CONSTRUCTION

CALIFORNIA STATE POLYTECHNIC UNIVERSITY, POMONA

COLLEGE OF BUSINESS ADMINISTRATION

Audit Report 13-11
August 6, 2013

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ABBREVIATIONS

AVP  Associate Vice President
BOT  Board of Trustees
Cal Poly  California State Polytechnic University
CM  Construction Manager
CM at Risk  Construction Manager at Risk
COBA  College of Business Administration
CPDC  Capital Planning, Design and Construction
CRB  Certification Review Board
CSU  California State University
EO  Executive Order
FPM  Facilities Planning and Management
GMP  Guaranteed Maximum Price
ICSUAM  Integrated California State University Administrative Manual
LEED  Leadership in Energy and Environmental Design
OUA  Office of the University Auditor
EXECUTIVE SUMMARY

At its January 2013 meeting, the Board of Trustees directed the Office of the University Auditor (OUA) to review construction activity. Construction auditing had been performed by KPMG since fiscal year 1997/98 with coordination from the OUA. In fiscal year 2008/09, OUA staff began performing construction audits.

We visited the California State Polytechnic University (Cal Poly), Pomona campus and the offices of the construction manager and selected subcontractors from May 15, 2013, through June 14, 2013, and audited the College of Business Administration (COBA) project focusing on the construction management policies and procedures and internal controls and processes in effect at that time.

In our opinion, the fiscal, operational, and administrative controls in effect for the COBA project were sufficient to meet the objectives stated in the “Purpose” section of this report.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

The following summary provides management with an overview of conditions requiring attention. Areas of review not mentioned in this section were found to be satisfactory. Numbers in brackets [ ] refer to page numbers in the report.

CONSTRUCTION MANAGEMENT AND ACCOUNTING [6]

Contractor monthly payment applications were not always properly approved. Further, the campus did not request certified payroll records and hourly labor rate worksheets for each subcontractor, which prevented the verification of wage rates for change order work. In addition, Group II equipment was not always properly tagged.

CHANGE ORDER ADMINISTRATION [8]

Change orders were not always approved according to authorized dollar thresholds. In addition, an inflated labor burden rate charged by one trade subcontractor increased labor costs by $2,426.
INTRODUCTION

BACKGROUND

In May 2007, the Board of Trustees (BOT) approved schematic plans for the California State Polytechnic University (Cal Poly), Pomona College of Business Administration (COBA) project at a cost of $42,461,000, with funding from a combination of state and non-state sources, including donations from foundations and private donors, the 2007/08 Governor’s budget, and the Higher Education Capital Outlay Bond Fund of 2006.

In September 2006, the campus executed an agreement with the architectural firm of AC Martin Partners, Inc., for services related and incidental to the design and construction of the COBA project. It also executed an agreement with the construction manager (CM), CW Driver, Inc., for pre-construction services that included design and bid phase services. In October 2010, the campus executed a guaranteed maximum price (GMP) agreement with the CM for construction phase services, at a construction cost of $30,306,102, and issued a Notice to Proceed on February 10, 2010, with a completion date of February 10, 2012. The campus filed the Notice of Completion on February 10, 2012.

The COBA project is a new three-building complex: Buildings 162, 163, and 164, totaling approximately 74,500 gross square feet. Buildings 162 and 163 are one-story and two-story concrete masonry buildings, respectively, and Building 164 is a three-story steel frame plastered structure for faculty and administration. The placement of these three buildings create an exterior landscaped courtyard, which serves as a pre-function gathering space, quiet study space, and special-occasion meeting space for the college. Building 162 includes two large lecture rooms, and Building 163 has five-station case-study classrooms, computer classrooms, large lecture classrooms, and conference rooms. Building 164 provides faculty and department offices, conference and multi-purpose rooms, and support spaces, along with a food services facility on the ground floor. The complex has installed state-of-the-art Learning Centered Technology Initiative equipment in all instructional and lecture classrooms. The project achieved a Leadership in Energy and Environmental Design (LEED) silver rating. LEED is a third-party certification program begun in 1999 by the United States Green Building Council and is a nationally accepted benchmark for the sustainable “green” design, construction, and operation of buildings.

The Cal Poly, Pomona campus managed the COBA project, and it chose the Construction Manager at Risk (CM at Risk) with GMP delivery method. In this method, a construction management firm chosen by a competitive bidding process provides all or significant portions of design and construction administrative services and takes part in establishing the GMP. The CM at Risk acts as the general contractor during construction, assumes the risk of subcontracting the work, and guarantees completion of the project. The liability for the success in completing the project on time and in budget lies with the construction manager, and not with the university. Further, there is a potential for cost savings should the project be completed below the GMP.

Executive Order (EO) 672, Delegation of Capital Outlay Management Authority and Responsibility, dated July 25, 1997, delegates to campus presidents the authority to manage directly state and non-state funded capital outlay projects. The chancellor’s office issues this delegated authority to the campus subject to its compliance with the capital outlay certification procedure. To comply, the campus submits
a request for Delegation of Capital Outlay Management Authority to the Certification Review Board (CRB) for review. Then the executive vice chancellor and chief financial officer in the chancellor’s office must approve the request. The campus president is responsible for ensuring that he or she exercises delegated authority in compliance with applicable statutes, regulations, and policies of the BOT; the campus manages capital projects via a process consistent with the provisions of the Integrated California State University Administrative Manual (ICSUAM); and the campus has in place appropriate internal controls and processes to ensure that responsibilities are carried out in a manner consistent with the campus capital outlay management plan submitted with the request for delegated authority.

The certification procedure required by EO 672 includes submission of a capital outlay management plan, which defines the campus organizational and operational structure and expenditure authority, and serves as the campus policies and procedures for the administration of construction activities. Updated plans are to be submitted when campus operational structure changes are made that impact the plan. Certification is continuous unless a Capital Planning, Design and Construction (CPDC) post-project performance review determines that problems were caused by campus negligence, in which case the CRB may recommend that the campus be placed on probation. The CRB may ultimately recommend that certification be withdrawn if identified operational/management deficiencies are not remedied.

For those campuses that are not certified, the chancellor’s office may execute a Memorandum of Delegation for a capital outlay project, which delegates administration, including construction management, to the campus. The CPDC construction management unit may also perform construction administration and management.

EO 666, *Delegation of Professional Appointments Related to Capital Outlay Projects and Campus Physical Development*, dated March 7, 1997, delegates the authority to each campus president or designee to make all professional appointments relative to capital outlay projects and campus physical development. Further, the campus president or designee is responsible for ensuring compliance with all applicable statutes and regulations, BOT policies, and ICSUAM guidelines; and the use of systemwide standardized architectural, engineering, and other professional appointment contract forms.

The ICSUAM, in part, contains an overview of all CPDC policies and procedures associated with the capital outlay process. ICSUAM §9700 through §9843, *Construction Management for Public Works Contracts*, describe the requirements for preparing and administering public works contracts under the provisions of Public Contract Code §10700 et seq. ICSUAM §9200 through §9212, *Professional Services for Campus Development*, describe the requirements for developing and administering professional services agreements with service providers such as architects and engineers and for testing services and project-related studies.

The California State University (CSU) *Construction Management Procedures Manual* contains the CSU construction management policies and procedures that apply to a project, and each construction administrator, project manager, inspector of record, campus representative, and design professional is required to use this manual as appropriate during the construction administration of a project.
PURPOSE

The overall audit objective was to ascertain the effectiveness of construction management policies and procedures and internal controls and processes related to the administration of construction activities and, specifically, the COBA project.

Within the overall audit objective, specific goals included determining whether:

- Delegated authority to manage capital outlay projects exists, and the campus capital outlay management plan is current for campus-managed projects.

- Project development is in accordance with statutory and CSU policy requirements, including required BOT and CPDC approvals.

- Administration and management of the project provide effective internal controls and processes consistent with the campus capital outlay management plan and the ICSUAM.

- Professional appointments are in accordance with statutory requirements, BOT policy, and the ICSUAM; and systemwide standardized professional appointment contract forms are used, approved by the Office of General Counsel, and fully executed prior to performance of work.

- Extra services are appropriate, authorized, and separately tracked; and an evaluation is performed for each professional service provided.

- The bidding process is rigidly controlled, performed in accordance with statutory requirements and the ICSUAM, and incorporates the contract documents maintained on the CPDC website.

- Contract documents are complete, routed to the Office of General Counsel as appropriate, and timely executed; required contract bonds and insurance are received; and a Notice to Proceed is issued.

- Subcontractors are adequately monitored, and requests for subcontractor substitutions are handled in accordance with statutory requirements and the ICSUAM.

- Operational and administrative controls ensure maintenance of financial accountability and completion of the project within the approved scope, schedule, and budget.

- Contract and service agreement payments are adequately supported, appropriately approved, and timely paid; and retention is handled in accordance with statutory requirements and the ICSUAM.

- Group II equipment is properly managed and accounted for, purchased materials meet specifications required by construction documents and drawings, and all required inspections and tests are timely and properly performed and adequately documented.
Change orders are appropriately approved, supported, accurately priced, and sufficiently tracked; and construction allowances and contingency balances are adequately administered and controlled.

Project completion is adequately administered, including completion of pre-final/final inspections, punch list items, project closeout checklist, and Notice of Completion; preservation of project files, equipment manuals/warranties, and spare parts/materials; and resolution of any liquidated damages.

SCOPE AND METHODOLOGY

The scope of audit included, but was not limited to, the review of design budgets and costs; the bid and award process; invoice processing and payment; change orders; construction management, architectural, and engineering services; use of major equipment/materials; the closeout process; administration of liquidated damages; and overall project cost accounting and reporting. This included any transactions or activity performed by the campus, construction management firm, and trade subcontractors.

Our study and evaluation were conducted in accordance with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors, and included the audit tests we considered necessary in determining whether fiscal, operational, and administrative controls are in place and operative. This review emphasized, but was not limited to, compliance with state and federal laws, BOT policies, and Office of the Chancellor and campus policies, letters, and directives.

We focused primarily on the operational and administrative controls in effect for the COBA project with an emphasis on compliance with the CSU Construction Management Procedures Manual, ICSUAM policies and procedures associated with the capital outlay process, the campus capital outlay management plan, and construction contract general conditions. We evaluated the effectiveness of construction management policies and procedures and adequacy of internal controls and processes, and sought opportunities for improvement to further the success of CSU’s capital outlay program.

Specifically, we reviewed and tested:

- Delegation of construction management authority.
- Review and approval of project design, budget, and funding.
- Professional services agreements and any extra services changes.
- Administration of the bid and award process.
- Contract execution and required contract bonds and insurance.
- Subcontractors and subcontractor substitutions.
- Contract and service agreement payment processing.
- Procurement of major equipment and materials.
- Performance of required inspections and tests.
- Review, approval, and tracking of change orders.
- Direct labor and associated burden.
- Construction management and overall project cost accounting and reporting.
- Construction allowances and contingency balances.
- Administration of the project closeout process and resolution of any liquidated damages.
OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES

CONSTRUCTION MANAGEMENT AND ACCOUNTING

MONTHLY PAYMENT APPLICATIONS

Contractor monthly payment applications were not always properly approved.

We reviewed 25 monthly payment applications, and we found that three were not approved by the campus construction administrator.

Integrated California State University Administrative Manual (ICSUAM) §9803, Contract Payment Procedures, states that the construction administrator must approve all monthly partial payments to the contractor and all other project costs.

The associate vice president (AVP) of facilities planning and management (FPM) stated that the campus had not obtained the construction administrator’s approval due to oversight.

The absence of proper approvals on contractor payment applications increases the risk of misunderstandings and miscommunication regarding rights and responsibilities.

Recommendation 1

We recommend that the campus reiterate to staff that contractor monthly payment applications must be approved by the construction administrator.

Campus Response

We concur. We will reiterate requirements to staff that contractor monthly payment applications must be approved by the construction administrator.

Timeline: January 8, 2014

CERTIFIED PAYROLL RECORDS

Administration of project certified payroll records required improvement.

We reviewed certified payrolls and hourly labor rate worksheets submitted to the campus, and we found that:

- The campus did not request or receive certified payroll records from 23 subcontractors.
- The campus did not request certified payroll records and hourly labor rate worksheets for change order work performed by second-tier subcontractors, and therefore it could not verify wage rates for change order work submitted under the direction of one subcontractor.
ICSUAM §9824.01, *CSU Request for Certified Payroll*, states that the construction administrator shall request a minimum of the first week’s certified payroll records from the general contractor and a minimum of the first week’s certified payroll records from each subcontractor of any tier. Having certified payroll, along with the hourly labor rate worksheet, will allow verification of payment of prevailing wage rates and will allow a check on wage rates submitted for change order work.

The FPM AVP stated that certified payroll records and hourly labor rate worksheets were not obtained due to a misinterpretation of the requirements under ICSUAM §9824.01.

The lack of certified payrolls and hourly labor rate worksheets prevents verification of wage rates submitted for change order work and may result in the campus being charged excess labor costs.

**Recommendation 2**

We recommend that the campus reiterate to staff that certified payroll records and hourly labor rate worksheets for subcontractors in all tiers should be requested and used to verify payment of prevailing wage rates and wage rates submitted for change order work.

**Campus Response**

We concur. We will reiterate to staff that certified payroll records and hourly labor rate worksheets for subcontractors in all tiers should be requested and used to verify payment of prevailing wage rates and wage rates submitted for change order work.

**Timeline: January 8, 2014**

**GROUP II EQUIPMENT**

Group II equipment, including sensitive or high-risk equipment and capitalized property with an acquisition cost of more than $5,000, was not always tagged with a unique identification number.

Specifically, we found that furniture valued at more than $5,000 and flat screen monitors, deemed as sensitive equipment, were not tagged with a campus unique identification number.

The Cal Poly, Pomona *Asset Management Inventory Procedures* states that all capital assets will be tagged with a campus identification tag. In addition, all sensitive or high-risk assets will be tagged with a campus identification tag.

ICSUAM §3151.04, *Equipment*, dated January 1, 2011, states that equipment with total acquisition cost of $5,000 or greater and a useful life of at least one year must be capitalized, tagged and recorded in the campus property inventory records and included in the campus’ financial statements prepared in accordance with generally accepted accounting principles.
The AVP of finance and administrative affairs and associate chief financial officer stated that current campus procedures do not require furniture to be tagged with a campus identification tag. He further stated that the campus did not tag sensitive or high-risk assets due to oversight.

Insufficient control over equipment increases the risk of misstated property records and theft, loss, or unauthorized use of state property.

**Recommendation 3**

We recommend that the campus properly tag all Group II equipment, including sensitive or high-risk equipment and capitalized property with an acquisition cost of more than $5,000, with a unique identification number.

**Campus Response**

We concur. The campus will tag all Group II equipment, including sensitive or high-risk equipment and capitalized property with an acquisition cost of more than $5,000 per individual item, with a unique identification number.

Timeline: September 30, 2013

**CHANGE ORDER ADMINISTRATION**

**APPROVAL**

The final change order, for a total credit amount of $798,039, did not include the vice president of administration’s approval, as required by the campus delegation of authority.

The Cal Poly, Pomona Capital Outlay Management Plan, dated September 9, 2011, states that approval by the vice president of administration is required for change orders exceeding $100,000.

The FPM AVP stated that the campus did not obtain the vice president of administration’s approval on this particular change order due to oversight.

Inadequate approval on change orders increases the risk that errors and irregularities will not be detected in a timely manner and may result in unwarranted changes and excess charges and expenses.

**Recommendation 4**

We recommend that the campus reiterate to staff that change orders must be approved according to authorized dollar thresholds.
Campus Response

We concur. We will reiterate to staff that change orders must be approved according to authorized dollar thresholds.

Timeline: January 8, 2014

LABOR RATES AND BURDEN

Administration of trade subcontractor labor rates and associated labor burden needed improvement.

We reviewed hourly labor rates and the associated labor burden charged by two subcontractors for a sample of change orders, and we found that one subcontractor charged an inflated labor rate and labor burden rate for federal insurance contribution payments. The inclusion of these inflated rates increased the labor cost for this trade subcontractor by $2,426.

The Contract General Conditions for Construction Manager (CM) at Risk with Guaranteed Maximum Price Projects §6.01.b (1) states that the CM and trade contractors shall submit a fully detailed breakdown of the cost of every labor classification to be utilized on a proposed change on the hourly labor rate worksheet. The unit cost of labor shall be an accurate accounting of actual costs being paid.

The FPM AVP stated that the construction management firm should have reviewed the labor rate and labor burden components before submitting the change orders to the campus.

Insufficient review of hourly labor rates and the associated labor burden charged to the project may result in increased project costs.

Recommendation 5

We recommend that the campus:

a. Pursue recovery of the $2,426 in inflated labor costs charged by the trade subcontractor and determine, as appropriate, if other change order work performed by the subcontractor was cost-inflated in a similar manner. The results of this recovery should be reported to the chancellor’s office capital planning, design and construction department.

b. Conduct staff training to ensure that hourly labor rates and the associated labor burden charged by trade subcontractors are properly reviewed and accurate in accordance with §6.00, Changes in the Work, of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects.
Campus Response

We concur. The campus will pursue recovery of the $2,426 in inflated labor costs charged by the trade subcontractor and conduct staff training to ensure that hourly labor rates and the associated labor burden charged by trade subcontractors are properly reviewed and accurate in accordance with §6.00 of the *Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects*.

Timeline: January 8, 2014
# APPENDIX A:
PERSONNEL CONTACTED

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
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<tbody>
<tr>
<td>Office of the Chancellor</td>
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<tr>
<td>James Hoffman</td>
<td>Chief of Construction Management</td>
</tr>
<tr>
<td>Elvyra San Juan</td>
<td>Assistant Vice Chancellor, Capital Planning, Design and Construction</td>
</tr>
<tr>
<td>California State Polytechnic University, Pomona</td>
<td></td>
</tr>
<tr>
<td>J. Michael Ortiz</td>
<td>President</td>
</tr>
<tr>
<td>Anita Aguirre</td>
<td>Administrative Analyst, Procurement and Support Services</td>
</tr>
<tr>
<td>Edwin Barnes</td>
<td>Vice President, Administrative Affairs/Chief Financial Officer</td>
</tr>
<tr>
<td>Chi Kwan Fong</td>
<td>Campus Sustainability and Capital Programs Manager, Facilities Planning, Design and Construction</td>
</tr>
<tr>
<td>Dan Johnson</td>
<td>Director, Facilities Planning, Design and Construction</td>
</tr>
<tr>
<td>Darwin Labordo</td>
<td>Associate Vice President, Finance and Administrative Affairs and Associate Chief Financial Officer</td>
</tr>
<tr>
<td>Darrick Lackey</td>
<td>Capital Outlay Accountant, Facilities Planning, Design and Construction</td>
</tr>
<tr>
<td>Walter Marquez</td>
<td>Associate Vice President, Facilities Planning and Management</td>
</tr>
<tr>
<td>Ted Nakasuji</td>
<td>Campus Inspector of Record</td>
</tr>
<tr>
<td>Candace Snodgrass</td>
<td>GAAP and Tax Manager, Finance and Administrative Services</td>
</tr>
<tr>
<td>Al Viteri</td>
<td>Director, Accounting Services</td>
</tr>
<tr>
<td>Joice Xiong</td>
<td>Director of Internal Audit</td>
</tr>
</tbody>
</table>
August 26, 2013

Mr. Larry Mandel, University Auditor
Office of the Auditor
The California State University
400 Golden Shore, Suite 210
Long Beach, CA 90802

Dear Mr. Mandel:

Subject: Campus Response to Recommendations of College of Business Administration 13-11

Enclosed is California State Polytechnic’s campus response to the College of Business Administration 13-11. We appreciate the effort you and your staff have made to indicate areas where our procedures or internal controls could be strengthened. We will take the necessary actions to address the report’s recommendations.

Please direct questions concerning the response to Darwin Labordo, Associate Vice President of Finance and Administrative Services and Associate Chief Financial Officer at 909-869-2008 or dlabordo@csupomona.edu.

Sincerely,

[Signature]

Edwin A. Barnes, III, Vice President
Administrative Affairs

Cc: J. Michael Ortiz, President
Darwin Labordo, Associate Vice President, Finance & Administrative Services
Walter Marquez, Associate Vice President, Facilities, Planning and Management
Kathleen Prunty, Director, Procurement & Support Services
Joice Xiong, University Auditor

Enclosure
CONSTRUCTION MANAGEMENT AND ACCOUNTING

MONTHLY PAYMENT APPLICATIONS

Recommendation 1

We recommend that the campus reiterate to staff that contractor monthly payment applications must be approved by the construction administrator.

Campus Response

We concur. We will reiterate requirements to staff that contractor monthly payment applications must be approved by the construction administrator.

Timeline: January 8, 2014

CERTIFIED PAYROLL RECORDS

Recommendation 2

We recommend that the campus reiterate to staff that certified payroll records and hourly labor rate worksheets for subcontractors in all tiers should be requested and used to verify payment of prevailing wage rates and wage rates submitted for change order work.

Campus Response

We concur. We will reiterate to staff that certified payroll records and hourly labor rate worksheets for subcontractors in all tiers should be requested and used to verify payment of prevailing wage rates and wage rates submitted for change order work.

Timeline: January 8, 2014
GROUP II EQUIPMENT

Recommendation 3

We recommend that the campus properly tag all Group II equipment, including sensitive or high-risk equipment and capitalized property with an acquisition cost of more than $5,000, with a unique identification number.

Campus Response

We concur. The campus will tag all Group II equipment, including sensitive or high-risk equipment and capitalized property with an acquisition cost of more than $5,000 per individual item, with a unique identification number.

Timeline: September 30, 2013

CHANGE ORDER ADMINISTRATION

APPROVAL

Recommendation 4

We recommend that the campus reiterate to staff that change orders must be approved according to authorized dollar thresholds.

Campus Response

We concur. We will reiterate to staff that change orders must be approved according to authorized dollar thresholds.

Timeline: January 8, 2014

LABOR RATES AND BURDEN

Recommendation 5

We recommend that the campus:

a. Pursue recovery of the $2,426 in inflated labor costs charged by the trade subcontractor and determine, as appropriate, if other change order work performed by the subcontractor was cost-inflated in a similar manner. The results of this recovery should be reported to the chancellor’s office capital planning, design and construction department.

b. Conduct staff training to ensure that hourly labor rates and the associated labor burden charged by trade subcontractors are properly reviewed and accurate in accordance with §6.00, Changes in the Work, of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects.
Campus Response

We concur. The campus will pursue recovery of the $2,426 in inflated labor costs charged by the trade subcontractor and conduct staff training to ensure that hourly labor rates and the associated labor burden charged by trade subcontractors are properly reviewed and accurate in accordance with §6.00 of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects.

Timeline: January 8, 2014
September 13, 2013

MEMORANDUM

TO: Mr. Larry Mandel
   University Auditor

FROM: Timothy P. White
       Chancellor

SUBJECT: Draft Final Report 13-11 on the College of Business Administration, California State Polytechnic University, Pomona

In response to your memorandum of September 13, 2013, I accept the response as submitted with the draft final report on the College of Business Administration, California State Polytechnic University, Pomona.

TPW/amd