: if the auxiliary organization has been formed or is operating as a *student body organization* under Education Code Section 89300 *et seq.*, the *Romero Act* applies; otherwise *Seymour* governs.

The main features of both *Romero* and *Seymour* deal with conducting meetings; notice requirements and exceptions, when a governing board may conduct business absent public access, and violation consequences.

B. Open Meeting Requirements and Exceptions

Appendix B compares the key provisions of *Romero* and *Seymour* to which governing bodies must comply. Under certain circumstances, a board may meet in closed session. Board members should stress with management that the applicable requirements be closely followed, and directors and officers should *individually* have a familiarity with the requirements.

C. Minimum Meeting Standards

There is an Education Code requirement that each auxiliary organization governing board must have at least one business meeting each fiscal year.⁷³ This minimum standard should not be confused with the more relaxed board meeting standard in the *California Nonprofit Public Benefit Law*⁷⁴ requiring a meeting each year in which directors are to be elected at that meeting.

Orientation programs for board members should present at least an overview of open meeting law requirements and compliance practices.

⁶⁹ Ibid Section 89305 *et seq.*

⁷⁰ Ibid Section 89920 *et seq.* State Senator Seymour authored these provisions without formal attribution to him, but it is handy in this monograph to refer to the provisions in this manner.

⁷¹ Cal Government Code Sections 54950-54962.

⁷² Ibid Sections 11120-11132.

⁷³ Section 89903(b). The Chancellor's Office has indicated that additional guidance on this minimum standard may be instituted to assure that prudent investment and similar board decisions are timely.

⁷⁴ California Corporations Code, Section 5510(b).

V. Keeping and Disclosing Records and Files

A. California Public Records Act

California public policy favors access to government records. The *California Public Records Act* (CPRA) ⁷⁵ is strong testimony to this bias. It is modeled upon the federal disclosure laws known as the *Freedom of Information Act* (FOIA). ⁷⁶

A corollary document-access issue can arise because of the close relationship between the university and the auxiliary: does the public -- student body, faculty or staff, or general citizenry -- have a concomitant right to the files and records of an auxiliary organization, and does the CPRA apply?

The short, but less than edifying answer is yes and no. So, let's analyze this answer.

Are Auxiliary Organizations subject to the CPRA?

Nonprofit corporations are typically held to be private in nature -- that is, not public or governmental agencies. There are many exceptions depending upon the role served by the entity and relationship with a public agency, or by virtue of unique statutory definition. Indeed, auxiliary organizations are closely related to the campus institution they serve, and the California State University is a "state agency" subject to the CPRA. In one circumstance, certain auxiliary organizations enjoy a statutory description that suggests public agency status. ⁷⁷ But the CPRA is fairly explicit about its coverage.

The CPRA defines "state agency" to mean:

...every state office, officer, department, division, bureau, board, and commission, or other state body or agency, except those agencies provided in Article IV (except Section 20 thereof) or Article VI of the California Constitution. ⁷⁸

California courts generally hold that auxiliary organizations are *not* part of the state body they support. ⁷⁹ But these cases never specifically arrived at whether a state university auxiliary organization is a "state agency" under the CPRA. Until recently, there were no cases addressing this issue.

⁷⁵ The CPRA is codified in the *California Government Code*, Section 6250 *et seq.*

⁷⁶ The FOIA (5 U.S.C. §55 *et seq.*) was enacted to ensure public access to vital information about the governmental conduct of its business.

⁷⁷ Cal Gov't Code Section 20057(c) contains a description of auxiliary organizations in the definition of "Public Agency" for California Public Employees Retirement System employer eligibility purposes.

⁷⁸ *Ibid* at Section 6252(a).

⁷⁹ See *Coppernoll v. Board of Directors* (1983) Cal. App.3d 915, 918; *Wanee v. Board of Directors* (1976) 56 Cal. App.3d 644, 648-649; see also 47 Ops.Cal.Atty.Gen. 8 (1966).

In California State University, Fresno Foundation, Inc. v. Superior Court,⁸⁰ the California Court of Appeals reviewed the role and relationship of a CSU auxiliary organization under the Education Code, FOIA and CPRA definitions, and both California and other case law. The court concluded, "...a non-governmental auxiliary organization is not a 'state agency' for purposes of the CPRA. The words 'state body' and 'state agency' simply do not include a non-governmental auxiliary organization."⁸¹

The case arose from a CPRA request to Fresno State for donor records from the local newspaper (thus acquiring the vernacular handle: the *Fresno Bee Case*), and involved several convoluted facts and circumstances. For purposes of this paper, the *Fresno Bee Case* provides some resolution to what the court referred to as "uncharted territory of legislative intent," while recognizing as it did that the extent of CPRA coverage is a matter to be developed by the courts on a case-by-case basis.⁸²

The *Fresno Bee Case* provides a practical legacy that deserves consideration, notwithstanding the CPRA's limited application to auxiliary records: the Fresno Foundation ended up *voluntarily* disclosing certain donor information that was at the center of the dispute. Furthermore, the case facts and circumstances point to some critical information management issues over files and records shared between the university and its auxiliary organizations. These "lessons learned" and other ideas are discussed below.

Before leaving this statutory information disclosure issue, it should be observed that auxiliary organizations are subject to disclosure requirements under Federal tax rules.⁸³ As an entity determined by the U.S. Internal Revenue Service to be exempt from corporate income tax (so-called "exempt organizations"),⁸⁴ an auxiliary organization must provide the public, upon request, a copy of its exempt organization application,⁸⁵ and most portions of its annual tax information returns.⁸⁶ A profile of these requirements appears as Appendix B.

Auxiliary boards should consider adopting policy that brings appropriate definition to what the entity considers to be public and proprietary or confidential information.

B. Maintaining Separate Files

Auxiliary organization governing bodies are typically composed of campus officers, staff or faculty. Their presence on the board may or may not stem

⁸⁰ 90 Cal. App. 4th 810 and 108 Cal. Rptr. 2d 870 (2001).

⁸¹ *Opinion*, F037383, dated July 16, 2001, at page 17.

⁸² *Ibid* at page 19.

⁸³ *Taxpayer Bill of Rights 2* and IRS Notice 88-120, 1988-2 C.B. 454.

⁸⁴ See Section II (D) above at page 6.

⁸⁵ IRS Form 1023, "Application for Recognition of Exemption under IRC Section 501(c)(3)."

⁸⁶ IRS Form 990, "Return of Organization Exempt From Income Tax."

from the position held with the institution. The important factor is that the records in their possession may be within the *CPRA* ambit. Acting in their board member capacity, these same individuals may hold a variety of auxiliary organization documents *not* subject to the *CPRA*.

What is the proper disposition of auxiliary organization records held by a campus employee serving as an officer or board member to avoid unintended *CPRA* access?

There appear to be two straightforward answers, and one with more complex dimensions. First, the officer/director could make it a practice to file auxiliary organization documents separate from university office files. Under this approach, the records are retained temporarily for review and use at board, committee or other auxiliary-related meetings, then either dispatched to the auxiliary organization's office or destroyed.

This approach may not prove practical for a campus official serving as an officer or as director on the board of a large, multi-function auxiliary organization. In these cases the official's files might be organized to clearly distinguish between institution records and those of the auxiliary. The separation might be a physical one by having two file sections or cabinets, or integrated subjects in a single file, but distinguished by different folder colors or tabs.

Another avenue to consider is inter-locking university and auxiliary organization policy statements. They would describe the role of campus officials serving on auxiliary boards, and articulating the position that the auxiliary organization records, files and documents held in the offices of such campus officials belong to the auxiliary, not the institution.

VI. Loyalty Owed to Organization or Constituency?

Trustee regulations⁸⁷ set out a composition framework for auxiliary organization governing boards.

Student body organizations must "consist primarily of students, with a representative of the campus president to advise on policy and to provide liaison between the student governing board and the president of the campus."⁸⁸

Most if not all student body auxiliary organizations elect governing body members through a system affording representation to constituent groups or institution academic units (such as departments, schools or colleges).

⁸⁷ Title 5, Section 42602.

⁸⁸ Ibid at 42602(a).

Students are qualified to stand for election to the board under organization bylaws that typically require status within such units or interest groups.

For auxiliary organizations other than student body organizations the composition requirement is different and tied to a date-triggering mechanism.

Non-student body auxiliary organizations "operating on April 1, 1969, may continue the composition of their governing board of directors existing at that time.⁸⁹ Those entities making "a substantial change in their governing board's composition, and any [non-student body] auxiliary organization established after that date, shall have a governing board consisting of a voting membership from the following categories:

- (A) Administration and staff
- (B) Faculty
- (C) Non-campus personnel
- (D) Students."

Auxiliary organization governing bodies must be large enough to handle these composition requirements, if they apply.⁹⁰

Student body organizations have an historic connection to the "governmental model" of structure. This model often includes the three branches: executive, legislative and judicial. The "corporate model" of organizational structure may be an emerging trend for these entities, but many articles and bylaws retain the "representative" form for qualifying and electing governing body members – more often referring to the body as the board of directors. This vestige, coupled with the "composition categories" required for other auxiliary boards, frequently leads uninitiated directors to conclude they owe a duty to a constituency, rather than to the organization.

Composition requirements in Trustee regulations do *not* mean that directors "represent" or hold an allegiance to a category or constituency that elected or qualified them for board membership. The purpose of the composition categories is to help assure that governing board deliberations and action are informed by perspectives likely to emanate from those categories. A close look at even the "governmental model" of organization structure reveals where the duty of a legislative "representative" truly resides.

A national, state or local candidate for an elected legislative-type office may indeed represent one or more constituencies (geographical, political or interest group). But once elected, the legal and moral duty of the official is owed to the public entity and its governing body.

⁸⁹ Ibid at 42602(b).

⁹⁰ Ibid at 42602(c).

Recall also that auxiliary organizations are incorporated under California nonprofit corporation laws.⁹¹ Board members first owe a duty to the corporation under duty-of-care and loyalty standards expressed in the California Nonprofit Corporation Law.⁹²

The duty owed by an auxiliary organization board member is a practical one. Board matters will or may significantly affect a constituency or composition category of a director. The director must certainly articulate and weigh that impact, and attempt a good faith balance that is best for the organization.

VII. Management, the University, Customers, Clientele or Constituents

A successful auxiliary board recognizes and understands key relationships that need to be established and nurtured. Some of these relationships are unique to public higher education and the nonprofit sector, while others are quite common.

A. Board – Management Relations

Governing boards typically delegate considerable authority to management to operate the organization on a day-to-day basis. In the nonprofit, or "independent" sector, the relationship between the board and management is only slightly akin to the private sector. In the corporate world, management leadership needs to be crisp and nimble, with the board in an oversight role. The governance balance struck in nonprofit governance is somewhat different. The nonprofit board typically plays a more active role – indeed, the relationship between board and manager is often described as a partnership. This balance for auxiliary organization boards and managers is more complex, since the campus president and the designated oversight officer must be factored in.

Auxiliary organizations in good standing⁹³ within the CSU are *separate* but *related* to the institutions they serve. This dynamic triggers the need for very discerning relationship protocols. These arrangements need to respect the prerogatives and role of the board, the operational effectiveness of management, and the critical oversight responsibilities held by the campus president, the Chancellor and the Trustees.

⁹¹ See Section II (B) above at page 4.

⁹² Cal Corps Code Section 5231(a). See also discussion of director duty standards at Section III (A) on page 8.

⁹³ Title 5 Section 42406 requires the Chancellor to maintain a current list of organizations "in good standing." The alternate term, "officially recognized auxiliary organizations" is used in Executive Order No. 698 and in other directives.

B. Setting Policy and Accountability Standards

Policy vs. Procedures

One primary responsibility of an auxiliary board is to establish formal policies within which the entity functions. Of course, the functions should be those authorized in Title 5 for auxiliary organizations⁹⁴ and specified in appropriate operating agreements and support service leases.⁹⁵ The term "policy" is frequently misunderstood or confused with operational "procedures" and "practices."

Simply put, policy is formal guidance needed to manage, coordinate and execute actions and activity throughout an organization – whether in the private, public or nonprofit sectors. When effectively deployed, policy statements help focus attention and resources on high priority matters – aligning and merging efforts within and for the organization to achieve its purpose and vision. Policy provides the operational framework within which the entity functions.

Procedures and practices, on the other hand, are the operational *processes* within the organization required to implement policy. Operating practices can be formal or rather informal, specific to a department or unit, or applicable across the entire organization. If policy is "what" the organization does, then its procedures are "how" it carries out those policies.

What's unique about auxiliary board policy-making? It is the operational context in which these entities must function. For, while the auxiliary organization is indeed a separate legal entity with important corporate prerogatives and statutory powers, it has as its sole corporate purpose service in support of the institution's mission. Furthermore, its "good standing" status with the Trustees through the Chancellor rests upon a high degree of conformance within system-wide and institution policies that apply to auxiliary organizations, and auxiliary board policy statements must synchronize with them. To strengthen this "test-of-relatedness" the auxiliary in good standing agrees to this conformity in the operating agreements and support service leases for the functions required of the auxiliary by the institution.⁹⁶

Accountability Standards

Setting and reviewing accountability standards is another important governance responsibility. Auxiliary organizations are principally in the "business" of service and stewardship. This calls for a higher standard of duty by the board and in management performance.⁹⁷ The board should be clear with itself and with management on sound business practices, including

⁹⁴ Ibid at Section 42500(a).

⁹⁵ Ibid at Sections 42501-2 and 42601.

⁹⁶ Ibid at Section 42502(l)-(m).

⁹⁷ There can be a natural tension for a multi-function auxiliary between "fiscally viable" services and the "due diligence" required over grant or gifted assets held for the institution.

internal controls and compliance policies and procedures. These should be well documented, monitored and brought up-to-date on a regular basis.

Successful service organizations pride themselves on measures of quality, responsiveness, integrity and value. These measures should be woven into all auxiliary program and activity objectives – objectives that can, in turn, assist the board in judging management's performance.

C. Operating Agreements/Leases

Merely because the Trustees have declared enumerated functions that auxiliary organizations can provide⁹⁸ does not give a particular auxiliary the right or privilege to undertake one or more of those functions. The Trustees also require that an auxiliary enter into an appropriate operating agreement for those functions⁹⁹ to include specified provisions.¹⁰⁰ If CSU property or facilities are to be used to perform any function, then a lease or license is required.¹⁰¹

D. Trustees and University Oversight

State, system and institution oversight is another unique feature of auxiliary organization governance. Auxiliaries may be separate legal entities, but each exists to supplement, support or enhance the institution served.

There is a legal interpretation maxim that holds less specific statutes on the same subject to be subordinate to more specific ones. This is the case with the oversight framework expressed in the *Education Code* and in *Title 5*. The State Legislature authorized auxiliary organizations to operate within the CSU on a limited basis, with a delegation of authority to the Board of Trustees. In turn, the Trustees established a more detailed operational framework and relationship standards under the delegated authority of the Chancellor and the campus presidents.

The public policy behind this "oversight context" secures needed flexibility by auxiliary organizations,¹⁰² while appropriate and prudent safeguards are in place.¹⁰³ There is considerable wisdom in the tension between "flexibility" and "oversight." It is doubtful either the general public or even the State Legislature would recognize the separateness of the CSU or campus from an out-of-step auxiliary organization.

⁹⁸ *Title 5* Section 42500(a) and inferentially 42659.

⁹⁹ *Ibid* Section 42501

¹⁰⁰ *Ibid* Section 42502

¹⁰¹ *Ibid* Section 42601 citing *Cal Ed Code* Section 89046.

¹⁰² *Ibid*, Section 42401 is a declaration of policy by the Trustees that lists the objectives to be served by auxiliary organizations, including "fiscal and management procedures to provide campus instructional and service aids not otherwise available; effective operations and elimination of undue difficulty that would otherwise arise, and the effective coordination of auxiliary activities under sound business practices."

¹⁰³ *Ibid* at Sections 42400-2, 42408, and 42500-3.

The true challenge for the policymakers is to carefully discern between oversight requirements that help rather than hinder flexible and viable auxiliary services to the campuses.

VIII. Risk Responsibility

Governing boards have an important role in managing risks posed by auxiliary operations in support of the served institution. Risk responsibility does not fall solely to management.

There are several dimensions to risk responsibility at the governance level.

First, and fundamentally, the board should consistently exercise its essential governance functions, and be receiving and evaluating reports and information clearly demonstrating that management is attending to day-to-day operations and the risk exposures from those services and activities. Also, auxiliary legal counsel should, as a sustaining function, be advising both the Board and management on the legal requirements for the organization, and on pending major litigation.

Next, the board should set risk management policy and standards covering all auxiliary operations.

Finally, the board should require and be familiar with a periodic, documented inventory and evaluation of the risks to which the auxiliary is normally exposed.

Appendix C is a list of Typical Governing Board Questions Concerning an Organization's Risk and Insurance.

A. Essential Governance Functions

The governing board serves important functions that by their nature and significance mitigate risk. As distinct from for-profit boards, non-profits in general, and auxiliary organization boards in particular, are not focused on enhancing shareholder values. They are more committed to the service mission of the organization and with stewardship over assets. These boards:

- Select, advise, evaluate, and, if need be, replace executive management;
- Establish and review strategic directions, approve specific objectives and set accountability standards;
- Ensure, to the extent possible, that the resources needed to accomplish those objectives and standards are at hand;
- Monitor management performance to established standards;
- Ensure that the organization operates responsibly (ethically) as well as effectively; and

- Establish and carry out an effective board-level governance system, involving the officers, committees and counsel.

Thus, a crucial first step toward corporate risk responsibility is *engaged* governance. Interestingly, there is little in either the *Education Code* or *Title 5* on this point. As discussed above, the *Education Code* sets governance limits on self-dealing, meetings, elections, fees and funds. *Title 5* replicates and details more of the same, and sets auxiliary board composition, permissible functions, fiscal administration, debt requirements, and external oversight, records, succession, and employee compensation requirements.

The Chancellor has issued executive orders covering an array of auxiliary *operational* issues, yet little of this direction deals directly with the *essential* governance functions of an auxiliary organization. Fortunately, the *Nonprofit Corporations Law* addresses these important governance responsibilities. Auxiliary organizations are incorporated under this statutory scheme and are, therefore, subject to its provisions.¹⁰⁴

B. Setting Risk Management Policy and Standards

The auxiliary board policy-making should extend to risk management. Such policy guidance should be designed to reduce or eliminate losses to which the organization may be exposed through a process of risk identification and evaluation, and appropriate risk management actions.

The scope of a comprehensive risk management policy statement should include: appropriate background, authority, and purpose provisions; a general policy statement on risk responsibility; more specific policy provisions on limited loss retention, insurance acquisition, and cooperative programs; and policy implementation provisions, including the role of management, management standards, risk management program practices and organization.

Any auxiliary risk management policy should be consistent with corresponding system and campus policy and practices that relate to auxiliary organization functions.¹⁰⁵

The *AOA Website* periodically posts sample policy statements, including those covering risk management and responsibility.

Once adopted, the risk management policy should be periodically reviewed by the board and management to assure the provisions are up-to-date and relevant to contemporary operations and exposures.

¹⁰⁴ See discussion of governance powers in Section II (A) at pages 3-4, and standards of conduct in Section III at page 8.

¹⁰⁵ For present system-wide policy and practices, see Executive Orders 715 and 849.

C. Periodic Risk Cataloging and Assessments

An important part of risk responsibility at the governance level is assuring that the auxiliary organization is aware of the risk at hand or under consideration. The board should require that management have an appropriate risk assessment process and periodic risk cataloging system established.

Again, the AOA has developed a model risk assessment checklist that could serve as a template for most auxiliary operations of functions. Try online at: http://www.foundation.sdsu.edu/aoa/resources/risk_mgmt/doc205.pdf.

The assessment process and cataloging system should be reevaluated from time to time.

IX. Managing (and Spending) Invested Funds

A. Policy Comes First!

Auxiliary governing boards carry the responsibility for developing, implementing and periodically evaluating policies that closely lead the extent and complexity of invested resources.¹⁰⁶

For organizations charged with managing the university endowment, this is an undertaking of profound consequences, and the managing of these *charitable funds* should be considered of singular importance by board members. Effective investment management requires the close collaboration between the board and management, and with investment counsel and portfolio managers. The effort must be a sustaining one, but it starts with the clear and complete articulation of the organization's policies *in formal statements* that include provisions governing the expenditure, investment, and use of such assets.

What are "charitable funds?" For the purposes of this section, the term refers to all assets that are held by an auxiliary organization from private or corporate donations to advance the charitable purpose(s) for which the organization was formed. These assets often come with various labels, none apparently accepted with any standardization or well-defined meanings. These included "endowment funds," "quasi-endowments," "annual funds," or "capital funds." These terms are often found in policies and are intended to convey different spending restrictions or uses to which the assets are dedicated. California laws over this area are of little help, since they rarely use such labels, and can carry somewhat different meanings.

Charitable funds do not include those funds used directly for the operations of the organization. How revenue from sources other than donations

¹⁰⁶ Exemplars for developing auxiliary organization investment policies, together with guidelines on endowment practices are posted by the Chancellor's Office at: www.calstate.edu/investment_policy/.

(commercial operations, earned indirect costs from externally-sponsored projects, or income from other activities related to corporate purposes) is invested and spent involves other more general standards discussed below. If the asset was donated, then the higher, more specific standards apply.

This section attempts to make some major technical distinctions important to managing charitable funds. Section B summarizes statutory standards applicable to this topic.

"True endowment" typically refers to a permanent fund whose principle is to be preserved in perpetuity, as conditioned by the donor(s) of the funds. Restrictions on the expenditure of the principle earnings may or may not be imposed by the donor, but the law requires adherence to any such conditions if the funds have been accepted by the organization (acting as a trustee under the law).¹⁰⁷ Such restrictions on an endowed fund are critical, since any subsequent contributions by others to the same fund take on the same primary fund characteristics, together with any earnings use restrictions.

"Term endowment" is a term used to set restrictions on the expenditure of fund principle or earnings for a fixed term (or when a specified event occurs). "Quasi endowment" funds are those unrestricted assets (gifts, or surplus operating funds) the organization itself places under voluntary restrictions similar to a true or term endowment. Subsequent additions to such a fund take on the characteristics of that quasi endowment.

It is important to discern between endowment-type funds and those considered non-endowed, since only endowed funds are resources for the future of ongoing organization programs. So-called "annual funds" are generally available in full for current needs. There may be donor-designations on the uses to which some funds may be put. "Capital funds" are typically for new or replacement facilities or equipment, but the term is loosely applied in many cases to describe major new projects.

B. Statutory Requirements

As California nonprofit public benefit corporations, auxiliary organizations are subject to a number of statutory requirements set out in the *Nonprofit Public Benefit Corporation Law*¹⁰⁸ and some of the laws applicable to trusts in *California Probate Code*¹⁰⁹ governing the expenditure and investment of charitable funds.¹¹⁰

There is solid statutory basis and case law precedent for the proposition that all charitable corporation (auxiliary organizations included) assets are

¹⁰⁷ Cal Probate Code Section 16000.

¹⁰⁸ Cal Corps Code Section 5240 et seq.

¹⁰⁹ Sections 15000-19403.

¹¹⁰ Nonprofit corporations are excluded from the *Uniform Prudent Investor Act* (UPIA) in Probate Code Sections 16045-16054.

considered to be in charitable trust by virtue of the organization's chartered purpose(s).¹¹¹ Unfortunately, there is some discordance when attempting to apply *Nonprofit Corporation Law*¹¹² and the *Trust Law*¹¹³ to how funds should be managed.

The most prudent approach is to attempt to comply with the provisions of both laws – at least stake out a documented and supportable path or fork taken!

UMIFA (Managing and Spending Charitable Funds).¹¹⁴

There is fairly clear statutory intent that charitable funds held by auxiliary organizations may be governed by the *Uniform Management of Institutional Funds Act* (UMIFA).¹¹⁵ UMIFA sets standards for spending and investing of so-called "institutional funds" and includes special provisions for the expenditure of "endowment funds." Also, UMIFA does *not* preclude the application of other, more restrictive laws on the expenditure of public funds.¹¹⁶

Under the Act, an "institutional fund" is a fund held for the exclusive use, benefit, or purposes of the organization.¹¹⁷ An "endowment fund" is defined as "an institutional fund, or any part thereof, not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument."¹¹⁸ A "gift instrument" is the document covering the transfer of the asset to or held by the institution as an institutional fund.¹¹⁹ If the entire fund cannot be spent at the current time by the institution under a restriction in the gift instrument, it is an endowment fund.

The organization's ("institution" under the Act) governing board is responsible for the management of "institutional funds."

Governing board members must administer these *invested* funds with the "care, skill, prudence and diligence under the circumstances then prevailing

¹¹¹ *Cal Bus & P C Code* Section 17510.8.

¹¹² *Cal Corps Code* Sections 5000 – 10841.

¹¹³ *Cal Probate Code* Sections 15000 – 19403.

¹¹⁴ First promulgated by the National Conference of Commissioners on Uniform State Laws in 1972, UMIFA was first adopted in California in the mid-70s, and its application expanded in 1990. The Act has recently been revised by the National Conference as the *Uniform Prudent Management of Institutional Funds Act* (UPMIFA), and there are efforts underway for its enactment in California.

¹¹⁵ *Ibid*, Sections 18500 – 18509. Section 18501(e) defines an institution as "...an incorporated or unincorporated organization and operated exclusively for educational, religious, charitable, or other eleemosynary purposes, or a governmental organization to the extent that it holds funds exclusively for any of the purposes."

¹¹⁶ *Ibid*, Section 18509

¹¹⁷ *Ibid*, Section 18501(f)

¹¹⁸ *Ibid*, Section 18501(a). The key aspect to this definition is that such funds may not be currently spent in their entirety.

¹¹⁹ *Ibid*, Section 18501(b)

that a prudent person acting in a like capacity" would use.¹²⁰ Board members must look at each investment in relation to its "fit" in the organization's overall investment policy, and consider:

- Long- and short-term needs of the institution in carrying out its purposes;
- Present and anticipated financial requirements;
- Expected total return on investments;
- General economic conditions;
- The appropriateness of a reasonable proportion of higher risk investment with respect to institutional funds as a whole;
- Income and growth;
- Long-term net appreciation; and
- The probable safety of funds.¹²¹

Endowment fund investment management may be delegated either to officers, committees, employees or agents, including investment counsel, or through contracts with compensated independent investment advisers, investment counsel or managers, banks, or trust companies with appropriate decision-making authority.¹²²

Investing and Spending Endowment Funds

Except as may be limited by the gift instrument, the governing board may invest endowment funds under UMIFA by any of the following:

- Invest and reinvest in any real or personal property considered advisable by the board, whether or not it produces a current return.¹²³
- Retain property contributed by a donor for as long as the board considers advisable.
- Place all or part in any pooled or common fund maintained by the institution or other entity.¹²⁴
- Pursue investments otherwise authorized by law.

The UMIFA spending provisions permit the board to "appropriate for expenditure"¹²⁵ "so much of the net appreciation, realized or unrealized, in the

¹²⁰ Ibid, Section 18506(a), and review board member duty standards relating to investments on page 9 above. Note that the duty of investment care spelled out in *Cal Corps Code* Section 5240 is harmonized with the UMIFA standard of care. See *Cal Corps Code* Section 5240(e).

¹²¹ Ibid, Section 18506(b)

¹²² Ibid, Section 18505(b) and (c).

¹²³ Permissible investment vehicles include "mortgages, deeds of trust, stocks, bonds, debentures, and other securities of profit or nonprofit corporations, shares in or obligations of associations or partnerships, and obligations of an government or subdivision or instrumentality thereof."

¹²⁴ Permissible pooled or common fund vehicles include shares or interests in regulated investment companies, mutual funds, common trust funds, investment partnerships, real estate investment trusts, or similar organizations in which funds are commingled and investment determinations are made by persons other than the board.

¹²⁵ Ibid, Section 18502.

fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent."¹²⁶ The spending limitation may also be expressed and applied based upon more restrictive provision in other law, the gift instrument, or the institution's charter.¹²⁷

There are also UMIFA guidelines for funds that may need to be managed to conserve net appreciation.¹²⁸

Investing and Spending Non-endowment Charitable Funds

UMIFA and more general nonprofit corporation law govern the management of non-endowment (e.g., annual and capital funds) charitable funds in a frankly un-harmonized fashion. Non-endowment "institutional funds" must be administered by the governing board with the "care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity" would use,¹²⁹ while avoiding "speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety of the corporation's capital."¹³⁰

Remember, the non-endowment charitable fund investment standards do not apply to the entity's operational funds for its chartered purpose.

Investing and Spending Other Funds

There are, of course, other idle organization assets that should be properly invested, even though they arguably fall outside UMIFA. The investment standards governing these funds are more general, keeping in mind that there is statutory authority for the position that such assets should also be considered *in charitable trust* given the corporate purpose(s) of the organization.

There has already been reference to the general duty of due care required by governing board members.¹³¹ See Section IIIA above.

Additionally, CSU guidance on investments should inform board members. A 1977 Board of Trustees resolution urges auxiliary boards to include a social responsibility provision in investment policies.¹³² Auxiliary organizations may, under current system-wide practices, invest idle funds in State investment vehicles. Funds of student body organizations are held by the university under Education Code custodianship requirements.¹³³

¹²⁶ Ibid, Section 18506. The "historic dollar value" is defined in Section 18501(d).

¹²⁷ Ibid, Section 18502.

¹²⁸ Ibid, Section 18503(a) and (b). There is some flexibility with respect to pre-UMIFA gift instruments.

¹²⁹ Ibid, Section 18506(a)

¹³⁰ Cal Corps Code Section 5240(b)(1). Also see the general standard of care to be exercised by a board member described above in Section IIIA at the bottom of page 8.

¹³¹ Cal Corps Code Section 5231(a)

¹³² RFIN 7-78-6.

¹³³ Cal Ed Code Section 89300 et seq.

Finally, Board members should be aware of the "Business Best Practice Guidelines" issued by the Chancellor's Office regarding investments. These guidelines seek "to protect and properly account for investments and investment income in accordance with source restrictions and other requirements," and include five (5) action standards dealing with investment policy, segregation of duties, recording of investment income, safekeeping physical assets, and reconciliation and reviews.¹³⁴

X. Borrowing

A. General

Nonprofit corporations have the power to incur indebtedness, subject to restrictions in their articles of incorporation or bylaws.

Auxiliary organizations have come to rely with increasing scope and frequency on borrowing for major projects through loans, bond issues or similar debt instruments. Financing arrangements can be complex and often represent long-term and consequential demands on operating assets.

While it is beyond the scope of this monograph to delve into the many aspects of nonprofit corporation/auxiliary organization project financing vehicles, it should be clearly understood that Board members must exercise the duty of due care analyzed in Section III above when considering and acting on such obligations.

Among the certain nonprofits that have the ability to borrow on a tax-exempt basis, auxiliary organizations have a credible history of such financing structures. However, under a system-wide policy framework, major capital project debt financing by auxiliary organizations has been relatively focused on a singular approach.

B. System-wide Revenue Board Program (SRB)

For the past several years the CSU has evolved a comprehensive financing and debt management policy,¹³⁵ together with implementing practices that include the financing needs and activities of auxiliary organizations.

Executive Order No. 994 details the practices to be followed by a university and an auxiliary organization to utilize the SRB or other "alternative financing activities." See: www.calstate.edu/EO/ (index to all Executive Orders).

¹³⁴ See "Compilation" at Section 8.9, online: www.calstate.edu/FT/AuxOrg/PDF0800/Compilation.shtml.

¹³⁵ Trustees CSU Policy for Financing Activities, Resolution RFIN 03-02-02. This resolution appears as Attachment B to Executive Order No. 994, dated October 23, 2006.

APPENDICES

Appendix A Suggested Reading on Nonprofit and Auxiliary Governance

Appendix B Open Meeting Law Requirements for Auxiliary Organizations

Appendix C Typical Governing Board Questions on Risk and Insurance

SUGGESTED SELECTED REFERENCES ON NONPROFIT AND AUXILIARY ORGANIZATION GOVERNANCE

General:

The *American Society of Corporate Secretaries* and the *American Bar Association Section of Business Law* publish a number of materials, most of which concerns the business corporation. Two are valuable to the nonprofit sector: The Society's Meetings of the Board of Directors and Its Committees (1985); and a joint publication, Nonprofit Governance – The Executive's Guide (1997).

Dorca, Nonprofit Boards: A Practical Guide to Roles, Responsibilities and Performance (Oryx Press, 1986).

Drucker, Managing the Nonprofit Organization – Principles and Practices (Harper Collins, 1990).

Hone, Michael, Reporter, Revised Model Nonprofit Corporation Act, Official Text with Official Comments and Statutory Cross-References (Prentiss Hall, Law and Business, 1988).

Houle, Governing Boards (Jossey-Bass, Inc., 1989).

Howe, The Board Member's Guide to Fund Raising (Jossey-Bass, 1991).

Kurtz, Board Liability (Moyer, Bell, 1988).

Overton, ed. Guidebook for Nonprofit Corporations (ABA, 1993).

Runquist, Responsibilities and Duties of a Director of a Nonprofit Organization (Englewood Cliffs, 1995).

Stanton, Trustee Handbook (National Association of Independent Schools, 1989).

Wolf, Managing a Nonprofit Corporation (Prentice Hall Press, 2d Ed. 1990)

U.S. Internal Revenue Service, online workshop on basic Exempt Organization compliance: <http://www.irs.gov/charities/article/0,,id=166625,00.html>

Auxiliary Organizations:

The *Auxiliary Organizations Association* (AOA) publishes a professional monograph series that includes papers of value to directors and officers of auxiliary organizations operating in the CSU. Of particular note is: J. Francis, Separate But Related (AOA, 1995). This monograph is available on the AOA Website.

OPEN MEETING LAW REQUIREMENTS

*Applicable to Auxiliary Organizations:
A Comparison Summary Chart*

Requirement	<i>Romero Act</i> (Student Body Organizations)	<i>Seymour</i> (Other Auxiliary Organizations)
Coverage	<p>Governing body ("legislative body") of student body organizations formed or operating under <i>Cal Ed Code § 89300</i>;</p> <p>[§89305.1(b)(A)(i)]</p> <p>Governing body of statewide student organization representing CSU students or CSU campus student body organization governing bodies.</p> <p>[§89305.1(b)(A)(ii)]</p>	<p>Governing board of an auxiliary organization formed under <i>Cal Ed Code §89900 et seq.</i> except student body organizations.</p> <p>[§89920]</p>
Sub-Bodies	<p>Any commission, committee, board, sub-board, or other board created by charter, resolution, or governing body formal action, excluding "advisory committee."</p> <p>[§89305.1(b)(A)(iii)]</p>	<p>Provisions apply to any sub-board of the auxiliary organization governing board.</p> <p>[§89920]</p>
Meeting Defined	<p>Congregation of majority membership of governing body or sub-body at same time and place to hear, discuss, or deliberate on item within its purview.</p> <p>[§89305.1(b)(B)]</p> <p>"Meeting" does not include:</p> <ul style="list-style-type: none"> • Individual contacts/conversations between a governing body or sub-body member and another person; or • A governing board or sub-body majority attending a noticed public meeting of another governing body or entity, a public conference on general public interest issues, or a purely social or ceremonial occasion, as long as they do not discuss among themselves specific business within its purview. <p>[§89305.1(b)(B)(i), (ii) & (iii)]</p>	<p>Provisions do not define the term "meeting." In general, a meeting is a gathering of a quorum of a body, no matter how informal, where business is discussed or transacted. (61 Ops. Cal. Atty. Gen. 220 (1978).)</p>
Secret Ballots & Semi-closed Meetings	<p>Secret ballots are prohibited.</p> <p>[§89305.1(e)]</p> <p>See Note A below on semi-closed meetings.</p>	<p>See Note A below.</p>

Requirement	<i>Romero Act</i> (Student Body Organizations)	<i>Seymour</i> (Other Auxiliary Organizations)
Public Participation at Meetings	<p>Any person may upon request obtain meeting agenda/documents packet. Request process is defined.</p> <p>[§89305.7]</p> <p>Every regular meeting agenda shall include opportunity for public to directly address governing body on any item affecting campus or statewide higher education. No action may be taken on such item unless it duly appeared on meeting agenda. Exceptions where a prior sub-body has met and afforded public input.</p> <p>[§89306(a)(1)(2)]</p> <p>Special meeting notices shall provide for public comment to governing body or sub-body on meeting agenda items.</p> <p>[§89306(a)(3)]</p> <p>Reasonable meeting regulations may limit public participation time limitations on any one agenda item and for each person.</p> <p>[§89306(b)]</p> <p>Governing body or sub-body may not prohibit public criticism of body and/or organization.</p> <p>[§89306(c)]</p> <p>No meeting shall be held in a facility that prohibits admittance of anyone in a classification protected by law or not free to attain entrance.</p> <p>[§89307.2(a)]</p> <p>Meeting notices, agenda, announcements or other required reports need not name any tortuous sexual conduct or child abuse victim or alleged victim unless the person's name has been publicly disclosed.</p> <p>[§89307.2(b)]</p>	<p>Any individual or medium shall upon written request receive a meeting notice one week before the meeting date. Meeting notice requests shall be valid for one year unless a renewal request is filed.</p> <p>[§89921]</p> <p>All persons are permitted to attend governing or sub-board meetings, unless otherwise provided by these provisions.</p> <p>[§89920]</p> <p>No governing or sub-board shall take action on any issue until that issue has been publicly posted for at least one week.</p> <p>[§89924]</p>
Notice of Regular Meetings	<p>Governing body or sub-body must annually set time and location(s) for holding regular meetings.</p> <p>[§89305.5(a)]</p> <p>A notice and agenda shall be posted in an accessible public place at least 72 hours before each regular governing or sub-body meeting. The agenda must include a general description of each meeting agenda item.</p> <p>[§89305.5(b)(1)]</p>	<p>Any individual or medium shall upon written request receive a meeting notice one week before the meeting date. Meeting notice requests shall be valid for one year unless a renewal request is filed.</p> <p>Governing or sub-boards must annually set time and location for holding regular meetings.</p> <p>[§89921]</p> <p>Governing or sub-boards shall at least one week before a regular meeting date give written notice of the meeting.</p> <p>[§89924]</p>

Requirement	<i>Romero Act</i> (Student Body Organizations)	<i>Seymour</i> (Other Auxiliary Organizations)
Notice of Special Meetings	<p>Written call and notice to each governing or sub-body member and requesting local media at least 24 hours before special meeting called by presiding officer or body majority. Notice must include meeting time, location and agenda.</p> <p>Written call and notice to body members may be dispensed with by filed written waivers before meeting or as to members actually present when meeting convenes.</p> <p>[§89306.5(a)]</p> <p>Special meeting call and notice shall also be posted in accessible public location.</p> <p>[§89306.5(b)]</p>	<p>Written call and notice (delivered personally or by mail) to each governing or sub-board member and requesting individuals and media, or persons directly affected by the meeting, at least 24 hours before meeting noting time, place and business to be conducted.</p> <p>Notice may be waived in writing by director(s) filed with clerk or secretary before or at special meeting; and is deemed waived by presence at meeting</p> <p>[§89922]</p>
Notice of Emergency Meetings	<p>For defined "emergency situations" governing body may dispense with 24-hour notice and posting requirement.</p> <p>1-hour telephone notice to local requesting media required unless service out, then as soon after meeting as possible.</p> <p>[§89306.5(c) & (d)]</p> <p>Emergency meetings may not be held in closed session.</p> <p>[§89306.5(e)]</p> <p>Otherwise, emergency meetings subject to special meeting notice requirements.</p> <p>[§89306.5(f)]</p> <p>Emergency meeting Minutes, with actions taken and roll call votes, together with list of those notified or attempted to notify, shall be posted in a public place as soon as possible after meeting and for at least 10 days.</p> <p>[§89306.5(g)]</p>	<p>No "emergency meeting" notice provision, but under "special meeting" provision (see above), the 24 hour notice requirement may be waived by directors under specified circumstances.</p> <p>[§89922]</p>
Notice of Sub-Body Meetings	<p>Same as apply to the governing body.</p> <p>[§89305.1(b)(1)(A)(iii)]</p>	<p>Same as apply to the governing board.</p> <p>[§89921]</p>

Requirement	<i>Romero Act</i> (Student Body Organizations)	<i>Seymour</i> (Other Auxiliary Organizations)
<p>Notice of Closed Sessions</p> <p><i>General:</i></p> <p><i>Liability Claim or Pending Litigation:</i></p>	<p>Prior to any closed session, the governing or sub-body shall disclose in open meeting, the item(s) to be discussed in closed session by reference to agenda listing.</p> <p>[§89307(f)(1)]</p> <p>Through the meeting agenda or by public announcement, the governing or sub-body must identify any closed session to be held, together with the statutory provision authorizing the session. In liability claim or litigation circumstances, either the title of the closed session matter shall also be identified, or a statement included that to do so would thwart service of process or pending settlement negotiations favorable to the organization.</p> <p>[§89307(b)(7)]</p>	<p>The governing or sub-board meeting notice and agenda should include reference to any closed session to be held, together with the authority for holding such a session.</p> <p>[§89923-24]</p>
<p>Closed Session [Exception to open meeting requirements]</p>	<p>A host of specific exceptions to open meeting requirements are afforded governing or sub-bodies.</p> <p>[§89307]</p>	<p>Provisions briefly identify specific matters that may be considered and in some cases acted upon in closed session.</p> <p>[§89923]</p>
<p><i>Basic Requirements</i></p>	<p>See above for closed session notice requirements.</p> <p>All closed session circumstances must be expressly authorized under the Act.</p> <p>[§89307(a)]</p> <p>Only matters stated in open meeting as being the subject of a closed session shall be considered in that closed session.</p> <p>[§89307(f)(1)]</p> <p>After closed session, governing or sub-board must reconvene into open session prior to adjournment and make any required disclosures on closed session action(s).</p> <p>[§89307(f)(2)]</p>	<p>Only closed session matters expressly enumerated are authorized.</p> <p>[§89923]</p>
<p><i>Real Property Transactions</i></p>	<p>May be used to advise negotiator on price & terms when property & parties are identified in advance.</p> <p>[§89307(a)(1)]</p>	<p>No provision, unless transaction could be classified as an investment decision where public discussion could have a negative impact on the organization's financial situation. See below.</p>

Requirement	<i>Romero Act</i> (Student Body Organizations)	<i>Seymour</i> (Other Auxiliary Organizations)
<i>Liability Claim or Pending Litigation</i>	Express definition of pending litigation, including process for implementation. This exception is the exclusive application of the attorney-client privilege to closed session. [§89307(b)]	May be used to consider matters relating to litigation. [§89923]
<i>Facility or Public Services Threats</i>	May be used to meet with law enforcement representatives on matters posing public services and/or facilities security threat. [§89307(c)(1)]	No provision.
<i>Employees</i>	May be used to consider employee appointment, performance evaluation, discipline or dismissal. [§89307(c)(1)] "Employee" includes an officer, independent contractor functioning as an officer, or an employee, but not elected official, governing or sub-board member, or other independent contractor. [§89307(c)(4)]	May be used to consider matters relating to the appointment, employment, performance evaluation, or dismissal of an employee. "Employee" does not include a person elected or appointed to an office. [§89923]
<i>Quasi-Judicial Deliberations</i>	May be used to hear complaints or charges brought against an employee by another person or employee, unless the employee requests a public session. [§89307(c)(1)]	May be used to hear complaints or charges brought against an employee by another person or employee, unless the employee requests a public hearing. [§89923]
<i>Labor Negotiations</i>	May be used to advise representative on negotiations with employees. [§89307(e)(1)]	May be used to consider matters relating to collective bargaining. [§89923]
<i>Investments</i>	No provisions.	Upon favorable majority vote, governing or sub-board may discuss investments where public a public discussion could have a negative impact on the organization's financial situation. The final decision must be made in open session. [§89923]
<i>Public Records & Confidentiality Privileges</i>	None specified in Act.	No provisions.
<i>Remedies</i>	None specified in Act.	None specified.

Requirement	<i>Romero Act</i> (Student Body Organizations)	<i>Seymour</i> (Other Auxiliary Organizations)
Violations	Misdemeanor sanctions against any governing or sub-body member attending meeting when "action taken" with knowledge of violation of open meeting law requirements. [§89307.4]	Misdemeanor sanctions against any governing or sub-board member attending meeting when "action taken" with knowledge of open meeting law violations. [§89927]

- A. The California Attorney General has issued a series of consistent written opinions relating to secret ballots and semi-closed meetings by local and state governing bodies under both the *Ralph M. Brown Act* and *Bagley-Keene Act*. These appear analogous to the public policy purposes of *Romero* and *Seymour* and are of some predictive value in judging requirements for auxiliary organization governing boards. These opinions concluded that meetings could not be "semi-closed" where only certain interested members of the public were given access to the meeting.

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Typical Questions from a Governing Board Concerning the Organization's Risk and Insurance

1. What risks does the organization face?
2. Has the risk manager listed and defined those risks?
3. With respect to the exposures faced, how probable is the occurrence of a loss resulting there from?
4. What would happen to the organization's services, programs and interests if such a loss were incurred?
5. Who outside the organization would be affected by such an event?
6. Of those risks, which could be avoided by reorganizing the organization's activities?
7. Which risks could be reduced by indemnification?
8. Is the party (indemnitor) financially responsible?
9. Is the indemnification adequately documented?
10. Where relying upon insurance of third parties (e.g., owners' insurance of automobiles used in the organization's business), has the organization secured adequate information on this coverage?
11. Of risks that cannot be reorganized or indemnified, which ones can be transferred or avoided?
12. Which risks cannot be transferred or avoided?

13. What kinds of insurance policies does the organization carry?
14. Do these policies cover all insurance risks?
15. What are the dollar limits of the various policies? Are they enough? Or are any of them unnecessarily high?
16. Does the insurance cover just the organization, or does it cover parties collaterally at risk as well, such as directors, officers, employees, volunteers or third parties injured with or without fault?
17. If those policies do not cover such parties, can riders be obtained to do so?
18. Have the insurance applications been reviewed to determine:
 - a. If they were truthful and accurate when made? or
 - b. Would they be truthful and accurate if applied to the present situation?
19. Does the risk manager read and analyze each insurance policy? How often? Are the *Best's* ratings of the various insurance companies known to the risk manager? When does the governing body receive a report on the risk management program?
20. Where does the organization buy insurance? What qualifications does this source have?
21. Are the topics of the above questions contained in the bylaws or written policy adopted by the governing board? Are these provisions reviewed periodically?