SixTen and Associates
Mandate Reimbursement Services

KEITH B. PETERSEN, President

San Diego
5252 Balboa Avenue, Suite 900
San Diego, CA 92117
Telephone: (858) 514-8605
Fax: (858) 514-8645
www.sixtenandassociates.com

Sacramento
P.O. Box 340430
Sacramento, CA 95834-0430
Telephone: (916) 419-7093
Fax: (916) 263-9701
E-Mail: kbpsixten@aol.com

RECEIVED
September 22, 2014
Commission on
State Mandates

September 22, 2014

Heather Halsey, Executive Director
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814

Dear Ms. Halsey:

RE: CSM 05-4206-I-05
State Center Community College District
Fiscal Years: 1999-2000, 2000-2001 and 2001-2002
Health Fee Elimination
Education Code Section 76355
Statutes of 1984, Chapter 1, 2nd. E.S.
Statutes of 1987, Chapter 1118
Incorrect Reduction Claim

I have received the Commission Draft Proposed Decision (DPD) dated September 9, 2014, for the above-referenced incorrect reduction claim, to which I respond on behalf of the District.

PART A. STATUTE OF LIMITATIONS APPLICABLE TO AUDITS OF ANNUAL REIMBURSEMENT CLAIMS

1. Audit Initiation

The District concurs that the audit of the FY 1999-00 and FY 2000-01 annual claims was commenced before the expiration of the statute of limitations to commence an audit.

2. Audit Completion

It is uncontested here that an audit is complete only when the final audit report is issued. The District asserts that the FY 1999-00 (filed January 13, 2001) and FY 2000-01 (filed December 27, 2001) annual claims were beyond the statute of limitations for

completion of the audit (December 31, 2003) when the Controller completed its audit on September 17, 2004. To the contrary, the Commission concludes (DPD, 15) that "at the time the costs were incurred in this case, section 17558.5 [1], did not expressly fix the time for which an audit must be completed." (Note that the reference to "the time the costs were incurred" is irrelevant to the statutory analysis, since the statute is based on filing dates of the annual claims and not when the costs were incurred.) Instead, the Commission only asserts that the time to commence the audit was not past the statute of limitations (DPD, 15):

> Based only upon the plain language of the 1995 version of section 17558.5, the reimbursement claims in issue would be "subject to audit" until the end of the calendar year 2003, for the reimbursement claims filed in 2001. 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 13, 2004, for the 1999-2000 reimbursement claim. Because an entrance conference was held May 12, 2003, the audit was initiated prior to the running of the statutory period. And, because the 2002 statute expanded the statutory period while it was still pending, the Controller receives the benefit of the additional time.

There is no objective basis or evidence in the record to conclude that the period of time allowed to complete an audit is contingent on the notice provision as to when the audit can commence. The numerous cases cited by the Commission speak to the issue of commencing an audit and the extension of that time by future changes to the statute of limitations. These are not relevant to the issue of the completion of the audit. The Commission cites no cases contradicting the practical requirement that completion is measured by the date of the audit report.

Section 17558.5 was amended two more times after the FY 1999-00 and FY 2000-01

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[1] First Amendment

Statutes of 1995, Chapter 945, Section 18, operative July 1, 1996, repealed and replaced Section 17558.5, changing only the period of limitations:

"(a) 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."

annual claims were filed. As a matter of law, these amendments are not relevant to the determination of statute of limitations for the FY 1999-00 and FY 2000-01 annual claims, so reliance upon the language of the subsequent amendments as a declaration of retroactively consistent legislative policy or intent is without foundation. The adjudication of the issue should end with the 1995 version of Section 17558.5. Regardless, the Commission concludes that its interpretation of the significance of the second sentence in the 1995 version is supported by the 2002 amendment to Section 17558.5[2] which extends the audit initiation period to three years. The 2002 amendment provides no new information about the audit completion date. The 2004 amendment to Section 17558.5[3] does establish a two-year limit to complete a timely filed audit based on date of audit initiation, not based on the date of claim filing. The 2004 amendment

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[2] Second Amendment

Statutes of 2002, Chapter 1128, Section 14.5, operative January 1, 2003, amended Section 17558.5 to state:

"(a) 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 the~~ 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."

[3] Third Amendment

Statutes of 2004, Chapter 890, Section 18, operative January 1, 2005 amended Section 17558.5 to state:

"(a) 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 three years after the 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 filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim. In any case, an audit shall be completed not later than two years after the date that the audit is commenced."

to Section 17558.5 is definitive to the issue of when the audit completion period was first placed in statute, but it is of no assistance to resolve the 1995 issue.

If, as the Commission asserts, that the first amended 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 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.

In the absence of explicit statutory language in support of its conclusion, the Commission (DPD, 15) then asserts that there is a common law requirement to complete the audit "within a reasonable period of time" and that a claimant can assert the defense of laches:

> 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 September 17, 2004 would be barred. This is the interpretation urged by the District, but this reading of the code is not supported by the plain language of the statute. At the time the costs were incurred in this case, section 17558.5 did not expressly fix the time for 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. In this case, the audit was completed when the final audit report was issued on September 17, 2004, approximately 16 months after the audit was initiated. Thus, there is no evidence of an unreasonable delay in the completion of the audit.

Reliance on the reasonableness of the actual length of the audit period process would mean in practice that the determination of a reasonable audit completion date would become a question of fact for every audit, which is contrary to the concept of a *statute* of limitations. The Commission's reliance on the equitable concept of laches is troublesome. Cases in law are governed by statutes of limitations, which are laws that determine how long a person has to file a lawsuit before the right to sue expires. Laches is the equitable equivalent of statutes of limitations. However, unlike statutes of limitations, laches leaves it up to the adjudicator to determine, based on the unique facts of the case, whether a plaintiff has waited too long to seek relief. Here there is no issue as to whether the District has been tardy in seeking relief. The incorrect reduction claim, the statutory form of relief from an audit, was timely-filed according to the statute.

Laches is a defense to a proceeding in which a plaintiff seeks equitable relief. Cases in equity are distinguished from cases at law by the type of remedy, or judicial relief, sought by the plaintiff. Generally, law cases involve a problem that can be solved by the payment of monetary damages. Equity cases involve remedies directed by the court against a party. An incorrect reduction claim is explicitly a matter of money due the claimant. The District is not seeking an injunction, where the court orders a party to do or not to do something; declaratory relief, where the court declares the rights of the two parties to a controversy; or an accounting, where the court orders a detailed written statement of money owed, paid, and held.

The Commission has not indicated that it has jurisdiction for equitable remedies. Therefore the finding that "there is no evidence of an unreasonable delay in the completion of the audit" is without jurisdiction or consequence and simply irrelevant. Or, if the Commission is suggesting that claimant resort to the courts for an equitable remedy on the issue of statute of limitations, that is contrary to fact that the Government Code establishes primary jurisdiction to the Commission for audit disputes, that is, the incorrect reduction claim process.

PART B. APPLICATION OF AN INDIRECT COST RATE

The audit asserts that the District overstated its indirect cost rates and costs in the amount of $415,502 for the audit period. This finding is based upon the Controller's statement that the district did not obtain federal approval for its ICRPs, a stated requirement of the Controller's claiming instructions.

The threshold Commission conclusion is that claimants must comply with the Controller's claiming instructions and that the Controller's use of its own instructions and forms to recalculate the indirect cost rates was not arbitrary and correct as a matter of law. The District asserts that the Controller's claiming instructions are not alone enforceable as a matter of law as they are not regulations nor were they adopted pursuant to the administrative rulemaking process required to enforce agency manuals and instructions, as did the *Clovis* Court.[4]

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[4] From the Clovis Appellate Court Decision (4):

"Once the Commission determines that a state mandate exists, it adopts regulatory "[P]arameters and [G]uidelines" (P&G's) to govern the state-mandated reimbursement. (§ 17557.) The Controller, in turn, then issues nonregulatory "[C]laiming [I]nstructions" for each Commission-determined mandate; these instructions must derive from the Commission's test claim decision and its adopted P&G's. (§ 17558.) Claiming Instructions may be specific to a particular mandated program, or general to all such programs." Emphasis added.

The Controller has never asserted that its claiming instructions are alone legally enforceable. The Community College Mandated Cost Manual General Instructions revised or updated September 29, 2000, September 28, 2001, and September 30, 2003 included the following language:

> The claiming instructions contained in this manual are issued for the sole purpose of assisting claimants with the preparation of claims for submission to the State Controller's Office. These instructions have been prepared based upon interpretation of the State of California statutes, regulations, and parameters and guidelines adopted by the Commission on State Mandates. Therefore, unless otherwise specified, these instructions should not be construed in any manner to be statutes, regulations, or standards. *Cited in Santa Monica CCD, 05-4206-I-12 (DPD, 15).*

Therefore, any documentation standards or cost accounting formulas published in the claiming instructions, to be enforceable, must derive from another source. However, there are no cost accounting standards for calculating the indirect cost rate for the Health Fee Elimination mandate published anywhere except the Controller's claiming instructions.

Regardless of the lack of legal sources for the indirect cost rate calculation, the Commission asserts (DPD, 17): because "the reference in the parameters and guidelines to the Controller's claiming instructions necessarily includes the general provisions of the School Mandated Cost Manual (and later the Mandated Cost Manual for Community Colleges), and the manual provides ample notice to claimants as to how they may properly claim indirect costs," and because the parameters and guidelines (DPD, 18) "which *were* duly adopted at a Commission hearing, require compliance with the claiming instructions on indirect cost rates," that (DPD, 18) "claimants are required to adhere to the general instructions for indirect cost claiming." Claiming indirect costs is not conditional on the claiming instruction methods. Colleges "may" claim indirect costs, or any other eligible cost, on every mandate, not just Health Fee Elimination.

From the Clovis Appellate Court Decision (15):

> "Given these substantive differences between the Commission's pre-May 27, 2004 SDC P&G's and the Controller's CSDR, we conclude that the CSDR implemented, interpreted or made specific the following laws enforced or administered by the Controller: the Commission's pre-May 27, 2004 P&G's for the SDC Program (§ 17558 [the Commission submits regulatory P&G's to the Controller, who in turn issues nonregulatory Claiming Instructions based thereon]; and the Controller's statutory authority to audit state-mandated reimbursement claims (§ 17561,subd. (d)(2))." Emphasis added.

The Commission attribution of the conditional "may" to the ultimate decision to claim indirect costs, rather than the subsequent discretionary choice to use claiming instructions method is gratuitous.

The District agrees that the parameters and guidelines have the force of law, but that it does not extend by mere reference to the general or specific claiming instructions for Health Fee Elimination. Neither the Commission nor the Controller has ever adopted the Controller's claiming instructions pursuant the process required by the regulations relevant to the Commission or the Administrative Procedure Act relevant to the Controller, nor has the Commission ever before stated that parameters and guidelines are subordinate to the Controller's claiming instructions. Regarding the requirement for the administrative rulemaking process to enforce agency manuals and instructions, the Commission (DPD, 18) misses the factual issue:

> Furthermore, the Commission is not in a position to declare the Controller's claiming instructions an underground regulation; the Commission assumes that duly-adopted claiming instructions are valid and enforceable, absent a contrary ruling by the courts.

The Commission does not need a court to declare the claiming instructions to be underground regulations or to ascertain whether they are consistent with the claiming instructions. The Commission need only ask the Controller if the claiming instructions have been adopted pursuant to the required process. If the answer is no, the Commission cannot enforce the claiming instructions for the Controller. The Controller's use of the FAM-29C method for audit purposes is a standard of general application without appropriate state agency rulemaking and is therefore unenforceable (Government Code Section 11340.5). The formula is not an exempt audit guideline (Government Code Section 11340.9(e)). State agencies are prohibited from enforcing underground regulations. If a state agency issues, enforces, or attempts to enforce a rule without following the Administrative Procedure Act, when it is required to, the rule is called an "underground regulation." Further, the audit adjustment is a financial penalty against the District, and since the adjustment is based on an underground regulation, the formula cannot be used for the audit adjustment (Government Code Section 11425.50).

Somehow the "assistance" provided by the claiming instructions has become a requirement even though the parameters and guidelines use the word "may." The Commission now has concluded that the contents of the claiming instructions are as a matter of law derivative of the authority of the parameters and guidelines, without benefit of a legal citation for this leap of jurisprudence. Assuming for argument that the leap can be made, would that derivative authority continue for any changes made to the claiming instructions after the adoption of the 1989 parameters and guidelines, that is, an open-ended commitment of the Commission's authority to the Controller who can make changes without reference to the Commission process? Is this derivative

authority limited to Health Fee Elimination or applicable to all mandates?

Note that the Heath Fee Elimination parameters and guidelines were amended on January 29, 2010. However, the indirect cost rate language remained the same:

> 3. Allowable Overhead Cost
>
> Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions.

The Commission has had numerous opportunities to clarify its intent and language regarding the indirect cost rate calculation methods and resolve or avoid the delegation and derivation issue. For example, and by contrast, the parameters and guidelines language for the new college mandate Cal Grants, adopted on the same date as the January 29, 2010, amendment for Health Fee Elimination, has the needed specific and comprehensive language:

> B. Indirect Cost Rates
>
> Indirect costs are costs that have been incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved. After direct costs have been determined and assigned to other activities, as appropriate, indirect costs are those remaining to be allocated to benefited cost objectives. A cost may not be allocated as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been claimed as a direct cost.
>
> Indirect costs include: (a) the indirect costs originating in each department or agency of the governmental unit carrying out state mandated programs, and (b) the costs of central governmental services distributed through the central service cost allocation plan and not otherwise treated as direct costs.
>
> Community colleges have the option of using: (1) a federally approved rate, utilizing the cost accounting principles from the Office of Management and Budget Circular A-21, "Cost Principles of Educational Institutions"; (2) the rate calculated on State Controller's Form FAM-29C; or (3) a 7% indirect cost rate.

This language in the parameters and guidelines for Cal Grants makes the Controller's guidance on the suggested three choices of indirect cost calculation methods legally enforceable. The Commission properly adopted this language within the scope of their regulatory discretion and has utilized it in new program college mandate parameters and guidelines since at least 2002. However, this language has never been adopted by the Commission for Health Fee Elimination.

In the absence of legally enforceable claiming instructions, rules or methods, or standards or specific language in the parameters and guidelines for the indirect cost rate calculation, the remaining standard is Government Code Section 17561. No particular indirect cost rate calculation method is required by law. Government Code Section 17561(d)(2) requires the Controller to pay claims, provided that the Controller may audit the records of any school district to verify the actual amount of the mandated costs, and may reduce any claim that the Controller determines is excessive or unreasonable. The Controller is authorized to reduce a claim if the Controller determines the claim to be excessive or unreasonable. Here, the District computed indirect cost rates utilizing cost accounting principles from the Office of Management and Budget Circular A-21, and the Controller has disallowed the rates without a determination of whether the product of the District's calculation is excessive, unreasonable, or inconsistent with cost accounting principles.

There is no rebuttable presumption for this mandate that the Controller's methods are per se the only reasonable method. The Controller made no determination as to whether the method used by the District was reasonable or not, but merely substituted the Controller's method for the method used by the Districts. The substitution of the Controller's method is an arbitrary choice of the auditor, not a "finding" enforceable either by fact or law. In order to move forward with the adjustment, the burden of proof is on the Controller to prove that the District's calculation is unreasonable. Indeed, federally "approved" rates which the Controller will accept without further action, are "negotiated" rates calculated by the district and submitted for approval, indicating that the process is not an exact science, but a determination of the relevance and reasonableness of the cost allocation assumptions made for the method used. Neither the Commission nor the Controller can assume that the Controller's calculation methods are intrinsically more accurate and the Commission cannot shift that burden or create the presumption to the contrary where none is present in law.

PART C. UNDERSTATED OFFSETTING REVENUES

This finding is the result of the Controller's recalculation of the student health services fees which may have been "collectible" which was then compared to the District's student health fee revenues actually received, resulting in a total adjustment of $385,753 for the audit period. The Controller computed the total student health fees collectible based on state rates while the District reported actual fees collected.

The Commission (DPD, 20) finds that the correct calculation and application of offsetting revenue from student health fees have been resolved by the *Clovis Unified* decision, and that the reduction is correct as a matter of law:

> After claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts

are statutorily authorized to charge students, whether or not a district chooses to charge its students those fees. As cited by the court, the Health Fee Rule states in pertinent part:

> Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.

The District agrees that claimants and state agencies are bound to apply the Health Fee Rule as decided law and that this extends to retroactive fiscal years still within the Commission's or Controller's jurisdiction.

On October 27, 2011, the Commission adopted a consolidated statement of decision for seven Health Fee Elimination incorrect reduction claims. The statement of decision for these seven districts included issues presented in this current incorrect reduction claim. The application of the Health Fee Rule, as determined by the Commission's October 27, 2011, statement of decision, however, involves two factual elements: the number of exempt students and the specific enrollment statistics for each semester. That decision approved the Controller's use of specific Community College Chancellor's MIS data to obtain these enrollment amounts. That approved method is stated in the more recent HFE audits as:

> **FINDING— Understated authorized health service fees**
>
> We obtained student enrollment data from the CCCCO. The CCCCO identified enrollment data from its management information system (MIS) based on student data that the district reported. CCCCO identified the district's enrollment based on its MIS data element STD7, codes A through G. CCCCO eliminated any duplicate students based on their Social Security numbers. *Cited from the October 19, 2012 HFE Audit Report for State Center CCD. Available at the Controller's web site.*

For this audit, completed September 17, 2004, well before the October 27, 2011, Commission decision, the source of the enrollment statistics used by the auditor was different:

> **FINDING 4— Understated authorized health service fees**
>
> The district's Institutional Research Office (IRO) provided student enrollment data for each fiscal year. The IRO also identified students who received Board of Governors Grants (BOGG waivers) and were exempt from health fees. Using the student enrollment and exemption data, the following table calculates authorized health fees the district was authorized to collect. *Table not cited here.*

Therefore, to properly implement the Health Fee Rule, it will be necessary for the Controller to utilize the statistics approved by the October 27, 2011, decision. Until then, the Commission's ultimate conclusion that the adjustments here are not arbitrary or lacking in evidentiary support is unfounded.

CERTIFICATION

By my signature below, I hereby declare, under penalty of perjury under the laws of the State of California, that the information in this submission is true and complete to the best of my own knowledge or information or belief, and that any attached documents are true and correct copies of documents received from or sent by the District or state agency which originated the document.

Executed on September 22, 2014, at Sacramento, California, by

Keith B. Petersen, President
SixTen & Associates

Service by Commission Electronic Drop Box

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

I am a resident of the County of Solano 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 September 23, 2014, I served the:

Claimant Comments
Health Fee Elimination, 05-4206-I-05
Education Code Section 76355
Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118
Fiscal Years 1999-2000, 2000-2001, and 2001-2002
State Center Community College 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 September 23, 2014 at Sacramento, California.

Heidi J. Palchik
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814
(916) 323-3562

COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 8/18/14

Claim Number: 05-4206-I-05

Matter: Health Fee Elimination

Claimant: State Center Community College 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.)

Socorro Aquino, *State Controller's Office*
Division of Audits, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 322-7522
SAquino@sco.ca.gov

Marieta Delfin, *State Controller's Office*
Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 322-4320
mdelfin@sco.ca.gov

Edwin Eng, *State Center Community College District*
1525 East Weldon Avenue, Fresno, CA 93704-6398
Phone: (559) 244-5910
ed.eng@scccd.edu

Donna Ferebee, *Department of Finance*
915 L Street, Suite 1280, Sacramento, CA 95814
Phone: (916) 445-3274
donna.ferebee@dof.ca.gov

Susan Geanacou, *Department of Finance*
915 L Street, Suite 1280, Sacramento, CA 95814
Phone: (916) 445-3274
susan.geanacou@dof.ca.gov

Ed Hanson, *Department of Finance*
Education Systems Unit, 915 L Street, 7th Floor, 915 L Street, 7th Floor, Sacramento, CA 95814

Phone: (916) 445-0328
ed.hanson@dof.ca.gov

Cheryl Ide, Associate Finance Budget Analyst, *Department of Finance*
Education Systems Unit, 915 L Street, Sacramento, CA 95814
Phone: (916) 445-0328
Cheryl.ide@dof.ca.gov

Matt Jones, *Commission on State Mandates*
980 9th Street, Suite 300, Sacramento, CA 95814
Phone: (916) 323-3562
matt.jones@csm.ca.gov

Jill Kanemasu, *State Controller's Office*
Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 322-9891
jkanemasu@sco.ca.gov

Jay Lal, *State Controller's Office (B-08)*
Division of Accounting & Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 324-0256
JLal@sco.ca.gov

Kathleen Lynch, *Department of Finance (A-15)*
915 L Street, Suite 1280, 17th Floor, Sacramento, CA 95814
Phone: (916) 445-3274
kathleen.lynch@dof.ca.gov

Yazmin Meza, *Department of Finance*
915 L Street, Sacramento, CA 95814
Phone: (916) 445-0328
Yazmin.meza@dof.ca.gov

Robert Miyashiro, *Education Mandated Cost Network*
1121 L Street, Suite 1060, Sacramento, CA 95814
Phone: (916) 446-7517
robertm@sscal.com

Andy Nichols, *Nichols Consulting*
1857 44th Street, Sacramento, CA 95819
Phone: (916) 455-3939
andy@nichols-consulting.com

Christian Osmena, *Department of Finance*
915 L Street, Sacramento, CA 95814
Phone: (916) 445-0328
christian.osmena@dof.ca.gov

Keith Petersen, *SixTen & Associates*
Claimant Representative
P.O. Box 340430, Sacramento, CA 95834-0430
Phone: (916) 419-7093
kbpsixten@aol.com

Sandra Reynolds, *Reynolds Consulting Group,Inc.*

P.O. Box 894059, Temecula, CA 92589
Phone: (951) 303-3034
sandrareynolds_30@msn.com

Kathy Rios, *State Controller's Office*
Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 324-5919
krios@sco.ca.gov

Nicolas Schweizer, *Department of Finance*
Education Systems Unit, 915 L Street, 7th Floor, 915 L Street, 7th Floor, Sacramento, CA 95814
Phone: (916) 445-0328
nicolas.schweizer@dof.ca.gov

David Scribner, *Max8550*
2200 Sunrise Boulevard, Suite 240, Gold River, CA 95670
Phone: (916) 852-8970
dscribner@max8550.com

Jim Spano, Chief, Mandated Cost Audits Bureau, *State Controller's Office*
Division of Audits, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 323-5849
jspano@sco.ca.gov

Dennis Speciale, *State Controller's Office*
Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 324-0254
DSpeciale@sco.ca.gov