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November 19, 2015

Mr. Keith B. Petersen
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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, 13-904133-I-11
Education Code Sections 48260.5
Statutes 1983, Chapter 498; Statutes 1994, Chapter 1023;
Statutes 1995, Chapter 19
Fiscal Years: 2006-2007, 2007-2008, 2008-2009, and 2009-2010
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

ITEM 9

INCORRECT REDUCTION CLAIM

PROPOSED DECISION

Education Code section 48260.5

Statutes 1983, Chapter 498; Statutes 1994, Chapter 1023; Statutes 1995, Chapter 19

Notification of Truancy

Fiscal Years 2006-2007, 2007-2008, 2008-2009, and 2009-2010

13-904133-I-11

San Juan Unified School District, Claimant

EXECUTIVE SUMMARY

Overview

This 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 2006-2007 through 2009-2010 under the *Notification of Truancy* program.

The following issues are in dispute:

- The statutory deadline to initiate the audit of the 2006-2007 reimbursement claim;
- Reductions based on notifications of truancy issued for pupils who had fewer than three unexcused absences or occurrences of tardiness and for pupils who accumulated fewer than three unexcused absences or occurrences of tardiness while between ages six and 18.
- Whether the Controller's use of the statistical sampling methodology to support the reduction constitutes an underground regulation, and whether the results from the audit sample are representative of all truancy notices issued.

As explained herein, staff recommends that the Commission deny this Incorrect Reduction Claim (IRC).

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.[1] A pupil who accumulates a certain number of unexcused absences or instances of tardiness is deemed to be in

[1] Education Code section 48200.

violation of the compulsory education requirement, and is a truant.[2] 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.[3]

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 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…"[4]

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

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[2] Education Code section 48260.

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

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

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."[5]

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…"[6] 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.[7] 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).[8] These are the parameters and guidelines applicable to this claim.

Procedural History

On February 14, 2008, claimant signed its fiscal year 2006-2007 reimbursement claim.[9] On February 11, 2009, claimant signed its 2007-2008 reimbursement claim.[10] On February 10, 2010, claimant signed its 2008-2009 reimbursement claim.[11] On February 14, 2011, claimant signed its 2009-2010 reimbursement claim.[12] On February 4, 2011, the Controller sent a letter to claimant confirming the entrance conference. On February 15, 2011, the entrance conference for the audit was conducted.[13] On November 30, 2011, the Controller issued the final audit report.[14] On October 1, 2013, claimant filed this IRC.[15] On October 3, 2014, the Controller filed late

[5]Exhibit A, IRC, page 69.

[6] Education Code section 48260, as amended by Stats. 1994, chapter 1023 and Statutes. 1995, chapter 19.

[7] Education Code section 48260.5, as amended by Statutes 1994, chapter 1023.

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

[9] Exhibit A, IRC, page 284.

[10] Exhibit A, IRC, page 287.

[11] Exhibit A, IRC, page 290.

[12] Exhibit A, IRC, page 292.

[13] Exhibit A, IRC, pages 262 and 267.

[14] Exhibit A, IRC, page 250.

[15] Exhibit A, IRC.

comments on the IRC.[16] On July 31, 2015, Commission staff issued the draft proposed decision.[17] On August 11, 2015, the Controller filed comments on the draft proposed decision.[18] On August 14, 2015, the claimant requested an extension of time to file comments and postponement of the hearing until December 3, 2015, which was granted for good cause shown. On September 10, 2015, the claimant filed comments on the draft proposed decision.[19]

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.[20] 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."[21]

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.[22]

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[16] Exhibit B, Controller's Late Comments on IRC.

[17] Exhibit C, Draft Proposed Decision.

[18] Exhibit D, Controller's Comments on Draft Proposed Decision.

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

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

[21] *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

[22] *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.

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.[23] In addition, sections 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.[24]

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 deadline to initiate the audit claimant's 2006-2007 reimbursement claim.	Based on the date the entrance conference occurred (February 15, 2011), claimant asserts that the Controller failed to timely initiate the audit of the 2006-2007 reimbursement claim, filed on February 14, 2008, within the three year statutory deadline required by Government Code section 17558.5. The Controller initially alleged that it timely initiated the audit within three years of the date the claim was filed based on a telephone phone call to Michael Dencavage, the district's former Chief Financial Officer, on January 24, 2011. In comments on the draft proposed decision, the Controller filed a letter dated February 4, 2011, confirming the entrance conference. The Controller now asserts that the audit was initiated with this letter. The claimant acknowledges the February 4, 2011 entrance conference letter, and states that "[i]f the Commission accepts the entrance conference letter as the start date for the audit, the audit was timely commenced."	*The audit of the 2006-2007 fiscal year reimbursement claim was initiated timely.* Staff finds that the audit of the claimant's reimbursement claim for fiscal year 2006-2007 was initiated no later than February 4, 2011 (the date of the entrance conference letter). This letter verifies the first unilateral act by the Controller to exercise its audit authority consistent with the plain language of section 17558.5, and supports the Controller's assertion that the claimant was on notice that an audit was being initiated before the | February 14, 2011 deadline.

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

[24] 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.

	At the time the underlying reimbursement claims were filed, Government Code section 17558.5 stated: 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 three years after the date the actual reimbursement claim is filed or last amended, whichever is later. . . .	
Reductions based on notifications of truancy issued for pupils who had fewer than three unexcused absences or occurrences of tardiness and for pupils who accrued fewer than three unexcused absences or occurrences of tardiness while between the ages of six and 18.	The Controller reduced costs claimed based on notices issued beyond the scope of the mandate. The claimant initially contended that these notices were eligible for reimbursement. In comments on the draft proposed decision, the claimant states that it no longer disputes these issues.	*Correct* - The claimant's request for reimbursement to provide truancy notices for pupils with *fewer than three* unexcused absences or tardiness occurrences goes beyond the scope of the mandate and is not eligible for reimbursement. In addition, the mandate applies to "any pupil subject to compulsory full-time education." (Ed. Code, § 48260.) Pupils subject to compulsory full-time education are pupils between the ages of six and 18. ((Ed. Code, § 48200.) Therefore, these reductions are correct as a matter of law.
The statistical sampling methodology used by the Controller to determine the amounts to be reduced.	Claimant, for all fiscal years combined, claimed reimbursement for 69,139 initial truancy notifications based on the unit cost totaling $1,192,046. In its audit of the reimbursement claims, the Controller examined a random sample of initial truancy notices distributed by the claimant (1,180 notifications distributed by elementary and secondary schools), with the calculation of the "sample size based on a 95% confidence level," and determined that 105 of those notices were beyond the scope of the mandate, as described in the issue above. The number of unallowable notifications	*Correct* - There is no evidence to support claimant's argument that the statistical sampling and extrapolation method used in the audit constitutes an underground regulation. The Commission is required to uphold the Controller's audit conclusions, absent evidence that the Controller's reductions are arbitrary, capricious, or entirely lacking in evidentiary support. Moreover, there is no

	within the sample for each fiscal year was then calculated as an error percentage, and extrapolated to the total number of notifications issued in those fiscal years (69,139 notifications), to approximate the total number of unallowable notifications (6,163 notifications), which is less than 10 percent of the notices claimed. The number of unallowable notices was then multiplied by the unit cost for each fiscal year to calculate the total reduction for all fiscal years of $105,533. Claimant argues that the use of statistical sampling should be rejected, that the extrapolation of findings is void, and that the audit findings can only pertain to documentation actually reviewed. Claimant further argues that the use of the sampling method is an underground regulation.	evidence in the record that the audit results are biased or unrepresentative as asserted by claimant. There is no dispute that the samples were randomly obtained and reviewed by the Controller. All notices randomly sampled have an equal opportunity for inclusion in the sample and, thus, the result is statistically objective and unbiased. Moreover, absent evidence to the contrary, the Commission and the Controller must presume that the schools within the claimant's district complied with the mandate in the same way.

Staff Analysis

A. The Audit of the 2006-2007 Fiscal Year Reimbursement Claim Was Timely Initiated Pursuant to Government Code Section 17558.5.

Claimant signed its reimbursement claim for fiscal year 2006-2007 on February 14, 2008, and the final audit report states that the claim was filed with the Controller's Office on the same date.[25] At that time, Government Code section 17558.5(a) stated the following:

> 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.[26]

Claimant asserts that the entrance conference was conducted on February 15, 2011, which is one day beyond three years after the date the annual claim was filed.

[25] Exhibit A, IRC, pages 262, 284.

[26] Government Code section 17558.5, as last amended by Statutes 2004, chapter 313.

The Controller's audit report states that the audit of the 2006-2007 reimbursement claim was timely initiated within three years of the date the claim was filed based on a phone call allegedly made on January 24, 2011 to Michael Dencavage, the district's former Chief Financial Officer.[27]

In comments to the draft proposed decision, the Controller argues that it timely initiated the audit based on the issuance of the Controller's entrance conference letter dated February 4, 2011, which confirms the scheduling of the entrance conference.[28]

The claimant acknowledges the February 4, 2011 entrance conference letter, and states that "[i]f the Commission accepts the entrance conference letter as the start date for the audit, the audit was timely commenced."[29]

Government Code section 17558.5 does not specifically define the event that initiates the audit and, thus, a phone call, a confirming letter, or an entrance conference, are all events that could reasonably be viewed as the initiation date under the statute. However, unlike other agencies that conduct audits and have adopted formal regulations to make it clear when the audit begins, the Controller has not adopted a regulation for the audits of state-mandate reimbursement claims.

The audit initiation provisions of Government Code section 17558.5 are best characterized as a statute of repose, which provides a period during which an audit may be initiated, and after which the claimant may enjoy repose, dispose of any evidence or documentation to support their claims, and assert a defense that the audit is not timely and therefore void. The characteristics of a statute of repose include that it is "not dependent upon traditional concepts of accrual of a claim, *but is tied to an independent, objectively determined and verifiable event*…"[30]

In this case, the Controller's February 4, 2011 entrance conference letter to the claimant verifies the first unilateral act by the Controller to exercise its audit authority consistent with the plain language of section 17558.5, and supports the Controller's assertion that the claimant was on notice that an audit was being initiated before the February 14, 2011 deadline. The plain language of the letter "confirms" that an audit of the mandated program "has been scheduled," thus supporting the Controller's assertion that a conversation between the parties about the scheduling of an entrance conference occurred *before* the February 4, 2011 date of the letter. Moreover, the Commission can take official notice of this letter as an "independent, objectively determined and verifiable event" supporting the date the audit was initiated.[31] Staff finds that the audit of the claimant's reimbursement claim for fiscal year 2006-2007 was timely initiated on or before February 4, 2011, within three years after the date the annual claim was filed on February 14, 2008.

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[27] Exhibit A, IRC, page 262.

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

[29] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 3.

[30] *Inco Development Corp. v. Superior Court* (2005) 131 Cal.App.4th 1014. (Emphasis added.)

[31] California Code of Regulations, title 2, section 1187.5(c).

B. The Controller's Reasons for Reducing Costs Are Correct as a Matter of Law and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced costs totaling $105,533 for all fiscal years at issue for initial truancy notifications that the Controller determined were not reimbursable. Of the notifications sampled during the audit, 19 notices were determined unallowable because the notices were sent to pupils who had fewer than three unexcused absences or tardiness occurrences, and 86 notices were unallowable because they were sent to pupils who were under age six or over age 18 and so were not subject to the compulsory education requirements of the Education Code when they accrued one or more of the requisite occurrences of unexcused absence or tardiness.[32]

1) Reimbursement is not required to provide initial truancy notices for pupils with fewer than three unexcused absences or tardiness occurrences.

The Controller found that the claimant sent 19 initial truancy notices within the audit sample to pupils who had fewer than three unexcused absences or tardiness occurrences.

Section 48260 as amended by Statutes 1994, chapter 1023 (SB 1728) and Statutes 1995, chapter 19 (SB 102) provides that a pupil who is absent or tardy from school without valid excuse "*on three occasions* in on school year" is a truant. The Commission amended the parameters and guidelines effective for costs incurred beginning July 1, 2006, to reflect that the mandate to provide a truancy notification is triggered by a pupil who is absent or tardy from school without valid excuse on three occasions in one school year and these parameters and guidelines apply to this IRC.

Staff finds that the claimant's request for reimbursement to provide truancy notices for pupils with fewer than three unexcused absences or tardiness occurrences goes beyond the scope of the mandate and is not eligible for reimbursement. In comments on the draft proposed decision, the claimant states that it no longer disputes this issue.[33]

Accordingly, the Controller's reduction of costs for the 19 notices provided to students with fewer than three unexcused absences or tardiness occurrences is correct as a matter of law.

2) Reimbursement is not required for pupils who had fewer than three unexcused absences or tardiness occurrences while between ages six and 18.

The Controller also found that the claimant sent 86 initial truancy notices within the audit sample to pupils who accumulated one or more of the requisite three unexcused absences or tardiness occurrences while the pupil was under age six or over age 18, and therefore had fewer than three unexcused absences or tardiness occurrences while the pupil was between ages six and 18. The Controller made reductions for these 86 notifications because it found that the truancy mandate applies only to students subject to the compulsory education requirements and, thus, student absences that occur before the student's sixth birthday or after the student's 18th birthday are not relevant when determining whether a student is truant. The claimant asserts that notifications of truancy sent to students under age six and over age 18 should be reimbursable because the Education Code provides that those students are statutorily entitled to attend school. Claimant further contends that school districts are required by Education Code section 46000 to record,

[32] Exhibit A, IRC, page 258.

[33] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 4.

keep attendance, and report absences of all pupils according to the State Board of Education (SBE) regulations. These regulations provide that records of attendance of every pupil shall be kept for apportionment of state funds and to ensure general compliance with the compulsory education law.[34]

School districts were required by state law to admit a child to kindergarten if the child would have his or her fifth birthday on or before December 2 of that school year,[35] are required by state and federal law to provide special education services to "individuals with exceptional needs" until the age of 21 if required by a pupil's individualized education plan (IEP),[36] and are required by state law to record the attendance of every pupil enrolled in school for apportionment of state funds and "to ensure the *general* compliance with the compulsory education law, and performance by a pupil of his duty to attend school regularly as provided in [California Code of Regulations, title 5] section 300."[37] However, the truancy laws apply only to "any pupil subject to compulsory full-time education." (Ed. Code § 48260(a).) "Compulsory full-time education" is defined in Education Code section 48200 as "each person between the ages of 6 and 18 years" (Ed. Code § 48200.)

In comments on the draft proposed decision, the claimant states that it no longer disputes this issue.[38]

Therefore, the Controller's reduction of costs claimed for 86 initial truancy notices within the audit sample for pupils who accumulated fewer than three unexcused absences or tardiness occurrences while between ages six and 18, is correct as a matter of law.

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

In its audit of the reimbursement claims, the Controller examined a random sample of initial truancy notices distributed by the claimant (1,180 notifications distributed by elementary and secondary schools), with the calculation of the "sample size based on a 95% confidence level," and determined that 105 of those notices were beyond the scope of the mandate, as described in the issue above. 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 claimed for those fiscal years (69,139 notifications), to approximate the total number of unallowable notifications (6,163 notifications), which is less than 10 percent of the notices claimed. The number of unallowable notices was then multiplied by the unit cost for each fiscal year to calculate the total reduction for all fiscal years of $105,533.

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[34] Exhibit A, IRC, pages 18-22.

[35] Education Code section 48000(a), as last amended by Statutes 1991, chapter 381.

[36] Title 20, United States Code, section 1401; Education Code section 56026.

[37] Education Code section 46000; California Code of Regulations, title 5, section 400. Section 300 of the regulations state in relevant part that "every pupil shall attend school punctually and regularly."

[38] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 4.

Since the Controller has not actually reviewed all 69,139 notifications and the records associated with those notices, the Controller's methodology results in an estimate based on statistical probabilities of the number of notices claimed beyond the scope of the mandate and the costs that Controller has determined to be excessive or unreasonable. The Controller states that the estimated reduction of costs has an "adjustment range" with a 95 percent confidence level and that the reduction taken represents best the point estimate.

Claimant asserts that the use of statistical sampling should be rejected and that the risk of extrapolating findings from a sample is that the conclusions obtained from the sample may not be representative of the universe. Claimant further asserts that the Controller's failure to adopt statistical sampling as a regulation renders its use void.[39]

The Controller counters that sampling and extrapolation is an audit tool commonly used to identify error rates, and that there is no law or regulation prohibiting that method; and, that 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 is not applicable."[40]

Staff finds that the evidence does not support the claimant's assertion that the sampling and extrapolation methodology used by the Controller constitutes an underground regulation, and there is no evidence that the reduction is arbitrary, capricious, or entirely lacking in evidentiary support.

1) <u>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.</u>

The claimant challenges the statistical sampling and extrapolation methodology used by the Controller as an underground regulation not adopted pursuant to the Administrative Procedure Act (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.[41] 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

[39] Exhibit A, IRC, pages 15-16.

[40] Exhibit B, Controller's Late Comments on IRC, page 16.

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

> must "implement, interpret, or make specific the law enforced or administered by [the agency], or ... govern [the agency's] procedure."[42]

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."[43] And in *Clovis Unified,* the court, in discussing the contemporaneous source 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."[44]

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."[45]

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

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[42] *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)].

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

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

[45] Exhibit B, Controller's Late Comments on IRC, page 17.

Code describe the Controller's authority in relatively general terms.[46] 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, the application of a reasonable reimbursement methodology, and may reduce any claim that the Controller determines is excessive or unreasonable[47]

In the absence of express statutory authority for statistical sampling and extrapolation, 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 procedures for their work.'"[48] 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.[49]

In accordance with the Controller's audit authority and duties under the Constitution and the Government 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 Controller's reduction of costs based on audit decisions is arbitrary, capricious, or entirely lacking in evidentiary support.[50] 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."[51]

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, staff finds that the Commission must uphold the Controller's auditing

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[46] 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."].

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

[48] Exhibit B, Controller's Late Comments on IRC, page 17.

[49] Exhibit F, Excerpt from Government Auditing Standards, 2003, page 13.

[50] *American Bd. of Cosmetic Surgery, Inc, v. Medical Bd. of California*, 162 Cal.App.4th 534, 547-548.

[51] Exhibit A, IRC, page 13.

decisions 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 by the district 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 further states that the risk of extrapolating findings from a sample is that the conclusions obtained from the sample may not be representative of the universe. In this respect, the claimant asserts that a kindergarten pupil is more likely to be under-age and a special education pupil is more likely to be over-age, and, thus, the extrapolation from the samples would not be representative of the universe. The claimant further contends that the sampling technique used by the Controller is also quantitatively non-representative because less than two percent of the total number of notices were audited, the stated precision rate was plus or minus eight percent even though the sample size (ranging from 146 to 148) is essentially identical for all four fiscal years, and that the audited number of notices claimed for daily accounting (elementary schools) in fiscal year 2006-2007 (8,680) is 45 percent larger than the size in fiscal year 2009-2010 (6,006). The claimant concludes by stating that "[t]he expected error rate is stated to be 50%, which means the total amount adjusted $105,533 [for the entire audit period, including fiscal year 2006-2007] is really just a number exactly between [the adjustment range]."

The Controller disagrees with the claimant's assertions that the sampling is non-representative of all notices claimed. The Controller states that "the fact that a particular student's initial truancy notification might more likely be identified as non-reimbursable is irrelevant to the composition of the audit sample itself. It has no bearing on evaluating whether the sample selection is representative of the population." Applying the statistical formula used by the Controller to the population of elementary and secondary notices in this case, with a 50 percent expected error rate (the "most conservative sample size estimate" when an error rate is not known) and a desired eight percent margin of error, as stated in the audit report, shows that an appropriate sample size for each level of elementary and secondary schools is between 146 and 148 notices for populations ranging from 6,006 to 8,680 notifications issued by elementary schools, and 8,837 to 11,197 notifications issued by secondary schools during the audit period.

Staff finds that there is no evidence 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.

There is no evidence in the record that the results are biased or unrepresentative as asserted by claimant. There is no dispute that the samples were randomly obtained and reviewed by the Controller. According to the *Handbook of Sampling for Auditing and Accounting* (Arkin), all notices randomly sampled have an equal opportunity for inclusion in the sample and, thus, the result is statistically objective and unbiased. Moreover, absent evidence, the Commission and the Controller must presume that the schools within the claimant's district complied with the mandate in the same way. In addition, the adjustment range for the population's true error rate

within the 95 percent confidence interval is approximately $50,912, added or subtracted from the point estimate (the amount reduced in those years) of $105,533.[52] Although there is a possibility that the $105,533 may provide more reimbursement or less reimbursement to the claimant than the actual costs correctly claimed, the adjustment range of $50,912 for the costs reduced represents just four percent (4%) plus or minus of the total amount claimed during the audit period ($1,192,046).[53]

Based on the analysis above, staff finds that the Controller's reduction of costs based on a statistical sampling method in this case, is not arbitrary, capricious, or entirely lacking in evidentiary support.

Conclusion

Staff finds that that the reduction of $105,533 claimed for notices distributed for pupils who had fewer than three unexcused absences or tardiness occurrences and for pupils who accrued one of more of the three requisite unexcused absences when they were not between ages six and 18, and thus not subject to the compulsory education laws, is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

Staff Recommendation

Staff recommends that the Commission adopt the proposed decision to deny the IRC, and authorize staff to make any technical, non-substantive changes following the hearing.

[52] See Exhibit B, Controller's Late Comments on IRC, page 28.

[53] Exhibit A, IRC, page 257 (final audit report.)

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Education Code section 48260.5 Statutes 1983, Chapter 498; Statutes 1994, Chapter 1023; Statutes 1995, Chapter 19 Fiscal Years 2006-2007 through 2009-2010 San Juan Unified School District, Claimant	Case No.: 13-904133-I-11 *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 3, 2015*)

DECISION

The Commission on State Mandates (Commission) heard and decided this incorrect reduction claim (IRC) during a regularly scheduled hearing on December 3, 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 2006-

2007 through 2009-2010, for the *Notification of Truancy* program. The Commission denies this IRC.

The Commission finds that the Controller's audit of the 2006-2007 reimbursement claim was timely initiated by the Controller within the meaning of Government Code section 17558.5, based on the Controller's entrance conference letter dated February 4, 2011.

The Commission further finds that the reduction of costs totaling $105,533 is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support. The claimant's request for reimbursement to provide initial truancy notices for pupils with fewer than three unexcused absences or tardiness occurrences, or for students who were under the age of six or over the age of 18 when they accrued one or more of the three requisite unexcused absences or tardiness occurrences, goes beyond the scope of the mandate and is not eligible for reimbursement. Moreover, the evidence in the record does not support the claimant's assertion that the Controller's use of sampling and extrapolation of its findings from the sampled notices to all notices claimed constitutes an illegal underground regulation. The Commission further finds that there is no evidence in the record that the Controller's audit conclusions and reductions are arbitrary, capricious, or entirely lacking in evidentiary support.

COMMISSION FINDINGS

I. Chronology

02/14/2008 Claimant signed its reimbursement claim for fiscal year 2006-2007.[54]

02/11/2009 Claimant signed its reimbursement claim for fiscal year 2007-2008.[55]

02/10/2010 Claimant signed its reimbursement claim for fiscal year 2008-2009.[56]

02/04/2011 The Controller sent a letter to claimant confirming the entrance conference.

02/14/2011 Claimant signed its reimbursement claim for fiscal year 2009-2010.[57]

02/15/2011 The entrance conference for the audit was conducted.[58]

11/30/2011 Controller issued the final audit report.[59]

10/01/2013 Claimant filed this IRC.[60]

10/03/2014 The Controller filed late comments on the IRC.[61]

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[54] Exhibit A, IRC, page 284.

[55] Exhibit A, IRC, page 287.

[56] Exhibit A, IRC, page 290.

[57] Exhibit A, IRC, page 292.

[58] Exhibit A, IRC, pages 262 and 267.

[59] Exhibit A, IRC, page 250.

[60] Exhibit A, IRC.

[61] Exhibit B, Controller's Late Comments on IRC.

07/31/2015 Commission staff issued the draft proposed decision.[62]

08/11/2015 The Controller filed comments on the draft proposed decision.[63]

08/14/2015 Claimant filed a request for extension of time to file comments and postponement of hearing to December 3, 2015, which was granted for good cause.

09/10/2015 Claimant filed comments on the draft proposed decision.[64]

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.[65] 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.[66] 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.
>
> (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:

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[62] Exhibit C, Draft Proposed Decision.

[63] Exhibit D, Controller's Comments on Draft Proposed Decision.

[64] Exhibit E, Claimant's Comments on Draft Proposed Decision

[65] Education Code section 48200.

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

> 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.[67]

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 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."[68]

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.[69] 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 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 absent for "three days." 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). These are the parameters and guidelines applicable to this claim.

<u>The Controller's Audit and Summary of the Issues</u>

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

[68] Exhibit F, Parameters and Guidelines, amended July 22, 1993.

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

The November 30, 2011 audit report determined that $1,086,513 in claimed costs was allowable and $105,533 was unallowable.[70]

The Controller found that the district claimed $105,533 during the audit period for initial truancy notifications that the Controller determined were not reimbursable for the following reasons:

- Some of the notices sampled were sent to pupils who had fewer than three unexcused absences as truancy is defined in the parameters and guidelines.[71]
- Some of the notices sampled were sent for pupils who accumulated fewer than three unexcused absences or tardiness occurrences while the pupil was between ages six and 18 and so were not subject to the compulsory education requirements.[72]

The Controller reached the dollar amount reduced by using an audit methodology known as "statistical sampling." The Controller examined a random sample of initial truancy notices distributed by the claimant,[73] with the calculation of the "sample size based on a 95% confidence level," and determined that 105 of those notices were claimed beyond the scope of the mandate, as described in the issue above.[74] 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 in those fiscal years, to approximate the total number of unallowable notifications claimed. The number of unallowable notices was then multiplied by the unit cost for each fiscal year to calculate the total reduction for the audit period.

II. Positions of the Parties

San Juan Unified School District

Claimant argued in the IRC filing that the Controller did not timely initiate the audit of the 2006-2007 fiscal year reimbursement claim and, thus, the reduction of costs for that year is void. However, claimant acknowledges the February 4, 2011 entrance conference letter, in comments on the draft proposed decision, and states that "[i]f the Commission accepts the entrance conference letter as the start date for the audit, the audit was timely commenced."[75]

Claimant also challenges the Controller's disallowance of notifications sent to pupils with fewer than three unexcused absences or tardiness occurrences. In addition, the claimant challenges the disallowance of notices sent to pupils who accrued one or more of the three requisite unexcused absences or tardiness occurrences while under age six or over age 18 because the Education Code allows these students to attend school and requires school districts to provide educational

[70] Exhibit A, IRC, page 251.

[71] Exhibit A, IRC, page 258.

[72] *Ibid*.

[73] The sample sizes for elementary schools and the sample sizes for secondary schools that were reviewed by the Controller each fiscal year ranged from 146 to 148. (Exhibit A, IRC, page 259 (final audit report); Exhibit B, Controller's Late Comments on IRC, page 28.

[74] Exhibit B, Controller's Late Comments on IRC, pages 16-17, 28.

[75] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 3.

services to these pupils.[76] In response to the draft proposed decision, the claimant states that it no longer disputes these legal issues.[77]

Claimant, however, continues to assert that the use of statistical sampling should be rejected, that the extrapolation of findings is void, and that the audit findings can only pertain to documentation actually reviewed.[78] The claimant 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."[79] The claimant further states that the risk of extrapolating findings from a sample is that the conclusions obtained from the sample may not be representative of the universe.[80] The claimant further contends that the sampling technique used by the Controller is also quantitatively non-representative because less 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 $105,533 is really just a number exactly between [the adjustment range]" and that "[a]n interval of possible outcomes cannot be used as a finding of absolute actual cost."[81] Claimant further asserts that the Controller's failure to adopt statistical sampling as a regulation renders its use void.[82]

State Controller's Office

The Controller asserts that it timely initiated the audit of the 2006-2007 reimbursement claim pursuant to Government Code section 17558.5 with a phone call. In comments on the draft proposed decision, the Controller continues to argue that it timely initiated the audit of the 2006-2007 reimbursement claim, and has filed as evidence an entrance conference letter dated February 4, 2011.[83]

The Controller also asserts that claimant is not entitled to claim reimbursement for notices sent for students who were under age six or over age 18 when they accrued one or more of the three requisite unexcused absences or tardiness occurrences as these students are not subject to compulsory full time education, as defined in Education Code section 48200, and are thus not part of the mandated program. The Controller further contends that its use of statistical sampling is a recognized audit methodology that "project[s] each sample's results to the applicable population."[84] The Controller supports its use of statistical sampling by referring to an auditing

[76] Exhibit A, IRC, pages 17-24.

[77] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 4.

[78] Exhibit A, IRC, pages 10-11; Exhibit E, Claimant's Comments on Draft Proposed Decision, pages 5-13.

[79] Exhibit A, IRC, page 14.

[80] Exhibit A, IRC, page 15.

[81] Exhibit A, IRC, page 16.

[82] Exhibit A, IRC, pages 15-16.

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

[84] Exhibit B, Controller's Late Comments on IRC, page 12.

handbook which specifically recommends the use of statistical sampling to "determine the frequency of an occurrence or type of item…." And the Controller asserts that is how statistical sampling is used here – to sample literally tens of thousands of individual documents, the notifications of truancy issued by claimant.[85]

III. 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.[86] 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."[87]

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.[88] 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

[85] Exhibit B, Controller's Late Comments on IRC, page 13.

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

[87] *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

[88] *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.

connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "[89]

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. [90] 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.[91]

A. The Audit of the 2006-2007 Fiscal Year Reimbursement Claim Was Timely Initiated Pursuant to Government Code Section 17558.5.

Claimant's reimbursement claim for fiscal year 2006-2007 was signed on February 14, 2008, and the final audit report states that the claim was filed with the Controller on the same date.[92] At that time, Government Code section 17558.5(a) stated the following:

> 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.[93]

Claimant, in the IRC filing, asserted that "the entrance conference was conducted on February 15, 2011, which is [one day] more than three years after the date the annual claim was filed as well as more than three years after the date of first payment ($54,550) on this annual claim which occurred on March 12, 2007."[94] Claimant therefore alleges that the audit reductions for fiscal year 2006-2007 are void.

The Controller's audit report states that it timely initiated the audit within three years of the date the claim was filed based on a phone call allegedly made on January 24, 2011, as follows:

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

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

[91] 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.

[92] Exhibit A, IRC, pages 262, 284.

[93] Government Code section 17558.5, as last amended by Statutes 2004, chapter 313.

[94] Exhibit A, IRC, page 266; see also Exhibit B, Controller's Late Comments on IRC, page 31, for the remittance advice issued to the claimant on March 12, 2007, showing an approved payment amount to the claimant for the *Notification of Truancy* program of $54,550, and a net payment amount of $35,363 to reflect offsets for fiscal year 2006-2007.

> The SCO initiated the audit on January 24, 2011, by telephone call to Michael Dencavage, the district's former Chief Financial Officer. On the same date, we requested supporting documentation from the district and the district responded that it was retrieving the requested documentation. Therefore, the SCO initiated the audit within three years of the date that the district filed its claim.[95]

In addition, the Controller's comments on the IRC include a declaration from Mr. Jim Spano, Chief of the Mandated Cost Audits Bureau, that the audit was initiated on January 24, 2011. The declaration does not otherwise reference the telephone call or provide any written documentation that the telephone call was made however.[96]

In comments on the draft proposed decision, the Controller argues that it timely initiated the audit based on the issuance of the Controller's entrance conference letter dated February 4, 2011.[97] To support this assertion, the Controller filed a second declaration from Jim Spano, Chief of the Mandated Cost Audits Bureau. Mr. Spano declares the following:

> The Auditor-in-Charge processed a formal entrance conference start letter, dated February 4, 2011 (Tab 2) which was addressed to the district's Associate Superintendent/CFO and signed by the Audit Manager. The start letter identified the Auditor-in-Charge, program being audited, reference to the authority to conduct the audit, the entrance conference date and time, and a basic records request.[98]

The Controller's comments also include in Tab 2 the February 4, 2011 letter, written on the letterhead of the Controller, to "Michael Dencavage, Associate Superintendent/C[F]O, San Juan Unified School District" regarding the "Audit of Mandated Cost Claims for the Notification of Truancy Program For the Period of July 1, 2006, through June 30, 2009." The letter was signed by Steve Van Zee, Audit Manager for the Division of Audits, State Controller's Office, and states in relevant part the following:

> This letter confirms that Masha Vorobyova has scheduled an audit of San Juan Unified School District's legislatively mandated Notification of Truancy Program cost claims filed by fiscal year (FY) 2006-07, FY 2007-08, and FY 2008-09. Government Code sections 12410, 17558.5, and 17561 provide the authority for this audit. The entrance conference is scheduled for Tuesday, February 15, 2011, at 8:30 a.m. We will begin audit fieldwork after the entrance conference.
>
> Please furnish working accommodations for and provide the necessary records (listed on the Attachment) to the audit staff.[99]

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[95] Exhibit A, IRC, page 262.

[96] Exhibit B, Controller's Late Comments on IRC, page 5.

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

[98] *Id*., page 6.

[99] *Id*., pages 9-11.

The claimant acknowledges the February 4, 2011 entrance conference letter, and states that "[i]f the Commission accepts the entrance conference letter as the start date for the audit, the audit was timely commenced."[100]

For the reasons described below, the Commission finds that the audit of the claimant's reimbursement claim for fiscal year 2006-2007 was timely initiated within the meaning of Government Code section 17558.5.

As indicated above, payment was made for this program to the claimant on March 12, 2007, for the fiscal year 2006-2007 costs. Thus, the first sentence of Government Code section 17558.5(a) controls, and requires the Controller to initiate the audit "no later than three years after the date that the actual reimbursement claim is filed." Since the reimbursement claim was filed on February 14, 2008, the Controller had until February 14, 2011 to initiate the audit.

However, the parties have disputed when the audit was initiated. Thus, the Commission must determine the event which constitutes the initiation of an audit for purposes of section 17558.5 in this case, because whether it was a January 24, 2011 telephone call (the first date alleged by the Controller to initiate the audit), a February 4, 2011 letter confirming the entrance conference, or the February 15, 2011 entrance conference (the date asserted by the claimant as the date the audit was initiated) is dispositive of the question whether the Controller met the three-year deadline to initiate the audit of the 2006-2007 reimbursement claim by February 14, 2011, pursuant to Government Code section 17558.5.

Government Code section 17558.5 does not specifically define the event that initiates the audit and, thus, a phone call, a confirming letter, or an entrance conference, are all events that could reasonably be viewed as the initiation date under the statute. However, unlike other agencies that conduct audits and have adopted formal regulations to make it clear when the audit begins, the Controller has not adopted a regulation for the audits of state-mandate reimbursement claims, and in this case, the parties dispute the event that initiated the audit.[101]

An audit of mandate reimbursement claims is not a civil action subject to a statute of limitations, and in any event the California Supreme Court has held that "the statutes of limitations set forth in the Code of Civil Procedure…do not apply to administrative proceedings."[102] Government

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[100] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 3.

[101] See, e.g., regulations adopted by the California Board of Equalization (title 18, section 1698.5, stating that an "audit engagement letter" is a letter "used by Board staff to confirm the start of an audit or establish contact with the taxpayer").

[102] *Coachella Valley Mosquito and Vector Control District v. Public Employees' Retirement System* (2005) 35 Cal.4th 1072, 1088 [citing *City of Oakland v. Public Employees' Retirement System* (2002) 95 Cal.App.4th 29; *Robert F. Kennedy Medical Center v. Department of Health Services* (1998) 61 Cal.App.4th 1357, 1361-1362 (finding that Code of Civil Procedure sections 337 and 338 were not applicable to an administrative action to recover overpayments made to a Medi-Cal provider); *Little Co. of Mary Hospital v. Belshe* (1997) 53 Cal.App.4th 325, 328-329 (finding that the three year audit requirement of hospital records is not a statute of limitations, and that the statutes of limitations found in the Code of Civil Procedure apply to the commencement of civil actions and civil special proceedings, "which this was not"); *Bernd v.*

Code section 17558.5 requires the Controller to initiate an audit within three years after the date that the actual reimbursement claim is filed or last amended, whichever is later, or within three years of the date the claim is first paid. The requirement to timely initiate an audit therefore requires a unilateral act of the Controller. And failure to timely initiate the audit within the three-year deadline is a jurisdictional bar to any reductions made by the Controller of claimant's reimbursement claims.

In this respect, the initiation provisions of Government Code section 17558.5 are better characterized as a statute of repose, rather than a statute of limitations. The statute provides a period during which an audit may be initiated, and after which the claimant may enjoy repose, dispose of any evidence or documentation to support their claims, and assert a defense that the audit is not timely and therefore void.[103] The courts have described a statute of repose as the period that "begins when a specific event occurs, regardless of whether a cause of action has accrued or whether any injury has resulted," and that "a statute of repose thus is harsher than a statute of limitations in that it cuts off a right of action after a specified period of time, irrespective of accrual or even notice that a legal right has been invaded."[104] The characteristics of a statute of repose include that it is "not dependent upon traditional concepts of accrual of a claim, *but is tied to an independent, objectively determined and verifiable event*…"[105] Whether analyzed as a statute of repose, or a statute of limitations, the act or event that must occur before the expiration of the statutory period (which is also the event that begins the procedural limitation period) may be interpreted similarly. That is, the filing of a civil action may be interpreted analogously to the initiation of an audit, to the extent that the initiation of the audit, like the commencement of a civil action, terminates the running of the statutory period, and vests authority in the party to proceed.[106] Because it is the Controller's authority to audit that must be exercised within a specified time, it must be within the Controller's exclusive control to demonstrate by documentary evidence that a timely audit is in progress, and that the claimant is on notice of the audit and may be required to produce documentation to support its claims.

Eu, supra (finding statutes of limitations inapplicable to administrative agency disciplinary proceedings)].

[103] Courts have ruled that when a deadline is for the protection of a person or class of persons, and the language of the statute as a whole indicates the Legislature's intent to enforce the deadline, the deadline is mandatory. (*People v. McGee* (1977) 19 Cal.3d 948, 962, citing *Morris v. County of Marin* (18 Cal.3d 901, 909-910). In this respect, the deadlines in Government Code section 17558.5 are mandatory and not directory, making the requirement to meet the statutory deadline jurisdictional.

[104] *Geist v. Sequoia Ventures, Inc.* (2000) 83 Cal.App.4th 300, 305.

[105] *Inco Development Corp. v. Superior Court* (2005) 131 Cal.App.4th 1014. (Emphasis added.)

[106] *Liptak v. Diane Apartments, Inc.* (1980) 109 Cal.App.3d 762, 773 ["A party does not have a vested right in the time for the commencement of an action [and nor] does he have a vested right in the running of the statute of limitations prior to its expiration." (citing *Kerchoff-Cuzner Mill and Lumber Company v. Olmstead* (1890) 85 Cal. 80; *Mudd v. McColgan* (1947) 30 Cal.2d 463, 468)].

In this case, the Controller's February 4, 2011 entrance conference letter to the claimant provides evidence in the record of the first unilateral act by the Controller to exercise its audit authority consistent with the plain language of section 17558.5, and supports the Controller's assertion that the claimant was on notice that an audit was being initiated before the February 14, 2011 deadline. The plain language of the letter "confirms" that an audit of the mandated program "has been scheduled," thus supporting the Controller's assertion that a conversation between the parties about the scheduling of an entrance conference occurred *before* the February 4, 2011 date of the letter. Moreover, the Commission can take official notice of this letter as an "independent, objectively determined and verifiable event" supporting the date the audit was initiated. 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.[107] Pursuant to Evidence Code section 452(c), the court may take judicial notice of the official records and files of the executive branch of state government, including the official records of the State Controller's Office.[108] The courts have also held that official letters issued by a state agency may be judicially noticed pursuant to Evidence Code section 452(c).[109] Moreover, the claimant does not dispute the date of the entrance conference letter or that the letter was actually sent to the claimant. Instead, the claimant acknowledges the letter, stating that "[i]f the Commission accepts the entrance conference letter as the start date for the audit, the audit was timely commenced."[110]

Based on the foregoing, the Commission finds that the audit of the claimant's reimbursement claim for fiscal year 2006-2007 was initiated no later than February 4, 2011, and is therefore timely initiated within the meaning of Government Code section 17558.5[111]

B. The Controller's Reasons for Reducing Costs at Issue in this IRC Are Correct as a Matter of Law and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced costs totaling $105,533 for initial truancy notifications that the Controller determined were not reimbursable. Of the notifications sampled during the audit, 19 notices were determined unallowable for the four fiscal years at issue because the notices were sent to pupils who had fewer than three unexcused absences or tardiness occurrences in a school year. In addition, 86 notices within the sample were unallowable because they were sent to pupils who accumulated fewer than three unexcused absences or tardiness occurrences while between ages six and 18, with one or more of the three requisite unexcused absences or tardiness occurrences

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[107] California Code of Regulations, title 2, section 1187.5(c); Government Code section 11515.

[108] See also, *Chas L. Harney, Inc. v. State* (1963) 217 Cal.App.2d 77, 86.

[109] *Stevens v. Superior Court* (1999) 75 Cal.App.4th 594, 607-608, where the court took judicial notice of letters issued by the Department of Insurance.

[110] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 3.

[111] This conclusion is consistent with the Commission's decision in *Health Fee Elimination*, 05-4206-I-06, adopted March 27, 2015, where it was determined that an entrance conference letter issued by the State Controller's Office, which documented the parties' earlier agreement on the scheduling of an entrance conference, was sufficient evidence to verify the date the audit was initiated.

when the pupil, by definition, was not subject to the compulsory education requirements of the Education Code.[112]

As described below, the Commission finds that the reasons for these reductions are correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

1) Reimbursement is not required to provide initial truancy notices for pupils with fewer than three unexcused absences or tardiness occurrences.

Section 48260 as amended by Statutes 1994, chapter 1023 and Statutes 1995, chapter 19 provides that 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, is a truant." The Commission amended the parameters and guidelines effective for costs incurred beginning July 1, 2006, to reflect that the mandate to provide a truancy notification is triggered by a pupil who is absent or tardy from school without valid excuse on three occasions in one school year and these parameters and guidelines apply to this IRC.

In its audit the Controller found, however, that the claimant sent truancy notices to pupils who had *fewer than* three unexcused absences or tardiness occurrences. The claimant's request for reimbursement to provide truancy notices for pupils with fewer than three unexcused absences or tardiness occurrences goes beyond the scope of the mandate and is not eligible for reimbursement.

In response to the draft audit report, the claimant contended that it "believes it properly complied with state law and issued truancy notifications after three absences but has been unable to locate the requested supporting documentation, and therefore will concede this adjustment based on insufficient documentation."[113] Even though the claimant conceded the issue in response to the draft audit report, the IRC requests reinstatement of the costs reduced on this basis. The claimant, however, has not provided any further information or evidence to show that it complied with the mandate to provide truancy notices to pupils who are "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." In comments on the draft proposed decision, the claimant states that it no longer disputes this issue.[114]

Accordingly, the Controller's reduction of costs for 19 notices provided to students with fewer than three unexcused absences or tardiness occurrences is correct as a matter of law.

2) Reimbursement is not required for pupils who had fewer than three unexcused absences or tardiness occurrences while between ages six and 18.

The Controller also found that the claimant sent 86 initial truancy notices within the audit sample to pupils who accumulated unexcused absences or tardiness occurrences while the pupil was

[112] Exhibit A, IRC 13-904133-I-11, page 258 (these numbers do not reflect the disallowed notices in fiscal year 2006-2007).

[113] Exhibit A, IRC, pages 260 and 266.

[114] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 4.

under age six or over age 18, and had fewer than three unexcused absences or tardiness occurrences while the pupil was between ages six and 18. The Controller made reductions for these 86 notifications because it found that the truancy mandate applies only to students subject to the compulsory education requirements and, thus, "student absences that occur before the student's 6th birthday or after the student's 18th birthday are not relevant when determining whether a student is truant."[115]

The claimant asserts that notifications of truancy sent for students who were under age six or over age 18 when they accrued one or more of the three requisite absences should be reimbursable because the Education Code provides that those students are statutorily entitled to attend school. Claimant further contends that school districts are required by Education Code section 46000 to record, keep attendance, and report absences of all pupils according to the CDE regulations. These regulations provide that records of attendance of every pupil shall be kept for apportionment of state funds and to ensure general compliance with the compulsory education law.[116]

The Commission finds that providing initial truancy notices for pupils who accumulated fewer than three unexcused absences or tardiness occurrences while between ages six and 18, who by definition were not subject to the compulsory education law when they accrued one or more of the three requisite unexcused absences or tardiness occurrences, is beyond the scope of the mandate and is not eligible for reimbursement.

The claimant is correct that at the time these reimbursement claims were filed, school districts were required by state law to admit a child to kindergarten if the child would have his or her fifth birthday on or before December 2 of that school year.[117] School districts are also required by state and federal law to provide special education services to "individuals with exceptional needs" until the age of 21 if required by a pupil's individualized education plan (IEP).[118] And schools are required by state law to record the attendance of every pupil enrolled in school for apportionment of state funds and "to ensure the *general* compliance with the compulsory education law, and performance by a pupil of his duty to attend school regularly as provided in [California Code of Regulations, title 5] section 300."[119]

However, the truancy laws apply only to those pupils who are subject to compulsory full-time education. Education Code section 48260(a) defines a truant as:

> *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

[115] Exhibit A, IRC, page 258.

[116] Exhibit A, IRC, pages 18-22.

[117] Education Code section 48000(a), as last amended by Statutes 1991, chapter 381.

[118] Title 20, United States Code, section 1401; Education Code section 56026.

[119] Education Code section 46000; California Code of Regulations, title 5, section 400. Section 300 of the regulations state in relevant part that "every pupil shall attend school punctually and regularly."

year, or any combination thereof, is a truant and shall be reported to the attendance supervisor or to the superintendent of the school district.

"Compulsory full-time education" is defined in Education Code section 48200 as "each person between the ages of 6 and 18 years" as follows:

> Each person between the ages of 6 and 18 years not exempted under the provisions of this chapter or Chapter 3 (commencing with Section 48400) is subject to compulsory full-time education. Each person subject to compulsory full-time education and each person subject to compulsory continuation education not exempted under the provisions of Chapter 3 (commencing with Section 48400) shall attend the public full-time day school or continuation school or classes and for the full time designated as the length of the schoolday by the governing board of the school district in which the residency of either the parent or legal guardian is located and each parent, guardian, or other person having control or charge of the pupil shall send the pupil to the public full-time day school or continuation school or classes and for the full time designated as the length of the schoolday by the governing board of the school district in which the residence of either the parent or legal guardian is located.

Education Code 48260(b) further states that "[n]otwithstanding subdivision (a) [which defines a truant as a pupil subject to compulsory full-time education], it is the intent of the Legislature that school districts shall not change the method of attendance accounting provided for in existing law." Therefore, even though schools are required by state law to report the attendance of all enrolled pupils, the truancy laws, including the first notice of initial truancy required by this mandated program, apply only to pupils between the ages of six and 18. In comments filed on the draft proposed decision, the claimant states that it no longer disputes this issue.[120]

Therefore, the Controller's reduction of costs claimed for 86 initial truancy notices within the audit sample for pupils who accumulated fewer than three unexcused absences or tardiness occurrences while between ages six and 18, is correct as a matter of law.

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

In its audit, the Controller examined a random sample of initial truancy notices distributed by the claimant for each year (totaling 1,180 notifications distributed by elementary and secondary schools),[121] with the calculation of the "sample size based on a 95% confidence level," and determined that 105 of those notices were claimed beyond the scope of the mandate, as described

[120] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 4.

[121] The sample sizes for elementary schools and the sample sizes for secondary schools that were reviewed by the Controller each fiscal year ranged from 146 to 148. The sample sizes for elementary and secondary schools were separately calculated because elementary schools took daily attendance and secondary schools took period attendance. (Exhibit A, IRC, page 259 (final audit report); Exhibit B, Controller's Late Comments on IRC, page 28.)

in the issue above.[122] 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 in those fiscal years (69,139 notifications), to approximate the total number of unallowable notifications (6,163 notifications), which is less than 10 percent of the notices claimed. The number of unallowable notices was then multiplied by the unit cost for each fiscal year to calculate the total reduction for the four fiscal years at $105,533.

Since the Controller has not actually reviewed all 69,139 notifications and the records associated with those notices during these fiscal years, the Controller's methodology results in an estimate based on statistical probabilities of the amount of costs claimed beyond the scope of the mandate that the Controller has determined to be excessive or unreasonable. The Controller states that the estimated reduction of costs has an "adjustment range" with a 95 percent confidence level for all four fiscal years between $54,620 and $156,444, and that the total reduction taken ($105,533) for all fours years falls within that range and represents best the point estimate.[123]

Claimant asserts that the use of statistical sampling should be rejected, that the extrapolation of findings is void, and that the audit findings can only pertain to documentation actually reviewed; that is, the 1,180 notifications examined and the 105 notifications disallowed for insufficient number of unexcused absences or tardiness occurrences to justify the initial notification of truancy and the age of the student.[124] The claimant 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."[125] The claimant further states that the risk of extrapolating findings from a sample is that the conclusions obtained from the sample may not be representative of the universe. In this respect, the claimant states the following:

> For example, kindergarten students present in the sample are more likely to be excluded because of the under-age issue, which makes these samples nonrepresentative of the universe. Also, if any of the notices excluded for being under-age or over-age are for students who are special education students, these samples would also not be representative of the universe since the possibility of a special education student being under-age or over-age is greater than the entire student body. The District does not assert that the incidence of kindergarten students or special education students is either proportionate or disproportionate, rather that a kindergarten pupil is more likely to be under-age and a special education pupil is more likely to be over-age than other students sampled, and thus not representative.[126]

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[122] Exhibit B, Controller's Late Comments on IRC, pages 16 and 28.

[123] Exhibit B, Controller's Late Comments on IRC, pages 16 and 29.

[124] Exhibit A, IRC, pages 10-11.

[125] Exhibit A, IRC, page 14.

[126] Exhibit A, IRC, page 15.

The claimant further contends that the sampling technique used by the Controller is also quantitatively non-representative because less than two percent of the total number of notices were audited, the stated precision rate was plus or minus eight percent even though the sample size (ranging from 146 to 148) is essentially identical for all four fiscal years, and that the audited number of notices claimed for daily accounting (elementary schools) in fiscal year 2006-2007 (8,680) is 45 percent larger than the size in fiscal year 2009-2010 (6,006). The claimant concludes by stating that "[t]he expected error rate is stated to be 50%, which means the total amount adjusted $105,533 [for the entire audit period, including fiscal year 2006-2007] is really just a number exactly between [the adjustment range]" and that "[a]n interval of possible outcomes cannot be used as a finding of absolute actual cost."[127] Claimant further asserts that the Controller's failure to adopt statistical sampling as a regulation renders its use void.[128]

The Controller counters that sampling and extrapolation is an audit tool commonly used to identify error rates, and that there is no law or regulation prohibiting that method; and, that 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 is not applicable."[129]

Based on the analysis herein, the Commission finds that the evidence in the record does not support the claimant's assertion that the Controller's use of sampling and extrapolation constitutes an illegal underground regulation. The Commission further finds that there is no evidence in the record that the Controller's findings are 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 as a regulation not adopted pursuant to the APA, to which the Controller responds that the APA is "not applicable."[130] 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]

[127] Exhibit A, IRC, page 16.

[128] Exhibit A, IRC, pages 15-16.

[129] Exhibit B, Controller's Late Comments on IRC, page 16.

[130] *Ibid*.

has been adopted as a regulation and filed with the Secretary of State pursuant to this chapter.

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."[131] 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."[132] 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*,[133] 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.

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."[134] 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…"[135] 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

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

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

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

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

[135] *Id.*, page 562.

employment contracts in California and are residents of California.'"[136] 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.'"[137]

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."[138] 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."[139] 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 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

[136] *Ibid*.

[137] *Ibid*.

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

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

> Nursery Co. v. Agricultural Labor Relations Bd. (1979) 100 Cal.App.3d 128, 142-143.)[140]

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."[141]

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;"[142] and, "[s]imilarly, agencies may provide private parties with advice letters, which are not subject to the rulemaking provisions of the APA."[143] And, the Court reasoned that "if an agency prepares a policy manual that is no more than a restatement or summary, without commentary, of the agency's prior decisions in specific cases and its prior advice letters, the agency is not adopting regulations."[144]

The Court cited a number of examples in which a policy or rule was or was not held to be a regulation,[145] 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:

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[140] *Tidewater*, *supra*, 14 Cal.4th 557, 568-569.

[141] *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)].

[142] *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].

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

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

[145] *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

> 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.[146]

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,[147] and pointed out that if the current interpretation were the only reasonable interpretation, as argued by DLSE, it would not be 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.[148]

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*[149] (*Grier*); *Union of American Physicians and Dentists v. Kizer*[150] (*UAPD*); and *Taye v. Coye*[151](*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."[152] 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

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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).

[146] *Tidewater, supra,* 14 Cal.4th 557, 572.

[147] *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.

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

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

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

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

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

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."[153] 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."[154] 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.[155] 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.[156] Now, with 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.[157]

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.[158] 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.[159] 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

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

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

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

[156] *Union of American Physicians and Dentists*, *supra*, 223 Cal.App.3d 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)].

[157] 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).

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

[159] *Id.*, page 1344.

> 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.[160]

This analysis and conclusion was cited approvingly in *Tidewater*, *supra*, as one of several examples of "interpretations that arise in the course of case-specific adjudication" and not subject to the regulatory process.[161]

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 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.[162] 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.[163] 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.[164]

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."[165] 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

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

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

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

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

[164] *Id.*, page 805.

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

discretion of each auditor to use the challenged methods, then the APA does not bar the exercise of that discretion.[166]

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.[167] 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 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."[168] 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."[169]

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…'"[170] 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;[171] others apply a

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[166] 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."].

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

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

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

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

[171] See, e.g., Exhibit F, Audit of Sweetwater Union High School District, *Notification of Truancy*, fiscal years 2006-2007 through 2009-2010 [In this audit report the Controller reduced

sampling and extrapolation method to determine whether the notifications issued complied with the eight required elements under section 48260.5;[172] 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.[173] 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 method…"[174] 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.'"[175]

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.

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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.].

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

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

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

[175] Exhibit B, Controller's Late Comments on IRC, page 17.

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.[176]

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 the law does not prohibit the audit methods used by the Controller. The Controller relies on Government Code section 12410, which requires the Controller to 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."[177] The Controller also relies on Government Code section 17561, which permits the Controller 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."[178]

The Commission finds that 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 Controller correctly states that there is no express prohibition in law or regulation of statistical sampling and extrapolation methods being used in an audit. However, 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

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

[177] Exhibit B, Controller's Late Comments on IRC, page 11.

[178] Exhibit B, Controller's Late Comments on IRC, page 16 [emphasis in original].

Controller's duly drawn warrant."[179] 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."[180]

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.[181] 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…" Section 17561 also provided, at the time the audit of the subject claims began in 2011, 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 except as follows: (A) The Controller may audit any of the following: (i) Records of any local agency or school district to verify the actual amount of the mandated costs. (ii) The application of a reasonable reimbursement methodology. (iii) The application of a legislatively enacted reimbursement methodology under Section 17573. (B) The Controller may reduce any claim that the Controller determines is excessive or unreasonable. (C) The Controller shall adjust the payment to correct for any underpayments or overpayments that occurred in previous fiscal years.[182]

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; however, a unit cost, which was adopted for this program, is included within the definition of a "reasonable reimbursement methodology." [183] Thus the Controller's audit authority pursuant to section 17561 expressly authorizes an audit of a claim based on a unit cost reimbursement scheme. The statutes, however, do not address how the Controller is to audit and verify the costs mandated by the state.

Accordingly, the Controller cites to Government Auditing Standards, as issued by the Comptroller General of the United States, to argue that it properly conducted the audit as follows:

> The SCO conducted its audit according to generally accepted government auditing standards *(Government Auditing Standards,* issued by the U.S.

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

[180] Statutes 1968, chapter 449.

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

[182] Government Code section 17561 (Stats. 2009-2010, 3rd Ex. Sess., c. 4.).

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

> Government Accountability Office, July 2007). *Government Auditing Standards*, section 1.03 states, "The professional standards and guidance contained in this document ... provide a framework for conducting high quality government audits and attestation engagements with competence, integrity, objectivity, and independence." Generally accepted government auditing standards require the auditor to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions. The standards recognize statistical sampling as an acceptable method to provide sufficient, appropriate evidence.[184]

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.[185] 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.[186]

In accordance with the Controller's audit authority and duties under the Government 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 Controller's reduction of costs based on audit decisions is arbitrary, capricious, or entirely lacking in evidentiary support.[187] 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."[188]

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. For example, the Department of Health Services has 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*[189] and *Union of American Physicians and Dentists v. Kizer*,[190] (*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."[191] The methods used by the Department of

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[184] Exhibit A, IRC, page 261 (Final Audit Report).

[185] Exhibit F, Excerpt from Government Auditing Standards, 2003, page 13.

[186] Exhibit B, Controller's Late Comments on IRC, page 19.

[187] *American Bd. of Cosmetic Surgery, Inc, v. Medical Bd. of California,* 162 Cal.App.4th 534, 547-548.

[188] Exhibit A, IRC, page 13.

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

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

[191] *Id.*, page 495.

Health Services were disapproved by the courts in *Grier* and *UAPD* only on the ground that they constituted a regulation not adopted in accordance with the APA (as discussed above), rather than on the substantive question whether statistical sampling and extrapolation was a permissible methodology for auditing.[192] 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.[193] Thus, after Grier, the Department has both regulatory and statutory authority for its sampling and extrapolation audit process.[194]

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.[195] 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."[196]

On that basis, and giving due consideration to the discretion of the Controller to audit the fiscal affairs of the state,[197] the Commission finds that it must uphold the Controller's auditing decisions 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 further states that the risk of extrapolating findings from a sample is that the conclusions obtained from the sample may not be representative of the universe. In this respect, the claimant asserts that a kindergarten pupil is more likely to be under-age and a special education pupil is more likely to be over-age, and, thus, the extrapolation from the samples would not be representative of the universe.[198] The claimant further contends that the sampling technique used by the Controller is

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

[193] *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)].

[194] 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).

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

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

[197] Government Code section 12410.

[198] Exhibit A, IRC, page 15.

also quantitatively non-representative because less than two percent of the total number of notices were audited, the stated precision rate was plus or minus eight percent even though the sample size (ranging from 146 to 148) is essentially identical for all four fiscal years, and that the audited number of notices claimed for daily accounting (elementary schools) in fiscal year 2006-2007 (8,680) is 45 percent larger than the size in fiscal year 2009-2010 (6,006). The claimant concludes by stating that "[t]he expected error rate is stated to be 50%, which means the total amount adjusted $105,533 [for the entire audit period, including fiscal year 2006-2007] is really just a number exactly between [the adjustment range]."[199]

The Controller disagrees with the claimant's assertions that the sampling is non-representative of all notices claimed. The Controller states that "the fact that a particular student's initial truancy notification might more likely be identified as non-reimbursable is irrelevant to the composition of the audit sample itself. It has no bearing on evaluating whether the sample selection is representative of the population."[200] Citing to Arkin's *Handbook of Sampling for Auditing and Accounting*, page 9, the Controller states the following:

> Since the [statistical] sample is objective and unbiased, it is not subject to questions that might be raised relative to a judgment sample. Certainly a complaint that the auditor had looked only at the worst items and therefore biased the results would have not standing. This results from the fact that an important feature of this method of sampling is that all entries or documents have an equal opportunity for inclusion in the sample.

The Controller further states that the district apparently reached the conclusion that the sampling was quantitatively non-representative because the sample sizes were essentially consistent, while the applicable population size varied. The Controller argues that the absolute size of the sample, not the relative size, is more important under "basic statistical sampling principles." 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.[201] 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 relies on the following formula outlined in Arkin's *Handbook of Sampling for Auditing and Accounting* to calculate the sample size:

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[199] Exhibit A, IRC, page 16.

[200] Exhibit B, Controller's Late Comments on IRC, page 14.

[201] Exhibit B, Controller's Late Comments on IRC, pages 15-16 [Citing Herbert Arkin, *Handbook of Sampling for Auditing and Accounting*, Third Edition, Prentice Hall, New Jersey, 1984, page 89].

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

n = sample size
p = percent of occurrence in population (expected error rate)
SE = desired sample precision
t = confidence level factor
N = population size[202]

Thus, applying the formula above to the population of elementary and secondary notices in this case, with a 50 percent expected error rate (the "most conservative sample size estimate" when an error rate is not known) and a desired eight percent margin of error, as stated in the audit report, shows that an appropriate sample size for each level of elementary and secondary schools is between 146 and 148 notices for populations ranging from 6,006 to 8,680 notifications issued by elementary schools, and 8,837 to 11,197 notifications issued by secondary schools during the audit period.[203]

Moreover, there is no evidence in the record that the results are biased or unrepresentative "because a kindergarten pupil is more likely to be under-age and a special education pupil is more likely to be over-age," as asserted by claimant. There is no dispute that the samples were randomly obtained and reviewed by the Controller. According to the *Handbook of Sampling for Auditing and Accounting* (Arkin), all notices randomly sampled have an equal opportunity for inclusion in the sample and, thus, the result is statistically objective and unbiased.[204] Moreover, absent evidence, the Commission and the Controller must presume that the schools within the claimant's district complied with the mandate in the same way.

In addition, the adjustment range for the population's true error rate within the 95 percent confidence interval is approximately $50,912, added or subtracted from the point estimate (the amount reduced in those years) of $105,533.[205] Although there is a possibility that the $105,533 may provide more reimbursement or less reimbursement to the claimant than the actual costs correctly claimed, the adjustment range of $50,912 for the costs reduced represents just four percent (4%) plus or minus of the total amount claimed during the audit period ($1,192,046).[206]

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.

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[202] *Id.*, page 16 [Citing Arkin, p. 56].

[203] Exhibit B, Controller's Late Comments on IRC, page 28.

[204] Herbert Arkin, *Handbook of Sampling for Auditing and Accounting*, Third Edition, Prentice Hall, New Jersey, 1984, page 9.

[205] See Exhibit B, Controller's Late Comments on IRC, page 28.

[206] Exhibit A, IRC, page 257 (final audit report.)

Based on the analysis above, the Commission finds that the Controller's reduction of costs, based on the statistical sampling method as applied in this case, is not arbitrary, capricious, or entirely lacking in evidentiary support.

IV. Conclusion

The Commission finds that that all reductions at issue in this IRC, totaling $105,533 for fiscal years 2006-2007, 2007-2008, 2008-2009, and 2009-2010, are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

Accordingly, the Commission denies this IRC.

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, 13-904133-I-11
Education Code Sections 48260.5
Statutes 1983, Chapter 498; Statutes 1994, Chapter 1023;
Statutes 1995, Chapter 19
Fiscal Years: 2006-2007, 2007-2008, 2008-2009, and 2009-2010
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: 13-904133-I-11

Matter: Notification of Truancy

Claimant: San Juan Unified School District

TO ALL PARTIES, INTERESTED PARTIES, AND INTERESTED PERSONS:

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