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
January 27, 2015
Commission on State Mandates

January 27, 2015

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

Dear Ms. Halsey:

RE: CSM 06-4206-I-13
Pasadena Area Community College District
Fiscal Years: 1999-00, 2000-01, and 2001-02
Health Fee Elimination
Incorrect Reduction Claim

I have received the Commission Draft Proposed Decision (DPD) dated January 9, 2015 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

The District asserted in its incorrect reduction claim filed July 3, 2006, that the first two years of the three claim years audited, fiscal years 1999-00 and 2000-01, were beyond the statute of limitations to complete the audit when the Controller issued its audit report on March 17, 2004. The Commission concludes that the audit was both timely initiated and timely completed.

Chronology of Annual Claim Action Dates

March 9, 2000	FY 1999-00 first payment $26,099
January 10, 2001	FY 1999-00 claim filed by the District
March 8, 2001	FY 2000-01 first payment $19,270

August 1, 2001	FY 1999-00 second payment $57,365
December 20, 2001	FY 2000-01 claim filed by the District
March 6, 2002	FY 2001-02 first payment $46,709
May 21, 2003	Entrance conference conducted
December 31, 2003	Statute of limitations expires FY 1999-00 and FY 2000-01
March 17, 2004	Controller's final audit report issued

Based on the annual claim filing dates, these two fiscal years are subject to the statute of limitations language established by Statutes of 1995, Chapter 945, Section 13, operative July 1, 1996:

> (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.

1. Audit Initiation

The District's FY 1999-00 annual claim was mailed to the Controller on January 10, 2001. The District's FY 2000-01 annual claim was mailed to the Controller on December 20, 2001. According to the 1995 version of Government Code Section 17558.5 these two annual claims are subject to audit no later than December 31, 2003. 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. The audit entrance conference of May 21, 2003, precedes the expiration of the date to commence the audit of December 31, 2003.

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 first two years of the three claim years audited, fiscal years 1999-00 and 2000-01, were beyond the statute of limitations to *complete* the audit when the Controller issued its audit report on March 17, 2004.

The Commission (DPD, 17) concludes that the 1995 version of Section 17558.5 "does not require the Controller to 'complete' the audit within any specified period of time." The Commission (DPD, 20) instead relies upon common law remedies:

> Although the statute in effect at the time the reimbursement claims were filed did not expressly fix the time for which an audit must be completed, 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.[73] Claimant argues that it would be "impossible" to know when the statute of limitations would expire under the Controller's interpretation.[74] However, the claimant was on notice of the audit when the entrance conference was conducted on May 21, 2003; the field audit was completed on November 21, 2003;[75] the draft audit report was issued on January 21, 2004; and the final audit report was issued March 10 [sic], 2004.[76] Moreover, there is no evidence that the claimant was prejudiced by the audit process. The audit was completed less than one year after it was started and, under the facts of this case, within a reasonable period of time.

Footnote 73 references the *Cedar-Sinai Medical Center* decision, for the proposal that claimants should or could rely upon the defense of laches. This is a misapplication of a decision in a civil matter with equity jurisdiction. The citation does not indicate whether the relevant state agency completed the audit within its three-year statute of limitations, or whether it was so required to do so. This footnote also references *Steen v. City of Los Angeles*, another civil matter, for the unnecessary proposal that a quasi-adjudicative local government agency, with unknown statutory or regulatory jurisdiction, can apply laches. However, the Commission is a state agency with a specific statute of limitations to apply and need not rely on laches, even if the Commission had such common law jurisdiction.

The Commission seems to be asserting that the Controller was required under common law to complete the audit within a reasonable period of time without regard to the positive law of the legislature's statute of limitations. 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. What objective standards are available for the determination or a reasonable period of time to complete an audit?

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 to 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 a Commission 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.

The adjudication of the audit completion date should end with the 1995 version of Section 17558.5. 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 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 and inevitable requirement that completion is measured by the date of the audit report.

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 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.

PART B. APPLICATION OF AN INDIRECT COST RATE Audit Finding 1

The Controller asserts that the District overstated its indirect cost rates and costs in the amount of $157,273 for FY 2000-01 and FY 2001-02. For FY 1999-00, the audit report states that the District correctly used a "federally approved" rate of 30%. The audit report states "that community college districts have the option of using a federally approved rate prepared in accordance with Office of Management and Budget (OMB) Circular A-21 or the alternative methodology using Form FAM-29C." For FY 2000-01

and FY 2001-02, the audit report, without explanation, reduced the indirect cost rate claimed to the same federally approved rate of 30% used for FY 1999-00. The apparent reason for the reduction was that the indirect cost rates for FY 2000-01 and FY 2001-02 were computed by the District's mandate consultant who prepared the annual claims and those rates were not federally approved.

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. 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.[1]

The Controller has never asserted that its claiming instructions are alone legally enforceable. 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.

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[1] 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.

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 (DPD, 21, 22) instead relies upon the "plain language" of the 1989 parameters and guidelines:

> Claimant's argument is unsound: the parameters and guidelines plainly state that "indirect costs *may be claimed in the manner described by the State Controller.*" The interpretation that is consistent with the plain language of the parameters and guidelines is that "indirect costs may be claimed," or may not, but if a claimant chooses to claim indirect costs, the claimant must adhere to the Controller's claiming instructions. This interpretation is urged by the Controller.[83]

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. 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.

Regarding the requirement for the administrative rulemaking process to enforce agency manuals and instructions, the Commission (DPD, 23) misses the factual issue:

> Claimant also argues that because the claiming instructions "were never adopted as law, or regulations pursuant to the Administrative Procedure Act, the claiming instructions are merely a statement of the ministerial interests of the SCO and not law." [89] In the *Clovis Unified* case, the Controller's contemporaneous source document rule, or CSDR, was held to be an unenforceable underground regulation because it was applied generally against school districts and had never been adopted as a regulation under the APA.[90] Here, claimant implies the same fault in the claiming instructions with respect to indirect cost rates. But the distinction is that here the parameters and guidelines, which were duly adopted at a Commission hearing, require compliance with the claiming instructions. Claimant had notice of the requirement in the parameters and guidelines to comply with the claiming instructions and notice of the claiming instructions' requirements for claiming indirect costs, both prior to and during the claim years in issue and did not challenge the parameters and guidelines or the claiming instructions when they were adopted.

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).

Instead, the Commission defaults to a threadbare excuse that either this District or some other District should have challenged the parameters and guidelines. This presupposes that the Commission finding today, that the use of "may" is really mandatory, would rationally occur, or did occur, to anyone during the process of adoption of the parameters and guidelines in 1989. When the parameters and guidelines were proposed and adopted, they were not circulated to all districts for review or notice. Further, the original adoption of the parameters and guidelines occurs before the claiming instructions are released for a new program. The Commission is, in this decision now, interpreting post-facto the legal significance of the parameters and guidelines language, and cannot fault or preempt a contrary assertion by the District today by relying upon the ephemeral and very limited scope of notice and participation permitted by the Commission parameters and guidelines adoption process.

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 discretion and has utilized it in college mandate parameters and guidelines since at least 2002. However, this language has never been adopted by the Commission for Health Fee Elimination. The District agrees that the parameters and guidelines have the force of law, but that it does not extend by reference (tenuous or not) to the general or specific claiming instructions for Health Fee Elimination. Neither the Commission nor the Controller have ever adopted the Controller's claiming instructions pursuant to the process required by the Administrative Procedure Act, nor has the Commission ever before stated that parameters and guidelines are subordinate to the Controller's claiming instructions.

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 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 apparently 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 District. 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 Audit Finding 2

Student health service fees collected reduce the total reimbursable costs. The audit reduced the claimed offset by $287,865. The audit report states that since the District was unable to provide enrollment data, the Controller audited the District's revenue ledgers. This was a choice of methods by the Controller.

The Commission (DPD, 24) correctly notes that the Controller did not calculate the "fee revenue *authorized* to be collected" according to the Health Fee Rule approved by the *Clovis* case which was decided after the audit was completed. However, the Commission is in error when it states (DPD, 24) that "the Controller recalculated offsetting revenues received by using attendance data the claimant reported to the Chancellor's Office (the claimant's GLD144-02 printouts)." See the Controller's December 31, 2007, rebuttal to the incorrect reduction claim, at Tab 2, page 9, which states that enrollment statistics were not used. The GLD printouts are District revenue ledgers (attached to the December 31, 2007, rebuttal at Tab 5). Thus, the Commission (DPD, 25) incorrectly concludes that the Controller "recalculated" the student enrollment based on enrollment:

> The Commission further finds that the Controller's recalculation of student enrollment using data provided by claimant to the Chancellor's Office was not arbitrary, capricious, or entirely lacking in evidentiary support. The documents are public records provided by claimant in the normal course of business, and claimant has provided no other documents to support enrollment data.

The Controller did not calculate the authorized collectible amount or otherwise use enrollment statistics to calculate the offset, so the absence of enrollment data, from any source, is irrelevant here and not a basis to approve the adjustment unless the Commission believes adjustments can be used for purpose of penalizing claimants.

Notwithstanding, and as separate basis for its finding, the Commission (DPD, 25) incorrectly concludes that districts are required to provide enrollment data to facilitate the calculation of collectible amounts:

> Thus, the parameters and guidelines expressly require claimants to identify offsetting revenue from health service fees for each full-time student enrolled, and further require documentation to support the costs claimed. Full documentation of increased costs, which by definition would include documentation of any offsets, is required.[99] As claimant did not provide any documentation to support its enrollment data, as required by the parameters and guidelines, the Controller's reduction is correct as a matter of law.

The Commission has not cited from the parameters and the guidelines a requirement to provide enrollment data or for the District to otherwise facilitate the application of the Heath Fee Rule. So, this is not a default basis to approve the adjustment

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 the audit of this District, completed before the October 27, 2011, Commission decision, enrollment statistics were not used by the auditor. 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.

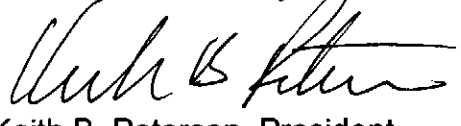
PART D. CLAIM PAYMENTS MADE TO THE DISTRICT

Until the Controller's December 31, 2007, rebuttal to the July 3, 2006, incorrect reduction claim, the District was unable to confirm, by state agency written evidence in the record, the payments made on the annual claims. This issue is no longer in dispute.

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 January 27, 2015, 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:

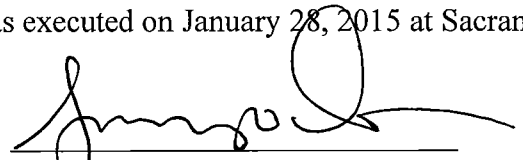
I am a resident of the County of Sacramento and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On January 28, 2015, I served the:

Claimant Comments
Health Fee Elimination, 06-4206-I-13
Pasadena Area Community College District, Claimant
Education Code Section 76355
Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118
Fiscal Years 1999-2000, 2000-2001, and 2001-2002

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 January 28, 2015 at Sacramento, California.



Lorenzo Duran
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814
(916) 323-3562

COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 1/20/15

Claim Number: 06-4206-I-13

Matter: Health Fee Elimination

Claimant: Pasadena Area 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

Giny Chandler, *Commission on State Mandates*
980 9th Street, Suite 300, Sacramento, CA
Phone: (916) 323-3562
giny.chandler@csm.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

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

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

Jameel Naqvi, Analyst, *Legislative Analystâ€™s Office*
Education Section, 925 L Street, Suite 1000, Sacramento, CA 95814
Phone: (916) 319-8331
Jameel.naqvi@lao.ca.gov

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

Arthur Palkowitz, *Stutz Artiano Shinoff & Holtz*
2488 Historic Decatur Road, Suite 200, San Diego, CA 92106
Phone: (619) 232-3122
apalkowitz@sashlaw.com

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