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November 19, 2015

Mr. Keith B. Petersen
SixTen and Associates
P.O. Box 340430
Sacramento, CA 95834-0430

Ms. Jill Kanemasu
State Controller's Office
Accounting and Reporting
3301 C Street, Suite 700
Sacramento, CA 95816

And Parties, Interested Parties, and Interested Persons (See Mailing List)

Re: **Proposed Decision**
Notification of Truancy, 07-904133-I-05 and 10-904133-I-07
Education Code Section 48260.5
Statutes 1983, Chapter 498
Fiscal Years 1999-2000, 2000-2001, and 2001-2002
San Juan Unified School District, Claimant

Dear Mr. Petersen and Ms. Kanemasu:

The proposed decision for the above-named matter is enclosed for your review.

Hearing

This matter is set for hearing on **Thursday, December 3, 2015**, at 10:00 a.m., State Capitol, Room 447, Sacramento, California. Please let us know in advance if you or a representative of your agency will testify at the hearing, and if other witnesses will appear. If you would like to request postponement of the hearing, please refer to section 1187.9(b) of the Commission's regulations.

Special Accommodations

For any special accommodations such as a sign language interpreter, an assistive listening device, materials in an alternative format, or any other accommodations, please contact the Commission Office at least five to seven *working* days prior to the meeting.

Sincerely,

Heather Halsey
Executive Director

Hearing Date: December 3, 2015
J:\MANDATES\IRC\2007\[90]4133 (Not of truancy)\07-904133-I-05 (Consolidated with 10-904133-I-07)\IRC\PD.docx

ITEM 6

INCORRECT REDUCTION CLAIM

PROPOSED DECISION

Education Code Section 48260.5

Statutes 1983, Chapter 498

Notification of Truancy

Fiscal Years 1999-2000, 2000-2001, and 2001-2002

07-904133-I-05 and 10-904133-I-07

San Juan Unified School District, Claimant

EXECUTIVE SUMMARY

Overview

This consolidated Incorrect Reduction Claim (IRC) analysis addresses reductions made by the State Controller's Office (Controller) to San Juan Unified School District's (claimant's) reimbursement claims for costs incurred during fiscal years 1999-2000 through 2001-2002 under the *Notification of Truancy* program.

The following issues are in dispute:

- The statutory deadlines for initiation and completion of an audit;
- Reductions based on initial truancy notifications that the Controller concluded were sent before pupils had accumulated the required number of unexcused absences to be classified as a truant under the mandated program; and
- Whether the use of statistical sampling to support the reduction is an underground regulation, and whether the resulting reductions are arbitrary, capricious, or entirely lacking in evidentiary support.

As explained herein, staff finds that the original final audit report was timely initiated and timely completed, but that the revised audit report was not timely completed. However, the revised audit report in this case makes no reductions and reinstates some of the costs reduced in original final audit. To the extent that the revised audit moots issues raised in the IRC by reinstating claimed costs, the Commission on State Mandates (Commission) may take judicial notice of the revised audit.

Staff also finds that the Controller's reduction based on a definition of truancy in prior law[1], which was never found to impose a mandated activity, is incorrect as a matter of law. That

[1] Four or more unexcused absences or instances of tardiness, rather than the three or more unexcused absences or instances of tardiness under the law at the time costs were incurred.

definition merely defines the triggering event for compliance with the mandated program and does not itself require any mandated activities.

Further, staff finds that the Controller's statistical sampling and extrapolation calculation of reductions for pupils who did not accumulate three unexcused absences or instances of tardiness is not inconsistent with the requirement of article XIII B, section 6 that local governments are entitled to reimbursement of all costs mandated by the state nor does the Controller's application of this methodology in this instance constitute an illegal underground regulation.

The *Notification of Truancy* Program

Under California's compulsory education laws, children between the ages of six and 18 are required to attend school full-time, with a limited number of specified exceptions.[2] A pupil who accumulates a certain number of unexcused absences or instances of tardiness is deemed to be in violation of the compulsory education requirement, and is a truant.[3] Statutes 1983, chapter 498 added Education Code Section 48260.5 which specified as follows:

> (a) Upon a pupil's initial classification as a truant, the school district shall notify the pupil's parent or guardian, by first-class mail or other reasonable means, of the following:
>
> (1) That the pupil is truant.
>
> (2) That the parent or guardian is obligated to compel the attendance of the pupil at school.
>
> (3) That parents or guardians who fail to meet this obligation may be guilty of an infraction and subject to prosecution pursuant to Article 6 (commencing with Section 48290) of Chapter 2 of Part 27.
>
> (b) The district also shall inform parents or guardians of the following:
>
> (1) Alternative educational programs available in the district.
>
> (2) The right to meet with appropriate school personnel to discuss solutions to the pupil's truancy.

On November 29, 1984, the Board of Control, the predecessor to the Commission, determined that Education Code Section 48260.5, as added by Statutes 1983, chapter 498, imposed a reimbursable state-mandated program to develop notification forms and provide written notice to the parents or guardians of the truancy.[4]

Accordingly, the Board of Control's test claim decision and the parameters and guidelines adopted by the Commission found that section 48260.5 imposed a state-mandated program requiring that upon a student's classification as a truant, the school must notify the pupil's parent or guardian. At the time of the test claim decision and adoption of the parameters and

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[2] Education Code section 48200.

[3] Education Code section 48260.

[4] Exhibit G, Brief Written Statement for Adopted Mandate issued by the Board of Control on the Notification of Truancy test claim (SB 90-4133).

guidelines, section 48260, as enacted in 1976 (which was found not to impose any mandated activities), provided that a truancy occurs when a student is "absent from school without valid excuse *more than three days* or tardy in excess of 30 minutes on each of *more than three days* in one school year…"[5]

The original parameters and guidelines were adopted by the Commission on August 27, 1987, and authorized reimbursement for the one-time activities of planning implementation, revising school district policies and procedures, and designing and printing the notification forms. Reimbursement was also authorized for ongoing activities to identify pupils to receive the initial notification and prepare and distribute the notification by first class mail or other reasonable means.

The Commission amended the parameters and guidelines on July 22, 1993, effective July 1, 1992, to add a unit cost of $10.21, adjusted annually by the Implicit Price Deflator, for each initial notification of truancy distributed in lieu of requiring the claimant to provide documentation of actual costs to the Controller. The parameters and guidelines further provide that "school districts incurring unique costs within the scope of the reimbursable mandated activities may submit a request to amend the parameters and guidelines to the Commission for the unique costs to be approved for reimbursement."[6] These are the parameters and guidelines applicable to this claim.[7]

As later amended by Statutes 1994, chapter 1023 and Statutes 1995, chapter 19, section 48260 provided that a pupil would be classified a truant "who is absent from school without valid excuse *three full days* in one school year, or tardy or absent for more than any 30-minute period during the school day without a valid excuse on *three occasions* in one school year, or any combination thereof…"[8] At the same time, the Legislature amended section 48260.5 to require the school to also notify parents that a pupil may be subject to prosecution under section 48264; that a pupil may be subject to suspension or restriction of driving privileges under section 13202.7 of the Vehicle Code; and that it is recommended that the parent or guardian accompany the pupil to school and attend classes with the pupil for one day.[9] Those amendments were incorporated into the parameters and guidelines on January 31, 2008, effective July 1, 2006, at the Legislature's direction, however, reimbursement for the program under the amended parameters and guidelines remained fixed at a unit cost of $10.21, adjusted annually by the Implicit Price Deflator ($19.63 for fiscal year 2013-14).[10]

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[5] Education Code section 48260 (Stats. 1976, ch. 1010).

[6] Exhibit A, IRC 07-904133-I-05, page 69.

[7] The parameters and guidelines as amended in 2008 are not applicable to this IRC.

[8] Education Code section 48260, as amended by Stats. 1994, ch. 1023 and Stats. 1995, ch. 19.

[9] Education Code section 48260.5, as amended by Stats. 1994, ch. 1023.

[10] Statutes 2007, chapter 69 (AB 1698).

Procedural History

On January 11, 2001, the claimant signed its fiscal year 1999-2000 claim.[11] On March 5, 2003, the entrance conference was held.[12] On December 30, 2004, the Controller issued the final audit report.[13] On December 18, 2007, claimant filed IRC 07-904133-I-05.[14]

On November 25, 2009, the Controller issued a revised audit report.[15] On July 16, 2010, the claimant filed a revised IRC, 10-904133-I-07, which was consolidated with IRC 07-904133-I-05.[16] On October 3, 2014, the Controller filed late written comments on the consolidated IRC.[17]

On July 31, 2015, Commission staff issued the draft proposed decision.[18] On August 24, 2015, the Controller filed comments on the draft proposed decision.[19] On September 10, 2015, the claimant filed comments on the draft proposed decision.[20]

Commission Responsibilities

Government Code section 17561(b) authorizes the Controller to audit the claims filed by local agencies and school districts and to reduce any claim for reimbursement of state-mandated costs that the Controller determines is excessive or unreasonable.

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to the local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9 of the Commission's regulations requires the Commission to send the decision to the Controller and request that the costs in the claim be reinstated.

The Commission must review questions of law, including interpretation of parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[21] The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the

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[11] Exhibit A, IRC 07-904133-I-05, page 81.

[12] Exhibit C, Controller's Late Comments on IRC, pages 5; 27.

[13] Exhibit A, IRC 07-904133-I-05, page 19.

[14] Exhibit A, IRC 07-904133-I-05, page 1.

[15] See Exhibit B, IRC 10-904133-I-07, pages 8; 20.

[16] Exhibit B, IRC 10-904133-I-07, page 1.

[17] Exhibit C, Controller's Late Comments on IRC.

[18] Exhibit D, Draft Proposed Decision.

[19] Exhibit E, Controller's Comments on Draft Proposed Decision.

[20] Exhibit F, Claimant's Comments on Draft Proposed Decision.

[21] *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

Commission must strictly construe article XIII B, section 6 and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."[22]

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.[23]

The Commission must also review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with claimant.[24] In addition, sections and 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[25]

Claims

The following chart provides a brief summary of the claims and issues raised and staff's recommendation.

Issue	Description	Staff Recommendation
Whether the Controller met the statutory deadlines to initiate and to complete the audits.	At the time the underlying reimbursement claims were filed, Government Code section 17558.5 provided that a claim is subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended. As amended by Statutes 2002, chapter 313 (AB 2224), effective January 1, 2003, section 17558.5 provided that a claim would be "subject to the initiation of an audit" for three years from the date the claim is filed or last amended.	*The original final audit report was timely initiated and timely completed, but the revised audit report was not timely completed* – Staff finds that the plain language of section 17558.5, at the time the reimbursement claims were filed, did not require the Controller to *complete* an audit within any specified period of time, but only to begin an audit within two years of the end of the calendar year in which the

[22] *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

[23] *Johnston v. Sonoma County Agricultural Preservation and Open Space District* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

[24] *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

[25] Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission's decision is not supported by substantial evidence in the record.

	Claimant asserts that its fiscal year 1999-2000 claim was no longer *subject to audit* at the time the original final audit report was issued, December 30, 2004, based on the filing date of January 11, 2001. As later amended by Statutes 2004, chapter 890 (AB 2856), section 17558.5 requires an audit to be *completed* not later than two years after the date that the audit is commenced. This provision became effective January 1, 2005, and applies to all audits then pending or thereafter completed.	claim(s) were filed. Additionally, a subsequent amendment to the statute demonstrates that "subject to audit" means "subject to the initiation of an audit," and because the period subject to audit had not yet closed at the time that amendment became effective, the Controller receives the benefit of the extra time. Therefore, staff finds that the final audit report is not barred. Additionally, staff finds that the two-year completion requirement for audits, effective January 1, 2005, was not applicable to the original final audit report, which was completed less than twenty-two months after initiation. However, the revised final audit report issued November 25, 2009 falls outside the two year completion requirement of section 17558.5, and is therefore not timely.
Reductions based on initial truancy notifications for which the Controller concluded that pupils had not accumulated the required number of unexcused absences to be classified as a truant under	The parameters and guidelines in effect from July 22, 1993 until July 1, 2006 require schools to issue notification to a parent or guardian upon a pupil's initial classification as truant, as defined in Education Code section 48260. The notice, pursuant to section 48260.5, was required, during the audit period, to include notice that the pupil is a truant; that the parent or guardian is obligated to compel the pupil's attendance; that parents or guardians who fail to do so may be guilty of an infraction and subject to prosecution; that alternative educational programs are available in the district; and that the parent or guardian has	*Partially correct*- To the extent reductions were made based on initial truancy notifications for pupils with fewer than three unexcused absences, those reductions are correct as a matter of law since, at the time costs were incurred, Education Code section 48260 defined a truant as a pupil who accumulates three or more unexcused absences or tardies in excess of 30 minutes. However, reductions for notices for pupils with three or more

the mandate program.	the right to meet with school personnel to discuss the pupil's truancy. The Controller reduced costs claimed for initial notifications of truancy based on the definition of a truant referenced in the parameters and guidelines under "Summary of Mandate." However, pursuant to amendments effected by Statutes 1994, chapter 1023 (SB 1728) and Statutes 1995, chapter 19 (SB 102), the parameters and guidelines were no longer consistent with the Education Code during the audit period.	unexcused absences is incorrect as a matter of law. Though the definition in Education Code section 48260, changed between the adoption of the test claim decision and the fiscal years in question here, the mandated program under section 48260.5, as added in 1983, did not change. Section 48260 is merely definitional and describes the triggering event for performance of the mandated activities. Section 48260 was never approved as imposing any activity and a reduction based on a provision of former law that is no longer applicable and did not impose the mandate is incorrect as a matter of law.
Reductions made by statistical sampling and extrapolation of unallowable notifications.	The Controller reduced costs in the subject audits by sampling a small number of initial notifications sent to parents or guardians and determining whether those notifications were sent in accordance with the parameters and guidelines (i.e., sent upon the fourth occurrence of an unexcused absence or unexcused tardiness). Based upon the number of notifications that the Controller determined were sent earlier than required under the former definition of truancy, the Controller calculated an error rate and applied that rate to all remaining notifications during the audit period, reducing costs claimed accordingly.	*Partially correct* – As discussed above, reductions for notices for pupils with three or more unexcused absences are incorrect as a matter of law; that conclusion extends to reductions based on an extrapolation of those incorrect reductions. However, with regard to the notices for which costs were correctly reduced, there is no evidence that Controller's auditing by statistical sampling and extrapolation is arbitrary, capricious or entirely lacking in evidentiary support. In addition, staff finds that this sampling and extrapolation method does not constitute an underground regulation since there is no

		evidence that it has been applied generally.

Staff Analysis

A. The Controller Met the Statutory Deadline for the Initiation and Completion of the Audit, but the Revised Audit Report Was Not Completed Within the Two Year Statutory Deadline.

1. *The Final Audit Report Issued December 30, 2004 Was Timely, Pursuant to Government Code Section 17558.5.*

Staff finds that the first final audit report was both timely initiated and timely completed, based on the plain language of section 17558.5, as added by Statutes 1995, chapter 945, and as amended by Statutes 2002, chapter 1128. The 1995 version of section 17558.5 provided that a claim was "subject to audit by the Controller *no later than two years after the end of the calendar year* in which the reimbursement claim is filed or last amended."[26] Based only upon the plain language of this section, the earliest reimbursement claim in issue, filed January 11, 2001,[27] would be "subject to audit" until the end of the calendar year 2003. However, staff finds that "subject to audit" does not require the *completion* of an audit before the end of the calendar year, and that initiating an audit before the expiration of that period is sufficient. Accordingly, the clarifying amendment made by Statutes 2002, chapter 1128 provided that a reimbursement claim "is subject to the initiation of an audit by the Controller no later than ~~two~~ three years after the ~~end of the calendar year in which~~ date that the actual reimbursement claim is filed or last amended, whichever is later."[28] This amendment supports the interpretation urged by the Controller that "subject to audit" requires only that an audit be initiated before a time certain. Moreover, because the amendment expanded the statutory period while it was still pending, the Controller receives the benefit of the additional time.[29] Therefore, based on the plain language as amended in 2002 (effective January 1, 2003), the reimbursement claims in issue would be "*subject to the initiation of an audit*" until three years after the claims were filed, or January 11, 2004, for the 1999-2000 reimbursement claim. Because an entrance conference was held March 5, 2003, the audit was initiated prior to the running of the statutory period under either the 1995 version of section 17558.5, or under the section as amended in 2002, and the audit was therefore timely initiated.[30]

At the time the costs were incurred in this case, section 17558.5 did not expressly fix the time during which an audit must be completed. Nevertheless, the Controller was still required under

[26] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)).

[27] Exhibit A, IRC 07-904133-I-05, page 81.

[28] Government Code section 17558.5 (Stats. 2002, ch. 1128 (AB 2834)).

[29] *Douglas Aircraft v. Cranston* (1962) 58 Cal.2d 462, 465.

[30] Staff acknowledges that the audit was likely initiated earlier than the entrance conference (such as when it can be independently verified that the audit initiation letter was sent or received) but there is no evidence of an earlier initiation in this record and, in this case an earlier date would not change the conclusion that the audit was timely initiated.

common law to complete the audit within a reasonable period of time. Under appropriate circumstances, the defense of laches may operate to bar a claim by a public agency if there is evidence of unreasonable delay by the agency and resulting prejudice to the claimant.[31] Here, the audit report was issued December 30, 2004, less than 22 months after the entrance conference date of March 5, 2003. Therefore, there is no evidence of an unreasonable delay in the completion of the audit.

Based on the foregoing, staff finds that the original final audit of the subject reimbursement claims is timely and not barred by section 17558.5.

2. The Revised Audit Issued November 25, 2009 Was Issued Beyond the Deadlines Imposed by Section 17558.5, but May Be Considered by the Commission to the Extent that it Narrows the Issues in Dispute or Makes Concessions to the Claimant.

Statutes 2004, chapter 890 (SB 2856), effective January 1, 2005, added a requirement in section 17558.5 that "[i]n any case, an audit *shall be completed* not later than two years after the date that the audit is commenced." Here, the Controller's audit of the relevant claim years was "commenced," within the meaning of section 17558.5, no later than March 5, 2003, when the entrance conference was held. The amendment to section 17558.5 that imposed the two year completion requirement became effective January 1, 2005. Therefore, a timely audit must be completed by March 5, 2005, and the Controller had over two months' notice of the requirement to complete the audit within two years. Moreover, the California Supreme Court has held that the Legislature may shorten or impose a period of limitation affecting a state agency without notice, even if the effect is to cut off the rights of the agency with respect to a pending matter.[32]

Based on relevant case law, two months' notice to complete the audit before applying the statutory bar is sufficient, and the Legislature's action cutting off the Controller's power to audit must be upheld.[33] As explained above, the original "final" audit report was timely, because it was completed approximately twenty-two months after the initiation date, and prior to the institution of the two-year completion requirement. However, the revised audit report, modifying the *original* "final" audit report, was issued on November 25, 2009, approximately six years and eight months after the audit was initiated. It therefore falls outside the statutory two year completion requirement imposed by section 17558.5, as amended by Statutes 2004, chapter 890. Nevertheless, staff finds that the Commission may take official notice[34] of the revised audit

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[31] *Cedar-Sinai Medical Center v. Shewry* (2006) 137 Cal.App.4th 964, 985-986.

[32] *California Employment Stabilization Commission v. Payne* (1948) 31 Cal.2d 210, 215 ["[A] statute which adversely affects only the right of the state is not invalid merely because it operates to cut off an existing remedy of an agency of the state."].

[33] See *Rosefield Packing Company v. Superior Court of the City and County of San Francisco* (1935) 4 Cal.2d 120, 123 ["The plaintiff, therefore, had practically an entire year to bring his case to trial…"]; *Kerchoff-Cuzner Mill and Lumber Company v. Olmstead* (1890) 85 Cal. 80 [thirty days to file a lien on real property]. See also *Kozisek v. Brigham* (Minn. 1926) 169 Minn. 57, 61 [three months].

[34] Code of Regulations, title 2, section 1187.5(c) ["Official notice may be taken in the manner and of the information described in Government Code section 11515."].

report, to the extent that the revised audit report narrows the issues in dispute or mitigates the amounts of the reductions originally asserted by the Controller.

Based on the foregoing, staff finds that the revised audit report issued November 25, 2009 was not completed within the deadline required by section 17558.5, but may be considered by the Commission to the extent that it narrows the issues in dispute or makes concessions to the claimant with respect to its allegations in the IRC.

B. The Controller's Reduction Based on the Former Definition of Truant Is Inconsistent with the Education Code, and Is Incorrect as a Matter of Law, But Reductions Based on the Current Definition of Truant Are Correct as a Matter of Law and Not Arbitrary, Capricious or Entirely Lacking in Evidentiary Support.

The parameters and guidelines provide for a uniform cost allowance "based on the number of initial notifications of truancy distributed pursuant to Education Code Section 48260.5, Chapter 498, Statutes of 1983."[35] As originally adopted, and as late as the July 22, 1993 amendments, the parameters and guidelines included the then-current definition of a truancy as occurring "when a student is absent from school without valid excuse more than three (3) days or is tardy in excess of thirty (30) minutes on each of more than three (3) days in one school year" in its summary of the mandate.[36]

However, as amended by Statutes 1994, chapter 1023, and Statutes 1995, chapter 19, section 48260 thereafter provided:

> Any pupil subject to compulsory full-time education or to compulsory continuation education who is absent from school without valid excuse *three full days* in one school year or tardy or absent for more than any 30-minute period during the schoolday without valid excuse on *three occasions* in one school year, *or any combination thereof*, is a truant and shall be reported to the attendance supervisor or to the superintendent of the school district.[37]

Additionally, section 48260.5 was substantively amended to require additional information in the notices. No test claim or request to amend parameters and guidelines on these changes was ever filed with the Commission. The Legislature in 2007 directed the Commission to amend the parameters and guidelines to reflect the changes to the Education Code affecting the *Notification of Truancy* mandate, and the Commission did so in January 2008, effective July 1, 2006, however, reimbursement for the program under the amended parameters and guidelines remained fixed at a unit cost of $10.21, adjusted annually by the Implicit Price Deflator ($19.63 for fiscal year 2013-14).[38] Therefore, between the amendment of the Education Code in 1995 and the amendment of the parameters and guidelines in 2008, the parameters and guidelines included an

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[35] Exhibit A, IRC 07-904133-I-05, page 33.

[36] Exhibit A, IRC 07-904133-I-05, page 31.

[37] Education Code section 48260 (Stats. 1995, ch. 19) [Emphasis added].

[38] Statutes 2007, chapter 69 (AB 1698); Exhibit G, Parameters and Guidelines, amended 05/27/2010.

obsolete definition of "truant" in its "summary of the mandate" (essentially an overview of the program).

The costs at issue in this IRC were incurred from fiscal year 1999-2000 to 2001-2002 and the reimbursement claims were filed in the year after costs were incurred. Therefore, at the time the costs were incurred and reimbursement claims were filed, and indeed at the time the first final audit report was issued, the definition of truancy included in the parameters and guidelines was not consistent with the definition of truancy in the Education Code. The dispositive issue, then, in this IRC, is whether the Controller may reduce costs claimed for a mandated program which has not changed (to provide notices) based upon an obsolete definition in the parameters and guidelines, which the Board of Control and the Commission found did not impose the mandate in the first instance.

Staff finds, based on the facts surrounding the adoption of the parameters and guidelines and the law in this case, that Education Code section 48260 does not impose a mandated activity; it merely defines the event that triggers the mandated activity.[39] This interpretation is consistent with the Board of Control's original test claim decision, which found that section 48260.5, and not section 48260, imposed the mandate. This reasoning is also consistent with the prior parameters and guidelines, in which the definition of truancy was not described as a reimbursable cost in the "Reimbursable Costs" section. Section 48260, as amended by Statutes 1994, chapter 1023, and Statutes 1995, chapter 19, does not impose a new program or higher level of service, and there is no evidence that the change to section 48260 imposes additional costs mandated by the state.[40] Moreover, though the parameters and guidelines were later amended at the direction of the Legislature, the unit cost was not changed nor was the mandated activity to provide the notice. Therefore, section 48260 was amended without altering the scope of the mandated activities, and did not require the filing of a test claim.

The mandated program requires school districts to send out an "initial notification of truancy" upon a pupil's classification as a truant under the Code. The Education Code, as of 1995 and after, provides for the initial notification to be issued upon the *third* unexcused absence or instance of tardiness (or any combination thereof). The parameters and guidelines in this case were understandably a source of confusion to the auditors in that they included a definition in the summary (i.e., *more than three* absences or instances of tardiness) which was never part of the mandate finding. The Controller's auditors are required to adhere to the parameters and guidelines and appear to have attempted to do so here. However, based on the foregoing, staff finds that reductions based on pupils who accumulated three (but not four) unexcused absences or instances of tardiness are incorrect as a matter of law. All costs reduced on this basis should be reinstated to the claimant.

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[39] An amendment to the definition of truancy may have also necessitated altering the text or content of the notice, but section 48260 made no such express requirement.

[40] Section 48260.5, also amended by Statutes 1994, chapter 1023, did alter the required elements of the notification issued by school districts, but there was never a test claim filed on that amended section alleging a new program or higher level of service, or increased costs, and the activity of issuing the notification was not altered.

However, a small number of initial notifications were issued for pupils who did not accumulate *three* unexcused absences during the school year, and thus were not truant even under the 1995 definition in the Education Code. Section 48260.5, as approved by the Board of Control's test claim decision, and as described in the Commission's 1993 parameters and guidelines, requires a school district to issue a notification of truancy "by first-class mail or other reasonable means" to the pupil's parent or guardian "upon a pupil's *initial classification* as a truant…"[41]

Therefore, the mandated program as approved by the Board of Control, and as articulated in the parameters and guidelines, is to issue a notification of truancy to a pupil's parent or guardian upon the pupil's initial classification as a truant. If a pupil cannot be classified as a truant, as defined in section 48260, a notification is not required, and any notification sent to that pupil's parent or guardian, whether or not intentional, is not reimbursable.

Based on the foregoing, staff finds that reductions based on pupils who did not accumulate three unexcused absences or instances of tardiness during the school year are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

C. The Controller's Reductions Based on Statistical Sampling and Extrapolation Are Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support to the Extent that the Extrapolation Is Based on Correctly Disallowed Notices.

In its audit the Controller examined a random sample of notices issued by the claimant, for each fiscal year, to determine the proportion of notifications that were unallowable for the Controller's asserted legal reasons. The number of unallowable notifications within the sample for each fiscal year was then calculated as an error percentage, and extrapolated to the total number of notifications issued and identified by the claimant, to project a total number of unallowable notifications, which was then multiplied by the unit cost for that year to estimate the reduction. In the first final audit report, a single error rate was calculated for all K-12 and special education students, which the claimant challenged as non-representative, due to the claimant's assertion that "the incidence of truancy in secondary schools is generally greater than elementary schools."[42] Therefore, in its revised audit, the Controller calculated error rates for elementary and special education students separately from middle and high school students, and extrapolated (projected) a number of unallowable notifications separately for each population.[43] The claimant responded in its revised IRC that "[t]he bifurcation of the extrapolation universe may be *more representative* in terms of the calculation of the extrapolated amount, but the District still disputes the use of the sampling method for the reasons stated in the original incorrect reduction claim."[44] The methodology results in an estimate of the amount of claimed costs that the

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[41] See, e.g., Exhibit C, Controller's Late Comments on IRC, page 9 [quoting the Commission's 1993 parameters and guidelines]. See also, former Education Code section 48260.5 (Stats. 1983, ch. 498) (emphasis added) ["Upon a pupil's initial classification as a truant, the school district shall notify…"].

[42] See Exhibit A, IRC 07-904133-I-05, page 15.

[43] Exhibit B, IRC 10-904133-I-07, pages 27-28.

[44] Exhibit B, IRC 10-904133-I-07, page 9 [Emphasis added].

Controller has determined to be excessive or unreasonable. The Controller states in the revised audit an estimated reduction of costs totaling $87,177.[45]

The claimant argues that the Controller's statistical sampling and extrapolation method is not legally supported, not correctly applied to state-mandated reimbursement, and is inappropriately error-prone and inaccurate. More specifically, claimant argues that this methodology constitutes an illegal underground regulation and does not reimburse claimant for all of its costs mandated by the state as required by article XIII B, section 6 of the California Constitution. Staff finds that sampling and extrapolation as a methodology to identify a dollar figure for an audit adjustment in this case is within the Controller's audit authority, is not applied generally in the manner of a regulation, provides for a reasonable estimate of unallowable costs, and is therefore not arbitrary, capricious, or entirely lacking in evidentiary support.

1. The evidence in the record does not support claimant's argument that the statistical sampling and extrapolation method used in the audit of the claimant's reimbursement claims constitutes an underground regulation.

The claimant challenges the statistical sampling and extrapolation methodology used by the Controller as an underground regulation not adopted pursuant to the APA, and argues that any findings and cost reductions extrapolated from the sample reviewed by the Controller should therefore be void. Government Code section 11340.5 provides, no state agency shall enforce or attempt to enforce a rule or criterion which is a regulation, as defined in section 11342.600, unless it has been adopted pursuant to the APA.[46] Therefore, if the Controller's challenged audit methods constitute a regulation not adopted pursuant to the APA, the Commission cannot uphold the reductions. Interpreting section 11342.600, the California Supreme Court in *Tidewater Marine Western v. Bradshaw* found that a regulation has two principal characteristics:

> First, the agency must intend its rule to apply generally, rather than in a specific case. The rule need not, however, apply universally; a rule applies generally so long as it declares how a *certain class of cases* will be decided. Second, the rule must "implement, interpret, or make specific the law enforced or administered by [the agency], or ... govern [the agency's] procedure."[47]

The necessary inquiry, then, is whether the challenged audit policy or practice is applied "generally," and used to decide a class of cases; and whether the rule "implement[s], interpret[s], or make[s] specific" the law administered by the Controller.

Here, there is not substantial evidence in the record that the audit methodology as applied in this case rises to the level of a rule of general application, and no clear "class of cases" to which it applies has been defined. In *Tidewater,* the Court held that a "rule need not, however, apply universally; a rule applies generally so long as it declares how a certain class of cases will be decided."[48] And in *Clovis Unified,* the court in discussing the contemporaneous source

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[45] Exhibit B, IRC 10-904133-I-07, page 28.

[46] Government Code section 11340.5 (Stats. 2000, ch. 1060).

[47] *Tidewater Marine Western v. Bradshaw* (1996) 14 Cal.4th 557, 571 (emphasis added) [Citing *Roth v. Department of Veteran Affairs* (1980) 110 Cal.App.3d 622, 630; Gov. Code § 11342(g)].

[48] *Tidewater, supra,* 14 Cal.4th 557, 571.

document rule (CSDR) explained that in the context of the Controller's audits of mandate reimbursement claims:

> As to the first criterion—whether the rule is intended to apply generally—substantial evidence supports the trial court's finding that the CSDR was "applie[d] generally to the auditing of reimbursement claims ...; the Controller's auditors ha[d] no discretion to judge on a case[-]by[-]case basis whether to apply the rule."[49]

Here, the sampling and extrapolation method is not published in the claiming instructions for this mandate; nor is it alleged that auditors were *required* to utilize such methods, and there is no evidence in the record that the challenged methods were used in all *Notification of Truancy* audits. Therefore, based on the case law discussed above, and the evidence in the record, staff finds that the Controller's sampling and extrapolation method, as applied in this case, is not a regulation within the meaning of the APA.

2. <u>The Controller's audit conclusions must be upheld absent evidence that the Controller's reductions are arbitrary, capricious, or entirely lacking in evidentiary support.</u>

The claimant argues that there is no statutory or regulatory authority for the Controller to reduce claimed costs based on extrapolation from a statistical sample. The Controller counters that "[t]here is no prohibitive language contained in statute…" and that no legal authority dictates "specific auditing tests to perform…" or requires the Controller "to provide claimants 'notice' that the SCO will use sampling techniques."[50]

The Controller correctly states that there is no express prohibition in law or regulation of statistical sampling and extrapolation methods being used in an audit; nor, as the claimant points out, is there any express authority to do so. The California Constitution and the Government Code describe the Controller's authority in relatively general terms.[51] With respect to mandate reimbursement, the Controller's audit authority is more specifically articulated. Government Code section 17561 provides that the controller may audit the records of any local agency or school district to verify the amount of mandated costs, and may reduce any claim that the Controller determines is excessive or unreasonable.[52]

In the absence of express statutory authority, the Controller cites to "Government Auditing Standards, as issued by the Comptroller General of the United States…" which, the Controller asserts, "specify that auditors may use professional judgment in 'selecting the methodology, determining the type and amount of evidence to be gathered, and choosing the tests and

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[49] *Clovis Unified School District v. Chiang*, 188 Cal.App.4th 794, 803.

[50] Exhibit C, Controller's Late Comments on IRC, page 17.

[51] California Constitution, article XVI, section 7 (added November 5, 1974, by Proposition 8) ["Money may be drawn from the Treasury only through an appropriation made by law and upon a Controller's duly drawn warrant."]; Government Code section 12410 (Stats. 1968, ch. 449) [The Controller "shall superintend the fiscal concerns of the state…" and "shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment."].

[52] Former Government Code section 17561 (Stats. 2002, ch. 1124), emphasis added.

procedures for their work.'"[53] While the standards cited do not provide *expressly* for statistical sampling and extrapolation to be applied to *mandate reimbursement*, they do provide for statistical methods to be used to establish the sufficiency, or validity of evidence.[54]

In accordance with the Controller's audit authority and duties under the code, it is not the Commission's purview to direct the Controller to employ a specific audit method, including when the audit pertains to the application of a unit cost, as here. The Commission's consideration is limited to whether the application of the method chosen is arbitrary, capricious, or entirely lacking in evidentiary support.[55] Based on the standards and texts cited by the Controller, statistical methods are an appropriate and commonly-used tool in auditing. The claimant, too, concedes that "[a] statistically valid sample methodology is a recognized audit tool for some purposes."[56]

In fact, statistical sampling methods such as those employed here are used in a number of other contexts, including Medi-Cal reimbursement to health care providers, and have not been held, in themselves, to be arbitrary and capricious, or incorrect as a matter of law. On that basis, and giving due consideration to the discretion of the Controller to audit the fiscal affairs of the state,[57] staff finds that the Commission must uphold the Controller's auditing decisions absent evidence that the audit reductions are arbitrary, capricious, or entirely lacking in evidentiary support.

3. <u>There is no evidence in the record that the Controller's findings using the sampling and extrapolation methodology are not representative of all notices claimed by the district during the audit period or that the findings are arbitrary, capricious, or entirely lacking in evidentiary support.</u>

In addition to challenging the legal sufficiency of the Controller's sampling and extrapolation methodology, the claimant also challenges the qualitative and quantitative reliability and fairness of using statistical sampling and extrapolation to evaluate reimbursement. The claimant argues that "[t]he ultimate risk for extrapolating findings from a sample is that the conclusions obtained from the sample may not be representative of the universe." The claimant asserts that there are "several methods of compliance…" and that the Controller has made "no showing that the sample accurately reflects the relative occurrence of truancies at different grade levels." The claimant asserts, without evidence, that "the incidence of truancy in secondary schools is generally greater than elementary schools."[58] And, the claimant argues that "[l]ess than two percent of the total number of notices were audited…" and that "[t]he expected error rate is stated to be 50%, which means the total amount adjusted of $108,307 is really just a number exactly between $54,154 (50%) and $162,461 (150%)."

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[53] Exhibit C, Controller's Late Comments on IRC, page 17.

[54] Exhibit G, Excerpt from Government Auditing Standards, 2003, page 13.

[55] *American Bd. of Cosmetic Surgery, Inc, supra*, 162 Cal.App.4th 534, 547-548.

[56] Exhibit A, IRC 07-904133-I-05, page 14.

[57] Government Code section 12410 (Stats. 1968, ch. 449).

[58] Exhibit A, IRC 07-904133-I-05, page 15.

The claimant has presented no evidence that schools within the claimant's district complied with the mandate in different ways, which may provide evidence that the results from the sample are not representative of all notices claimed. The Commission, and the Controller, must presume that the claimant uniformly complied with the mandate, absent evidence to the contrary. Moreover, the claimant's assertion regarding the incidence of truancy in secondary schools is no longer relevant since the Controller, in the revised audit, calculated error rates for elementary and special education students separately from middle and high school students, and extrapolated (projected) a number of unallowable notifications separately for each population.[59] Furthermore, the claimant's concerns about the proportional size of the sample are unfounded, and the claimant's conclusions about the "expected error rate" are entirely mistaken.

The Controller demonstrates that the absolute size of the sample, not the relative size, is more important. The Controller explains that an "expected error rate" in this context is an assumption used to determine the appropriate sample size, rather than a measure of the ultimate accuracy of the result. In addition, the desired accuracy of the result, which might be called a "margin of error," is determined by the auditor before calculating the sample size (shown below as "SE = desired sample precision"). If "two percent" were a relevant proportion with respect to the selection of sample size, we would expect sample sizes to vary widely from one population to the next (two percent of 5,049 would yield a sample of 105, while two percent of 9,531 would yield a sample of 191). Applying the formula provided by the Controller illustrates that an appropriate sample size is not so closely correlated to the size of the population; instead, a sample size of 145 to 148 is appropriate, based on the Controller's calculations, for populations ranging from 5,049 to 9,531.[60]

Moreover, although the record indicates an objectively wide range of accuracy in the Controller's estimated reduction, in this case, once the number of unallowable notifications in the samples are adjusted based on the findings, the range of the total extrapolated dollar amount adjustment becomes substantially smaller as well. In other words, because this analysis concludes that only approximately ten percent of the notifications that the Controller deemed unallowable were legally correct (16 out of 167), the dollar amount reduction, and its wide ranging accuracy, must narrow accordingly. The "point estimate" for the *total reduction* for three years is revised from $87,177 to $7,972, based on staff's findings. Thus, the range of the possible adjustment, formerly approximately $52,000 wide, as stated by the Controller, can no longer be more than a few thousand dollars in excess of or below the estimated adjustment. Using the Controller's formula, provided in Tab 3 of Exhibit C, page 31, the approximate range of adjustment based on the reinstatement as described, is $5,916 above or below the new "point estimate" of $7,972, or $2,056 to $13,888.

Finally, due to the volume of notifications that the school district issues in each year (45,785 notices were issued by the claimant during the audit period), and the objectively small transaction cost (i.e., the unit cost value of reimbursement for each of those notifications, ranging from $12.23-$12.91 during the audit period), the Controller's use of sampling and extrapolation to audit whether the notifications were issued properly and supported by the claimant's

[59] Exhibit B, IRC 10-904133-I-07, pages 27-28.

[60] Exhibit C, Controller's Late Comments on IRC, pages 21-22.

attendance records is not unreasonable. Therefore, the Controller's showing that its method is statistically significant and mathematically valid is sufficient.

Based on the foregoing, staff finds that there is no evidence in the record that the Controller's sampling and extrapolation methodology is arbitrary, capricious, or entirely lacking in evidentiary support.

Conclusion

Based on the forgoing, staff concludes that reductions of costs claimed for notifications issued to pupils who accumulated three but not four unexcused absences or instances of tardiness are incorrect as a matter of law, and are arbitrary, capricious, or entirely lacking in evidentiary support. In addition, staff concludes that the Controller's sampling and extrapolation method for estimating the appropriate amount of reduction is not arbitrary, capricious, or entirely lacking in evidentiary support. Therefore, staff finds that those notifications sampled which were disallowed because pupils had accumulated fewer than three unexcused absences may be extrapolated to project a number of unallowable notifications, and to estimate a reduction, for the entire audit period.

Staff Recommendation

Staff recommends that the Commission adopt the proposed decision to partially approve the IRC, and, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, request that the Controller reinstate $23,030 for fiscal year 1999-2000, $25,294 for fiscal year 2000-2001, and $30,881 for fiscal year 2001-2002. Staff further recommends that the Commission authorize staff to make any technical, non-substantive changes following the hearing.

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Education Code Section 48260.5 Statutes 1983, Chapter 498 Fiscal Years 1999-2000, 2000-2001, and 2001-2002 San Juan Unified School District, Claimant	Case No.: 07-904133-I-05 and 10-904133-I-07 *Notification of Truancy* DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5. ARTICLE 7 (*Adopted December 03, 2015*)

DECISION

The Commission on State Mandates (Commission) heard and decided this consolidated incorrect reduction claim (IRC) during a regularly scheduled hearing on December 03, 2015. [Witness list will be included in the adopted decision.]

The law applicable to the Commission's determination of a reimbursable state-mandated program is article XIII B, section 6 of the California Constitution, Government Code section 17500 et seq., and related case law.

The Commission [adopted/modified] the proposed decision to [approve/partially approve/deny] this IRC at the hearing by a vote of [vote count will be included in the adopted decision] as follows:

Member	**Vote**
Ken Alex, Director of the Office of Planning and Research	
Richard Chivaro, Representative of the State Controller, Vice Chairperson	
Mark Hariri, Representative of the State Treasurer	
Sarah Olsen, Public Member	
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	
Carmen Ramirez, City Council Member	
Don Saylor, County Supervisor	

Summary of the Findings

This IRC addresses reductions made by the State Controller's Office (Controller) to reimbursement claims filed by San Juan Unified School District (claimant) for fiscal years 1999-2000 through 2001-2002, for the *Notification of Truancy* program.

The Controller reduced costs claimed for each of the three audit years based on its interpretation that the parameters and guidelines require an initial truancy notification to be issued upon a pupil's fourth unexcused absence or instance of tardiness. However, the definition of "truant" was never found to impose a reimbursable activity and an intervening amendment to the Education Code altered the underlying definition of truancy and thus the timing of the requirement to issue an initial truancy notification: during the audit period a school district was required to issue an initial notification of truancy upon a pupil's *third* unexcused absence or instance of tardiness. The Commission finds that this intervening amendment was not made to a previously-approved code section, and does not impose a new program or higher level of service since it does not require any activity but only changes the trigger for the performance of the mandated activity. This interpretation is also consistent with the fact that Education Code section 48260 was found not to impose any mandated activities and was therefore not listed as a reimbursable activity in the "Reimbursable Costs" section and that when the parameters and guidelines were amended at the direction of the Legislature, the reimbursable unit cost did not increase. For these reasons, the Commission finds that the Controller's reduction of costs claimed for pupils who accumulated three unexcused absences but not four is incorrect as a matter of law.

In addition, the Controller, in each of the audit years, examined a small sample of the total initial truancy notifications issued, and determined an error rate within that sample of notifications that were unallowable, which was then extrapolated to the whole. The Commission finds, as explained herein, that this sampling and extrapolation method is not a regulation within the meaning of the Administrative Procedure Act (APA); and as applied in this case, to estimate a reduction for the audit period based on notifications correctly disallowed is not arbitrary, capricious or entirely lacking in evidentiary support.

The Commission partially approves the IRC, as described above, and pursuant to section 1185.9 of the Commission's regulations, requests that the Controller reinstate $23,030 for fiscal year 1999-2000, $25,294 for fiscal year 2000-2001, and $30,881 for fiscal year 2001-2002.

COMMISSION FINDINGS

I. Chronology

01/11/2001	Claimant signed its fiscal year 1999-2000 reimbursement claim.[61]
03/05/2003	The entrance conference for the audit of all three fiscal years was held.[62]
12/30/2004	The Controller issued the final audit report.[63]

[61] Exhibit A, IRC 07-904133-I-05, page 81.

[62] Exhibit C, Controller's Late Comments on IRC, pages 5; 27.

[63] Exhibit A, IRC 07-904133-I-05, page 19.

12/18/2007	Claimant filed IRC 07-904133-I-05.[64]
11/25/2009	The Controller issued a revised audit report.[65]
07/16/2010	The Claimant filed a revised IRC, 10-904133-I-07.[66]
10/03/2014	The Controller filed late comments on the IRCs.[67]
07/31/2015	Commission staff issued the draft proposed decision.[68]
08/24/2015	Controller filed comments on the draft proposed decision.[69]
09/10/2015	Claimant filed comments on the draft proposed decision.[70]

II. Background

The *Notification of Truancy* Program

Under California's compulsory education laws, children between the ages of six and 18 are required to attend school full-time, with a limited number of specified exceptions.[71] Once a pupil is designated a truant, as defined, state law requires schools, districts, counties, and the courts to take progressive intervention measures to ensure that parents and pupils receive services to assist them in complying with the compulsory attendance laws.

The first intervention is required by Education Code section 48260.5, as added by the test claim statute.[72] As originally enacted, section 48260.5 specified:

> (a) Upon a pupil's initial classification as a truant, the school district shall notify the pupil's parent or guardian, by first-class mail or other reasonable means, of the following:
>
> (1) That the pupil is truant.
>
> (2) That the parent or guardian is obligated to compel the attendance of the pupil at school.
>
> (3) That parents or guardians who fail to meet this obligation may be guilty of an infraction and subject to prosecution pursuant to Article 6 (commencing with Section 48290) of Chapter 2 of Part 27.

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[64] Exhibit A, IRC 07-904133-I-05, page 1.

[65] See Exhibit B, IRC 10-904133-I-07, pages 8; 20.

[66] Exhibit B, IRC 10-904133-I-07, page 1.

[67] Exhibit C, Controller's Late Comments on IRC.

[68] Exhibit D, Draft Proposed Decision.

[69] Exhibit E, Controller's Comments on Draft Proposed Decision.

[70] Exhibit F, Claimant's Comments on Draft Proposed Decision.

[71] Education Code section 48200.

[72] Education Code section 48260.5, Statutes 1983, chapter 498.

(b) The district also shall inform parents or guardians of the following:

(1) Alternative educational programs available in the district.

(2) The right to meet with appropriate school personnel to discuss solutions to the pupil's truancy.

On November 29, 1984, the Board of Control, the predecessor to the Commission, determined that Education Code section 48260.5, as added by Statutes 1983, chapter 498, imposed a reimbursable state-mandated program to develop notification forms and provide written notice to the parents or guardians of the truancy. The decision was summarized as follows:

> The Board determined that the statute imposes costs by requiring school districts to develop a notification form, and provide written notice to the parents or guardians of students identified as truants of this fact. It requires that notification contain other specified information and, also, to advise the parent or guardian of their right to meet with school personnel regarding the truant pupil. The Board found these requirements to be new and not previously required of the claimant.[73]

The original parameters and guidelines were adopted on August 27, 1987, and authorized reimbursement for the one-time activities of planning implementation, revising school district policies and procedures, and designing and printing the forms. Reimbursement was also authorized for ongoing activities to identify pupils to receive the initial notification and prepare and distribute the notification by first class mail or other reasonable means.

The Commission amended the parameters and guidelines on July 22, 1993, effective July 1, 1992, to add a unit cost of $10.21, adjusted annually by the Implicit Price Deflator, for each initial notification of truancy distributed in lieu of requiring the claimant to provide documentation of actual costs to the Controller. The parameters and guidelines further provide that "school districts incurring unique costs within the scope of the reimbursable mandated activities may submit a request to amend the parameters and guidelines to the Commission for the unique costs to be approved for reimbursement."[74] These are the parameters and guidelines applicable to this claim.[75]

The Legislature enacted Statutes 2007, chapter 69, effective January 1, 2008, which was sponsored by the Controller's Office to require the Commission to amend the parameters and guidelines, effective July 1, 2006, to modify the definition of a truant and the required elements to be included in the initial truancy notifications in accordance with Statutes 1994, chapter 1023, and Statutes 1995, chapter 19.[76] These statutes required school districts to add the following information to the truancy notification: that the pupil may be subject to prosecution under Section 48264, that the pupil may be subject to suspension, restriction, or delay of the pupil's driving privilege pursuant to Section 13202.7 of the Vehicle Code, and that it is recommended

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[73] Exhibit G, Brief Written Statement for Adopted Mandate issued by the Board of Control on the *Notification of Truancy* test claim (SB 90-4133).

[74] Exhibit G, Parameters and Guidelines, amended July 22, 1993.

[75] The parameters and guidelines as amended in 2008 are not applicable to this IRC.

[76] Exhibit G, Controller's Letter dated July 17, 2007 on AB 1698.

that the parent or guardian accompany the pupil to school and attend classes with the pupil for one day. The definition of truant was also changed from a pupil with unexcused instances of absence or tardiness for "more than three days" to a pupil who "is absent from school without valid excuse three full days in one school year or tardy or absent for more than any 30-minute period during the schoolday without a valid excuse on three occasions in one school year, or any combination thereof."[77] In 2008, the Commission amended the parameters and guidelines, for costs incurred beginning July 1, 2006, as directed by the Legislature. However, reimbursement for the program under the amended parameters and guidelines remained fixed at a unit cost of $10.21, adjusted annually by the Implicit Price Deflator ($19.63 for fiscal year 2013-14).

The Controller's Audit and Summary of the Issues

The December 30, 2004 audit report determined that $470,268 in claimed costs was allowable and $108,442 was unallowable.[78] The Controller found 11 truancy notifications that were not supported by attendance records, totaling $135, for fiscal year 1999-2000, however, these 11 notifications are not the subject of this IRC. In addition, the Controller found that the district claimed $108,307 during the audit period for initial truancy notifications that the Controller determined were not reimbursable, because "pupils did not accumulate the required number of unexcused absences to be classified as truant under the mandate program."[79] The Controller reached the dollar amount reduced by sampling approximately 300 initial truancy notifications in each audit year, out of approximately 14,400 to 16,800 claimed, and determining the rate at which the district issued initial truancy notifications for pupils who did not accumulate four or more unexcused absences during the school year. For fiscal year 1999-2000, the Controller found 57 notifications unallowable "because they were issued to pupils who did not have four or more unexcused absences during the entire school year." Of those, "6 were issued to pupils who had fewer than three unexcused absences during the entire school year."[80] Similar findings are made with respect to fiscal years 2000-2001 and 2001-2002. The Controller thus relied on the former definition of truancy, which was included in the Summary of Mandate section of the parameters and guidelines but was never found to impose a mandated activity, to determine whether individual cases are reimbursable, and extrapolated that error rate to determine the amount of the reduction.

In the revised audit, issued November 25, 2009, the Controller continues to rely on the former definition of truancy, and to hold initial notifications of truancy not based on four or more unexcused absences to be non-reimbursable.[81] However, the Controller recalculated its sampling and extrapolation:

> The audit report stated that we conducted a *stratified* sample for elementary and special education students, and middle and high school students. The results from

[77] Education Code section 48260 (Stats. 1994, ch. 1023; Stats. 1995, ch. 19).

[78] Exhibit A, IRC 07-904133-I-05, page 51.

[79] Exhibit A, IRC 07-904133-I-05, page 53.

[80] Exhibit A, IRC 07-904133-I-05, page 54.

[81] The finding regarding 11 notifications of truancy that were not supported by attendance records for fiscal year 1999-2000 is unchanged.

> the sample were combined and extrapolated to the total population of notifications claimed for each fiscal year to determine unallowable notifications. While the samples were representative *for each student population*, the results of the sampling were *incorrectly applied to all students* in the audit report. Consequently, our extrapolation was not accurate. Therefore, we recomputed the extrapolation for each sampled population *separately* and made corresponding changes in our audit adjustments. The revised allowable costs increased by $21,130.[82]

The revised audit report states that the Controller sampled notifications for 146 elementary and special education students for fiscal years 1999-2000 and 2000-2001 and 147 for fiscal year 2001-2002. For middle and high school students, the Controller sampled 148 notifications for each of the three fiscal years. For fiscal year 1999-2000, the Controller found 52 unallowable notifications for elementary and special education students, and five unallowable notifications for middle and high school students. Those unallowable notices were issued to pupils who did not accumulate *four or more* unexcused absences "during the entire school year," and six of those, one for a middle or high school student, and five for elementary or special education students, were issued to "pupils who had fewer than three unexcused absences during the entire school year." Similar findings were made with respect to fiscal years 2000-2001 and 2001-2002.[83] The number of unallowable notifications within each sample for each fiscal year was then calculated as an error percentage, and extrapolated to the total number of notifications issued by the claimant for middle and high school students, and elementary and special education students, respectively, to approximate the total number of unallowable notifications issued, which was then multiplied by the unit cost for that year.

III. Positions of the Parties

San Juan Unified School District

The claimant does not dispute the Controller's finding with respect to the 11 notifications of truancy that are not supported by attendance records and this reduction is not the subject of this IRC.[84] However, the claimant notes that the audit report recognizes the inconsistency between the definition of truant included in the parameters and guidelines (four or more unexcused absences) and the Education Code, as amended in 1994 and 1995 (three or more unexcused absences or instances of tardiness, or any combination thereof), but nevertheless incorrectly reduces truancy notifications that were issued according to the amended code section. The claimant argues:

> Attendance accounting is controlled by the Education Code. The District complied with the Education Code as amended after the parameters and guidelines, and the parameters and guidelines, which as quasi-regulations, are inferior to the Code…The truancies were recorded and the notices were

[82] Exhibit B, IRC 10-904133-I-07, page 25 [emphasis added].

[83] Exhibit B, IRC 10-904133-I-07, pages 27-28.

[84] Exhibit A, IRC 07-904133-I-05, page 7.

> distributed, therefore actual costs were incurred, and the audit report does not state that the work was not performed.[85]

In response to the draft proposed decision, the claimant agrees with the findings reinstating costs for pupils with three unexcused absences, but sustaining the reduction for pupils with fewer than three unexcused absences, but only "to the extent of the actual number of sampled notices involved…not as to the extrapolation of these sampled notices."[86]

The claimant argues, with respect to the Controller's sampling and extrapolation methodology, that "findings from the review of less than two percent of the total number of notices are extrapolated to the total number of notices claimed and the annual reimbursement claims adjusted based on the extrapolation." The claimant argues that the validity of the Controller's methodology "is a threshold issue in that if the methodology used is rejected, as it should be, the extrapolation is void and the audit findings can only pertain to documentation actually reviewed, that is, the 883 notifications used in the audit report."[87] And, the claimant argues that the findings in the draft proposed decision sustaining the Controller's sampling and extrapolation methodology, to the extent that the underlying reductions in the sample are valid, is "based on factually unrelated case law, broad legislative grants of authority, and unadopted audit standards intended for other purposes."[88]

The claimant concedes that "[a] statistically valid sample methodology is a recognized audit tool for some purposes." However, the claimant argues that "[t]esting to detect the rate of error within tolerances is the purpose of sampling, but it is not a tool to assign an exact dollar amount to the amount of the error, which the Controller has inappropriately done so here."[89]

Moreover, the claimant attacks the quantitative validity of the Controller's methods:

> For the three fiscal years, the Controller determined that there were 45,785 notices distributed by the District. The total sample size for the three years was 883 notices, 294 notices per year for fiscal years 1999-00 and 2000-01, and 295 notices per year for fiscal year 2001-02. Less than two percent of the total number of notices were audited (1.93%). The number of notices sent by one school would be about 1.43% of the total notices. The stated precision rate was plus or minus 8%, even though the sample size was nearly identical for all three fiscal years, and even though the audited number of notices claimed in FY 2000-01 (14,413) is 14% smaller than the size of FY 2001-02 (16,792). The expected error rate is stated to be 50%, which means the total amount adjusted of $108,307 is really just a number exactly between $54,154 (50%) and $162,461 (150%). An "interval" cannot be used as a finding of actual cost. Nor can be the midrange amount.[90]

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[85] Exhibit A, IRC 07-904133-I-05, page 12.

[86] Exhibit F, Claimant's Comments on Draft Proposed Decision, page 5.

[87] Exhibit A, IRC 07-904133-I-05, page 13.

[88] Exhibit F, Claimant's Comments on Draft Proposed Decision, pages 5-6.

[89] Exhibit A, IRC 07-904133-I-05, page 14.

[90] Exhibit A, IRC 07-904133-I-05, page 16.

The claimant also urges the Commission to find that the sampling and extrapolation methodology is an underground regulation within the meaning of the APA. The claimant argues that in analyzing the "generality" of application of an audit procedure, the question is whether "factual circumstances are present that are amenable to the use of sampling and whether sampling was used…"[91] In addition, the claimant argues that the draft proposed decision inappropriately relies on *Clovis Unified* to establish that an auditor must be without discretion in applying the challenged procedure. The claimant argues that "[t]he perceived lack of auditor discretion for using the CSDR derives from the claiming instructions and thus *Clovis* is not a standard available for the sampling and extrapolation method since that process was not published." The claimant continues: "[r]egardless, as a factual matter, sampling and extrapolation was used in all relevant audit circumstances, so discretion is no longer an issue."[92]

In addition to asserting that the sampling and extrapolation methodology employed by the Controller constitutes an underground regulation, the claimant also argues that there is no statutory or regulatory authority for the Controller to reduce claimed reimbursement based on extrapolation of a statistical sample. The claimant argues that the Controller's general grant of authority to audit claims against the state for correctness, legality and for sufficient provisions of law for payment is not sufficient to support a sampling and extrapolation methodology.[93]

The claimant thus concludes that "[s]ince the statistical sampling performed by the auditor fails for legal, qualitative, and quantitative reasons, the remaining revised audit findings are limited to the 883 notices in the audit report that were actually investigated."[94]

Finally, the claimant also challenges the timeliness of the audit report. The claimant agrees with the Commission's finding that the revised audit report was not timely completed in accordance with Government Code section 17558.5, but the claimant asserts that the earliest claim year in issue, fiscal year 1999-2000, is subject to the older language of section 17558.5, which must be interpreted to require an audit to be completed within two years. The claimant also argues that a determination that the audit was timely initiated and completed within a reasonable time, presents "a question of fact for every audit, which is contrary to the concept of a statute of limitations."[95] The claimant further argues as follows:

> If, as the Commission asserts, the 1995 version establishes no statutory time limit to complete a timely commenced audit, Section 17558.5 becomes absurd. Once timely commenced, audits could remain unfinished for years either by intent or neglect and the audit findings revised at any time. Thus, the claimant's document retention requirements would become open-ended and eventually punitive. Statutes of limitations are not intended to be open-ended; they are intended to be

[91] Exhibit F, Claimant's Comments on Draft Proposed Decision, page 6.

[92] Exhibit F, Claimant's Comments on Draft Proposed Decision, pages 7-8.

[93] Exhibit F, Claimant's Comments on Draft Proposed Decision, pages 8-11.

[94] Exhibit A, IRC 07-904133-I-05, pages 16-17.

[95] Exhibit F, Claimant's Comments on Draft Proposed Decision, page 3.

> finite, that is, a period of time measured from an unalterable event, and in the case of the 1995 version of the code, it is the filing date of the annual claim.[96]

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In its revised audit report, the Controller conceded that its extrapolation was not accurate, because it did not calculate error rates for elementary and special education students separately from middle and high school students, for which group the error rates were significantly lower. The correction resulted in an increase in allowable costs, totaling $21,130 over the audit period.[97]

However, with respect to the merits of the reduction itself, the Controller argues that "[t]he parameters and guidelines as adopted on July 22, 1993, are the applicable audit criteria for the purposes of this audit."[98] The Controller acknowledges the amendment to Education Code section 48260, but argues that the parameters and guidelines in effect during the audit period "define what is reimbursable…" The Controller therefore reasons:

> While the legal requirements governing school districts originate in the Education Code, there is no language in the Education Code authorizing school districts to file reimbursement claims with the State for mandated costs incurred or language setting forth the method by which to claim these costs. The right to reimbursement and the method to claim reimbursement are set forth in the parameters and guidelines, adopted by the CSM. The district must comply with the requirements of these criteria to claim reimbursement for mandated costs incurred.[99]

In addition, the Controller argues that the draft proposed decision is inconsistent with the Legislature's intent and the plain language of AB 1698, which directed the amendment of the parameters and guidelines. The Controller argues that AB 1698 directs the Commission to amend the parameters and guidelines, including with respect to the definition of truancy, and to make those amendments effective on July 1, 2006. "Despite this clear language the DPD proceeds to retroactively amend the definition of truant to some date prior to the fiscal years audited, presumably 1995." The Controller continues, "[h]ad the Legislature desired to make the changes retroactive to 1995, they could have easily done so, but they chose not to." And, the Controller argues that the analysis in the draft proposed decision "renders portions of AB 1698 surplusage, a result that is to be disfavored."[100] The Controller argues that the distinction made in the draft proposed decision between a "definitional" and a "mandatory" provision is meaningless and unsupported; and that the draft proposed decision ignores the basic

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[96] Exhibit F, Claimant's Comments on Draft Proposed Decision, page 4.

[97] Exhibit B, IRC 10-904133-I-07, page 27. See also, Exhibit C, Controller's Late Comments on IRC, page 7.

[98] Exhibit C, Controller's Late Comments on IRC, page 11.

[99] Exhibit C, Controller's Late Comments on IRC, page 16.

[100] Exhibit E, Controller's Comments on Draft Proposed Decision, page 2.

requirements of the mandates process, including the burden placed on local government to establish that a requirement is a reimbursable mandate.[101]

In response to the claimant's challenge to the statistical sampling methodology, the Controller states that there is nothing in the Government Code that prohibits sampling, and "the parameters and guidelines do not specify the methodology the SCO must use to validate program compliance."[102] The Controller argues that the audit was conducted in accordance with Government Auditing Standards, and that those standards allow auditors to "use professional judgment in 'selecting the methodology, determining the type and amount of evidence to be gathered, and choosing the tests and procedures for their work.'"[103] In addition, the Controller notes that the auditing standards state: "statistical methods may be used to establish sufficiency."[104]

IV. Discussion

Government Code section 17561(b) authorizes the Controller to audit the claims filed by local agencies and school districts and to reduce any claim for reimbursement of state mandated costs that the Controller determines is excessive or unreasonable.

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to a local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9 of the Commission's regulations requires the Commission to send the decision to the Controller and request that the costs in the claim be reinstated.

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[105] The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."[106]

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to

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[101] Exhibit E, Controller's Comments on Draft Proposed Decision, page 2.

[102] Exhibit C, Controller's Late Comments on IRC, page 17.

[103] Exhibit C, Controller's Late Comments on IRC, page 17 [citing Government Auditing Standards, Section 3.35, 2003 Revision, United States General Accounting Office].

[104] Exhibit C, Controller's Late Comments on IRC, page 17.

[105] *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

[106] *County of Sonoma, supra*, 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.[107] Under this standard, the courts have found that:

> When reviewing the exercise of discretion, "[t]he scope of review is limited, out of deference to the agency's authority and presumed expertise: 'The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]'"…"In general…the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support…" [Citations.] When making that inquiry, the " ' "court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "[108]

The Commission must review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with claimant. [109] In addition, section 1185.1(f)(3) and 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[110]

A. The Controller Met the Statutory Deadline for the Initiation and Completion of the Original Audit, but the Revised Audit Report Was Not Completed Within the Two Year Statutory Deadline.

1. <u>The Final Audit Report Issued December 30, 2004 Was Timely, Pursuant to Government Code Section 17558.5.</u>

The Commission finds that the audit is both timely initiated and timely completed, based on the plain language of section 17558.5, as added by Statutes 1995, chapter 945, and as amended by Statutes 2002, chapter 1128. The 1995 version of section 17558.5 provides as follows:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller *no later than two years after the end of the calendar year* in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[111]

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[107] *Johnston v. Sonoma County Agricultural Preservation and Open Space District* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

[108] *American Bd. of Cosmetic Surgery, Inc, supra*, 162 Cal.App.4th 534, 547-548.

[109] *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

[110] Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission's decision is not supported by substantial evidence in the record.

[111] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)) [emphasis added].

Based only upon the plain language of this section, the earliest claim in issue, fiscal year 1999-2000, filed January 11, 2001, would be "subject to audit" until the end of the calendar year 2003. The Commission finds that "subject to audit" does not require the completion of an audit before the end of the calendar year; initiating an audit before the expiration of that period is sufficient. This interpretation is supported by reading the two sentences above together, and interpreting them in a manner that seeks to harmonize the provisions. The second sentence provides that if no funds are appropriated for a program, the *time to initiate an audit* will be tolled until the initial payment; however, the second sentence does not state what that time frame should be, but relies on the "two years after the end of the calendar year" of the first sentence. In relying on the time period defined in the first sentence, the second sentence clearly states that the tolling shall affect "the time for the Controller to initiate an audit." There is no reason in law or in the record of this IRC to interpret "subject to audit" in the first sentence to mean something other than "the time for the Controller to initiate an audit."

Additionally, the interpretation that "subject to audit" means the time to initiate an audit is further supported by the clarifying amendment made by Statutes 2002, chapter 1128, which provides:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than ~~two~~ three years after the ~~end of the calendar year in which~~ date that the actual reimbursement claim is filed or last amended, whichever is later. However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the claim is ~~made~~ filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[112]

Moreover, the period provided under the prior statute was open until December 31, 2003, and this amendment was effective January 1, 2003. Because the amendment expanded the statutory period while the audit at issue in this matter was still pending, the Controller receives the benefit of the additional time.[113] Therefore, based on the plain language as amended in 2002 (effective

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[112] Government Code section 17558.5 (Stats. 2002, ch. 1128 (AB 2834)).

[113] In *Douglas Aircraft v. Cranston* (1962) 58 Cal.2d 462, 465, the court stated the general rule as follows:

> The extension of the statutory period within which an action must be brought is generally held to be valid if made before the cause of action is barred. (*Weldon v. Rogers*, 151 Cal. 432.) The party claiming to be adversely affected is deemed to suffer no injury where he was under an obligation to pay before the period was lengthened. This is on the theory that the legislation affects only the remedy and not a right. (*Mudd v. McColgan*, 30 Cal.2d 463; *Davis & McMillan v. Industrial Acc. Com.*, 198 Cal. 631; 31 Cal.Jur.2d 434.) An enlargement of the limitation period by the Legislature has been held to be proper in cases where the period had not run against a corporation for additional franchise taxes (*Edison Calif. Stores, Inc. v. McColgan*, 30 Cal.2d 472), against an individual for personal income taxes (*Mudd v. McColgan, supra*, 30 Cal.2d 463), and against a judgment debtor (*Weldon v. Rogers, supra*, 151 Cal. 432). It has been held that unless the statute

January 1, 2003), the reimbursement claims in issue would be "*subject to the initiation of an audit*" until three years after the claims were filed, or January 11, 2004, for the 1999-2000 reimbursement claim. Because an entrance conference was held March 5, 2003, the audit was initiated prior to the running of the statutory period, under either the 1995 version of section 17558.5, or as amended in 2002, and the audit was therefore timely initiated.[114]

The only reading of these facts and of section 17558.5 that could bar the subject audits would be to hold that section 17558.5 requires an audit to be *completed* within two years of filing, in which case the final audit report issued December 30, 2004 would be barred. This is the interpretation urged by the claimant, but this reading of the code is not supported by the plain language of the statute, as explained above. At the time the costs were *incurred* in this case, section 17558.5 did not expressly fix the time during which an audit must be completed. Nevertheless, the Controller was still required under common law to complete the audit within a reasonable period of time. Under appropriate circumstances, the defense of laches may operate to bar a claim by a public agency if there is evidence of unreasonable delay by the agency and resulting prejudice to the claimant.[115] However, here the audit report was issued December 30, 2004, less than 22 months after the entrance conference on March 5, 2003. Thus, there is no evidence of an unreasonable delay in the completion of the audit in this case.

Based on the foregoing, the Commission finds that the final audit of the subject reimbursement claims was both timely initiated and timely completed, and is not barred by section 17558.5.

2. <u>The Revised Audit Issued November 25, 2009 Was Issued Beyond the Deadline Imposed by Section 17558.5, but May Be Considered by the Commission to the Extent That it Narrows the Issues in Dispute or Makes Concessions to the Claimant.</u>

Statutes 2004, chapter 890 (AB 2856) amended Government Code section 17558.5, to provide that "[i]n any case, an audit *shall be completed* not later than two years after the date that the audit is commenced." Applying the amended section to the date of initiation, *no later than* the March 5, 2003 entrance conference, means a timely audit would be required to be completed by March 5, 2005 at the latest.

The courts of this state have held that "[i]t is settled that the Legislature may enact a statute of limitations 'applicable to existing causes of action or shorten a former limitation period if the time allowed to commence the action is reasonable."[116] The courts have held that "[a] party does not have a vested right in the time for the commencement of an action."[117] And neither "does he

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expressly provides to the contrary any such enlargement applies to matters pending but not already barred. (*Mudd v. McColgan*, *supra,* 30 Cal.2d 463.)

[114] See Exhibit C, Controller's Late Comments on IRC, page 27.

[115] *Cedar-Sinai Medical Center v. Shewry* (2006) 137 Cal.App.4th 964, 985-986.

[116] *Scheas v. Robertson* (1951) 38 Cal.2d 119, 126 [citing *Mercury Herald v. Moore* (1943) 22 Cal.2d 269, 275; *Security-First National Bank v. Sartori* (1939) 34 Cal.App.2d 408, 414].

[117] *Liptak v. Diane Apartments, Inc.* (1980) 109 Cal.App.3d 762, 773 [citing *Kerchoff-Cuzner Mill and Lumber Company v. Olmstead* (1890) 85 Cal. 80].

have a vested right in the running of the statute of limitations prior to its expiration."[118] A statute of limitation is "within the jurisdictional power of the legislature of a state," and therefore may be altered or amended at the Legislature's prerogative.[119] However, "[t]here is, of course, one important qualification to the rule: where the change in remedy, as, for example, the shortening of a time limit provision, is made retroactive, there must be a reasonable time permitted for the party affected to avail himself of his remedy before the statute takes effect."[120] If a statute "operates immediately to cut off the existing remedy, or within so short a time as to give the party no reasonable opportunity to exercise his remedy, then the retroactive application of it is unconstitutional as to such party."[121] In other words, a party has no more vested right to the time remaining on a statute of limitation than the opposing party has to the swift expiration of the statute, but if a statute is newly imposed or shortened, due process demands that a party must be granted a reasonable time to vindicate an existing claim before it is barred. The California Supreme Court has held that approximately one year is more than sufficient, but has cited to decisions in other jurisdictions providing as little as thirty days.[122]

However, with respect to state agencies' rights and powers, *California Employment Stabilization Commission v. Payne*[123] held:

> This principle, however, does not apply where the state gives up a right previously possessed by it or by one of its agencies. Except where such an agency is given powers by the Constitution, it derives its authority from the Legislature, which may add to or take away from those powers and therefore a statute which adversely affects only the right of the state is not invalid merely because it operates to cut off an existing remedy of an agency of the state.[124]

Thus, the Controller's authority to audit is subject to limitation by the Legislature, even to the extent that the authority may be unexpectedly cut off.

Here, the Controller's audit of the relevant claim years was "commenced," within the meaning of section 17558.5, no later than March 5, 2003, when the entrance conference was held. The amendment to section 17558.5 that imposed the two year completion requirement became

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[118] *Liptak, supra*, 773 [citing *Mudd v. McColgan* (1947) 30 Cal.2d 463, 468].

[119] *Scheas, supra*, 126 [citing *Saranac Land & Timber Co v. Comptroller of New York*, 177 U.S. 318, at p. 324].

[120] *Rosefield Packing Company v. Superior Court of the City and County of San Francisco* (1935) 4 Cal.2d 120, 122.

[121] *Rosefield Packing Co., supra*, 122-123.

[122] See *Rosefield Packing Co., supra*, 123 ["The plaintiff, therefore, had practically an entire year to bring his case to trial…"]; *Kerchoff-Cuzner Mill and Lumber Company v. Olmstead* (1890) 85 Cal. 80 [thirty days to file a lien on real property]. See also *Kozisek v. Brigham* (Minn. 1926) 169 Minn. 57, 61 [three months].

[123] *California Employment Stabilization Commission v. Payne* (1947) 31 Cal.2d 210.

[124] *Id.*, page 215.

effective January 1, 2005.[125] Therefore, a timely audit must be completed by March 5, 2005 at the latest, and the Controller had over two months' notice of the requirement to complete the audit within two years. Based on the case law described above, two months' notice to complete the audit is sufficient, and the Legislature's action cutting off the Controller's power to effectively audit must be upheld. As explained above, the original "final" audit report was timely, being issued December 30, 2004. However, the revised audit report, *modifying the original* "final" audit report, was issued on November 25, 2009, approximately six years and eight months after the audit was initiated. It therefore falls outside the statutory two year completion requirement imposed by section 17558.5, as amended by Statutes 2004, chapter 890.

The Commission notes that the revised audit report states that it recalculated the extrapolated error rates, and increased allowable costs, in part as a response to the claimant's filing of this IRC. Although the revised audit is beyond the deadlines imposed by 17558.5, the Commission may take official notice[126] of the revised audit report, to the extent that the revised audit report narrows the issues in dispute or mitigates the amount of reductions originally asserted by the Controller.

Based on the foregoing, the Commission finds that the revised audit report issued November 25, 2009 was not completed within the deadline required by section 17558.5, but may be considered by the Commission to the extent that it narrows the issues in dispute or makes concessions to the claimant with respect to its allegations in the IRC.

B. The Controller's Reduction Based on the Former Definition of Truant Is Inconsistent with the Education Code, and Is Incorrect as a Matter of Law, but Reductions Based on the Current Definition of Truant Are Correct as a Matter of Law and Not Arbitrary, Capricious or Entirely Lacking in Evidentiary Support.

The parameters and guidelines provide for a uniform cost allowance "based on the number of initial notifications of truancy distributed pursuant to Education Code Section 48260.5, as added by Chapter 498, Statutes of 1983."[127] As enacted in 1976, and as analyzed by the Board of Control in its November 29, 1984 decision, Education Code section 48260 stated that a pupil who is absent or tardy from school without valid excuse for "more than three days in one school year" is a truant, as follows:

> Any pupil subject to compulsory full-time education or to compulsory continuation education who is absent from school without valid excuse more than three days or tardy in excess of 30 minutes on each of more than three days in one school year is a truant and shall be reported to the attendance supervisor or to the superintendent of the school district.

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[125] The precise date of initiation is not determined in this analysis since it is unnecessary to the determination that the first audit was timely initiated and completed and the second audit was not.

[126] Code of Regulations, title 2, section 1187.5(c) ["Official notice may be taken in the manner and of the information described in Government Code section 11515."].

[127] Exhibit A, IRC 07-904133-I-05, page 33.

Accordingly, the parameters and guidelines as originally adopted, and as amended July 22, 1993, included the then-current definition of a "truant" under Section I., Summary of Mandate:

> A truancy occurs when a student is absent from school without valid excuse *more than three* (3) days or is tardy in excess of thirty (30) minutes on each of more than three (3) days in one school year. (Definition from Education Code Section 48260).[128]

Subsequent to the adoption and 1993 amendment of parameters and guidelines for this program, section 48260 was amended by Statutes 1994, chapter 1023 (SB 1728) and Statutes 1995, chapter 19 (SB 102) to provide that a pupil who is absent or tardy from school without valid excuse "*on three occasions* in on school year" is a truant. Therefore during the fiscal years here at issue section 48260 stated:

> Any pupil subject to compulsory full-time education or to compulsory continuation education who is absent from school without valid excuse *three full days* in one school year or *tardy or absent* for more than any 30-minute period during the schoolday without a valid excuse *on three occasions* in one school year, or any combination thereof, is a truant and shall be reported to the attendance supervisor or to the superintendent of the school district.[129]

No test claim or request to amend parameters and guidelines was ever submitted by a school district on the 1994 and 1995 statutes. However, section 48260 is definitional and was never found to impose any mandated activities on school districts. Accordingly, the section 48260 definition of truancy was not included as a reimbursable activity under the "Reimbursable Costs" section of the parameters and guidelines and the unit cost for sending notices was not increased when that definition was later updated to reflect current law in a 2008 amendment to the parameters and guidelines.

The 1994 statute also changed the content of the notice required by the test claim statute (Education Code section 48260.5) to require school districts to also notify the pupil's parent or guardian that the pupil may be subject to prosecution; or may be subject to suspension or restriction of driving privileges; and that "it is recommended that the parent or guardian accompany the pupil to school…for one day."[130] The parameters and guidelines were amended to reflect the changes made by the 1994 and 1995 statutes, on January 31, 2008, pursuant to Legislative direction enacted in Statutes 2007, chapter 69. The amendments were made expressly retroactive to July 1, 2006, in accordance with the Legislature's direction.[131]

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[128] See Exhibit C, Controller's Late Comments on IRC, page 9 [emphasis added].

[129] Former Education Code section 48260 (as amended, Stats. 1995, ch. 19 (SB 102)).

[130] Education Code section 48260.5 (as amended, Stats. 1994, ch. 1023 (SB 1728)).

[131] Statutes 2007, chapter 69 (AB 1698) states:

> Notwithstanding any other provision of law, by January 31, 2008, the Commission on State Mandates shall amend the parameters and guidelines regarding the notification of truancy, test claim number SB-90-4133, and modify the definition of a truant and the required elements to be included in the initial truancy notifications to conform reimbursable activities to Chapter 1023 of the

Based on the analysis herein, the Commission finds that the Controller's reductions of costs claimed for notifications issued upon a pupil's third unexcused absence or instance of tardiness are incorrect as a matter of law. However, the Commission also finds that reductions for notifications issued for pupils that did not accumulate three unexcused absences or instances of tardiness are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

1. Reductions based on pupils who accumulated three, but not four, unexcused absences or instances of tardiness are incorrect as a matter of law.

The dispositive issue in this IRC is whether the Controller may reduce costs claimed for a mandated program which has not changed (to provide notices) based upon an obsolete definition included in the parameters and guidelines which the Board of Control and the Commission never found to impose the mandate in the first instance. The Commission finds, as explained herein, that the Controller's reductions based on notices provided for three or more unexcused instances of tardiness or absence for pupils subject to compulsory education are incorrect as a matter of law, because the Education Code was amended to change the definition of "truant" from a pupil accruing four or more unexcused absences to a pupil accruing three or more unexcused absences or instances of tardiness, or any combination thereof.

The Controller protests, in comments filed on the draft proposed decision, that this result is inconsistent with the plain language of Statutes 2007, chapter 69, which directed the Commission to amend the parameters and guidelines, effective July 1, 2006. The Controller argues that applying the current definition of "truant" in this incorrect reduction claim amounts to a retroactive amendment of the parameters and guidelines, which is not authorized by Statutes 2007, chapter 69.[132] In addition, the Controller challenges the distinction made between "definitional" and "mandatory" provisions.[133] And finally, the Controller argues that applying the current definition of an initial truant "ignores the basic concepts and procedures of the mandate process," in that the burden to establish reimbursement is on the claimant, and "there may often be discrepancies between what a local [agency] is legally obligated to do, and what they are reimbursed for doing."[134] The Controller argues that the amendment to Education Code section 48260 constitutes a new program or higher level of service, and that "the only way for the claimant's to receive reimbursement therefore, would have been for them to file a test claim, which no school district ever did."[135]

The Commission disagrees. The Commission has never found the amendment to Education Code section 48260 to impose a new program or higher level of service and the unit cost for providing the notices was unchanged by the amendment to parameters and guidelines. The

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> Statutes of 1994 and Chapter 19 of the Statutes of 1995…Changes made by the commission to the parameters and guidelines shall be deemed effective on July 1, 2006.

[132] Exhibit E, Controller's Comments on Draft Proposed Decision, pages 1-2.

[133] Exhibit E, Controller's Comments on Draft Proposed Decision, page 2.

[134] Exhibit E, Controller's Comments on Draft Proposed Decision, page 2.

[135] Exhibit E, Controller's Comments on Draft Proposed Decision, page 3.

Controller's interpretation is untenable, and inconsistent with the findings of the Commission in the test claim decision, the decisions on the parameters and guidelines and amendment thereto and the terms of the parameters and guidelines themselves.

As explained above, when Education Code section 48260 was amended in 1994 and 1995, it created a discrepancy between what triggered the mandated activities under law and what the parameters and guidelines in effect during that period stated was the trigger under the Summary of Mandate. The inconsistency was corrected by an amendment to the parameters and guidelines adopted January 31, 2008 (an amendment made retroactive to July 1, 2006), but for over a decade the requirements of the code and language included in the parameters and guidelines were at odds. In 2007, the Legislature acted to correct the problem at the request of the State Controller's Office, recognizing that: "The school districts must adhere to the state statute, nevertheless, the State Controller uses the commission's parameters and guidelines to conduct the audits." The discrepancy, the Legislature found, "forces the State Controller's Office to request school districts to return the reimbursements even though the districts have been following the law."[136] As a result, the Legislature directed the Commission to amend the parameters and guidelines, the committee analysis noting that "[t]he commission is no longer able to update the definition of truancy due to one-year statute of limitations on revisions following amending statute."[137]

When an amendment to a code section or regulation imposes a new program or higher level of service that increases the costs of a local government, a test claim must be filed within one year of the effective date of the amendment or subsequent statute in order for the local government to exercise its right to reimbursement under the Constitution, as alluded to by the committee analysis comments on AB 1698.[138] But here, the amendment to section 48260 did not impose a new activity, let alone a new program or higher level of service that increased costs; the amendment affected only the *definition* of truancy. Education Code section 48260 is definitional, and does not contain any mandatory or directory language. [139] And no change has been made to the mandated activities. However, under the Controller's interpretation, a school district complying with the law would be foreclosed from reimbursement. As explained above, reimbursement is required by article XIII B, section 6 of the California Constitution to issue notification upon the pupil's *initial* classification as a truant, as defined by the Legislature (i.e., on or after the third unexcused absence or instance of tardiness as currently defined). This activity has been approved as a reimbursable state-mandated activity since the adoption of the test claim decision, and the activity continues to be mandated by the state. Thus, the Commission's finding is not tantamount to a retroactive amendment to the parameters and guidelines.

Therefore, section 48260 was amended without altering the scope of the mandated activities, and reimbursement under the terms of the approved code section (48260.5) for sending a notice

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[136] Exhibit G, Assembly Bill 1698 (2007), Education Committee Analysis.

[137] Exhibit G, Assembly Bill 1698 (2007), Education Committee Analysis.

[138] Government Code section 17551.

[139] An amendment to the definition of truancy may have also necessitated altering the text or content of the notice, but section 48260 made no such express requirement.

"upon a pupil's initial classification as a truant," does not require a new test claim finding, or even an amendment to the parameters and guidelines based on changes to section 48260. This interpretation is consistent with the Board of Control's original test claim decision, which found that section 48260.5, and not section 48260, imposed the mandate. This reasoning is also consistent with the prior parameters and guidelines, in which the definition of truancy was not included as a reimbursable activity under the "Reimbursable Costs" section.

The Controller's auditors in this case reasonably relied on the outdated definition of truancy included in the "Summary of Mandate" section of the 1993 parameters and guidelines (*i.e.*, *more than three* unexcused absences or instances of tardiness). The Controller correctly asserts that "[t]he parameters and guidelines as adopted on July 22, 1993, are the applicable audit criteria for the purposes of this audit."[140] And here, the parameters and guidelines, which "helpfully" included the text of a definition (which was *not* the subject of the mandate finding) in the Summary of Mandate, rather than citing to the code section where the definition could be found, were understandably a source of confusion for the auditors.

However, the Commission finds that because the amendment to section 48260 affected only the definition of truancy, and not the mandated program, neither a new test claim nor parameters and guidelines amendment was necessary for the districts to continue to be reimbursed for complying with the approved mandate imposed by section 48260.5 that "*upon a pupil's initial classification as a truant*, the school district shall notify the pupil's parent or guardian."

Based on the foregoing, the Commission finds that reductions based on pupils who accumulated three unexcused absences or instances of tardiness are incorrect as a matter of law. All costs reduced on this basis should be reinstated to the claimant.

2. Reductions based on pupils who did not accumulate three unexcused absences or instances of tardiness during the school year are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

The Controller also found that a small portion of the notifications claimed were issued for students who did not accumulate even *three* unexcused absences or instances of tardiness. In those cases, the pupils at issue did not meet the *amended* definition of a truant under the Education Code, and the claimant's issuance of a notification was not mandated by the state.

The revised audit report states that for fiscal year 1999-2000, of the 294 notifications sampled, one was issued to a middle or high school student, and five to elementary or special education students who had fewer than three unexcused absences or instances of tardiness during the school year. For fiscal year 2000-2001, of 294 notifications sampled, one was issued to a middle or high school student, and eight to elementary or special education students who had fewer than three unexcused absences or instances of tardiness. And for fiscal year 2001-2002, of 295 notifications sampled, only one was issued to a student (an elementary or special education student) who had fewer than three unexcused absences or instances of tardiness.[141] Therefore, during the audit period, and within the sample of notifications examined by the Controller, 16

[140] Exhibit C, Controller's Late Comments on IRC, page 11.

[141] Exhibit B, IRC 10-904133-I-07, page 28.

initial notifications were sent for pupils who did not accumulate three unexcused absences during the school year.

As discussed above, Education Code section 48260, during the fiscal years here at issue, provided:

> Any pupil subject to compulsory full-time education or to compulsory continuation education who is absent from school without valid excuse three full days in one school year or tardy or absent for more than any 30-minute period during the schoolday without a valid excuse on three occasions in one school year, or any combination thereof, is a truant and shall be reported to the attendance supervisor or to the superintendent of the school district.[142]

Section 48260.5, as approved by the Board of Control's test claim decision, and as described in the Commission's 1993 parameters and guidelines, requires a school district to issue a notification of truancy "by first-class mail or other reasonable means" to the pupil's parent or guardian "upon a pupil's initial classification as a truant…"[143]

Therefore, the mandated program as approved by the Board of Control, and as articulated in the parameters and guidelines, is to issue a notification of truancy to a pupil's parent or guardian upon the pupil's initial classification as a truant. If a pupil cannot be classified as a truant, as defined in section 48260, a notification is not required, and any notification sent to that pupil's parent or guardian, whether or not intentional, is not reimbursable.

Based on the foregoing, the Commission finds that reductions based on pupils who did not accumulate three unexcused absences or instances of tardiness during the school year are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

C. The Controller's Reductions Based on Statistical Sampling and Extrapolation Are Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

In its audit, the Controller examined a random sample of notices issued by the claimant, for each fiscal year, to determine the proportion of notifications that were unallowable for the Controller's asserted legal reasons. The number of unallowable notifications within the sample for each fiscal year was then calculated as an error percentage, and extrapolated to the total number of notifications issued by the claimant, to project a total number of unallowable notifications, which was then multiplied by the unit cost for that year to estimate the reduction. In the final audit report, a single error rate was calculated for all K-12 and special education students, which the claimant challenged as non-representative, due to the claimant's assertion that "the incidence of truancy in secondary schools is generally greater than elementary schools."[144] Therefore, in its revised audit, the Controller calculated error rates for elementary and special education students separately from middle and high school students, and extrapolated (projected) a number of

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[142] Former Education Code section 48260 (as amended, Stats. 1995, ch. 19 (SB 102)).

[143] See, e.g., Exhibit C, Controller's Late Comments on IRC, page 9 [quoting the Commission's 1993 parameters and guidelines]. See also, former Education Code section 48260.5 (Stats. 1983, ch. 498) ["Upon a pupil's initial classification as a truant, the school district shall notify…"].

[144] See Exhibit A, IRC 07-904133-I-05, page 15.

unallowable notifications separately for each population.[145] The claimant responded in its revised IRC that "[t]he bifurcation of the extrapolation universe may be *more representative* in terms of the calculation of the extrapolated amount, but the District still disputes the use of the sampling method for the reasons stated in the original incorrect reduction claim."[146]

The methodology results in an estimate of the amount of claimed costs that the Controller has determined to be excessive or unreasonable. The Controller states that "the point estimate provides the best, and thus reasonable, single estimate of the population's error rate."[147] In the revised audit that estimate totals $87,177 for all fiscal years.[148] The Controller asserts that sampling and extrapolation is an audit tool commonly used to identify error rates; that there is no law or regulation prohibiting that method; and, that the claimant misstates and misunderstands the meaning of an expected error rate and confidence interval. The Controller argues that its method is reasonable, and "the Administrative Procedures Act [sic] is not applicable."[149]

The claimant argues that the Controller's statistical sampling and extrapolation method is not legally supported, not correctly applied to state-mandated reimbursement, and is inappropriately error-prone and inaccurate. The claimant further argues that "[t]he propriety of a mandate audit adjustment based on the statistical sampling technique is a threshold issue in that if the methodology used is rejected, as it should be, the extrapolation is void and the audit findings can only pertain to documentation actually reviewed, that is, the 883 notifications used in the audit report."[150] The claimant further attacks the statistical reliability and accuracy of the Controller's methodology, arguing that "[t]esting to detect the rate of error within tolerances is the purpose of sampling, but it is not a tool to assign an exact dollar amount to the amount of the error, which the Controller has inappropriately done so here."[151] The claimant argues that "[l]ess than two percent of the total number of notices were audited…" and that "[t]he expected error rate is stated to be 50%, which means the total amount adjusted of $108,307 is really just a number exactly between $54,154 (50%) and $162,461 (150%)."[152] And, the claimant challenges the Controller's failure to adopt the methodology as a regulation pursuant to the Administrative Procedure Act (APA).[153]

Based on the analysis herein, the Commission finds that sampling and extrapolation as a methodology to identify a dollar figure for an audit adjustment in this case is not applied

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[145] Exhibit B, IRC 10-904133-I-07, pages 27-28.

[146] Exhibit B, IRC 10-904133-I-07, page 9 [Emphasis added].

[147] Exhibit C, Controller's Late Comments on IRC, page 22.

[148] Exhibit B, IRC 10-904133-I-07, page 28.

[149] Exhibit C, Controller's Late Comments on IRC, page 17.

[150] Exhibit A, IRC 07-904133-I-05, page 13.

[151] Exhibit A, IRC 07-904133-I-05, page 14.

[152] Exhibit A, IRC 07-904133-I-05, page 16 [These figures are based on the reduction taken in the first final audit report, in the amount of $108,307, which was revised to $87,117 in the revised audit report].

[153] Exhibit A, IRC 07-904133-I-05, pages 13-17.

generally in the manner of a regulation, and provides for a reasonable estimate of unallowable costs, and is therefore not arbitrary, capricious, or entirely lacking in evidentiary support.

1. The evidence in the record does not support claimant's argument that the statistical sampling and extrapolation method used in the audit of the claimant's reimbursement claims constitutes an underground regulation.

The claimant has challenged the statistical sampling methodology applied in this case as a regulation not adopted pursuant to the APA, to which the Controller responds that the APA is "not applicable."[154] Based on the analysis below, the Commission finds that the evidence in the record does not support the argument that the statistical sampling and extrapolation method applied here is a "regulation" within the meaning of the APA, and therefore was required to be adopted pursuant to the APA's public notice and comment requirements.

The relevant portions of the APA include Government Code sections 11340.5 and 11342.600. Government Code Section 11340.5 provides, in pertinent part:

> No state agency shall issue, utilize, enforce, or attempt to enforce any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a regulation as defined in Section 11342.600, unless [the rule] has been adopted as a regulation and filed with the Secretary of State pursuant to this chapter.[155]

Section 11342.600, in turn, defines a regulation to mean "…every rule, regulation, order, or standard of general application or the amendment, supplement, or revision of any rule, regulation, order, or standard adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure."[156] Finally, Government Code section 11346 provides that "[e]xcept as provided in Section 11346.1, the provisions of this chapter are applicable to the exercise of any quasi-legislative power conferred by any statute heretofore or hereafter enacted, but nothing in this chapter repeals or diminishes additional requirements imposed by any statute." Section 11346 continues: "This chapter shall not be superseded or modified by any subsequent legislation except to the extent that the legislation shall do so expressly."[157] Therefore, if the Controller's challenged audit methods constitute a regulation not adopted pursuant to the APA, the Commission cannot uphold the reductions.

The seminal authority on so-called "underground regulations" is the California Supreme Court's opinion in *Tidewater Marine Western v. Bradshaw*,[158] in which a group of shipping companies and associations challenged the application of the Industrial Welfare Commission's (IWC's) wage orders to their businesses and employees as an invalid underground regulation, not adopted under the APA.

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[154] Exhibit C, Controller's Late Comments on IRC, page 17.

[155] Government Code section 11340.5 (Stats. 2000, ch. 1060).

[156] Government Code section 11342.600 (Stats. 2000, ch. 1060).

[157] Government Code section 11346 (Stats. 1994, ch. 1039; Stats. 2000, ch. 1060).

[158] *Tidewater Marine Western v. Bradshaw* (1996) 14 Cal.4th 557.

Tidewater Marine Western, Inc. (Tidewater) and Zapata Gulf Pacific, Inc. (Zapata) were two of the petitioners whose principal business was transporting workers and supplies between oil-drilling platforms in the Santa Barbara Channel and coastal ports. The employees at the center of the dispute were California residents, working 12 hour shifts with intermittent break or rest periods, at a flat daily rate without overtime pay, which the employers explained was reasonable because: "the demands of work are inconstant, and crew members may spend part of this duty period engaged in leisure activities."[159] The IWC had existing wage orders for transportation employees and for technical and mechanical employees, which required an overtime pay rate when an employee worked more than eight hours in any twenty-four hour period. Beginning in 1978, maritime employees had begun filing claims under these wage orders with the Division of Labor Standards Enforcement (DLSE), which examined those claims on a case-by-case basis, "considering such factors as the type of vessel, the nature of its activities, how far it traveled from the California coast, how long it was at sea, and whether it left from and returned to the same port…"[160] After an unstated number of these claims, "DLSE eventually replaced this case-by-case adjudication with a written enforcement policy, which provides: 'IWC standards apply to crews of fishing boats, cruise boats, and similar vessels operating exclusively between California ports, or returning to the same port, if the employees in question entered into employment contracts in California and are residents of California.'"[161] Initially, this written policy was contained in a "draft policy manual" that DLSE created to guide its deputy labor commissioners, but in 1989, DLSE formalized the policy in its "Operations and Procedures Manual," which was available to the public upon request. The manual, prepared internally and without public input, "reflected 'an effort to organize…interpretive and enforcement policies' of the agency and 'achieve some measure of uniformity from one office to the next.'"[162]

In 1987, the DLSE began applying the IWC's wage order requiring overtime pay to the maritime workers in the Santa Barbara Channel, including those of Tidewater and Zapata, which were among the entities that brought suit to challenge the application of the order on several grounds, including the theory that application of the order constituted an underground regulation.

The Court noted that while "DLSE's primary function is enforcement, not rulemaking," DLSE does have power to promulgate "regulations and rules of practice and procedure."[163] The Court further noted that the Labor Code does not include special rulemaking procedures for DLSE, "nor does it expressly exempt the DLSE from the APA."[164] The Court analyzed the underground regulation challenge raised by Tidewater, beginning with the requirements and underlying purpose of the APA, as follows:

> The APA establishes the procedures by which state agencies may adopt regulations. The agency must give the public notice of its proposed regulatory

[159] *Tidewater*, *supra*, 14 Cal.4th 557, 561.

[160] *Id.*, page 562.

[161] *Ibid.*

[162] *Ibid.*

[163] *Tidewater*, *supra*, 14 Cal.4th 557, 570.

[164] *Ibid.* [Citing Labor Code § 98.8].

> action (Gov. Code, §§ 11346.4, 11346.5); issue a complete text of the proposed regulation with a statement of the reasons for it (Gov. Code, § 11346.2, subds. (a), (b)); give interested parties an opportunity to comment on the proposed regulation (Gov. Code, § 11346.8); respond in writing to public comments (Gov. Code, §§ 11346.8, subd. (a), 11346.9); and forward a file of all materials on which the agency relied in the regulatory process to the Office of Administrative Law (Gov. Code, § 11347.3, subd. (b)), which reviews the regulation for consistency with the law, clarity, and necessity (Gov. Code, §§ 11349.1, 11349.3).
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> One purpose of the APA is to ensure that those persons or entities whom a regulation will affect have a voice in its creation (*Armistead v. State Personnel Board* (1978) 22 Cal.3d 198, 204-205 (*Armistead*)), as well as notice of the law's requirements so that they can conform their conduct accordingly (*Ligon v. State Personnel Bd.* (1981) 123 Cal.App.3d 583, 588 (*Ligon*)). The Legislature wisely perceived that the party subject to regulation is often in the best position, and has the greatest incentive, to inform the agency about possible unintended consequences of a proposed regulation. Moreover, public participation in the regulatory process directs the attention of agency policymakers to the public they serve, thus providing some security against bureaucratic tyranny. (See *San Diego Nursery Co. v. Agricultural Labor Relations Bd.* (1979) 100 Cal.App.3d 128, 142-143.)[165]

The Court in *Tidewater* found that the APA "defines 'regulation' very broadly." The Court explained that a regulation has two principal characteristics:

> First, the agency must intend its rule to apply generally, rather than in a specific case. The rule need not, however, apply universally; a rule applies generally so long as it declares how a *certain class of cases* will be decided. Second, the rule must "implement, interpret, or make specific the law enforced or administered by [the agency], or ... govern [the agency's] procedure."[166]

The Court acknowledged that "interpretations that arise in the course of case-specific adjudication are not regulations, though they may be persuasive as precedents in similar subsequent cases;"[167] and, "[s]imilarly, agencies may provide private parties with advice letters, which are not subject to the rulemaking provisions of the APA."[168] And, the Court reasoned that "if an agency prepares a policy manual that is no more than a restatement or summary, without

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[165] *Tidewater, supra*, 14 Cal.4th 557, 568-569 [Italics supplied].

[166] *Tidewater, supra*, 14 Cal.4th 557, 571 (emphasis added) [Citing *Roth v. Department of Veteran Affairs* (1980) 110 Cal.App.3d 622, 630; Gov. Code § 11342(g)].

[167] *Ibid*. [Citing *Bendix Forest Products Corp. v. Division of Occupational Safety and Health* (1979) 25 Cal.3d 465, 471; *Carmona v. Division of Industrial Safety* (1975) 13 Cal.3d 303, 309-310; *Taye v. Coye* (1994) 29 Cal.App.4th 1339, 1345; *Aguilar v. Association for Retarded Citizens* (1991) 234 Cal.App.3d 21, 28].

[168] *Tidewater, supra*, 14 Cal.4th 557, 571 [citing Government Code sections 11343; 11346.1].

commentary, of the agency's prior decisions in specific cases and its prior advice letters, the agency is not adopting regulations."[169]

The Court cited a number of examples in which a policy or rule was or was not held to be a regulation,[170] but applying the above reasoning, the Court concluded that the application of the challenged wage orders to the plaintiffs was indeed an invalid underground regulation:

> The policy at issue in this case was expressly intended as a rule of general application to guide deputy labor commissioners on the applicability of IWC wage orders to a particular type of employment. In addition, the policy interprets the law that the DLSE enforces by determining the scope of the IWC wage orders. Finally, the record does not establish that the policy was, either in form or substance, merely a restatement or summary of how the DLSE had applied the IWC wage orders in the past. Accordingly, the DLSE's enforcement policy appears to be a regulation within the meaning of Government Code section 11342, subdivision (g), and therefore void because the DLSE failed to follow APA procedures.[171]

The Court went on to distinguish or disapprove prior cases finding that a challenged policy or position of the DLSE was not an underground regulation,[172] and pointed out that if the current interpretation were the only reasonable interpretation, as argued by DLSE, it would not be

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[169] *Ibid*. [citing Labor Code section 1198.4].

[170] *Tidewater, supra*, 14 Cal.4th 557, 571-572 ["Examples of policies that courts have held to be regulations subject to the rulemaking procedures of the APA include: (1) an informational "bulletin" defining terms of art and establishing a rebuttable presumption (*Union of American Physicians & Dentists v. Kizer*, [(*UAPD*) (1990)] 223 Cal.App.3d [490,] 501); (2) a "policy of choosing the most closely related classification" for determining prevailing wages for unclassified workers (*Division of Lab. Stds. Enforcement v. Ericsson Information Systems, Inc.* (1990) 221 Cal.App.3d 114, 128); and (3) a policy memorandum declaring that work performed outside one's job classification does not count toward qualifying for a promotion (*Ligon, supra*, 123 Cal.App. [583,] 588). In contrast, examples of policies that courts have held not to be regulations include: (1) a Department of Justice checklist that officers use when administering an intoxilyzer test (*People v. French* (1978) 77 Cal.App.3d 511, 519); (2) the determination whether in a particular case an employer must pay employees whom it requires to be on its premises and on call, but whom it permits to sleep (*Aguilar* [*v. Association for Retarded Citizens* (1991)] 234 Cal.App.3d [21,] 25-28); (3) a contractual pooling procedure whereby construction tax revenues are allocated among a county and its cities in the same ratio as sales tax revenues (*City of San Joaquin v. State Bd. of Equalization* (1970) 9 Cal.App.3d 365, 375); and (4) resolutions approving construction of the Richmond-San Rafael Bridge and authorizing issuance of bonds (*Faulkner v. Cal. Toll Bridge Authority* (1953) 40 Cal.2d 317, 323-324)."] (Italics supplied).

[171] *Id.*, page 572.

[172] *Skyline Homes, Inc. v. Department of Industrial Relations* (1985) 165 Cal.App.3d 239, 253; *Bono Enterprises, Inc. v. Bradshaw* (1995) 32 Cal.App.4th 968, 978.

necessary to state in a policy manual in order to achieve uniformity in enforcement, which DLSE claimed to be part of its initial motivation for articulating the policy.[173]

In addition to the Court's thorough examination in *Tidewater* of the APA and case law pertaining to underground regulations generally, and specifically in the labor standards enforcement context, three court of appeal decisions have addressed underground regulation challenges to an auditing methodology: *Grier v. Kizer*[174] (*Grier*); *Union of American Physicians and Dentists v. Kizer*[175] (*UAPD*); and *Taye v. Coye*[176](*Taye*).

In *Grier* and *UAPD* "the Department conducted audits of Medi-Cal providers by taking a small random sample [to determine the frequency and extent of over- or under-claiming for services provided], then extrapolating that error rate over the total amount received by the provider during the period covered by the audit."[177] The courts found the sampling and extrapolation methodology in that case invalid, solely because of the failure of the Department of Health Services to adopt its methodology in accordance with the APA. The court in *Grier*, *supra*, concurred with the OAL's determination, made in a parallel administrative proceeding, that the challenged method constituted a regulation, and should have been duly adopted. The court observed that "the definition of a regulation is broad, as contrasted with the scope of the internal management exception, which is narrow."[178] And, the court rejected the Department's argument that sampling and extrapolation was the only legally tenable interpretation of its audit authority: "While sampling and extrapolation may be more feasible or cost-effective,...[a] line by line audit is an alternative tenable interpretation of the statutes."[179] The court also noted that the Department "acquiesced" in that determination and in the time between the trial court's determination and the hearing on appeal, it adopted a regulation providing expressly for statistical sampling and extrapolation in the conduct of Medi-Cal audits.[180] Accordingly, the court in *UAPD* assumed, without deciding, that having satisfied the APA, the statistical methodology could be validly applied to pending audits, or remanded audits.[181] Now, with

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[173] *Tidewater*, *supra*, 14 Cal.4th 557, 562.

[174] *Grier v. Kizer* (*Grier*) (1990) 219 Cal.App.3d 422.

[175] *Union of American Physicians and Dentists v. Kizer* (*UAPD*) (1990) 223 Cal.App.3d 490.

[176] *Taye v. Coye* (*Taye*) (1994) 29 Cal.App.4th 1339.

[177] *UAPD*, *supra*, 223 Cal.App.3d 490, 495.

[178] *Grier*, *supra*, 219 Cal.App.3d 422, 435.

[179] *Id*, pages 438-439.

[180] *Id*, pages 438-439.

[181] *Union of American Physicians and Dentists*, *supra*, 223 Cal.App.3d 490, 504-505 [finding that the statistical audit methodology did not have retroactive effect because it did not alter the legal significance of past events (i.e., the amount of compensation to which a Medi-Cal provider was entitled)].

respect to Medi-Cal audits, a statistical sampling methodology is provided for in *both* the Welfare and Institutions Code and in the Department's implementing regulations.[182]

In *Taye*, another health care provider seeking reimbursement under Medi-Cal for services and products supplied to patients was audited, this time by the State Controller's Office.[183] Taye argued that the method of conducting the audit, and in particular the decision to exclude "opening inventory" when calculating the difference between the amount of product purchased by Taye during the audit period and the amount of product he billed for during the same period, constituted a "regulation" within the meaning of the APA, and as such could not be applied or enforced until duly adopted as a regulation and filed with the Secretary of State.[184] The court distinguished *Grier* as follows:

> In *Grier*, cited here by Taye, the court found that a challenged method of conducting an audit by extrapolating from a small, select, sample of claims submitted was in fact a regulation. The court concurred in the reasoning of the Office of Administrative Law, determining that the method was a regulation *because it was a standard of general application applied in every Medi-Cal case reviewed by the Department audit teams* and used to determine the amount of the overpayment. [Citation] The auditing method used by LaPlaunt here, in contrast, was not a standard of general application used in all Medi-Cal cases. Thus, LaPlaunt declared: "The audit procedures used to conduct the audit of Pride Home Care Medical were designed to fit the particular conditions that were encountered upon the arrival at the audit site. [¶] ... While all audits are performed along generally accepted audit principles, these principles are not intended to be steadfast rules from which deviation is prohibited. In the twelve years that I have been employed as an auditor for the California State Controller's Office, I have been involved in numerous audits varying in subject and complexity. In these endeavors, I have found that the flexibility to adopt auditing principles to unique situations, including treatment of inventory, is imperative in the successful completion of an audit." It follows that the method was not a "regulation," and no error attended its employment.[185]

This analysis and conclusion was cited approvingly in *Tidewater*, as one of several examples of "interpretations that arise in the course of case-specific adjudication" and not subject to the regulatory process.[186]

And finally, in *Clovis Unified*, the court held that the Controller's contemporaneous source document rule (CSDR), which was contained solely in the Controller's claiming instructions and not adopted in the regulatory parameters and guidelines, was applied *generally* to audits of all

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[182] See, e.g., Welfare and Institutions Code section 14170(b) (added, Stats. 1992, ch. 722; Code of Regulations, title 22, section 51458.2 (Register 1988, No. 17).

[183] *Taye v. Coye* 29 Cal.App.4th 1339, 1342.

[184] *Id.*, page 1344.

[185] *Id.*, page 1345 [emphasis added].

[186] *Tidewater*, *supra*, 14 Cal.4th 557, 571.

reimbursement claims for certain programs, in that individual auditors had no discretion to judge on a case-by-case basis whether to apply the rule.[187] As to the second criterion, the court found that the CSDR was more specific, and in some ways inconsistent with the parameters and guidelines for the subject mandated programs. Specifically, the court found that the CSDR defined "source documents" differently and more specifically than the parameters and guidelines, including relegating employee declarations to "corroborating documents, not source documents…", and failing to recognize the appropriate use of a time study.[188] The court therefore held, "[g]iven these substantive differences…we conclude that the CSDR implemented, interpreted, or made specific…" the parameters and guidelines and the Controller's audit authority and was, therefore, an underground regulation.[189]

The necessary inquiry, then, is whether the challenged audit policy or practice is applied "generally," and used to decide a class of cases; and whether the rule "implement[s], interpret[s], or make[s] specific" the law administered by the Controller. Here, that presents a close question, which turns on the issue of general applicability: if it is the Controller's policy that *all audits* of the *Notification of Truancy* program be conducted using the statistical sampling and extrapolation methods here challenged, then perhaps that meets the standard of a rule applied "generally, rather than in a specific case."[190] On the other hand, if statistical sampling and extrapolation is only one of an auditor's tools, and happens to be the most practical method for auditing claims involving a unit cost with many thousands of units claimed, and it is within the discretion of each auditor to use the challenged methods, then the APA does not bar the exercise of that discretion.[191]

As explained in *Tidewater*, an agency may provide an advice letter to a party, which is not subject to the APA, or may prepare a policy manual that is "*no more than* a restatement or summary, without commentary, of the agency's prior decisions…" without implicating the public notice and comment requirements of the APA.[192] However, in *Tidewater*, and later in *Clovis Unified*, where a written policy was applied generally to a class of cases, the courts have held that the APA is implicated, and the application of the policy is void.

Here, the Controller argues that the auditor "conducted appropriate statistical samples that identified a reasonable estimate of the non-reimbursable initial truancy notifications, thus properly reducing the claims for the unreasonable claimed costs," and that therefore "the Administrative Procedures Act [sic] is not applicable." But that argument essentially rests on the theory that the auditors acted appropriately, and therefore the APA could not have been violated. This conclusion does not follow. Looking no further than *Clovis Unified*, and especially in light

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[187] *Clovis Unified*, *supra*, 188 Cal.App.4th 794, 803.

[188] *Id.*, pages 803-805.

[189] *Id.*, page 805.

[190] *Tidewater*, *supra*, 14 Cal.4th 557, 571.

[191] See *Taye v. Coye* (1994) 29 Cal.App.4th 1339, 1345 [Finding that an auditor's decision was not an underground regulation where it was "designed to fit the particular conditions that were encountered upon arrival at the audit site."].

[192] *Tidewater*, *supra*, 14 Cal.4th 557, 571.

of *Grier* and *UAPD*, it is clear that an audit practice may be reasonable and otherwise permissible, yet still constitute an illegal underground regulation.

However, the Commission finds that the evidence in the record does not support the assertion that the audit methodology as applied in this case rises to the level of a rule of general application, and no clear "class of cases" to which it applied has been defined. In *Tidewater*, the Court held that a "rule need not, however, apply universally; a rule applies generally so long as it declares how a certain class of cases will be decided."[193] And in *Clovis Unified*, *supra*, the court explained that in the context of the Controller's audits of mandate reimbursement claims:

> As to the first criterion—whether the rule is intended to apply generally—substantial evidence supports the trial court's finding that the CSDR was "applie[d] generally to the auditing of reimbursement claims ...; the Controller's auditors ha[d] no discretion to judge on a case[-]by[-]case basis whether to apply the rule."[194]

Therefore, a "class of cases" must be identifiable; in *Grier*, as noted above, the court concurred with OAL's determination that "this particular audit method was a standard of general application 'applied in *every Medi-Cal case* reviewed by [Department] audit teams…'"[195] Here, of the 44 completed audits of the Notification of Truancy mandate, some do not apply a statistical sampling and extrapolation methodology to calculate a reduction;[196] others apply a sampling and extrapolation method to determine whether the notifications issued complied with the eight required elements under section 48260.5;[197] and still others use sampling and extrapolation methods to determine the proportion of notifications issued that were supported by documentation, including attendance records, rather than the proportion unallowable based on absences, as here.[198] The claimant has argued that these examples are not factually relevant, and that "[i]t is not that every audit must be a Tidewater 'case' to support the concept of generality…but more logically it is that if the *factual circumstances* are present that are amenable to the use of sampling and whether sampling was used, rather than another audit

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[193] *Tidewater*, *supra*, 14 Cal.4th 557, 571.

[194] *Clovis Unified*, *supra*, 188 Cal.App.4th 794, 803.

[195] *Taye*, *supra*, 219 Cal.App.3d 422, 434-435.

[196] See, e.g., Exhibit G, Audit of Sweetwater Union High School District, *Notification of Truancy*, fiscal years 2006-2007 through 2009-2010 [In this audit report the Controller reduced based on the claimant's failure to comply with the notification requirements of section 48260.5, rather than performing a sampling and estimation audit to determine whether notifications were issued in compliance with section 48260.].

[197] See, e.g., Exhibit G, Audit of Colton Joint Unified School District, *Notification of Truancy*, fiscal years 1999-2000 through 2001-2002, issued November 26, 2003.

[198] See, e.g., Exhibit G, Audit of Bakersfield City School District, *Notification of Truancy*, fiscal years 2007-2008 through 2009-2010, issued October 25, 2012.

method…"[199] The Commission disagrees. In *Taye*, *supra*, the court gave substantial weight to the declaration of the auditor, LaPlaunt, who explained

> While all audits are performed along generally accepted audit principles, these principles are not intended to be steadfast rules from which deviation is prohibited. In the twelve years that I have been employed as an auditor for the California State Controller's Office, I have been involved in numerous audits varying in subject and complexity. In these endeavors, I have found that the flexibility to adopt auditing principles to unique situations, including treatment of inventory, is imperative in the successful completion of an audit.

The Controller has explained here, along similar lines, that "the parameters and guidelines do not specify the methodology the SCO must use to validate program compliance." And, the Controller cites "Government Auditing Standards, as issued by the Comptroller General of the United States," which, the Controller asserts, "specify that auditors may use professional judgment in 'selecting the methodology, determining the type and amount of evidence to be gathered, and choosing the tests and procedures for their work.'"[200]

Moreover, the sampling and extrapolation method is not published in the claiming instructions for this mandate, as was the case in *Clovis Unified*; to the extent the sampling and extrapolation methodology implements, interprets, or makes specific the law enforced or administered by the Controller, a published policy might well be dispositive of the issue. In *Tidewater*, *supra*, the DLSE policy at issue was formalized in its "Operations and Procedures Manual," and was "expressly intended as a rule of general application to guide deputy labor commissioners on the applicability of IWC wage orders to a particular type of employment." There is no evidence in this record of any formalized policy, or any intent to require all field auditors to perform their audits in a particular manner.

Therefore, because the evidence in the record does not reflect the formalization in written policy or guidance for field auditors of the challenged sampling and extrapolation methodology; and because there is no evidence that auditors were deprived of discretion whether to use the challenged methodology, the record does not support a finding by the Commission that the sampling and extrapolation methodology constitutes a regulation generally applied to a class of cases. Moreover, the Commission takes official notice, as discussed above, that sampling and extrapolation has not be used in every audit of the *Notification of Truancy* program, and where it has been used, it has been applied in a number of different ways, to justify a number of different reductions.[201]

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[199] Exhibit F, Claimant's Comments on Draft Proposed Decision, page 6.

[200] Exhibit C, Controller's Late Comments on IRC, page 17.

[201] See Exhibit G, Audit Reports for the *Notification for Truancy* program. Under the Commission's regulations, the Commission has the authority to take official notice of any fact which may be judicially noticed by the courts. (Cal. Code Regs., tit. 2, § 1187.5(c); Gov. Code, § 11515.) Evidence Code section 452(c) authorizes the court to take judicial notice of the official records and files of the executive branch of state government, including the official records of

Based on the case law discussed above, and the evidence in the record, the Commission finds that the Controller's sampling and extrapolation method, as applied in this case, is not a regulation within the meaning of the APA.

2. The Controller's audit conclusions must be upheld absent evidence that the Controller's reductions are arbitrary, capricious, or entirely lacking in evidentiary support.

The claimant argues that there is no statutory or regulatory authority for the Controller to reduce claimed costs based on extrapolation from a statistical sample. The Controller counters that "[t]here is no prohibitive language contained in statute…" and that no legal authority dictates "specific auditing tests to perform…" or requires the Controller "to provide claimants 'notice' that the SCO will use sampling techniques."[202] In addition, the Controller relies on "Government Auditing Standards, as issued by the Comptroller General of the United States" to argue that sampling and extrapolation techniques are within accepted practice for auditors. The Controller asserts that "[t]hese audit standards specify that auditors may use professional judgment in 'selecting the methodology, determining the type and amount of evidence to be gathered, and choosing the tests and procedures for their work.'"[203] The Controller states that the Government Auditing Standards provide that "statistical methods may be used to establish sufficiency" of evidence supporting audit findings.[204] Furthermore, the Controller relies on Government Code section 17561, which permits the Controller generally to reduce any claim that is determined to be excessive or unreasonable: "The SCO conducted appropriate statistical samples that identified a *reasonable* estimate of the non-reimbursable initial truancy notifications, thus properly reducing the claims for the *unreasonable* claimed costs."[205]

Based on the analysis herein, the Commission finds that the Controller's auditing methods for mandate reimbursement claims and audit conclusions must be upheld absent evidence that the Controller's reductions are arbitrary, capricious, or entirely lacking in evidentiary support.

The Controller correctly states that there is no express prohibition in law or regulation of statistical sampling and extrapolation methods being used in an audit. Indeed, the Controller's authority to audit is commonly described in the broadest terms: article XVI, section 7 states that "Money may be drawn from the Treasury only through an appropriation made by law and upon a Controller's duly drawn warrant."[206] Government Code section 12410 provides that the Controller "shall superintend the fiscal concerns of the state…" and "shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment."[207]

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the State Controller's Office. (See also, *Chas L. Harney, Inc. v. State* (1963) 217 Cal.App.2d 77, 86.)

[202] Exhibit C, Controller's Late Comments on IRC, page 17.

[203] Exhibit C, Controller's Late Comments on IRC, page 17.

[204] Exhibit C, Controller's Late Comments on IRC, page 17.

[205] Exhibit C, Controller's Late Comments on IRC, page 17 [emphasis in original].

[206] California Constitution, article XVI, section 7 (added November 5, 1974, by Proposition 8).

[207] Statutes 1968, chapter 449.

With respect to mandate reimbursement, the Controller's audit authority is more specifically articulated. Article XIII B, section 6 provides that "the State shall provide a subvention of funds to reimburse…local government for the costs of the program or increased level of service…" whenever the Legislature or a state agency mandates a new program or higher level of service.[208] Government Code section 17561, accordingly, provides that the state "shall reimburse each local agency and school district for *all* 'costs mandated by the state,' as defined in Section 17514…" However, section 17561 also provided, at the time the audit of the subject claims began (i.e., 2003-2004), the following:

> In subsequent fiscal years each local agency or school district shall submit its claims as specified in Section 17560. The Controller shall pay these claims from funds appropriated therefor, provided that the Controller (A) may audit the records of any local agency or school district *to verify the actual amount of the mandated costs*, (B) may reduce any claim that the Controller determines is excessive or unreasonable, and (C) shall adjust the payment to correct for any underpayments or overpayments which occurred in previous fiscal years.[209]

The current provisions of section 17561 also provide for the Controller to audit "[t]he application of a reasonable reimbursement methodology…."[210] However, the parameters and guidelines for the *Notification of Truancy* mandate predate the statutory authorization for a "reasonable reimbursement methodology," as defined in sections 17518.5 and 17557;[211] and the former section, quoted above, provided for an audit to "verify the actual amount of the mandated costs," and to "reduce any claim that the Controller determines is excessive or unreasonable."[212] There was no reference in section 17561 to auditing the application of a unit cost or uniform allowance prior to the statutory creation of a "reasonable reimbursement methodology."[213] Thus the Controller's audit authority pursuant to section 17561 neither expressly authorizes nor expressly prohibits an audit of a claim based on a unit cost reimbursement scheme. Nor does the statute address how the Controller is to audit and verify costs mandated by the state.

Accordingly, the Controller cites to "Government Auditing Standards, as issued by the Comptroller General of the United States." "These audit standards," the Controller asserts, "specify that auditors may use professional judgment in 'selecting the methodology, determining the type and amount of evidence to be gathered, and choosing the tests and procedures for their work.'"[214] While the standards cited do not provide *expressly* for statistical sampling and

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[208] California Constitution, article XIII B, section 6 (Stats. 2004, ch. 133 (SCA 4; Proposition 1A, November 2, 2004)).

[209] Former Government Code section 17561 (Stats. 2002, ch. 1124), emphasis added.

[210] As amended by Statutes 2009, 3d Extraordinary Session, chapter 4.

[211] Government Code section 17518.5 (added, Stats. 2004, ch. 890); Government Code section 17557 (as amended, Stats. 2004, ch. 890; Stats. 2007, ch. 329).

[212] Former Government Code section 17561 (Stats. 2002, ch. 1124).

[213] Compare Government Code section 17561 (Stats. 2002, ch. 1124) with Government Code section 17561 (Stats. 2007, ch. 329).

[214] Exhibit C, Controller's Late Comments on IRC, page 17.

extrapolation to be applied to mandate reimbursement, they do provide for statistical methods to be used to establish the sufficiency, or validity of evidence.[215] The Controller also cites the "Handbook of Sampling for Auditing and Accounting," by Herbert Arkin, for the proposition that a sampling methodology to determine the frequency of errors in the population (i.e., notifications that were not reimbursable for an asserted legal reason) is a widely used approach to auditing.[216]

In accordance with the Controller's audit authority and duties under the code, it is not the Commission's purview to direct the Controller to employ a specific audit method, including when the audit pertains to the application of a unit cost, as here. The Commission's consideration is limited to whether the audit reductions are arbitrary, capricious, or entirely lacking in evidentiary support.[217]

Statistical methods are a commonly-used tool in auditing, based on the texts cited by the Controller. The claimant, too, concedes that "[a] statistically valid sample methodology is a recognized audit tool for some purposes."[218] In fact, statistical sampling methods such as those employed here are used in a number of other contexts and have not been held, in themselves, to be arbitrary and capricious, or incorrect as a matter of law. As discussed above, when the Department of Health Services used statistical sampling and extrapolation to determine the amount of over- or under-payment in the context of Medi-Cal reimbursement to health care providers in *Grier v. Kizer*[219] (*Grier*) and *Union of American Physicians and Dentists v. Kizer*[220] (*UAPD*), those methods were disapproved by the courts only on the ground that they constituted a regulation not adopted in accordance with the APA, rather than on the substantive question whether statistical sampling and extrapolation was a permissible methodology for auditing.[221] Once the Department adopted a regulation in accordance with the APA – a reaction to the proceedings in *Grier* – the court in *UAPD* had no objection to the methodology on its merits.[222] Thus, after *Grier*, the Department has both regulatory and statutory authority for its sampling and extrapolation audit process.[223]

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[215] Exhibit G, Excerpt from Government Auditing Standards, 2003, page 13.

[216] Exhibit C, Controller's Late Comments on IRC, page 19.

[217] *American Bd. of Cosmetic Surgery, Inc, supra*, 162 Cal.App.4th 534, 547-548.

[218] Exhibit A, IRC 07-904133-I-05, page 14.

[219] *Grier v. Kizer* (1990) 219 Cal.App.3d 422.

[220] *Union of American Physicians and Dentists v. Kizer* (1990) 223 Cal.App.3d 490.

[221] E.g., *Grier*, *supra*, 219 Cal.App.3d 422, 439-440.

[222] *Union of American Physicians and Dentists*, *supra*, 223 Cal.App.3d 490, 504-505 [finding that the statistical audit methodology did not have retroactive effect because it did not alter the legal significance of past events (i.e., the amount of compensation to which a Medi-Cal provider was entitled)].

[223] See, e.g., Welfare and Institutions Code section 14170(b) (added, Stats. 1992, ch. 722 (SB 485); Code of Regulations, title 22, section 51458.2 (Register 1988, No. 17).

In addition to the Medi-Cal reimbursement context, the courts have declined to reject the use of statistical sampling and extrapolation to calculate damages due to plaintiffs in a class action or other mass tort action.[224] And, in a case addressing audits of county welfare agencies, the court declined to consider whether the sampling and extrapolation procedures were legally proper, instead finding that counties were not required to be solely responsible for errors "which seem to be inherent in public welfare administration."[225]

On that basis, and giving due consideration to the discretion of the Controller to audit the fiscal affairs of the state,[226] the Commission finds that the Controller's use of statistical sampling and extrapolation to audit the reimbursement claims at issue in this case, and the audit conclusions, must be upheld absent evidence that the audit reductions are arbitrary, capricious, or entirely lacking in evidentiary support.

3. There is no evidence in the record that the Controller's findings using the sampling and extrapolation methodology are not representative of all notices claimed during the audit period or that the findings are arbitrary, capricious, or entirely lacking in evidentiary support.

In addition to challenging the legal sufficiency of the Controller's sampling and extrapolation methodology, the claimant also challenges the qualitative and quantitative reliability and fairness of using statistical sampling and extrapolation to evaluate reimbursement. The claimant argues that "[t]esting to detect the rate of error within tolerances is the purpose of sampling, but it is not a tool to assign an exact dollar amount to the amount of the error, which the Controller has inappropriately done so here."[227] In addition, the claimant argues that "[t]he ultimate risk for extrapolating findings from a sample is that the conclusions obtained from the sample may not be representative of the universe." The claimant asserts that there are "several qualitative reasons that a random selection of notices will not be representative of the universe."[228] For example, the claimant alleges that there are "several methods of compliance…" and that the Controller has made "no showing that the sample accurately reflects the relative occurrence of truancies at different grade levels." The claimant asserts, without evidence, that "the incidence of truancy in secondary schools is generally greater than elementary schools."[229] And, the claimant argues that "[l]ess than two percent of the total number of notices were audited…" and that "[t]he expected error rate is stated to be 50%, which means the total amount adjusted of $108,307 is really just a number exactly between $54,154 (50%) and $162,461 (150%)."

The Controller disagrees that statistical methods are inappropriate, stating: "We properly used estimation sampling to establish the frequency of occurrence of non-reimbursable initial truancy

[224] See, e.g., *Bell v. Farmers Insurance Exchange* (2004) 115 Cal.App.4th 715.

[225] *County of Marin v. Martin* (1974) 43 Cal.App.3d 1, 7.

[226] Government Code section 12410 (Stats. 1968, ch. 449).

[227] Exhibit A, IRC 07-904133-I-05, page 14.

[228] Exhibit A, IRC 07-904133-I-05, page 15.

[229] Exhibit A, IRC 07-904133-I-05, page 15.

notifications."[230] The Controller further states that the claimant "provided no testimonial or documentary evidence to support its assertion" that the error rate in a random sample is not reflective of the error rate within the universe.[231] Furthermore, in its comments on the IRCs, the Controller demonstrates that the claimant's understanding and description of "expected error rate" and the appropriate size of a sample is also erroneous.

Here, the claimant has presented no evidence that schools within the claimant's district complied with the mandate in different ways, which may provide evidence that the results from the sample are not representative of all notices claimed. The Commission, and the Controller, must presume that the claimant uniformly complied with the mandate, absent evidence to the contrary. Moreover, the claimant's assertion regarding the incidence of truancy in secondary schools has been obviated by the "stratified" samples and separate error rate extrapolation performed by the Controller in the revised audit.[232] Furthermore, the claimant's concerns about the proportional size of the sample are unfounded, and the claimant's conclusions about the "expected error rate" are entirely mistaken.

The Controller demonstrates that the absolute size of the sample, not the relative size, is more important. The Controller explains that an "expected error rate" in this context is an assumption used to determine the appropriate sample size, rather than a measure of the ultimate accuracy of the result. In other words, when "the auditor has no idea whatsoever of what to expect as the maximum rate of occurrence or does not care to make an estimate…" an expected error rate of 50 percent as the beginning assumption will provide "the most conservative possible sample size estimate" in order to achieve the precision desired.[233] In addition, the desired accuracy of the result, which might be called a "margin of error," is determined by the auditor before calculating the sample size (shown below as "SE = desired sample precision"). Therefore, the "margin of error" of the Controller's resulting percentage is a known value. The Controller provides the following formula:

$$n = \frac{p(1-p)}{\left(\frac{SE}{t}\right)^2 + \left(\frac{p(1-p)}{N}\right)}$$

n = sample size
p = percent of occurrence in population (expected error rate)
SE = desired sample precision
t = confidence level factor
N = population size[234]

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[230] Exhibit C, Controller's Late Comments on IRC, page 19.

[231] Exhibit C, Controller's Late Comments on IRC, page 20.

[232] Exhibit B, IRC 10-904133-I-07, pages 27-28.

[233] Exhibit C, Controller's Late Comments on IRC, page 22 [Citing Herbert Arkin, *Handbook of Sampling for Auditing and Accounting*, Third Edition, Prentice Hall, New Jersey, 1984, p. 89].

[234] *Id.*, page 22 [Citing Arkin, p. 56].

The formula above, when applied with a 50 percent expected error rate (the assumption when an error rate is not known), and a desired eight percent margin of error, as stated in the audit report,[235] shows that an appropriate sample size is between 145 and 148 pupils for populations ranging from 5,049 notifications (elementary and special education pupils for fiscal year 1999-2000) to 9,531 notifications (middle and high school pupils for fiscal year 1999-2000).[236] If "two percent" were a relevant proportion with respect to the selection of sample size, we would expect sample sizes to vary widely from one population to the next (two percent of 5,049 would yield a sample of 105, while two percent of 9,531 would yield a sample of 191). Applying the formula shown above illustrates that an appropriate sample size is not so closely correlated to the size of the population. The Controller explains:

> Although complete confidence can only be approached with a complete examination, the underlying mathematical basis of statistical sampling shows clearly that a small audit test can achieve a relatively high degree of reliability and that, beyond a certain point, additional testing improves reliability by only a very small amount. With the use of statistical sampling, the auditor can, in any given audit test, mathematically determine the extent of testing necessary to achieve a desired degree of reliability as well as the degree of risk associated with the extent of testing.[237]

Therefore, the claimant's concern that the Controller's sampling technique is "quantitatively non-representative" because fewer than two percent of the total notices issued were examined in the sample,[238] is unfounded.

Moreover, although the record indicates an objectively wide range of accuracy in the Controller's estimated reduction, in this case, once the number of unallowable notifications in the samples are adjusted based on the Commission's findings regarding the number of unexcused absences required to trigger the mandate, the range of the total extrapolated dollar amount adjustment becomes substantially smaller as well. In other words, the Controller states that the dollar amount "adjustment range is $61,238 to $114,216" for all three fiscal years (while also noting that "the point estimate provides the best, and thus reasonable, single estimate of the population's error rate").[239] But because the Commission concludes that only approximately ten percent of the notifications that the Controller examined and deemed unallowable were legally correct (16 out of 167), the dollar amount reduction, and its wide ranging accuracy, must narrow accordingly.

For example, in fiscal year 1999-2000, the Controller found 57 total unallowable notifications, based on pupils that accumulated fewer than four unexcused absences. However, only six of those, one for a middle or high school student, and five for elementary or special education students, were issued for pupils who accumulated fewer than three unexcused absences, which

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[235] See, e.g., Exhibit B, IRC 10-904133-I-07, page 27.

[236] Exhibit C, Controller's Late Comments on IRC, pages 21-22.

[237] Exhibit C, Controller's Late Comments on IRC, page 22.

[238] Exhibit A, IRC 07-904133-I-05, page 16.

[239] Exhibit C, Controller's Late Comments on IRC, page 22.

the Commission has determined above is a legally correct reason for disallowance. Therefore, based on the Commission's findings above, the adjusted error rates for fiscal year 1999-2000 are now 0.07 percent for middle and high school students (formerly 3.38 percent)[240]; and 3.42 percent for elementary and special education students (formerly 35.61 percent).[241] When extrapolated to the respective populations, those percentages result in a projected disallowance of 6 notifications for middle and high school students (formerly 322); and 173 notifications for elementary and special education students (formerly 1,798).[242] This results in a total dollar amount reduction for fiscal year 1999-2000 of $2,897 (formerly $25,927). The same pattern holds true for fiscal years 2000-2001 and 2001-2002, as shown below, and thus the adjustment range can be expected also to decrease substantially: the "point estimate" for the *total reduction* for three years is thus revised from $87,177 to $7,972, based on the Commission's findings. Thus, the range of the possible adjustment, formerly approximately $52,000 wide, as stated by the Controller, can no longer be more than a few thousand dollars in excess of or below the estimated adjustment.[243]

Finally, due to the volume of notifications that the school district issues in each year (45,785 notices were issued by the claimant during the audit period), and the objectively small transaction cost (i.e., the unit cost value of reimbursement for each of those notifications, ranging from $12.23-$12.91 during the audit period), the Controller's use of sampling and extrapolation to audit whether the notifications were issued properly and supported by the claimant's attendance records is not unreasonable. Therefore, the claimant's assertion that "the conclusions obtained from the sample may not be representative of the universe" is unfounded, and the Controller's showing that its method is statistically significant and mathematically valid is sufficient.

Based on the foregoing, the Commission finds that there is no evidence in the record that the Controller's application of sampling and extrapolation methodology at issue in this audit is arbitrary, capricious, or entirely lacking in evidentiary support.

V. Conclusion

Based on the foregoing, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, the Commission requests that the Controller reinstate $23,030 for fiscal year 1999-2000, $25,294 for fiscal year 2000-2001, and $30,881 for fiscal year 2001-2002, as follows:

Fiscal Year 1999-2000:		
Elementary and Special Education	**Controller's Audit**	**Commission's Finding**

[240] Exhibit B, IRC 10-904133-I-07, page 28.

[241] Exhibit B, IRC 10-904133-I-07, page 27.

[242] Exhibit B, IRC 10-904133-I-07, pages 27-28.

[243] Using the Controller's formula, provided in Tab 3 of Exhibit C, page 31, the approximate range of adjustment based on the reinstatement as described, is $5,916 above or below the new "point estimate" of $7,972, or $2,056 to $13,888.

Notifications Sampled	146	146
Unallowable Notifications	52	5
Unallowable Percentage	35.61%	3.42%
Total Notifications	5,049	5,049
Unallowable (Extrapolated)	1,798	173
Uniform Cost Allowance	$12.23	$12.23
Subtotal Costs Unallowable	$21,989	$2,115
Middle and High School	**Controller's Audit**	**Commission's Finding**
Notifications Sampled	148	148
Unallowable Notifications	5	1
Unallowable Percentage	3.38%	0.067%
Total Notifications	9,531	9,531
Unallowable (Extrapolated)	322	64
Uniform Cost Allowance	$12.23	$12.23
Subtotal Costs Unallowable	$3,938	$783
TOTAL Costs Unallowable	$25,927	$2,897

Fiscal Year 2000-2001:		
Elementary and Special Education	**Controller's Audit**	**Commission's Finding**
Notifications Sampled	146	146
Unallowable Notifications	62	8
Unallowable Percentage	42.47%	5.48%
Total Notifications	5,203	5,203
Unallowable (Extrapolated)	2,210	285
Uniform Cost Allowance	$12.73	$12.73
Subtotal Costs Unallowable	$28,133	3,628
Middle and High School	**Controller's Audit**	**Commission's Finding**
Notifications Sampled	148	148
Unallowable Notifications	2	1
Unallowable Percentage	1.35%	0.067%

Total Notifications	9,210	9,210
Unallowable (Extrapolated)	124	62
Uniform Cost Allowance	$12.73	$12.73
Subtotal Costs Unallowable	$1,578	$789
TOTAL Costs Unallowable	$29,711	$4,417

Fiscal year 2001-2002:		
Elementary and Special Education	**Controller's Audit**	**Commission's Finding**
Notifications Sampled	147	147
Unallowable Notifications	38	1
Unallowable Percentage	25.85%	0.068%
Total Notifications	7,509	7,509
Unallowable (Extrapolated)	1,941	51
Uniform Cost Allowance	$12.91	$12.91
Subtotal Costs Unallowable	$25,058	$658
Middle and High School	**Controller's Audit**	**Commission's Finding**
Notifications Sampled	148	148
Unallowable Notifications	8	0
Unallowable Percentage	5.41%	N/A
Total Notifications	9,283	
Unallowable (Extrapolated)	502	N/A
Uniform Cost Allowance	$12.91	$12.91
Subtotal Costs Unallowable	$6,481	$0
TOTAL Costs Unallowable	$31,539	$658

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

I am a resident of the County of Sacramento and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On November 19, 2015, I served the:

Proposed Decision
Notification of Truancy, 07-904133-I-05 and 10-904133-I-07
Education Code Section 48260.5
Statutes 1983, Chapter 498
Fiscal Years 1999-2000, 2000-2001, and 2001-2002
San Juan Unified School District, Claimant

By making it available on the Commission's website and providing notice of how to locate it to the email addresses provided on the attached mailing list.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on November 19, 2015 at Sacramento, California.

Jill L. Magee
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814
(916) 323-3562

COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 10/29/15

Claim Number: 07-904133-I-05 Consolidated with 10-904133-I-07

Matter: Notification of Truancy

Claimant: San Juan Unified School District

TO ALL PARTIES, INTERESTED PARTIES, AND INTERESTED PERSONS:

Each commission mailing list is continuously updated as requests are received to include or remove any party or person on the mailing list. A current mailing list is provided with commission correspondence, and a copy of the current mailing list is available upon request at any time. Except as provided otherwise by commission rule, when a party or interested party files any written material with the commission concerning a claim, it shall simultaneously serve a copy of the written material on the parties and interested parties to the claim identified on the mailing list provided by the commission. (Cal. Code Regs., tit. 2, § 1181.3.)

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