

Report from the Review Committee on the Status of Auxiliaries in the California State University

Executive Summary

Chancellor Reed commissioned a Review Committee to look at issues that had been raised by various sources during the last year. These issues are both public policy as well as potential external and internal control issues. The Review Committee was made up of Presidents, Vice Presidents and a CSU student representative. Vice Chancellors and their staff also met with the Review Committee. The Committee met during the period of September through December of 2010. The background and findings of the Committee are summarized here.

The origin of separate non-profit auxiliary organizations supporting California State University (CSU) campuses can be documented to the 1920s and 1930s. The authority for auxiliaries is found in state statute (Education Code, non-profit law) and Title 5. Although the term “auxiliaries” is used throughout higher education, the term has a specific and unique meaning within the CSU. Only the CSU creates auxiliaries that are founded in non-profit law, state law specific to these entities, and Trustee policy. A general history of the development of auxiliaries is included as Appendix A to this report. Auxiliaries were created to enable performance of certain business and educational functions that are common at institutions of postsecondary education, but which are found to be less efficiently and effectively accomplished as a result of difficult and cumbersome requirements placed on traditional governmental departments under California law and/or for the state budget to fund.

There are currently more than 90 recognized auxiliaries in the CSU. Recognized auxiliaries are those that meet all legal requirements and Trustee policy and have been formally approved by the chancellor. Auxiliaries can only perform certain functions as authorized by the Trustees. In 2008-09 there was over \$1.2 billion in revenue and expenses associated with the auxiliaries. The majority of the revenue comes from external sources (sponsored research, philanthropic gifts) and fee for service activities such as food services and bookstores.

There have been a number of issues that have arisen around auxiliary activities in the last year. These topics range from public policy questions to internal and external audit findings. Also, during the last year the California State Attorney General's Office has examined, or is still in the process of examining, documents and activities of CSU auxiliaries.

Most of the time and effort of the Review Committee focused on identifying and discussing the issues that have been raised from all sources. The Review Committee has organized the issues into the following general categories:

- Are there proper CSU controls over auxiliary expenditures of funds and auxiliary purposes and activities?
- Are auxiliary operations appropriately transparent to the public and to the general campus community?
- Are funds contained and managed by the auxiliaries appropriately placed with the auxiliary?
- For services provided by the campus (state) to auxiliaries, is there proper reimbursement and documentation by the auxiliaries?
- Do CSU auxiliaries comply with California non-profit requirements?

The Review Committee makes recommendations in each of these areas that will improve control and transparency of auxiliary operations. Confusion was found in the area of fund management. Policy gaps were found when major changes in CSU's treasury and accounting functions were authorized by new legislation in 2006. Reinstatement of policies that had been in place prior to these changes, but made consistent with the new treasury functions, should give proper management and internal audit guidelines for auxiliary management of funds. Other recommendations will help the CSU respond to all of the issues that have been identified from internal and external sources.

The review by the Committee did not find any compelling reason to move functions performed by auxiliaries to campus (state) operations as long as all the appropriate internal control mechanisms and operating agreements are in place to govern the auxiliary activities. There is a long tradition of auxiliary management and staff performing these functions well for the CSU.

Report from the Review Committee on the Status of Auxiliary Organizations in the California State University

History and Legal Basis of CSU Auxiliary Organizations

The origin of separate non-profit auxiliary organizations supporting California State University (CSU) campuses can be documented to the 1920s and 1930s. The authority for auxiliaries is found in state statute (Education Code, non-profit law) and Title 5. Although the term “auxiliaries” is used throughout higher education, the term has a specific and exclusive meaning within the CSU. The CSU uniquely creates auxiliaries that are founded in non-profit law, state law specific to these entities, and Trustee policy¹. A general history of the development of auxiliaries is included as Appendix A to this report.

There are currently more than 90 recognized auxiliaries supporting the CSU and its campuses. Recognized auxiliaries are those that meet all legal requirements and Trustee policy, and have been formally approved by the chancellor.

Trustee policy requires auxiliary organization activities to be essential to the educational mission of a campus. Auxiliaries were created to enable performance of certain business and educational functions that are common at institutions of postsecondary education, but which are found to be less efficiently and effectively accomplished as a result of difficult and cumbersome requirements placed on traditional governmental departments under California law and/or for the state budget to fund. The objectives set for them are to provide for: a) student self-government, b) the fiscal means and the management procedures that allow the campus to carry on activities providing those instructional and service aids not normally furnished by the state budget, c) effective operation and to eliminate the undue difficulty which would otherwise arise under the usual governmental budgetary, purchasing, and other fiscal controls, and d) fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices.²

Auxiliaries can only perform certain functions as authorized under Trustee policy. The current authorized functions for auxiliaries are:

- 1) Student Body Organization Programs
- 2) Bookstores, Food Services and Campus Services
- 3) Housing
- 4) Student Union Programs
- 5) Supplementary Health Services

¹ The California Community Colleges also have auxiliary functions some of which are non-profit entities. The referenced statute and Title 5 authorization is strictly for CSU auxiliaries.

² Title 5 §42401

- 6) Loans, Scholarships, Grants-in-Aid, Stipends, and Related Financial Assistance
- 7) Externally Funded Projects Including Research, Workshops, Conferences, and Institutes
- 8) Instructionally-related Programs, and activities, including Agriculture, Athletics, Radio and Television Stations, Newspapers, Films, Transportation, Printing and other Instructionally Related Programs and Activities
- 9) Alumni Programs
- 10) Gifts, Bequests, Devises, Endowments, Trusts and similar funds
- 11) Public Relations, Fundraising, Fund Management, and similar Development Programs
- 12) Acquisition, Development, Sale, and Transfer of Real and Personal Property including Financing Transactions related to these Activities

Each auxiliary has an operating agreement with the campus and the Board of Trustees that specifies the functions and the activities each specific entity is allowed to perform. These agreements are reviewed by the campus and formally approved by the president. In addition to the specific functions outlined in law and Title 5, there are other restrictions that are placed on auxiliary activities. There are some things that the CSU has determined its auxiliary organizations can never do:

- 1) Hold state general funds, except in limited and approved circumstances, that are appropriated to the CSU through the annual legislative process
- 2) Hold tuition fee revenue
- 3) Hold most other mandatory student fees required for registration
- 4) Own or sponsor an instructional program awarding credit or Continuing Education Units (CEUs)

Since the CSU cannot engage in certain activities, the auxiliaries allow the university more flexibility in these areas. These are areas where the CSU is severely restricted by state law or the state constitution. Under state law auxiliaries are to be created “to promote or assist any campus of the CSU, or to receive gifts, property, and funds to be used for the benefit of such campus”³. Presently, they perform essential functions associated with a higher educational institution that are “rendered difficult and cumbersome” under California law to perform. Examples of these activities include:

- 1) Invest in equities
- 2) Buy, sell and hold real property without legislative act
- 3) Engage in state wide education bond campaigns

Auxiliaries can do other things that are permissive in statute, as long as the function is among the list of authorized activities permitted by law and Trustee policy. To actually perform these functions requires the formal agreement of the campus president in the

³ Education Code §89901

auxiliaries' operating agreements with the campus and the Trustees. Although many functions, such as externally sponsored programs/research, have historically been performed by campus auxiliaries there is no requirement that an auxiliary perform the activity. A few campuses are organized to have sponsored programs/research and other programs performed on the campus state-side of operations. Examples of activities traditionally performed by auxiliaries, that could also be done on the state-side of campus operations include:

- 1) Operation of student body organizations
- 2) Research and sponsored programs
- 3) Providing workshops, conferences, meeting and program management support
- 4) Operation of commercial services, e.g. food services and bookstores
- 5) Management of a philanthropic program, including acceptance of donor gifts

Auxiliaries can be organized around one specific function, such as student government, or an auxiliary can perform multiple functions, such as commercial services and sponsored programs/research.

There are specific board composition requirements depending on the function the auxiliary performs. For example, student body organizations' governing boards "shall consist primarily of students." However, each student body organization shall have "a representative of the campus president as either voting or nonvoting member of the governing board"⁴ to advise on policy and to provide liaison between the students and the campus administration. Similarly, philanthropic foundation boards usually consist of members who have personal influence and financial resources to support the organization and university priorities. Other auxiliaries that focus on sponsored programs/research and/or workshop and conference program management may have a larger number of faculty on the board than a philanthropic or commercial services board. In addition to serving the interests of the university and complying with university policy, auxiliary governing boards are responsible for governance and fiduciary duties as required under California non-profit corporations law.

The examination by the Auxiliary Review Committee did not find any compelling reason to move these types of activities to campus state-side operations as long as all the appropriate internal control mechanisms and operating agreements are in place to govern the auxiliary activities. There is a long history of auxiliary management and staff performing these functions well for the CSU. Going back to the 1920's the CSU has continued, with the approval of state control agencies or the Board of Trustees, to turn to auxiliary organizations as the best mechanism to perform certain activities for the university.

⁴ Title 5 §42602

Types and Scale of CSU Auxiliaries

Auxiliary organizations, under statutory standards, must be self-supporting and do not receive state funding. The revenue that is raised by the auxiliary is used to support the programs or activities of the organization, and each auxiliary must maintain fiscal viability and solvency and not have a net operating loss.

Student body organization programs operate extra-curricular activities such as student government, student newspapers, recreation and cultural programs, and other student life activities essential to the overall educational experience of students. Revenues come from student fees assessed of all registered students, and set at rates approved through student referenda.

Campuses have constructed a student union facility (or otherwise identified a facility to serve as the union) that serves as the hub of community for the campus. The union typically provides gathering spaces for students and staff of the campus, meeting rooms for student clubs, quiet study spaces, and typically house most of the food services provided on campuses, as well other student union programs. Fees are charged to all registered students and are set at rates to cover construction/debt service, maintenance and the programs offered at the facility.

Philanthropic auxiliaries have been created at most CSU campuses to provide a focus for fund-raising activities in support of the institution. These entities have diversified investment strategies for endowment management intended to generate additional funds to support the university and its activities. The expectation is that once the fund-raising program has sufficient maturity and capacity it will be a self-supporting program. In the interim, the long-term benefits of building and sustaining a robust fund-raising program for the university justify some level of support from the campus for the program.

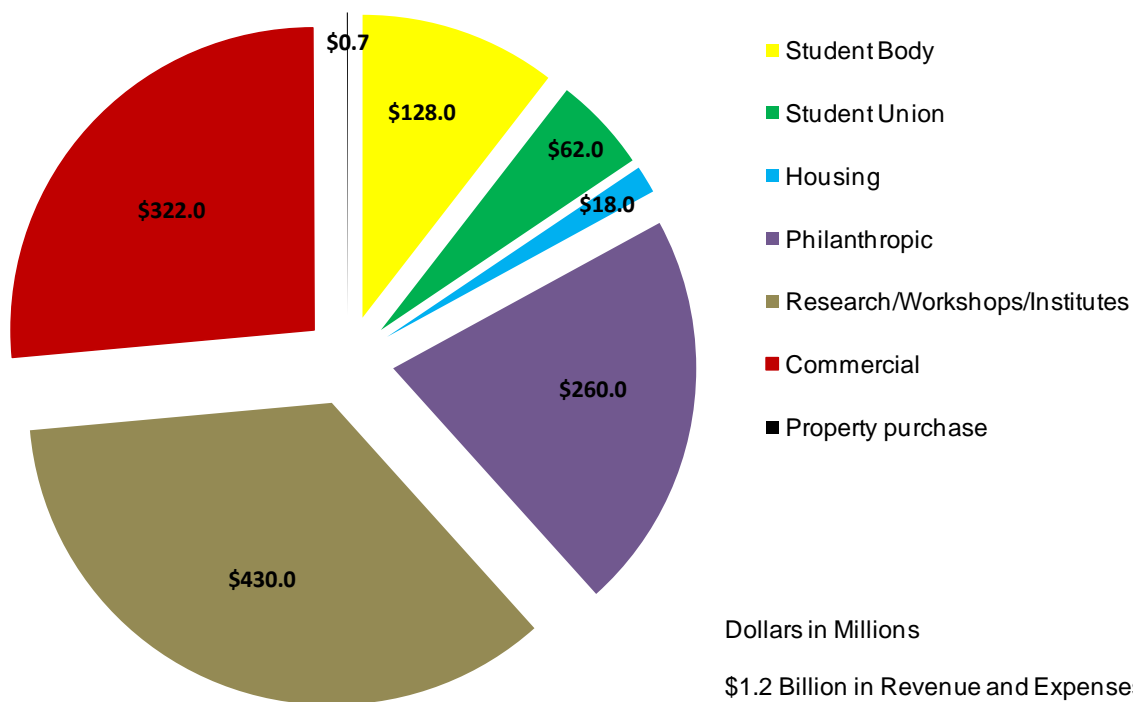
Auxiliaries that manage sponsored programs/research, workshops and other special educational projects administer externally funded activities with a direct connection to the educational mission of the campus. Funds may come from federal, state and/or private grants and contracts.

The operation of bookstores, food and vending services, and agricultural projects are the focus of a class of auxiliary termed "commercial". Revenues are derived from the sales of products and services to students, faculty and staff as well as to the public who come to the university to participate in community, educational or cultural events on or in CSU facilities; and funds are reinvested in the operations of the program to keep current with both technology and the changing expectations of students, faculty and staff. Agrarian activities are particularly important to campuses offering instruction involving direct experience with farms, cattle, poultry, and related management programs.

Just short of half of the campuses have an auxiliary organization that conducts both the sponsored programs/research function and the commercial services function.

In recent years some CSU campuses have established auxiliaries focused on developing and/or constructing housing for students, faculty and staff. In the case of faculty and staff housing these programs assist the university's recruitment efforts to hire talented individuals who want to find affordable housing near the campus. The revenue to support these activities varies, depending on the program. For example housing fees paid by students to live in university-provided units or mortgages with faculty/staff who have purchased homes.

This chart shows the distribution of revenue for the different types of CSU auxiliaries based on 2008-09 financial statement data and the annual external support report produced by campuses. The total amount of revenues and expenses flowing through auxiliaries for this time period is approximately \$1.2 billion. State revenue appropriated to the CSU can be used to purchase goods and services from an auxiliary just as it also may purchase such goods and services from an external vendor.



Number of Auxiliaries

The number of auxiliaries has increased from 69 to 94 during the period from 1994 to present with nearly one-third devoted to student-led functions. The growth in the auxiliaries comes in three major areas:

- New campuses
- Faculty and staff for-sale housing
- Creation of a single purpose philanthropic foundation

The single largest growth in the number of auxiliaries has been to create a philanthropic auxiliary with the ability to invest in equities or to separate the philanthropic function from an existing campus auxiliary. The significant and continued reduction in state support for the university has caused the CSU to focus greater energy in building a strong base of supporters who provide additional fiscal support to the institution. The single focus philanthropic organization can develop friends and donors for the campus. Board members can be selected based solely on their willingness to help the campus raise money and build community relationships. The careful selection of philanthropic board members has been a stated part of the overall CSU strategy to help meet the Trustee's goals in campus fund raising. This close linkage with the local community is one critical role auxiliary organizations play in the CSU.

Another area of growth is housing. The buying and selling of real property is perfectly suited for an auxiliary. Real property acquired by the university requires legislative approval. Selling property also requires legislative action. During the period of high escalation in housing costs, auxiliaries were created to allow for the sale of faculty and staff housing. In certain cases, land was acquired specifically for this purpose. Once real property improvements are made, such as building a housing unit, there was a need for straightforward purchase and sale of the houses to faculty and staff. Auxiliaries meet this need well since they are able to develop the specialized skills and expertise of the staff needed to perform this activity. Auxiliaries participate in the Systemwide Revenue Bond program and all projects are approved by the Board of Trustees. During the course of this review, the amount of auxiliary debt associated with capital construction was examined to ensure it was not excessive and the projects were appropriate for the campus. There were no problems identified.

When examined in detail, the growth in auxiliaries is understandable and desirable. However, campuses should review each of their auxiliaries to assure there are not conflicting duplication of activities/functions between and among auxiliaries and between auxiliaries and the campus. Some integration of auxiliaries performing similar duties would be logical.

Issues and Recommendations

Auxiliaries are valuable entities and provide important services to the CSU. Nevertheless, there have been a number of issues that have arisen around auxiliary activities in the last year. These topics range from public policy questions to internal and external audit findings. Also, during the last year the California State Attorney General's Office has examined, or is still in the process of examining, documents and activities of CSU auxiliaries. There have been no violations of policy or legal guidelines, or improper administration of any funds held in auxiliary accounts.

Most of the time and effort of the Review Committee focused on identifying and discussing the issues that have been raised from all sources. The Review Committee has organized the issues into the following general categories:

- Are there proper CSU controls over expenditures of funds and auxiliary purposes and activities?
- Are auxiliary operations appropriately transparent to the public and to the general campus community?
- Are funds contained and managed by the auxiliaries appropriately placed with the auxiliary?
- For services provided by the campus to auxiliaries, is there proper reimbursement to the university and documentation by the auxiliaries?
- Do CSU auxiliaries comply with applicable California non-profit corporation law?

General Issue One: Are There Proper CSU Controls Over Auxiliary Expenditures of Funds and Auxiliary Purposes and Activities?

There is a long and detailed history of controls the university has established for its auxiliary organizations. There are rules established in state law (Education Code) and Trustee policy (Title 5) regarding the president's authority over each campus auxiliary organization⁵. Over time the CSU has increased the amount of controls placed on the auxiliaries. For example, clear reporting requirements via the annual CSU financial statement have been in place since 1995. When the CSU implemented the Systemwide Revenue Bond program in 2002—a program for university-related debt issuance—

⁵ Title 5 §42402 "Authority of Campus President: The president of each campus is responsible for the educational effectiveness, academic excellence and general welfare of the campus, over which he presides. As stated, auxiliary organizations operate as an integral part of the overall campus program. Therefore, for the president to exercise his responsibility over the entire campus program, he shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. To execute this authority, the president shall require that each auxiliary organization submit its programs and budgets for review at a time and in a manner specified by the president. Should the president determine that any program or appropriation planned by an auxiliary organization is not consistent with policy of the Board of Trustees and the campus, the program or appropriation shall not be implemented? ..."

auxiliary organization debt financings were expressly included in the university program in order to manage the overall debt capacity of the institution and its auxiliaries. A summary of the types of controls in place and how they have evolved is described in Appendix B.

As explained further in another section of this report, CSU auxiliaries have to meet the tests of any California non-profit, but they also must receive the approval of the campus president and the chancellor when the auxiliary is initially established. Each auxiliary also is required to have a written operating agreement between the auxiliary, the campus and the Trustees. These operating agreements identify the functions that the auxiliary is authorized to perform. Failure of an auxiliary to comply with any term of an operating agreement may result in the removal, suspension, or placing on probation of the auxiliary as an auxiliary organization in good standing. Such action may involve the limitation or removal of the auxiliary's right to utilize the resources, facilities, and name of the California State University and campus (Title 5 §42406). Currently, these operating agreements can have any agreed upon term, which is based on the function performed by the auxiliary.

One important control exercised by the campus president is the appointment of members to the board of the auxiliary. Many of the board members of auxiliaries are, by design, members from the community where the campus is located. Many of these board members have likely served on other non-profit boards and understand the responsibilities required of a board member. In addition to the normal non-profit fiduciary requirements, the CSU auxiliaries also operate in accord with state law, Trustee and campus policy.

Most all auxiliaries have at least one student member. Over one-third of the auxiliaries are led by students. Some auxiliaries, such as student government or student unions have a majority of student members. As part of this review, the question was raised whether presidents should appoint student auxiliary board members from a list of candidates provided by the campus recognized student body organization consistent with the Trustee resolution affirming student participation in policy development (REP 07-01-04 and coded memorandum AA 2009-2)⁶. A proposal on this topic is part of the Review Committee's recommendations and is found in Appendix C.

Not all auxiliaries have employees. There are different requirements placed on employees of auxiliaries by law and CSU policy. Generally, auxiliary organizations are required to provide salaries, working conditions, and benefits for the full-time employees of each auxiliary organization that are comparable to those provided California State

⁶ The Board of Trustee policy states, "The presidents will provide [the] officially recognized associated student body organizations an opportunity to offer opinions and make recommendations about campus policy and procedures that have or will have an effect upon students. Nominations of student representatives to serve on campus-wide governance committees, campus-wide task forces, or other campus-wide advisory groups will be made by the appropriate officially recognized associated student body organization."

University employees performing similar services. Though the benefits packages are to be comparable, they are not required to be the same. As such, employee salaries and benefits vary by auxiliary and by campus. For those full-time employees whose duties are not comparable to existing positions in CSU employment, the salaries established are required to be at least equal to the salaries prevailing in other educational institutions in the area or commercial operations of like nature. Salary surveys and other market research may satisfy this condition.

There also are explicit employment exemptions available to auxiliaries. For example, an auxiliary that is funded primarily by mandatory student fee income may have retirement benefits for its employees withheld by action of the governing board. Further, retirement benefits or permanent status benefits, or both, may be withheld from temporary or executive employees of an auxiliary.

The Review Committee did find a major inconsistency between practice and policy in the treatment of university employees who perform work on sponsored grants and contracts administered through an auxiliary. Existing Executive Order 890 defines the auxiliary as the employer of the Principal Investigator⁷ as well as any other personnel working on a grant or contract, regardless of whether the auxiliary reimburses the university for salary and benefits costs or pays the employee directly. Thus, a university employee whose responsibilities included work on a sponsored grant or contract would be considered part time employed by the auxiliary and part time employed by the university.

This is not current practice within the CSU. Instead, when a university employee is assigned by the university to work on a grant or contract, the individual is retained as a full time employee of the university. The university is reimbursed for salary and benefits costs associated with work on the grant or contract when such funds have been provided in the grant or contract. This practice ensures that the employee's status with the university is unaffected, and there is no break in service or loss of retirement credit for the employee. By retaining the employee's status, the university avoids creating a significant disincentive for faculty and staff to apply for grants to support research and other activities. Research, scholarship and creative activity are recognized as one of the primary responsibilities of instructional faculty, and research grants assist tenure/tenure-track faculty in meeting expectations for tenure and promotion.

⁷ **NIH Definition of a Principal Investigator:** The individual(s) judged by the applicant organization to have the appropriate level of authority and responsibility to direct the project or program supported by the grant. The applicant organization may designate multiple individuals as PD/PIs who share the authority and responsibility for leading and directing the project, intellectually and logistically. Each PD/PI is responsible and accountable to the applicant organization, or, as appropriate, to a collaborating organization, for the proper conduct of the project or program including the submission of all required reports. The presence of more than one identified PD/PI on an application or award diminishes neither the responsibility nor the accountability of any individual PD/PI.

There are several models for the administrative/operational structure of auxiliary organizations:

- Each auxiliary at a campus manages all its own administrative/operational activity; or
- One auxiliary at the campus manages the administrative/operational activities for the other auxiliaries at the campus; or
- The campus manages the administrative/operational activities for some or all the auxiliaries.

Regardless of which model is used, it is important that the campus affirm the value of segregation of duties, especially at a smaller campus. Further, campuses and auxiliaries should review administrative structures with an eye toward streamlining operations, increasing efficiencies and reducing costs.

Recommendations related to “Are There Proper CSU Controls Over Auxiliary Expenditures of Funds and Auxiliary Purposes and Activities?”:

- 1) The chancellor should review the list of authorized functions in Title 5 and recommend modifications or clarifications, as appropriate.
- 2) At this time, all CSU auxiliaries in good standing should have their operating agreements reviewed, and modified as appropriate, by the campus president and chancellor’s office. Particular emphasis should be placed on assuring that the desired functions are being performed. The campus president’s authority over auxiliary actions should be incorporated into all auxiliary operating agreements.
- 3) Operating agreements for auxiliary organizations should be reviewed no less than every five years by the campus president and chancellor’s office. As part of these periodic reviews, the president should look at the efficiency of the auxiliary operations and administration, ensure there is an evaluation as to the auxiliary’s viability, and examine the need for each auxiliary.
- 4) The chancellor should reaffirm and clarify as part of an Executive Order the campus president’s authority over auxiliary organization budgets, expenditures, and programs. Additionally, the Executive Order should establish the campus Chief Financial Officer’s responsibility as the single campus officer designated to ensure auxiliary organizations maintain sound systems of internal controls and remain in compliance with legal and regulatory requirements, including non-profit law, Trustee policies and directives of the chancellor.
- 5) Campus presidents should solicit nominations for student auxiliary board members from the campus recognized student body organization. The process for selecting auxiliary board members that are students should generally follow the process described in Appendix C.
- 6) The chancellor should review Education Code 89900 regarding comparability of salaries and benefits to determine whether comparability with the CSU salary and benefits is appropriate.
- 7) The chancellor should review and revise, as appropriate, existing policy to recognize that university employees should retain their employment status with the university even when some salary and benefit costs are reimbursed from sponsored programs/research.

General Issue Two: Transparency of Auxiliary Operations

CSU auxiliaries are a product of both California non-profit law and the CSU. Since they are separate, legal corporate entities CSU auxiliaries have not been subject to the same disclosures and public records access rules that are required of the university. Legislation was passed in the 2010 legislative session that would have required expanded disclosure of auxiliary records to the public. This legislation was vetoed by the governor.

The Public Records Act, among other laws, governs what public entities must disclose upon request by a member of the public. The Review Committee believes additional disclosure of auxiliary activity is appropriate and that transparency of operations should be a guiding principle. That being said, there are certain types of transactions that the Review Committee believes should be protected. Donor records such as wills, estate plans, trusts, annuities and other financial and personal information should remain confidential to avoid an unwarranted invasion of personal privacy.

Similarly, certain proprietary terms contained in vendor contracts were seen as needing to remain confidential where the public interest in disclosing such terms does not outweigh that which might be served from disclosure. An example of such a term would be payments for exclusive beverage serving rights in campus food services; such “pouring rights” terms should be protected from disclosure. Specific and exclusive terms negotiated in auxiliary business contracts, if disclosed, would give vendor competitors an unfair advantage, and would likely reduce those willing to compete and potentially damage an auxiliary’s ability to negotiate the most favorable terms.

Recommendations related to “Transparency of Auxiliary Operations”

- 8) The Trustees should consider sponsoring legislation for the 2011-12 legislative session that clarifies disclosure rules for CSU auxiliary activities. Under proposed legislation, auxiliaries would respond to public requests for information to the extent that such requests do not conflict with the need to protect (a) confidentiality of donors and volunteers and (b) proprietary terms of financial instruments.
- 9) The chancellor should determine if the Public Records Act offers sufficient protection for certain proprietary terms contained in some vendor contracts, such as exclusive beverage serving rights (“pouring rights”).
- 10) The chancellor should consider including in Title 5 and/or policy statements guidelines regarding transparency of auxiliary operations, including the types of information that will be disclosed to the public consistent with the principles included in the draft legislative proposal.

General Issue Three: Proper Placement of Funds

The Review Committee considered issues raised in external and internal audit reports for the last few years. The policy history regarding the placement of funds with either the university or an auxiliary also was reviewed. There are several different policies that established the requirements surrounding which funds can be managed by an auxiliary. These policies have been modified over the years as state law has changed as it applies to the management of CSU funds.

The Review Committee found policy gaps in this important area. Effective with the 2006-07 fiscal year the CSU was given authority to deposit student fee income in CSU accounts, but outside the state treasury. Understandably, most CSU policy that addressed where funds can be placed had been built around fee income being deposited in the State Treasury. The implementing policy for the proper treatment of certain fee revenue was Executive Order 1000 issued in July 2007. One of the many things that this policy did was rescind previous policies that spoke to the placement of funds in auxiliaries. Issuance of revised policy guidance for those superseded directives was expected, as well as other policies that were rescinded, in new Executive Orders that would be written consistent with Executive Order 1000 and new state law regarding fund management. Unfortunately, these policies have not been written leaving a void in policy guidance. The Review Committee recommends the completion of this original intent from 2007 and issuance of a new Executive Order that presents policy that describes which funds can be placed in an auxiliary.

The Review Committee has concluded that the key issue for a campus in making a decision about the placement of funds is the concept of ownership. Ownership of an activity is evidenced by:

- Authority and discretion to contract for services or materials required by an activity
- Responsibility for business losses
- Legal liability as an owner or principal entity
- Acceptance of fiduciary obligations associated with an activity
- Responsibility for the establishment of operating and administrative policies
- Primary control or discretion over the expenditure of funds

Ownership of an activity is not necessarily evidenced by which entity:

- Employs individuals granted signatory authority related to an activity (e.g., person or persons who can sign a letter or other related documents on behalf of a principal entity)
- Owns the facility where the activity occurs
- Has limited authority to request an expenditure
- Has academic or similar programmatic control over an activity

This policy approach is contrasted with an interpretation that the funding source for personnel involved in an activity determines the placement of funds. For example, faculty are expected, as part of their normal job duties, to perform teaching, research, and service to the university, profession, and community, and may conduct seminars, institutes and conferences. Faculty, with very few exceptions, keep their employment status on the CSU state-side of operations. When conducting sponsored programs/research a faculty member's (or other employee's) salary and benefits may be partially reimbursed by a contract or grant. The placement of the grant is appropriately in an auxiliary as long as the sponsor awards the grant to the auxiliary, and the auxiliary is authorized for this function by the operating agreement. The same logic would apply to conferences, institutes or workshops. Fees charged for a workshop could be deposited in an auxiliary as long as the auxiliary meets the ownership tests described above and those activities are an authorized function of the auxiliary, regardless of whether the person conducting the workshop is employed by the university.

The same ownership concepts can be applied to sponsored program funds and donor gift receipts, and provide the policy basis for having those types of funds deposited in an auxiliary. The application of these business principles, which was incorporated in CSU policies prior to issuance of Executive Order 1000, should allow current internal audit issues around placement of funds to be resolved.

Recommendations related to "Proper Placement of Funds"

- 11) The chancellor should issue policy that re-implements the "ownership" tests to determine proper placement of funds. A draft of such an Executive Order, implementing this policy, is included in Appendix D.
- 12) The campuses and the University Auditor should use these policy principles to resolve current outstanding internal audit findings regarding the placement of funds.
- 13) The chancellor should review all current policy to separate the issues of placement of funds and the reimbursement of costs to the campus by an auxiliary.

General Issue Four: The Reimbursement of Costs Incurred by the CSU for Auxiliary Activity

When the CSU was formed in 1960, and the original rules governing auxiliary organization activity were enshrined into Title 5, this included various statements about reimbursement to the state for use of facilities or services provided by state employees. These rules were driven by Article 16, Section 6 of the California Constitution which prohibits making gifts of any public funds. Further, Government Code Section 8314 prohibits the use of state resources for non-state purposes, except uses that are "incidental and minimal". This principle was articulated fully in Executive Order (EO) 753 and then reaffirmed via EO 1000, which states in part, "Ensure that costs incurred by the CSU Operating Fund for services, products, and facilities provided to other CSU funds and to auxiliary organizations are properly and consistently recovered with cash and/or a documented exchange of value."

The Review Committee found that the policies governing reimbursement of CSU state-side costs incurred by auxiliaries were spread throughout several different Executive Orders, including one that was recently issued. Reimbursement of costs does not have to be in cash and can be in-kind. There are activities performed by faculty and staff, employed by the CSU state-side that might only be reimbursed in-kind. For example, although sponsored programs/research paid by the federal government, may reimburse some costs associated with the research activities, not all costs are reimbursed. There are contracts and grants that may not pay for any portion of the faculty member's salary. However, the university and its instructional programs derive significant benefits from sponsored program activities, regardless of whether the programs are administered through an auxiliary or through the university. These benefits, recognized in-kind, are exchanged for the university's support which is in the best interest of the overall educational program.

Recommendations related to “The Reimbursement of Costs Incurred by the CSU for Auxiliary Activity”

- 14) The chancellor should review all policies dealing with reimbursement of costs and reissue the key principles regarding reimbursement within one policy statement that should be distinct from any policies dealing with placement of funds.
- 15) The chancellor should develop some “frequently asked questions” to give campuses guidance regarding when “in kind” or less than full cost reimbursement is appropriate.

General Issue Five: Do Auxiliaries Comply with Applicable Non-profit Corporation Law?

Regulations require that each auxiliary governing board have the benefit of the advice and counsel of at least one attorney admitted to practice law in this state and at least one licensed certified public accountant. Neither the attorney at law nor accountant need to be members of the governing board. These professionals should have expertise in serving non-profit clients and become familiar with the unique legal construct of CSU auxiliary organizations. Those examining auxiliary audits have commented that auxiliaries may not be fully utilizing or receiving sufficient advice from these professionals.

The State Attorney General has conducted a series of inquiries reviewing the audited financial statements of nearly all auxiliaries and is performing a few special investigations. The inquiries have found no misuse, misappropriation or waste of charitable funds. The major finding to date by the State Attorney General, after review of some CSU auxiliaries, is that some procedural requirements were not followed such as conducting the appropriate number of meetings, recording minutes of board meetings, and filings of appropriate state and federal forms. In one report, the Attorney General noted that board members would benefit from additional training in fiduciary responsibilities.

The university’s external auditor, KPMG, has suggested in conversation that deficiencies in some auxiliary stand-alone audits may be related to the timely application of changes in non-profit law and associated updates to generally accepted accounting standards. Auxiliaries engage their own independent auditors to perform annual financial audits. These audits are then presented to the chancellor’s office for review by staff and KPMG for consolidation into the university’s annual financial audit. It

has been suggested that some of the firms currently engaged by auxiliaries may not have sufficient expertise in preparing non-profit financial audits.

The university auditor currently conducts auxiliary compliance audits every three years. The objectives of these audits are to provide management with reasonable assurance that auxiliary operations are conducted in accordance with applicable law and Trustee policy; assets are adequately safeguarded from unauthorized use or disposition; and transactions are recorded properly to permit the timely preparation of reliable financial statements. Findings from these audits are reported to the Board of Trustees and made publicly available on the university auditor's website. Conditions requiring corrective action are remedied within a mutually agreeable timeframe.

Given the scope and nature of auxiliary activity on each campus and that some auxiliaries have no or very few employees, it is appropriate that some campuses centralize responsibility for compliance with all non-profit requirements.

Recommendations related to "Do Auxiliaries Comply with Non-profit Requirements?":

- 16) The chancellor should develop guidelines as part of the annual audit process, which identifies the criteria that campus auxiliaries should use in selecting local audit firms. These guidelines should emphasize the experience and training of the audit firm staff and partners in current non-profit tax law.
- 17) The chancellor should ensure an annual update is provided to campuses regarding changes in compliance requirements for non-profit organizations that may have occurred during the preceding year.
- 18) Campuses should assure that each auxiliary auditor is aware of these changes and incorporate them into their local audit plan.
- 19) The chancellor should give guidance to the campuses regarding the level of governance training provided to non-profit board members.
- 20) The chancellor should ensure in a policy statement that the campus Chief Financial Officer is recognized as the single campus officer responsible for ensuring auxiliary organizations comply with non-profit requirements.

Summary

The Review Committee examined a number of issues that have been raised about auxiliary organizations or related to auxiliaries at the California State University. The topics ranged from public policy questions to internal and external audit findings, as well as questions raised from within the university. Most of the time and effort of the Review Committee focused on identifying and discussing the issues that have been raised from all sources. The Review Committee organized the issues around proper internal controls; transparency of operations; placement of funds; reimbursement of university costs; and finally compliance with non-profit requirements.

The Review Committee makes recommendations in each of these areas that will improve control and transparency of auxiliary operations. Confusion was found in the area of fund management. Policy gaps were found when major changes in CSU's treasury and accounting functions were authorized by new legislation in 2006. Reinstatement of policies that had been in place prior to these changes, but made consistent with the new treasury functions, should give proper management and internal audit guidelines for auxiliary management of funds. Other recommendations will help the CSU respond to all of the issues that have been identified from internal and external sources.

The review by the Committee did not find any compelling reason to move functions performed by auxiliaries to campus (state) operations as long as all the appropriate internal control mechanisms and operating agreements are in place to govern the auxiliary activities.