

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

**HASTINGS COLLEGE OF THE LAW
NEEDS TO IMPROVE THE MANAGEMENT
OF ITS REAL PROPERTY**

REPORT BY THE
OFFICE OF THE AUDITOR GENERAL

P-624

HASTINGS COLLEGE OF THE LAW NEEDS TO
IMPROVE THE MANAGEMENT OF ITS REAL PROPERTY

OCTOBER 1986



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Auditor General

October 30, 1986

P-624

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning Hastings College of the Law's management of its real property. Hastings retains property that it does not plan to develop for academic use and that it acquired through the use of restricted scholarship, student loan, and other funds. In addition, Hastings does not regularly perform or arrange for health, safety, and fire inspections of its buildings to ensure that they meet health and safety standards.

Respectfully submitted,

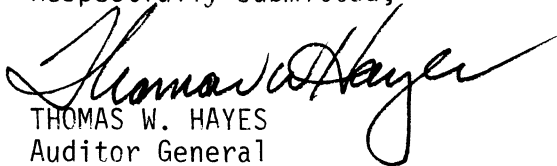

THOMAS W. HAYES
Auditor General

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SUMMARY

RESULTS IN BRIEF

Hastings College of the Law (Hastings) has retained four pieces of property that it does not plan to develop for academic use and that it acquired through the improper use of restricted funds. Although Hastings acquired the property for part of the Hastings Law Center it planned to build, Hastings abandoned plans for the portion involving the four properties in 1977. Since Hastings used restricted funds to purchase these and other properties for the Hastings Law Center and since Hastings failed to repay all of these funds, over \$820,000 of endowment income has not been available for scholarships and student loans. According to Hastings' dean, however, no student's need for financial aid has gone unmet. Furthermore, Hastings believes that the properties are good investments.

In addition, Hastings does not regularly perform or arrange for health, safety, and fire inspections of its buildings to ensure that they are clean and safe. There have, in fact, been Health and Safety Code violations in some of Hastings' rental property. However, Hastings' board of directors has stated that it will arrange for the appropriate inspections of Hastings' property and correct deficiencies to meet all state standards.

BACKGROUND

Hastings College of the Law provides education in all branches of the law. Although the college is, by statute, affiliated with the University of California, it is managed by its own board of directors. Hastings' academic budget for fiscal year 1985-86 was approximately \$12 million. Approximately \$11.3 million of that amount was from the State's General Fund.

PRINCIPAL FINDINGS

Hastings College of the Law Owns Property
That It Does Not Plan To Develop
For Academic Use and That It
Acquired With Restricted Funds

Hastings has retained four pieces of property that it does not plan to develop for academic use. Since July 1, 1981, Hastings' expenses for these properties have been \$142,933 more than the income they have generated. As a result of Hastings' ownership of this property, the City and County of San Francisco has been deprived of approximately \$275,000 in property tax revenue that it would have collected had the owners been private citizens. Hastings has retained this property because it believes that the property is a good investment. As an

affiliate of the University of California, Hastings does not believe that it must follow state law that requires state agencies to dispose of surplus property. Hastings also does not believe that it must adhere to the University of California's policy of not retaining property for which it has no academic plans or that it believes to be an imprudent investment.

To acquire these and other properties, Hastings used over \$1 million in restricted scholarship, loan, endowment, and other funds. After auditors from a certified public accounting firm notified Hastings of the improper use of these funds in 1979, the board of directors established an interest rate to be paid on these funds that was lower than the rate Hastings was earning on other endowment investments. The rate established by the board of directors was also lower than the rates paid on three-month United States treasury bills and on the State's pooled money investments. As of October 20, 1986, Hastings had paid only \$75,170 to these funds. As a result, over \$820,000 in income from endowment funds that could have been available for scholarships and student loans has not been available to students. According to Hastings' dean, however, no student's need for financial aid has gone unmet.

Hastings College of the Law Has Not
Ensured That Its Properties Meet
State Health and Safety Standards

State law stipulates the safety and health standards that certain kinds of property must meet. The University of California, which is administratively separate from Hastings, employs a staff of qualified inspectors who periodically inspect its properties to ensure that they meet state standards. However, Hastings does not regularly perform or arrange for health, safety, or fire inspections of its properties to ensure that they meet state standards. As a result, Hastings' buildings have not always met health and safety standards. For example, in 1980, the Office of the State Fire Marshal informed Hastings that three of the four residential buildings Hastings owns needed sprinklers, wired smoke detectors, and smoke separators to ensure fire safety for the tenants. Hastings did not fully comply with the state fire marshal's requirements until 1983. According to Hastings' general counsel, Hastings has not performed routine inspections of its property because it was not aware of all standards and inspections required by state law. However, Hastings' board of directors has stated that it will arrange to have the appropriate inspections made of Hastings' property and will correct all identified deficiencies to ensure that the properties meet all state standards.

RECOMMENDATIONS

Hastings College of the Law should take the following actions:

- Dispose of property that it does not plan to develop for academic use and use the proceeds to immediately repay restricted funds;
- Adhere to restrictions placed on donated funds; and
- Fulfill the board of directors' commitment to arrange for regular inspections of Hastings' buildings and to correct all deficiencies.

AGENCY COMMENTS

Hastings does not agree that it should dispose of the property that it does not plan to develop for academic use and that it should repay the restricted funds with the proceeds. According to Hastings, all properties that it owns will be used to further the legitimate objectives of the college. However, Hastings admits that the precise manner in which these properties will be used for academic purposes has not yet been determined. Further, Hastings believes our findings are inaccurate and misleading and that our recommendation that it dispose of the property is unwarranted. Even

though Hastings' response points out that the properties have increased in value, Hastings does not state how or when the restricted funds will be repaid.

Hastings' response states that the college is fulfilling the board of directors' commitment to arrange for regular inspections of its buildings and to correct all deficiencies.

INTRODUCTION

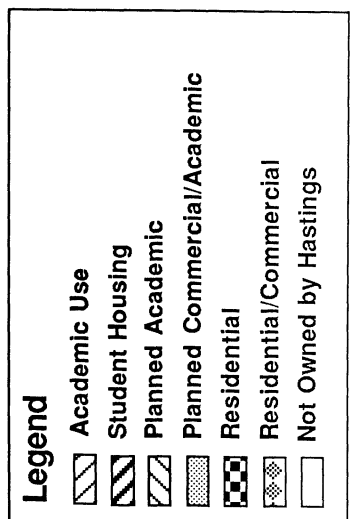
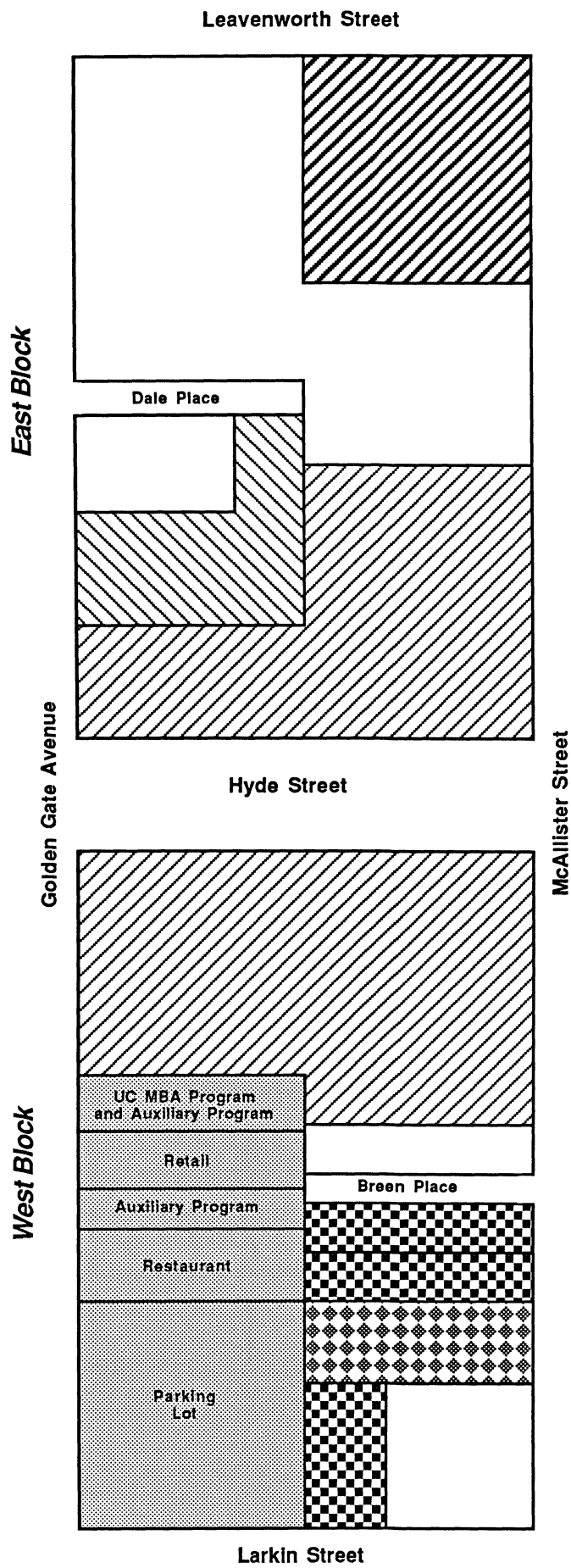
In 1878, the California Legislature authorized the State's first Chief Justice, Serranus Clinton Hastings, to establish Hastings College of the Law (Hastings) to provide education in all branches of the law. Although the Legislature stipulated an affiliation between Hastings and the University of California, it specified that Hastings' business would be managed by a separate board of directors. California's Education Code, Section 92206, specifies that vacancies on the board, other than the position held by the heir or representative of the founder of the college, are filled by the governor, whose decision must be approved by a majority of the Senate.

As a result of the affiliation between Hastings and the University of California, Hastings' dean is an ex officio member of the university's faculty, and Hastings' students receive diplomas granted by the university and signed by the president of the university. Otherwise, the affiliation between the two organizations has been informal and undefined.

Hastings' property is held in the name of Hastings College of the Law. Hastings' campus and its other San Francisco properties are spread across a two-block area near the Civic Center. (See Figure 1.)

Figure 1

Hastings College of the Law
 Properties in San Francisco
 September 1986



In the east block, Hastings owns one academic building, a building that is used primarily for student housing, and a building that it plans to use for academic purposes in the future. In the west block, Hastings owns another academic building, three apartment buildings, a building that houses a residential hotel and a restaurant, four commercial buildings, and a parking lot. Nonresidential tenants of these properties consist of two restaurants, one retail business, a parking lot, a University of California program in business administration, and two of Hastings' auxiliary law programs.

The State annually appropriates funds for Hastings' academic budget. Hastings' academic budget for fiscal year 1985-86 was approximately \$12 million. The State's General Fund provided approximately \$11.3 million of that amount. The federal government and the California State Lottery provided the remaining \$700,000. For fiscal year 1986-87, Hastings' academic budget is approximately \$12 million to educate 1,450 law students.

The Hastings Law Center Project

In July 1977, Hastings published an environmental impact report on its plans to develop the Hastings Law Center in its west block. Hastings planned to build this law center in three stages, beginning with an academic building. This building, which was completed in 1980, includes a library, study space, faculty offices, student government and student organization offices, administrative offices, and a cafeteria.

In the second stage of the Hastings Law Center project, Hastings planned a building that would be used for both academic programs and government offices. This stage of the project caused community controversy because, at the time, two residential hotels were located on this site. In the 1970s, Hastings closed the hotels because, according to Hastings' environmental impact report for the law center project, they were unsafe and in need of repair. When Hastings closed the residential hotels and removed its tenants, some tenants filed a suit against Hastings. This suit, McKeon, et al v. Hastings College of the Law, was filed in the Superior Court of the City and County of San Francisco, which issued a judgment against Hastings on July 2, 1982. On September 22, 1986, the Court of Appeals of the State of California reversed this judgment. The building currently planned for the site will be six stories high. Hastings will use part of the building, and the rest will be leased for governmental and, to a lesser extent, commercial uses. This building is now called the Golden Gate Building and is no longer referred to as part of the Hastings Law Center project.

In the third stage of the Hastings Law Center project, Hastings planned to build an open plaza on the southwest portion of the west block, which is currently occupied by apartment buildings, a residential hotel, and a restaurant. In the final environmental impact report for the first phase of the Hastings Law Center project, Hastings indicated that it has abandoned this stage of the project.

SCOPE AND METHODOLOGY

The purpose of this audit was to assess Hastings' management of its real property. To determine whether Hastings manages its property in a manner consistent with state law and University of California policy, we reviewed property records at the assessor's office in San Francisco, Hastings' financial records from July 1978 through August 1986, a draft of Hastings' environmental impact report, and minutes of meetings of Hastings' board of directors from December 1970 through March 1986. In addition, we interviewed Hastings' dean, general counsel, director of facilities planning and operations, director of administrative services, and property managers. We also interviewed representatives of the University of California, the Office of the State Fire Marshal, the Department of Health Services, the Department of Housing and Community Development, the Department of General Services, and the City and County of San Francisco.

AUDIT RESULTS

I

HASTINGS COLLEGE OF THE LAW OWNS PROPERTY THAT IT DOES NOT PLAN TO DEVELOP FOR ACADEMIC USE AND THAT IT ACQUIRED WITH RESTRICTED FUNDS

Hastings College of the Law (Hastings) has retained four pieces of property that it acquired in the mid-1970s even though it has no current plans to develop this property. In 1977, Hastings abandoned the portion of the project for which these properties were to be used; however, Hastings retains these properties because it does not believe that either the laws governing state agencies or the University of California's policies regarding disposal of property apply to Hastings. Hastings also believes that these properties are good investments. However, since July 1, 1981, the operating costs and interest expenses for the four properties have exceeded the income they generate by \$142,933. As a result of Hastings' ownership of these properties, the City and County of San Francisco has not collected tax revenues of approximately \$275,000 that would have been collected had the owners been private citizens.

To acquire the properties for the Hastings Law Center project, Hastings improperly used restricted scholarship, loan, and endowment funds. In addition, after private financial auditors informed Hastings of the inappropriate use of the funds, the board of directors established an interest rate to be paid on these funds that was lower

than the rate Hastings was earning on other endowment investments, lower than the rate on three-month United States treasury bills, and lower than the rate on the State's pooled money investments. As of October 20, 1986, Hastings had repaid only \$75,170 to the restricted funds. As a result, over \$820,000 in income from endowment funds that could have been available for scholarships and student loans has not been available for students. According to Hastings' dean, no student's need for financial aid has gone unmet.

Hastings Owns Property That
It Does Not Plan To Develop
for Academic Use

Hastings has not adopted plans to use properties on the south and west sides of its west block as part of the law school. These properties, which Hastings acquired in the mid-1970s for its Hastings Law Center project, consist of an apartment building on Larkin Street, two apartment buildings on McAllister Street, and a building on McAllister Street that houses a residential hotel and a restaurant. In 1977, the board of directors abandoned the third stage of the project and deferred plans for these properties for a substantial but indefinite period. In 1982, Hastings' board of directors adopted a finance committee recommendation to offer these properties for sale. The finance committee made this recommendation because the director of administration reported that the buildings were deteriorated and that Hastings' income from these buildings was too low to repay the funds Hastings had used to purchase the properties. Furthermore, he

recognized that Hastings had no plans for the properties. In our review of the board of directors' minutes from December 1970 through March 1986, we found no evidence that the board has made any decision to develop these properties as part of the law school.

Section 11011 of the California Government Code requires each state agency to report property that exceeds its foreseeable needs to the Department of General Services. The Department of General Services then requests the Legislature's authorization to dispose of the surplus property. Although the University of California is exempt from this requirement, the university's assistant treasurer told us that it is the university's policy to acquire and keep property only if the university plans to develop the property for academic use or if the university expects the property to be a prudent investment. According to prudent management policy, Hastings should not spend resources maintaining property that it does not plan to develop for academic purposes.

Hastings' records and information provided by Hastings' director of administrative services indicate that, since July 1, 1981, Hastings' expenses for these properties have exceeded the income they have generated by \$142,933. Further, because Hastings is a state organization, it does not pay property tax. As a result, from fiscal year 1974-75 through fiscal year 1986-87, Hastings' ownership of these properties has deprived the City and County of San Francisco of an estimated \$275,000 in property tax revenue that it would have received from private owners.

Hastings retains these properties because, as an affiliate of the University of California, Hastings does not believe it must follow state requirements regarding the disposition of surplus property. Further, Hastings' chairman of the board and its general counsel made the following statement concerning this property:

Hastings, as the law department of the University of California, is governed by its own board of directors. Thus, Hastings' board must exercise its own judgement on the retention or sale of its properties. While Hastings does not have a formalized or specific surplus property policy, its policy is to follow the requirements of the "Prudent Investor Rule". As such, Hastings retains these properties because under the laws of the State of California, it believes it is not required to sell them unless retention of the properties violates the state law requiring its investments to comply with the California "Prudent Investor Rule".

Hastings believes that the property is a good investment. In fact, capital appreciation of the four properties may be significant: Hastings paid \$1,414,142 for the four properties in the mid-1970s and, in 1980, the properties were appraised at \$1,971,000. However, the chief appraiser in the San Francisco assessor's office told us that the value of properties in the Civic Center area has not always increased; in fact, in some cases, the value has decreased. He cautioned us against assuming that the value of Hastings' properties has increased since Hastings acquired the properties. Hastings has not had the four properties appraised since 1980.

Hastings Improperly Used Restricted
Funds To Acquire Property

In an audit performed for fiscal year 1978-79, Deloitte, Haskins, and Sells, a certified public accounting firm, reported that Hastings inappropriately used money from 63 (71 percent) of its 89 restricted funds for the Hastings Law Center project, which included the acquisition of the four properties that Hastings planned to develop as an open plaza. The restricted funds Hastings used consisted of loan funds, endowment funds, scholarship funds, and other funds. Many of the funds Hastings used for the Hastings Law Center project are entitled "endowment funds," which are to be permanently invested so that income from the investment can be used for the specified purposes.

The use of restricted endowment funds to purchase property as an investment is not necessarily improper. However, the plaza was planned as a capital improvement and was not expected to produce income. In addition, according to the chairman of Hastings' board of directors and Hastings' general counsel, who is a former board member, the decision to use restricted funds to purchase the property was not made by the board of directors but by the former dean without the board's knowledge. According to information from the fiscal year 1978-79 audit of Deloitte, Haskins, and Sells, Hastings imprudently used \$589,339 (50.6 percent) of the \$1,164,014 in its endowment funds for real property and \$152,728 (13.1 percent) for other unauthorized purposes.

In addition to the endowment funds, Hastings also used previous interest income from endowment funds to purchase property for the Hastings Law Center. The use of income from the endowment funds for this purpose is clearly improper; income from endowment funds is to be used only for the purposes specified by the donors, such as scholarships and student loans. According to the fiscal year 1978-79 audit by Deloitte, Haskins, and Sells, Hastings used \$271,902 of previous interest income from endowment funds for real property and for other unauthorized purposes. This income should have been used only for scholarships and student loans.

According to the 1978-79 audit by Deloitte, Haskins, and Sells, Hastings used approximately \$1.05 million (45 percent) of the \$2.31 million in its restricted funds for unauthorized uses. That audit reported that approximately \$900,000 of the \$1.05 million was used for the Hastings Law Center project. A fiscal year 1984-85 audit by Peat, Marwick, Mitchell and Company identified the amount used in the 1970s to purchase properties for the Hastings Law Center project as \$1.05 million. According to Deloitte, Haskins, and Sells, Hastings used these funds without designating interest rates, repayment terms, or source of repayment.

On December 14, 1979, after Deloitte, Haskins, and Sells informed Hastings of its improper use of restricted funds, the board of directors resolved to pay back these restricted funds at 7 percent simple interest from other, unrestricted funds. However, at the time,

Hastings was earning higher rates of interest on its invested endowment funds. For example, on one restricted fund, Hastings earned 9.8 percent in fiscal year 1978-79; the average yield on Hastings' endowment funds during fiscal year 1978-79 was 7.6 percent. In addition, in December 1979, when the board of directors made its decision to repay the restricted funds at 7 percent, three-month United States treasury bills were yielding an average annual return of 12.1 percent. Furthermore, from fiscal year 1978-79 through fiscal year 1985-86, three-month United States treasury bills yielded an average annual return of 9.9 percent, and the State's Pooled Money Investment Account yielded an average annual return of 10.3 percent.

In June 1984, Hastings' dean informed the board of directors that \$70,000 had been paid on the restricted fund debt. In October 1984, the chairman of the board's committee on finance reported to the board that the restricted funds were being repaid with income generated by the properties. On October 20, 1986, Hastings claimed to have repaid \$82,708 to the restricted funds. However, Hastings was able to document repayments of only \$75,170 to the restricted funds.

Restrictions on Funds

Donors of the restricted funds specified that the money they donated was to be used for specific purposes, such as scholarships, student loans, and professorships. Endowments, like the James S. O'Neill Loan Fund, for example, are to be permanently invested

so that income from the investment may be used for the purposes specified by the donor. The donor of this endowment fund stipulated that the income be used for loans to "poor and deserving" students from Sacramento County. Although some scholarship donors place more restrictions than others on the acceptable recipients of the scholarships, the funds are to be used only to provide scholarships. The Sonia Werchick Memorial Scholarship Fund, for example, was established by her son to provide scholarships to Hastings' students, but it leaves to Hastings' discretion the selection of those students.

In addition to restrictions placed on the use of the funds by their donors, the Civil Code restricts the use of funds held in trust. Section 2216 defines a voluntary trust as an obligation arising out of a personal confidence placed in and voluntarily accepted by the trustee for the benefit of another. In addition, Section 2229 prohibits a trustee from using funds held in trust for any purpose other than that for which the trust was created. Further, Section 2236 prohibits a trustee from mingling funds held in trust with its other funds, and Section 2228 requires a trustee to act "in the highest good faith toward his beneficiary."

Finally, the University of California maintains the policy of investing its endowment funds to achieve a return that is as high as possible but still safeguards the university's fiduciary responsibility to the donors and beneficiaries of the funds. As of June 30, 1985, only 1.9 percent of the university's endowment funds were invested in real estate.

Funds Unavailable for
Loans and Scholarships

We identified a total of over \$820,000 in income from endowment funds that could have been available for scholarships and student loans from fiscal year 1978-79 through fiscal year 1985-86. Since Hastings improperly used previous endowment income for the Hastings Law Center project, \$271,902 was not available for scholarships and student loans in fiscal year 1978-79. An additional \$389,558 in accumulated interest was not available for scholarships and student loans from fiscal year 1978-79 through fiscal year 1985-86 because Hastings has not paid the 7 percent simple interest on the endowment funds used for the project. Furthermore, because Hastings imprudently used endowment funds for the Hastings Law Center project rather than investing the funds to earn interest as high as was available on three-month treasury bills, an additional \$162,390 was not available for scholarships and student loans during the same eight-year period. As we pointed out earlier, Hastings used 50.6 percent of its endowment funds to purchase real property. In contrast, as of June 30, 1985, the University of California had 1.9 percent of its endowment funds invested in real estate.

According to Deloitte, Haskins, and Sells, in fiscal year 1978-79, the total income of \$50,377 from the James S. O'Neill Loan Fund, which should have been available to qualified students from Sacramento County, had been inappropriately advanced to other funds. Furthermore, of the \$394,254 in the endowment portion of the loan fund

at June 30, 1979, \$268,933 (68 percent) had been advanced to the Hastings Law Center project, and \$59,060 (15 percent) had been advanced to other funds without the board of directors' authorization. The entire endowment portion of this fund should have been earning income that would have been available for student loans in fiscal year 1979-80 and subsequent years. For example, if Hastings had paid rather than accrued 7 percent simple interest each year on the \$327,993 advanced from the James S. O'Neill Loan Fund to other funds, this fund would have provided \$22,959 for loans in fiscal year 1979-80 and for every year thereafter. If Hastings had invested the funds in three-month treasury bills, the fund would have earned an average of \$32,530 per year for student loans. According to Hastings' accounting records, as of August 1986, the west block property owed the O'Neill fund \$336,387 in principal and \$90,787 in interest.

Hastings also inappropriately used scholarship funds for the Hastings Law Center project. In fiscal year 1978-79, \$59,776 of the Hastings College Scholarship Fund was appropriately invested and earned a 9.8 percent return of \$5,863. According to Deloitte, Haskins, and Sells, Hastings awarded \$1,000 of this amount in scholarships. However, as of June 30, 1979, the endowment portion of the fund had outstanding advances to the project of \$24,123 and to other funds of \$192,439. Although Hastings owes interest on these amounts, according to the director of administrative services, as of September 5, 1986, Hastings had not paid this interest. Had Hastings paid the interest, this fund alone would have made over \$15,000 per year available for

student scholarships. Furthermore, if Hastings had invested the advanced amounts in three-month treasury bills, an average of \$21,479 per year would have been available for student scholarships. According to Hastings' accounting records, as of August 1986, the west block property owed the General Scholarship fund (formerly the Hastings College Scholarship Fund) \$290,950 in principal and \$153,071 in interest.

The Deloitte, Haskins, and Sells audit also reported that the Sonia Werchick Memorial Scholarship Fund awarded scholarships totalling \$2,750 in fiscal year 1978-79. However, another \$4,010 that should have been available for scholarships had been advanced to the Hastings Law Center project. In addition, Hastings had advanced \$35,022 to other funds from the endowment portion of this fund. According to Hastings' accounting records, as of August 1986, the west block property owed the fund \$62,981 in principal and \$15,138 in interest. Furthermore, this scholarship fund had no cash or short-term investments available for scholarships.

According to Hastings' dean, no student's need for financial aid has gone unmet. However, we identified a total of over \$820,000 that could have been available for scholarships and student loans if Hastings had not improperly used restricted funds and had invested the endowment funds in three-month treasury bills. In addition, the Deloitte, Haskins, and Sells audit pointed out that Hastings has a fiduciary responsibility to the donors and the potential recipients in

administering funds donated for restricted purposes. We believe that, by using the funds for other purposes such as acquiring and developing property, Hastings may have breached this responsibility.

Hastings' Reasons for Its Actions

Hastings' director of administrative services stated that Hastings has not made all payments on the monies it used from restricted funds because the west block properties have not generated enough income. According to Peat, Marwick, Mitchell, and Company, Hastings' management believed that all restricted funds would be recovered when the properties were developed. Hastings' director of administrative services reported in 1984 that Hastings would pay interest on the advanced amounts using income from the properties. However, as noted before, Hastings has not had plans to develop the four properties since abandoning the third stage of the Hastings Law Center project in 1977. Moreover, as stated earlier, since 1981, the operating costs and interest payments for these properties have exceeded the income they have generated. However, 1980 appraised values of these properties exceed the principal and the accumulated interest that Hastings owed to the restricted funds as of June 30, 1986.

The chairman of Hastings' board of directors and Hastings' general counsel, who is a former board member, stated that the previous dean used the restricted funds to acquire real estate without the

board's knowledge. They stated that when they became aware of the problem, the board asked Deloitte, Haskins, and Sells to audit Hastings' nonstate funds.

In the absence of a formal investment policy, Hastings' board of directors decided, in December 1979, to repay the restricted funds at 7 percent simple interest. Hastings' general counsel, who was then a member of the board, stated that the board decided to pay 7 percent simple interest because, at the time, state law limited the amount of interest that plaintiffs could demand on legal judgments to 7 percent. In addition, he stated that the board considered 7 percent simple interest an appropriate rate because Hastings was paying only 3 percent interest on one of its other loans. In addition, the general counsel confirmed that the board of directors agreed in 1982 to offer the properties for sale. However, he stated that the board did not intend to sell the property.

CONCLUSION

Hastings College of the Law has retained four pieces of property that it does not plan to develop for academic use. Hastings acquired these properties to use as part of its proposed Hastings Law Center. However, in 1977, Hastings abandoned the part of the project for which it intended to use these properties. Since July 1, 1981, Hastings has earned \$142,933 less on the four properties than their operating

costs and interest expenses. In addition, the City and County of San Francisco was deprived of tax revenues of approximately \$275,000 that would have been collected had the owners of these properties been private citizens.

Hastings improperly used restricted scholarship, loan, and endowment funds to acquire the properties for the Hastings Law Center project. In addition, after private financial auditors informed Hastings of the inappropriate use of the funds, the board of directors established an interest rate to be paid on these funds that was lower than the rate Hastings could have earned on endowment investments. As of October 20, 1986, Hastings had repaid only \$75,170 to the restricted funds. As a result, over \$820,000 in income from endowment funds that could have been available for scholarships and student loans has not been available for award to students.

RECOMMENDATIONS

Hastings College of the Law should take the following actions:

- Dispose of its surplus property immediately. Hastings' director of administration presented this recommendation to the board of directors in 1982;

- Use proceeds from selling the surplus property to immediately repay the principal and the accumulated interest to the restricted funds. According to an appraisal made in 1980, the value of the surplus property exceeds the principal and interest that Hastings owes the restricted funds as of June 30, 1986;

- Adopt either the State's or the University of California's guidelines and policies concerning the disposition of surplus property, or develop and adhere to a policy of disposing of property that will not be developed for academic purposes or that is an imprudent investment;

- Adhere to donors' restrictions on the use of donated funds;

- Adopt University of California policies regarding investment of endowment and other restricted funds, or develop and adhere to a policy that specifies how restricted funds can be invested; and

- Consider applying to the state treasurer to deposit endowment funds in the State's Pooled Money Investment Account or employing the services of some other institutional investor.

II

HASTINGS COLLEGE OF THE LAW HAS NOT ENSURED THAT ITS PROPERTIES MEET STATE HEALTH AND SAFETY STANDARDS

State law stipulates the safety and health standards that certain kinds of property must meet. The University of California, which is administratively separate from Hastings, employs a staff of qualified inspectors who periodically inspect its properties to ensure that they meet state standards. However, Hastings has not regularly performed or arranged for health, safety, or fire inspections of its properties to ensure that they meet standards. As a result, Hastings has not always ensured safe, sanitary conditions in its buildings. According to Hastings' general counsel, Hastings has not performed routine inspections of its property because it was not aware of all standards and inspections required by state law. However, Hastings' board of directors has agreed to have the appropriate inspections performed and to correct identified deficiencies.

The State has a number of laws requiring different kinds of facilities to be inspected to ensure that they meet specific standards. For example, the California Uniform Retail Food Facilities Law, commencing with Section 27500 of the Health and Safety Code, requires uniform statewide health and sanitation standards for retail food facilities, vending machines, and other places where food is sold to ensure that food will be pure and safe. Although this law gives

primary responsibility for its enforcement to local health agencies, the law also states that nothing will prevent the State from taking any necessary actions for the protection of public health and safety.

The State has also passed a law governing buildings used for human habitation. Section 17910 et seq. of the Health and Safety Code, entitled the State Housing Law, lists conditions that would lead the State to declare a building used for human habitation to be substandard. These conditions include poor sanitation, such as inadequate heat or an insect infestation. The conditions also include different types of structural hazards, wiring hazards, and plumbing hazards. This law applies to all motels, hotels, lodging houses, apartments, and dwellings in all parts of the State. The law states that the enforcement of these regulations is the responsibility of the housing or health department of every city or county. Where there is no local agency charged with enforcing this law, the Department of Housing and Community Development is to enforce the State Housing Law. This law also authorizes the state fire marshal to develop rules and regulations governing fire safety for housing.

Finally, Section 13100 et seq. of the Health and Safety Code addresses fire safety in all state institutions and state-owned buildings. This law established the Office of the State Fire Marshal and gives the state fire marshal the responsibility for developing and enforcing regulations regarding fire prevention measures. These regulations are contained in Titles 19 and 24 of the California Administrative Code.

According to associate directors of the environmental health and safety section at the University of California, Berkeley, the University of California does not consider itself subject to local rules and regulations. However, the university employs a staff of qualified inspectors in its environmental health and safety section who conduct routine inspections of the university's cafeterias, student housing, and academic buildings to ensure that these properties meet the State's health, housing, and building standards. For example, university officials in the environmental health and safety section stated that they perform quarterly sanitation inspections of their cafeterias. Further, they conduct weekly inspections of their student housing for rodent and insect infestations and biannual inspections of student housing for fire safety. These same university officials also stated that their other buildings are inspected annually for fire safety.

Hastings and the University of California own similar kinds of property: academic buildings, residential buildings, and retail food facilities. One of Hastings' academic buildings contains a cafeteria that is open to the public. In addition, several food vending machines are located in one of the academic buildings and in the student housing building. Hastings, however, does not maintain a staff of qualified inspectors to perform regular inspections of property for health, fire safety, or substandard housing conditions. Although Hastings periodically has its fire extinguishers and elevators inspected, it has not arranged for regular inspections of its properties to ensure that

they meet all state health and safety laws. Hastings' general counsel stated that Hastings contacts inspection groups from the University of California when the Hastings' management decides that Hastings' buildings need an inspection, and the university sends an inspection team to perform the appropriate inspection. The general counsel also indicated that Hastings usually asks the university to perform an inspection for Hastings when Hastings receives a complaint from one of its employees, students, or tenants. Although associate directors of the university's environmental health and safety section stated that they have inspected Hastings' properties when Hastings officials have asked them to, they stated that they have never performed routine inspections of Hastings' properties. These university officials stated that the university does not have the resources to perform routine inspections of Hastings' properties but that they would perform inspections if Hastings reimbursed the university.

Hastings' general counsel also stated that Hastings' management is willing to allow local inspectors to inspect Hastings' properties but does not believe that it must abide by the local inspectors' findings because Hastings is, like the University of California, a state constitutional agency. San Francisco city inspectors have inspected property owned by Hastings occasionally in the past and have reported their inspection findings. However, Hastings has not always allowed San Francisco city inspectors access to Hastings' properties to perform or complete inspections. For example, in March 1986, San Francisco city inspectors received a complaint from

a Hastings' tenant that the ceiling leaked in one of the apartments owned by Hastings. When the city inspector attempted to respond to the complaint, he was denied access to the property by the property manager. Hastings' property manager told the city inspector that Hastings allows only state inspectors to inspect its property.

In addition, although the Office of the State Fire Marshal inspects Hastings' properties in response to Hastings' requests, the San Leandro regional chief of this office indicated that the office does not have enough staff to periodically inspect state property. Furthermore, the Office of the State Fire Marshal does not inspect for compliance with all requirements, only those related to fire safety.

As a result of this lack of routine inspections for fire safety, sanitation, and substandard housing conditions, some of Hastings' tenants have been exposed to unsanitary and unsafe living conditions on Hastings' properties. For example, representatives of the Bureau of Building Inspection in San Francisco's Department of Public Works stated that, in September 1983, when they inspected apartments owned by Hastings located at 270 McAllister Street, they noted some violations of San Francisco's heating code. They also indicated in correspondence dated April 25, 1986, that these code violations were still outstanding. We noted that, as late as April 4, 1986, Hastings continued to assert that it was not subject to the codes of the City and County of San Francisco.

In another instance, in February 1985, San Francisco's Department of Public Health received two complaints of unsanitary conditions at a residential hotel owned by Hastings. In this case, Hastings permitted health inspectors from the city's Department of Public Health, accompanied by inspectors from the University of California, to inspect portions of the building. These inspectors reviewed 11 rooms, 13 percent of all the rooms in the hotel, and noted a moderately heavy cockroach infestation. They also noted that walls, floors, and ceilings needed resurfacing or repair. Although Hastings' general counsel responded in writing to San Francisco's deputy city attorney on the measures Hastings was taking to correct these identified deficiencies, the assistant director of the city's Department of Public Health stated that Hastings officials did not allow his inspectors back into this building to confirm that these deficiencies had been corrected. The general counsel requested that the city direct further complaints to Hastings so that Hastings could act on the complaints.

In yet another instance, in September 1982, Hastings' director of administration reported to the board of directors that the state fire marshal had informed his office in 1980 that three of the four residential buildings owned by Hastings needed sprinklers, wired smoke detectors, and smoke separators in the main stairways. In early 1981, Hastings obtained an estimate of the cost to make the required repairs. In June 1982, Hastings' general counsel informed the state fire marshal that the Legislature did not allocate funds to Hastings to make

modifications or improvements to the properties in question. The general counsel also indicated that the only alternative Hastings may have had, in light of the expenses of the repairs required by the state fire marshal to correct the fire safety deficiencies, was to close the buildings and remove the residents. In February 1983, the state fire marshal informed Hastings that Hastings would have to correct the conditions noted in the apartment buildings if these buildings were to remain occupied. A deputy state fire marshal stated that, as of mid-October 1983, Hastings had corrected the identified problems.

The general counsel, who is a former board member, stated that routine health inspections, fire safety inspections, and inspections for substandard housing have not been conducted because the board of directors was not aware of all the standards that needed to be met by Hastings' properties. In correspondence from Hastings' general counsel to San Francisco's acting superintendent of the bureau of building inspection in April 1986, Hastings maintained that, as a state constitutional agency, it was not subject to local ordinances regarding health, fire safety, and substandard housing conditions. As a result, Hastings did not always allow inspectors from the City and County of San Francisco to inspect its property. However, Hastings' general counsel indicated that the board of directors had not been aware of all state standards for their property and that the board believed that the state fire marshal performed all necessary inspections to ensure that standards were met.

During our audit, we informed Hastings' board of directors that, in the absence of appropriate inspections of its properties, we were prepared to contract with the state agencies responsible for enforcing these state standards and to instruct them to make all necessary inspections of Hastings' properties. The board of directors then informed us that the appropriate inspections will be arranged to determine whether Hastings' properties meet state standards. The board also stated that its intent is to meet all state standards.

CONCLUSION

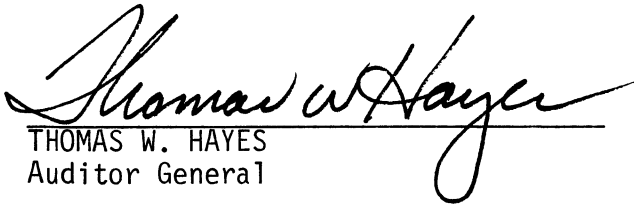
Hastings College of the Law has not ensured that its properties are routinely inspected to determine whether they comply with state laws. As a result, some of Hastings' tenants have been exposed to unsafe and unsanitary living conditions. However, Hastings' board of directors stated that its intent is to meet all state standards.

RECOMMENDATIONS

We recommend that Hastings' board of directors fulfill its commitment to ensure that all appropriate property inspections required by state law are routinely performed and that all identified deficiencies are corrected.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,


THOMAS W. HAYES
Auditor General

Date: October 27, 1986

Staff: William S. Aldrich, Audit Manager
Mark Lowder
Ann Campbell



UNIVERSITY OF CALIFORNIA
HASTINGS COLLEGE OF THE LAW

Chairman
HAROLD S. DOBBS

October 20, 1986

PERSONAL & CONFIDENTIAL

Mr. Thomas W. Hayes
Auditor General
State of California
Office of the Auditor General
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Hayes:

In response to your letter of October 3rd, enclosing your confidential draft report entitled "Hastings College of the Law Needs To Improve the Management of Its Real Property" I am enclosing herewith a detailed statement in response and opposition to your draft report on behalf of The Board of Directors and the Dean of Hastings.

I was requested by your staff to meet and discuss this letter and the enclosed response of Hastings before it is released, which I together with the Dean and General Counsel will do later today in the office of the Dean at Hastings.

In addition to the facts set forth in the enclosed Hastings response, I would like to call your attention to six (6) items of misstatement which we believe should be eliminated. The items are the following:

1. Page S-3. The statement "as of September 6 Hastings had not paid any principal or interest . . . etc". As noted below, the statement is untrue and should be deleted. ①*
2. Page 1. The concluding sentence of the second paragraph -- "the board of directors is currently considering a clarification . . . etc." is untrue. Although we are

*The Auditor General's comments on specific points contained in Hastings College of the Law's response begin on page 45.

always interested in methods of cooperation with the University it is untrue that we are currently considering a clarification with the Board of Regents. (2)

3. Page 4. The first paragraph refers to the McKeon case and should be corrected to reflect the reversal in favor of Hastings. (3)

4. Page 4. The penultimate sentence in the first paragraph on page four refers to Hastings' proposed project as including commercial space. This is misleading simply because all space will be used only for governmental office space and not commercial uses. (4)

5. Page 10. The first paragraph on page ten attributes comments to the Dean which are specifically disavowed. They were not made by him. They should be deleted. (5)

6. Page 13. The first paragraph on page 13 refers to the Dean's report of an \$82,708.00 payment. The information attributed to the Director of Administrative Services is inaccurate and denied. The paragraph should be deleted or rewritten to reflect the fact that Hastings did in fact pay \$82,708.00 on these accounts. (1)

The aforementioned items are misstatements unsupported by facts and should be deleted or corrected.

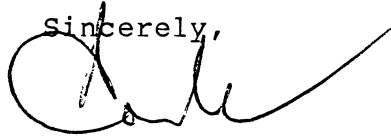
I have prepared and enclose a Statement of Particularity responding to each and all of the erroneous statements and conclusions in your report which unfairly cast a cloud upon the good name of Hastings College Of The Law as well as the entire University of California system.

This letter together with the enclosed Statement of Particularity represents our comments to your report.

Finally, I find it difficult to understand the integrity of the present audit in view of the fact, which our records clearly confirm, that your same Audit Committee requested and obtained permission from Hastings to conduct an audit in 1979 following which you made no report or comment to my knowledge. Why didn't you mention in your current draft report that in 1979 you examined the same subjects which you raise seven (7) years later in an attempt to breathe life into matters already audited?

Your failure in the current report to factually recite and cover your own failure to deal with the subject matter seven (7) years ago leaves the entire report highly suspect and questionable in my opinion. (6)

Sincerely,



Harold S. Dobbs

HSD/jm

Encs.

1655L

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cc: Ms. Mary Noble, Deputy Auditor General
cc: William S. Aldrich, Audit Manager
cc: Mark Lowder
cc: Ann Campbell
cc: Bert S. Prunty, Dean
cc: Members of the Hastings
Board of Directors
cc: Max K. Jamison, General Counsel

HASTINGS COLLEGE OF THE LAW

STATEMENT OF PARTICULARITY

In response to the information contained in the draft report of the Auditor General, I submit the following facts under the titles conforming to the report.

IA

RETENTION OF PROPERTY

The Auditor General's draft report asserts that Hastings retain properties for which it has no plans for use or development. The draft report further recommends the disposition of these properties as "surplus". The draft report implies that Hastings retention of these properties is at variance with general University of California policy against the retention of property believed to be "an imprudent investment". (page S-3). We believe these assertions and findings are inaccurate and misleading and that the recommendation of disposition is unwarranted.

Hastings owns no property in the City of San Francisco which it considers surplus or for which it has

no plans. ⑦ All properties owned by Hastings were acquired for and will be utilized in furtherance of the legitimate objective of the College. This statement specifically applies to the four parcels particularized in the Auditor General's draft report.

The precise manner in which these properties will be utilized for College purposes has not yet been determined. It is clear, however, that they will aid in the fulfillment of the Board's commitment to the enhancement of the educational experience of the College, the quality of life for our students, staff and faculty and service to our community. The location of these properties in the Civic Center makes them particularly valuable in the furtherance of the objectives of a major national law school which is a member of the family of the world's most prestigious public university. Development may include (1) direct academic use; (2) ancillary use as student or faculty housing; (3) related professional use such as housing for courts; (4) the production of endowment income; or (5) a combination of the foregoing. In the past eighteen months the College has held extensive discussions with judicial officers at their request concerning the possibility of creating a courthouse on this site which would permit integration of

court and law school libraries, development of clinical and clerkship education for law students and the direct enhancement of Civic Center activities.

The assertion that these properties represent an imprudent investment is unsupportable. ⑧ Between their acquisition in the late 1970s and their appraised value in 1980 they show an appreciation of 39% or an increase over cost in the amount of \$556,858. Current appraised value of these four properties is \$5,200,000 which is 367% of their cost. The appreciation of \$2,785,858 is 167% of cost.

The Board of Directors of the College and its administration are confident that these properties represent a safe and sound investment and that they should and will be retained in furtherance of College purposes. ⑨

I-B

Manner of Acquisition

Many pages of the draft report of the Auditor General are devoted to a detailed historical discussion of funding sources and the manner of acquisition of some

Hastings properties.

These are matters that have been addressed by the Board of Directors on a continuous basis since mid-1979.

Substantial attention is directed in the draft report to the fact that some non-state funds held by Hastings were invested in real estate. These monies represent funds classified as "Endowment Funds", "Loan Funds", "Restricted Current Funds", and "Unrestricted Current Funds". While the draft report concedes the propriety of such use of restricted funds, it seeks to challenge this investment on the grounds that it was not for income producing properties.⁽¹⁰⁾ This analysis completely ignores the fact that when the Board first learned of the expenditures the plans to create a plaza on the property had been officially abandoned and the property was indeed held as an investment.⁽¹¹⁾

At this very time i.e. 1979 the Auditor General requested Hastings to permit his office to audit Hastings' non-state funds.⁽⁶⁾

That permission was promptly granted in an Executive meeting of December 14, 1979, page 198, "The Board reaffirmed its earlier decision to cooperate fully with the Auditor General and instructed the General Counsel of Hastings to so inform the Auditor General." On January

4, 1980 the General Counsel advised the Auditor General as follows: At its December 14, 1979 meeting, the Board of Directors "directed that I inform you that your request is granted and that the administration of the College as well as the Board of Directors will do everything possible to assist your auditors with this project." The project referred to was for an audit of all of the College non-state funds including funds consisting of scholarships, loans and endowments.

Thus in 1979 at the specific request of the Legislative Committee each and all of the various matters set forth in the current Auditor General's report were available to the Auditor General. The Auditor General now attempts to breathe life into an old issue in which its own office undertook an investigation seven years ago. The Auditor General does this in spite of the fact that the Auditor General was specifically invited to examine the entire record including the Board Minutes and Special Audit that was done for the Board by Deloitte, Haskins and Sells in mid-1979! (6)

It is the judgment of the Hastings Board that the restricted funds invested in its real properties are entirely secure and they are experiencing a more than satisfactory appreciation for the protection of our

students and for the fulfillment and the enhancement of the wishes of the donors of these funds. (12)

During the period of this appreciating investment sources of support for the financial needs of our students were developed to more than offset the accruals on the reinvestment of the original funds. In the past few years alone we have succeeded in increasing our endowed scholarship accounts by cash contributions of over \$200,000 and distributable scholarship income by more than \$100,000. (13) Since 1977 the total assistance available to students at Hastings from all sources has increased by 150%. Non-repayable grants have increased by 123% while loan assistance has increased by 157%. The annual amount of College administered scholarships has remained fairly stable in these years averaging \$76,534 per year with a 37% variable. On the other hand, scholarships from outside organizations has averaged \$57,496 per year with an 88% variable.

Future students at Hastings will benefit from these investments, and past students have suffered no detriment. (14) The individual need figure of our students as determined by the United States Department of Education has been met as documented through the Graduate and Professional School Financial Aid Service.

No Hastings' students have at any time been deprived of funds available to students under the various student aid programs. The fact that some of Hastings' funds for student aid were invested in long-term investments rather than in investments that would return current funds has not resulted in any diminution in the average amount of student aid nor in the total amounts available to students.

II

State Health and Safety Standards

We find most of the material set forth in this section of the draft report of the Auditor General to be irrelevant to current conditions at the College. We do not believe that any of our buildings are maintained in a substandard manner or that occupants of our buildings are subjected to unsafe and unsanitary conditions. All Hastings buildings are inspected by the Office of the State Fire Marshal and no building fails to meet the State standards enforced by that office. (15)

The Board of Directors of the College, however, is aware of the need to regularize and improve the process

of inspection of College buildings to insure full and continued compliance with all applicable standards for the protection of the health, safety and welfare of the occupants of Hastings buildings and the preservation of the buildings themselves. As stated in in the Auditor General's draft report the Auditor General has been informed of the intent of the Board and its full commitment to meet all State standards for its facilities.

In furtherance of the above commitment, the administration of the College on September 24 met with Mr. Donald Birrer, Director of Public Works, Mr. Frank H. Moss, Jr., Deputy Director for Engineering/City Engineer and Mr. Franklin Lew, S.E., Superintendent, Bureau of Building Inspection. At this meeting, the administration of the College informed the above mentioned City officials that the College was formally requesting cooperation of the appropriate City officials in effectuating proper inspection of College facilities. City officials expressed willingness to cooperate with the College in this undertaking and an agreement is now being drafted for that purpose. It is our intent that under this agreement the City inspection services will be granted access to College facilities for the purpose of

determining compliance with all State standards and that the College will be notified of any deficiencies discovered. It is our further intent to insure that any identified deficiencies will be corrected as soon as possible.

We will be pleased to forward to the Auditor General a copy of that agreement when it has been executed.

A handwritten signature in black ink, appearing to read 'H. S. Dobbs', with a long, sweeping flourish extending to the right.

Harold S. Dobbs

Chairman of the Board

HSD/jm

1656L

**AUDITOR GENERAL'S COMMENTS ON THE
HASTINGS COLLEGE OF THE LAW'S RESPONSE**

In its response to our report, Hastings charges that we make erroneous statements and conclusions that unfairly cast a cloud upon Hastings as well as the University of California. Hastings also challenges the integrity of the Office of the Auditor General. We strongly disagree with Hastings' response, and we stand by the major finding of our report: Hastings has retained four pieces of property that it does not plan to develop for academic use and that it acquired through the improper use of restricted funds. Since Hastings used restricted funds to purchase these and other properties and has failed to repay all of these funds, over \$820,000 of endowment income has not been available for scholarships and student loans.

After reviewing Hastings' response, we made five minor changes to our report to reflect information provided by Hastings since our fieldwork ended. Listed below are the detailed reasons for our disagreement with specific points of Hastings' response.

- ① Hastings' comments in these two sections refer to the repayment of restricted funds used to acquire real property. We state on page 13 of our report that the dean reported to the board of directors in June 1984 that \$70,000 had been paid on the restricted fund debt. We obtained this information from the board of director's minutes of June 15, 1984. Hastings now contends that the amount reported by the dean to the board of directors in June 1984 was \$82,708.

Although the director of administrative services told us on September 5, 1986, that Hastings had not repaid any of the principal or interest to the restricted fund accounts, Hastings now contends that the director was referring only to the last two fiscal years. On October 20, 1986, Hastings provided us with additional documentation to support its claim that it has repaid \$82,708 to the restricted funds. Our review of this documentation indicates that Hastings has repaid only \$75,170 to the restricted funds. The text of our report has been changed to reflect this repayment. Hastings' records as of October 18, 1986, indicate that the amount of unpaid principal is \$1.05 million. This amount is the same as the original principal amount identified by the certified public accountant firms of Deloitte, Haskins, and Sells in its fiscal year 1978-79 audit and by Peat, Marwick, Mitchell and Company in its fiscal year 1984-85 audit.

- ② Hastings contends that it is untrue that it is currently considering a clarification of its affiliation with the University of California. Our statement is based on a September 5, 1986, interview with Hastings' general counsel. Hastings has attempted to clarify this relationship before, as indicated by the board of directors' resolution on September 22, 1978, and the subsequent

letter from their general counsel to the Office of the Attorney General on November 14, 1978. However, the statement has been deleted in accordance with Hastings' request.

- ③ Text changed to reflect the reversal of the McKeon judgement on September 22, 1986.
- ④ Hastings contends that all space in the planned Golden Gate building will be used for governmental offices only. Nevertheless, Hastings' Draft Environmental Impact Report states that the building will be leased for governmental and, to a lesser extent, commercial uses. We have changed the text to reflect a minor commercial use of this building.
- ⑤ The statement that the dean "disavows" was made to the audit team by the dean on July 8, 1986, in a meeting to inform the dean of the areas we planned to audit. On October 21, 1986, the chairman of the board of directors and the general counsel amplified on Hastings' policy. However, this amplification, which we have included in our report, reiterates the dean's original contention that Hastings exercises its own judgment on the retention or sale of its properties.
- ⑥ The 1979 "audit" that the chairman refers to was never performed. At that time, our office was performing revenue-sharing audits of all state agencies and departments on behalf of the U.S. Department of Treasury. Although Hastings' fiscal year 1976-77 operations had been audited by the State's Department of Finance in 1978, the U.S. Department of Treasury was initially unwilling to accept the Department of Finance's audit in fulfillment of the audit requirement. As a result, we notified Hastings that we would have to perform financial audit work for the year ended June 30, 1979. Hastings initially rejected our attempts to gain access to its accounting records, and the board minutes that the chairman refers to reflect the deliberation over our authority to review Hastings' records.

After fewer than ten days of audit fieldwork, the Department of Treasury notified us that the 1978 Department of Finance's audit of Hastings for fiscal year 1976-77 would be acceptable to them, so we notified Hastings that no audit would be necessary and we left.

At no time during the short preliminary audit work we performed did we have an opportunity to review any of the accounting records relating to restricted funds, nor did Hastings provide us with a copy of the Deloitte, Haskins, and Sells audit report that identified the improper expenditures.

- ⑦ When we state that Hastings has no plans for these properties, we mean that Hastings has not determined how it will use these properties. Hastings confirms this fact in the first sentence of the next paragraph of its response by stating that it has not yet determined how it will use these properties. Furthermore, as we state on page 9, "Our review of the board of directors' minutes

from December 1970 through March 1986 found no evidence that the board has made any decision to develop these properties as part of the law school."

- ⑧ Hastings claims that we assert that these properties represent an imprudent investment. We do not state that Hastings' use of restricted funds to acquire these properties was an investment, imprudent or otherwise. The board never made a deliberate decision to invest restricted funds in real estate. As we report on page 18, the chairman of Hastings' board of directors and Hastings' general counsel, who is a former board member, stated that the previous dean used the restricted funds to acquire property without the board's knowledge. This property was acquired for the Hastings Law Center project; it was not acquired as an investment. When the board of directors determined that these funds had been used to acquire these properties, the board decided to treat these funds as a loan by deciding to repay the funds at 7 percent simple interest. In our review of the board of directors' minutes from December 1970 through March 1986, we found no evidence that the board has made any commitment to pay the restricted funds any capital gain that Hastings may realize on the properties. In fact, since 1979, Hastings has repaid only \$75,170 to these funds. This is one of the reasons that over \$820,000 was not available for scholarships and student loans from fiscal year 1978-79 through fiscal year 1985-86.
- ⑨ Although Hastings now believes that these properties represent a safe and sound investment, as we point out on page 9, Hastings' expenses for these properties since July 1, 1981, have exceeded the income they have generated by \$142,933. On page 10, we recognize that the properties have appreciated in value. On page 20, we recommend that Hastings sell the four pieces of property and, on page 21, we recommend that Hastings repay the principal and accumulated interest on the restricted funds.
- ⑩ The report does not concede that it is proper to use all restricted funds for investment in property. On page 12, we specify that the use of income from endowment funds for this purpose is clearly improper.
- ⑪ As we state in Comment 8 above, the board did not make a deliberate decision to invest restricted funds in property. When the board became aware of the improper use of the restricted funds, it decided to treat the use of the funds as a loan by repaying these funds with 7 percent simple interest.
- ⑫ Hastings states that the appreciation of these properties will benefit the potential recipients and donors of these restricted funds. As we have stated in Comment 8, Hastings' board has committed itself to pay the restricted funds 7 percent simple interest only, not capital gains. Furthermore, as we state on page 18, we believe that by using restricted funds for purposes other than those designated by the donors, Hastings may have breached its fiduciary responsibility.

- ⑬ Hastings claims that it has increased its distributable scholarship income by more than \$100,000. On page 14, we report that we identified a total of over \$820,000 in income from endowment funds that could have been available for scholarships and student loans from fiscal year 1978-79 through fiscal year 1985-86. This \$820,000 could have been available in addition to the \$100,000 in distributable scholarship income discussed here.
- ⑭ Hastings claims that future students will benefit from these "investments" and that past students have suffered no detriment. Students do not realize maximum benefit from an "investment" in property whose appreciation does not accrue to its student financial aid accounts and which accrues only 7 percent simple interest as its financial return.
- ⑮ Hastings states that its buildings are not "unsafe" or "unsanitary," that they are inspected by the Office of the State Fire Marshal, and that no building fails to meet the state standard enforced by that office. As we state on page 27, the Office of the State Fire Marshal does not inspect for compliance with all structural, health or sanitation requirements, only with those related to fire safety.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps