



AUDIT AND ADVISORY SERVICES

Donor-Built Facilities Audit Project No. 15-646

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October 23, 2015

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Vice Chancellors Bidy and Lalanne:

We have completed our audit of Donor-Built Facilities as per our annual service plan in accordance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing* and the University of California Internal Audit Charter.

Our observations with management action plans are presented in the accompanying report. Please destroy all copies of draft reports and related documents. Thank you to the staff of the following areas for their cooperative efforts throughout the audit process: Real Estate, Office of Legal Affairs, Donor and Gift Services, Planning and Design, and Construction and Design.

Please do not hesitate to call on Audit and Advisory Services if we can be of further assistance in this or other matters.

Respectfully reported,

Wanda Lynn Riley
Chief Audit Executive

cc: Vice Chancellor John Wilton
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**University of California, Berkeley
Audit and Advisory Services
Donor-Built Facilities Audit**

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OVERVIEW

Executive Summary

The purpose of our audit is to assess management's internal controls and processes associated with the development and execution of donor-built facility projects, where a donor or group of donors typically leases land from the campus, builds a building using the donor's resources and team, and then, upon completion, gifts the facility to the campus as a gift-in-kind. Our audit scope covered the life cycle of a donor-built project, from project planning through construction to receipt of the gift by the university.

Donor-built facility projects are opportunistic in nature and are currently treated on an individual, ad hoc basis. Given that donor-developer projects most likely will continue to be utilized, among other methods, to meet the current and future facilities needs of the campus, we concluded that controls and processes associated with donor-built facility projects can be improved to promote the effectiveness and consistency in execution of these projects. In particular, we note the following four observations:

- Although the roles and responsibilities of each central unit and individual unit may be similar from opportunity to opportunity, they have not been formalized within a business process to ensure consistency in execution across the project lifecycle. Campus departments who become involved with a donor-built facility generally have limited experience with this project type. Without developing roles and responsibilities specific to donor-built facility projects, there is risk that there may be misunderstanding among central units and individual campus departments as to their roles over the lifecycle of a donor-built facility project. There is also risk of insufficient monitoring and oversight and non-compliance with university policies.
- In the absence of documented guidelines for donor-built facility projects and more formalized definitions of roles and responsibilities (see prior observation), specifically allowable campus support provided to donor-developer 501(c)3 organizations, campus units may be approached for future projects to provide services that may put at risk the structure of the donor development agreement and the gift-in-kind transaction. These units may be well-intentioned and inclined to provide assistance to the 501(c)3's in their fundraising efforts, but may not be aware of what activities may be deemed as exercising control over the project that may impact the treatment of the arrangement as a gift-in-kind transaction.
- Change orders, which are ultimately at the discretion of the donor-developer, may impact the suitability of the completed facility. Campus Construction and Design review of change orders for potential material deviations may identify and prevent suitability issues. We understand that such review has not been done consistently by the campus' project managers for recent donor-built facility projects and the extent to which the project manager is expected to review any change orders is unclear because such responsibility is not yet defined (see prior observation). Campus units pursuing the donor-developer model to meet their facility needs may not be aware that their decision authority related to change orders during construction differs from the traditional model whereby the campus is responsible for directly managing construction.

- Each donor-built facility project typically contains a number of agreements (usually a Memorandum of Understanding, Primary Agreement [ground lease], Sub-lease Agreement, and Gift Agreement), each identifying specific terms and provisions of the project. Currently, standard templates for these agreements are not consistently employed. While each donor-built facility project is unique, project agreements generally contain many key considerations that are relevant from project to project. A standardized checklist of key considerations (e.g., clauses) designated as either mandatory or elective, along with the campus' suggested language, can be useful to the preparer when drafting a new agreement and to the reviewer when reviewing it.

Source and Purpose of the Audit

The purpose of our audit was to assess management's internal controls and processes associated with the development and execution of donor-built facility projects. The audit was included in Audit and Advisory Services' Fiscal Year 2015 Service Plan.

Scope of the Audit

The audit scope includes assessment of existing controls and processes associated with the lifecycle of a donor-built project, from project planning through construction to the receipt of the gift by the university. Field work was conducted during a several-month period ending February 2015. Three recent donor-built facility projects were reviewed: Blum Hall (completed 2010), the Haas Academic Building (under construction), and the Cal Aquatics Center (ground lease agreement under review during our fieldwork). Our audit procedures included interviews of appropriate campus and University of California (UC) Office of the President personnel, process walkthroughs, and examination of supporting documentation.

Background Information

A donor-built facility is a relatively new project model used by educational institutions to acquire capital assets. Real Estate Services and Strategies at the UC Office of the President represents that the primary objective for using donor-built facilities is to obtain facilities for use by the campus during times when it otherwise would not have the resources to fund construction of the facilities. Alternatively, it is an option when the campus is approached by a donor who has the capability and preference to assume full-responsibility for planning, design, and construction as well as securing all funds.

For a donor-built facility project, the donor typically leases land from the campus, builds a building using the donor's resources and team, and then gifts the facility to the campus as a gift-in-kind upon completion. On the other hand, in a donor-funded facility, the donor makes a contribution to the campus to build a specific building, and then the campus coordinates the building project through the use of an external contractor and other resources.

The campus has undertaken four donor-built facility projects over the past several years; the Ky Ebright Boathouse, Blum Hall, the Haas Academic Building, and the Cal Aquatics Center.

A donor-built facility can be a new facility, renovation of an existing facility, or a tenant improvement. Donor-built facilities satisfy a need defined by the campus and fulfilled by a donor or donor group. A donor-built facility is often built on university land and requires approval of the Regents. The donor is responsible for key aspects of the facility's creation, including fundraising, financing, design, and construction. The campus is responsible for defining the design parameters of the project based on UC Berkeley's Long Range Development Plan, approving the design, overseeing inspections, and confirming completion in accordance with plans and specifications. Upon completion, the facility is conveyed to the university as a gift-in-kind and the campus places it in operation. The campus is responsible for maintaining the facility going forward. Authorization by the Regents entails their approval of both the design and

gift acceptance unless the parameters of the project are within limits delegated to the campus by them.¹ Regental approval is required for all donor-built facilities projects over \$60 million.

The donor-built facility project must adhere to campus requirements for new building projects. It must be included in the Long Range Development Plan (initially or by amendment), and must adhere to the Physical Design Framework and the California Environmental Quality Act (CEQA). Design review of a donor-built facility is comparable to a campus-developed project, including review in terms of applicable policies on sustainable development, campus design standards, and seismic safety. Projects must also adhere to the campus's construction and inspection standards. The Capital Projects Committee is responsible for the oversight of donor-built facility projects.

Subsequent Events

Since the conclusion of our principle fieldwork in February 2015, Robert Hathaway retired as Assistant Vice Chancellor - Real Estate Development and Portfolio, and Rajiv Parikh was hired to assume this role. As of May 2015, we understand that the Construction and Design group within the Vice Chancellor – Real Estate organization also reports to him.

Summary Conclusion

Donor-built facility projects are opportunistic in nature and are currently treated on an individual, ad hoc basis. Given that donor-developer projects most likely will continue to be utilized, among other methods, to meet the current and future facilities needs of the campus, we concluded that controls and processes associated with donor-built facility projects can be improved to promote the effectiveness and consistency in execution of these projects. In particular, we note the following four observations:

- Although the roles and responsibilities of each central unit and individual unit may be similar from opportunity to opportunity, they have not been formalized within a business process to ensure consistency in execution across the project lifecycle. Campus departments who become involved with a donor-built facility generally have limited experience with this project type. Without developing roles and responsibilities specific to donor-built facility projects, there is risk that there may be misunderstanding among central units and individual campus departments as to their roles over the lifecycle of a donor-built facility project. There is also risk of insufficient monitoring and oversight and non-compliance with campus policies.
- In the absence of documented guidelines for donor-built facility projects and more formalized definitions of roles and responsibilities (see prior observation), specifically allowable campus support provided to donor-developer 501(c)3 organizations, campus units may be approached for future projects to provide services that may put at risk the structure of the donor development agreement and the gift-in-kind transaction. These units may be well-intentioned and inclined to provide assistance to the 501(c)3's in their fundraising efforts, but may not be aware of what activities may be deemed as exercising

¹ Based on information contained in the *Donor Development* whitepaper prepared by UC Office of the President Capital Resources Management (no date).

control over the project that may impact the treatment of the arrangement as a gift-in-kind transaction.

- Change orders, which are ultimately at the discretion of the donor-developer, may impact the suitability of the completed facility. Campus Construction and Design review of change orders for potential material deviations may identify and prevent suitability issues. We understand that such review has not been done consistently by the campus' project managers for recent donor-built facility projects and the extent to which the project manager is expected to review any change orders is unclear because such responsibility is not yet defined (see prior observation). Campus units pursuing the donor-developer model to meet their facility needs may not be aware that their decision authority related to change orders during construction differs from the traditional model whereby the campus is responsible for directly managing construction.
- Each donor-built facility project typically contains a number of agreements (usually a Memorandum of Understanding, Primary Agreement [ground lease], Sub-lease Agreement, and Gift Agreement) each identifying specific terms and provisions of the project. Currently, standard templates for these agreements are not consistently employed. While each donor-built facility project is unique, project agreements generally contain many key considerations that are relevant from project to project. A standardized checklist of key considerations (e.g., clauses), designated as either mandatory or elective, along with the campus' suggested language, can be useful to the preparer when drafting a new agreement and to the reviewer when reviewing it.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Definition of Roles and Responsibilities

Observation

UC Office of the President has not yet issued systemwide policy related to donor-built facilities, either as part of the Facilities Manual or a standalone policy. However, their Real Estate Services and Strategies group drafted a white paper titled *Donor Development* that provides information and suggested guidance on the subject of donor-built facilities.

In the absence of systemwide policy, the campus does not currently have equivalent local policy or guidelines related to the donor relations, planning, design, construction, and gift administration related specifically to donor-built facilities. However, the campus is currently pursuing a number of these types of projects.

Based upon our interviews of key stakeholders in Donor and Gift Relations, the Real Estate division, Construction and Design, Planning and Design, Office of Legal Affairs, and individual units pursuing such projects, we found that donor-built facility projects are opportunistic in nature and are currently treated on an individual, ad hoc basis. Although the roles and responsibilities of each central unit and individual unit may be similar from opportunity to opportunity, they have not been formalized within a business process to ensure consistency in execution across the project lifecycle.

Campus units and departments who become involved with a donor-built facility generally have limited experience with this project type. Given that donor-development projects most likely will continue to be utilized to meet the current and future facilities needs of the campus, defining the roles and responsibilities of the central units and individual departments supporting a donor-built facility project provides the following benefits:

- Understanding by both central units and departments as to the role of the UC Office of the President and the Regents, and of university policy requirements. .
- Understanding among central units and departments as to their own responsibilities and responsibilities they owe to each other during the lifecycle of a donor-developed project including key milestones, deliverables, handoffs, and adherence to campus policies.
- Understanding by both central units and departments of the limitations and restrictions to allowable activities in order to preserve the nature of the transaction as a gift-in-kind, particularly with respect to maintaining the independent relationship of the donor-developer to the campus, the level of assistance a department may provide to a donor-developer organization, and the use of campus funds.
- Understanding by both central units and departments as to how their roles may differ from a project that is supported by state funds, donor funds, or other financing and construction models.

Defining roles and responsibilities may also provide the basis and opportunity for the following:

- The identification of gaps in responsibilities and accountabilities.
- The identification of key risk points during the project lifecycle and the potential need for the development and implementation of internal controls to mitigate risks.
- Periodic monitoring and oversight by central campus units as well as departments of overall project progress and communication to key stakeholders. The oversight and monitoring could be subsumed by an existing campus group or committee, or more informally, by an ad hoc working group composed of the key central campus units involved in the project lifecycle such as Donor and Gift Services, Planning and Design, the Real Estate division, Construction and Design, Office of Legal Affairs, etc.
- Continuous process improvement resulting in potential increased efficiencies and elimination of redundancies by incorporating better practices and lessons learned from prior projects.

Defining roles and responsibilities may also provide a level of assurance that

- key contingencies, milestones, and deliverables are met during the course of the project lifecycle between campus units, departments, and the donor-developer organization;
- material changes to the approved design and construction during construction are appropriately considered by both Construction and Design and the department with an appropriate level of discussion with the donor-developer taking place; and
- the proper closure of the project is done, including satisfactory resolution of any construction punch list items, full legal conveyance of the facility, full recognition of the gift-in-kind, and removal of any external liens or encumbrances. In one donor-developer project, the ground lease agreement indicated that the property title was to be conveyed upon expiration of the ground lease. While this was completed on a timely basis, the donor gift was not received for several additional months. Management has since corrected this situation and the gift was appropriately received.

Without developing roles and responsibilities specific to donor-built facility projects, there is risk that there may be misunderstanding among central units and individual campus departments as to their roles over the lifecycle of a donor-built facility project and that appropriate internal controls, including sufficient monitoring and oversight, may not be addressed and implemented for these projects. Without defined roles and responsibilities, completion of the donor-built facility project lifecycle in an efficient manner, and as planned and even required, may not be assured.

Management Response and Action Plan

The Real Estate division will convene a working group to document the roles and responsibilities of key campus stakeholders in the planning and implementation of the donor-developer projects. The working group will highlight where the roles of the key parties differ from the standard campus project planning, approval, and implementation process. This work will be done in parallel with and follow the same timeframe as the working group that will be convened to address fundraising support issues. The work group will complete a written description of roles and responsibilities by June 30, 2016.

Fundraising Activities Performed in Support of Independent 501(c)3 Organizations

Observation

In the UC Office of the President white paper titled *Donor Development*, one of the defining characteristics of the donor development model is that the donor-developer takes sole responsibility for fundraising and assumes the full risk for the cost of constructing the facility. The campus does not contribute to the cost of construction, but the master agreement with the donor-developer should assure that “any donor(s) fundraising efforts are compatible with University campaigns and policies.”

Recent donor-developer projects on campus have involved donor-developers creating an independent 501(c)3 corporation whose purpose is to conduct fundraising for the specific project. Some projects have a single significant donor that is able to provide most, if not all, of the funds required. Other projects have a few significant donors that pool their donations and may solicit additional funds of smaller amounts from other donors.

For one current donor-developer project with a group of significant donors, campus staff in the department perform limited functions for their 501(c)3 organization, including soliciting interest from new and prior donors for this particular project, accepting pledges (but not actual donations), and preparing and issuing donor commitment letters using the 501(c)3’s letterhead.

We have discussed these specific unit activities to support the 501(c)3 with campus counsel who believes that these limited activities do not preclude the fundraising and funding responsibilities of the donor and do not affect the final treatment of the gift-in-kind transfer to the campus.

However, we envision that in the absence of documented guidelines for donor-built facility projects and more formalized definitions of roles and responsibilities (see prior observation), specifically what support is potentially allowable to provide to donor-developer 501(c)3 organizations, campus units may be approached for future projects to provide services that may put at risk the structure of the donor development agreement and the gift-in-kind transaction. These units may be well-intentioned and inclined to provide assistance to the 501(c)3’s in their fundraising efforts, but may not be aware of what activities may be deemed as exercising control over the project that may impact the treatment of the arrangement as a gift-in-kind transaction.

Management Response and Action Plan

Development and Alumni Relations will convene a working group to document guidelines for the campus’ role in fundraising for donor-developer projects. The working group will consider solicitation activities, the gift documentation process, and the campus’ role in acknowledging and recognizing gifts, and will clarify those activities deemed to exercise sufficient control of the project so as to impact the treatment of the arrangement as a gift-in-kind transaction. This work will be done in parallel with and follow the same timeframe as the working group that will be convened to document roles and responsibilities (see prior observation). The targeted completion date is June 30, 2016.

Handling Change Orders During Construction Phase

Observation

In the UC Office of the President white paper titled *Donor Development*, another defining characteristic of the donor-development model is that the donor-developer typically takes sole responsibility for project design (with campus input), construction financing, and construction, and assumes one hundred percent of the risk for the cost of constructing the project. However, the university also needs to ensure that the completed facility aligns with its long-term needs.

As a result, the white paper notes that “Since the Project is often built on Regents’ land . . . , the University must be responsible for: (i) defining the scope and design parameters of the Project, (ii) retaining approval over the design, (iii) overseeing plan check and inspection (as the responsible building official for a programmatic project on Regents’ land), (iv) confirming completion in accordance with plans and specifications and accepting ownership of the Project. . . .”

Typically during construction projects, unanticipated changes to the project arise that may deviate from the approved plans and these changes are captured by the contractor using change orders. For the Haas Academic Building, the ground lease (Section 8.6) with the donor-developer as tenant provides that the “Tenant shall advise Landlord by written notice to Landlord’s Project Representative of any proposed change to Landlord-approved 100% complete Construction Documents”. It further states that the landlord (campus) is provided time to “conduct a thorough review” and to “notify Tenant in writing if Landlord reasonably believes that each proposed change deviates materially from the Construction Documents, Code or other Exhibit C requirements”.

Even though the donor-built projects are structured where the donor-developer 501(c)3 organization is solely responsible for construction, the campus as landlord has a right to notice the tenant that the proposed changes are a material deviation. If notice is given, the “Tenant shall make such revisions as shall be required to render the proposed change consistent, in the reasonable judgment of Landlord, with the Construction Documents, Code . . .”. We believe there is at least moderate risk that change orders, which are ultimately at the discretion of the donor-developer, may impact the suitability of the completed facility. Campus Construction and Design review of change orders for potential material deviations may identify and prevent suitability issues. We understand that such review has not been done consistently by the campus’ project managers for recent donor-built facility projects and the extent to which the project manager is expected to review any change orders is unclear because such responsibility is not yet defined (see prior observation).

Campus units pursuing the donor-development model to meet their facility needs may not be aware that their decision authority related to change orders during construction differs from the traditional model whereby the campus is responsible for directly managing construction.

Management Response and Action Plan

Action to be taken on all donor projects to ensure contractor change orders issued during the course of construction do not materially change the university approved construction documents:

- Allocate a timeframe per week for assigned project manager to review change orders.
- Prior to the start of construction, establish the review process with developer, design team, and contractor.
- Project manager should review the contractor change order log weekly and from the change order description, identify any change order that has potential to materially change the construction documents. Should the project manager identify such change orders he shall request back up documents from the contractor for review. If after review, the project manager determines the change causes a material deviation to the construction documents the project manager shall request a meeting with the developer team. The project manager along with the developer and design team shall decide if such change shall be incorporated into the project.

These actions were implemented August 2015.

Use of Standardized Checklist of Key Considerations

Observation

Each donor-built facility project typically contains a number of agreements (usually a Memorandum of Understanding, Primary Agreement [ground lease], Sub-lease Agreement, and Gift Agreement) each identifying specific terms and provisions of the project. Creation of new agreements is complicated and can be confusing considering their extent and complexity.

Currently, a standard checklist of key considerations for these agreements is not employed. While prior agreements are referenced to initially construct a new agreement, each donor-built facility project is unique and each agreement may differ in content and format from previous or subsequent agreements. Parts of previous agreements may have been included, excluded, or modified to accommodate the specifics of a project. Unless the preparers and reviewers review all prior donor-built facility agreements, and know the history of each one, they may not be able to readily identify the differences between agreements. A modification in one agreement designed to meet unique requirements of a specific project may be considered by future preparers and reviewers to be usual and normal.

While each donor-built facility project is unique, project agreements generally contain many key considerations that are relevant from project to project. A checklist of key considerations (e.g., clauses), designated as either mandatory or elective, along with the campus' suggested language for each clause can be useful to the preparer when drafting a new agreement and to the reviewer when reviewing it. As an agreement is being drafted, the suggested wording of a clause can be modified to address the unique attributes and requirements of that agreement. The existence of this information need not restrict development of an agreement but can aid in its development. By also identifying differences within prior agreements as compared with the list of key clauses, differences can be readily identified and considered.

Use of a checklist of key considerations can strengthen control by serving as a guide to ensure that each agreement contains all relevant and appropriate clauses and clause content, that no key clauses are inadvertently omitted or misstated, and that differences have been identified and considered.

Management Response and Action Plan

Using a previously approved ground lease for a donor built facility, in consultation with campus counsel, the Real Estate office has drafted a template for future ground lease agreements with donor builders. The Berkeley campus will use this document as a template for future agreements and adapt as necessary to meet the particular circumstances of the particular project subject to review by university counsel. The template for future ground lease agreements with donor builders was implemented August 2015.