

ITEM 11
INCORRECT REDUCTION CLAIM
REVISED PROPOSED DECISION

Government Code Sections 3540-3549.9

Statutes 1975, Chapter 961; Statutes 1991, Chapter 1213

Collective Bargaining and Collective Bargaining Agreement Disclosure

Fiscal Years 2002-2003 through 2005-2006

09-4425-I-17 and 10-4425-I-18

Sierra Joint Community College District, Claimant

EXECUTIVE SUMMARY

This matter was originally scheduled for the Commission on State Mandates' (Commission's) January 2015 hearing. After the proposed decision for the January hearing was issued, the State Controller's Office (Controller) requested a postponement of the hearing, and filed additional comments. This revised proposed decision addresses the Controller's comments and concludes that the Controller's audit of the reimbursement claims was not timely completed in accordance with Government Code section 17558.5.

Overview

This analysis addresses two consolidated incorrect reduction claims (IRCs) filed by Sierra Joint Community College District (claimant) regarding reductions made by the Controller to reimbursement claims for fiscal years 2002-2003 through 2005-2006 under the *Collective Bargaining and Collective Bargaining Agreement Disclosure* program.

The following issues are in dispute in this IRC:

- The statutory deadlines applicable to audits;
- Unallowable costs related to salaries and benefits; and
- Whether underclaimed indirect costs which are supported by the reimbursement claim and other supporting documentation in the record are required to be paid in favor of a local government claimant.

Because staff finds that the audit was not timely completed in accordance with section 17558.5, it must be held void, and staff recommends that the Commission approve this IRC and direct the Controller to reinstate \$12,116 based on unallowable salaries and benefits for fiscal year 2002-2003.

Collective Bargaining and Collective Bargaining Agreement Disclosure Mandates

On July 17, 1978, the Board of Control, predecessor to the Commission, found that Statutes 1975, chapter 961 imposed a reimbursable state mandate. On March 26, 1998, the Commission

adopted a second test claim decision on Statutes 1991, chapter 1213. Parameters and guidelines for the two programs were consolidated on August 20, 1998 and were amended on January 27, 2000.

At the time the reimbursement claims at issue were prepared and submitted to the Controller, the amended parameters and guidelines, adopted on January 27, 2000, were applicable. These parameters and guidelines authorize reimbursement for costs incurred to comply with sections 3540 through 3549.1 of the Government Code, and “regulations promulgated by the Public Employment Relations Board,” including:

- Determination of appropriate bargaining units for representation and determination of the exclusive representation and determination of the exclusive representatives;
- Elections and decertification elections of unit representatives are reimbursable in the event the Public Employment Relations Board determines that a question of representation exists and orders an election held by secret ballot;
- Negotiations: reimbursable functions include – receipt of exclusive representative’s initial contract proposal, holding of public hearings, providing a reasonable number of copies of the employer’s proposed contract to the public, development and presentation of the initial district contract proposal, negotiation of the contract, reproduction and distribution of the final contract agreement;
- Impasse proceedings, including mediation, fact-finding, and publication of the findings of the fact-finding panel;
- Collective bargaining agreement disclosure before the adoption of the agreement by the governing body;
- Contract administration and adjudication of contract disputes either by arbitration or litigation, including grievances and administration and enforcement of the contract; and
- Unfair labor practice adjudication process and public notice complaints.¹

Procedural History

On January 15, 2004, claimant filed its 2002-2003 reimbursement claim.² On January 10, 2005, claimant filed its 2003-2004 reimbursement claim.³ On January 17, 2006, claimant filed its 2004-2005 reimbursement claim.⁴ On October 30, 2006, the 2002-2003 reimbursement claim

¹ Exhibit A, IRC, page 24 (Exhibit B to the IRC, Parameters and Guidelines amended January 27, 2000).

² Exhibit B, IRC 10-4425-I-18, page 11.

³ *Ibid.*

⁴ *Ibid.*

was paid by the Controller.⁵ On December 21, 2006, claimant filed its 2005-2006 reimbursement claim.⁶ On June 9, 2008, the Controller issued its draft audit report for the fiscal years at issue. On July 3, 2008, the claimant notified the Controller that it was disputing some of the proposed adjustments. On April 17, 2009, the Controller issued its final audit report for fiscal years 2002-2003 through 2005-2006.⁷ On August 4, 2009, the claimant filed 09-4425-I-17.⁸ On August 25, 2010, the Controller issued a revised final audit report.⁹ As of September 9, 2010, no reimbursement claims for 2003-2004 through 2005-2006, had been paid. On February 4, 2011, the claimant filed 10-4425-I-18.¹⁰ On November 14, 2014, Commission staff issued a draft proposed decision on the consolidated IRC.¹¹ On November 26, 2014, the claimant filed comments on the draft proposed decision.¹² On December 2, 2014, the Controller filed comments on the draft proposed decision.¹³

On January 9, 2015, Commission staff issued the proposed decision.¹⁴ The same day, the Controller requested postponement of the hearing, which was granted.¹⁵ On February 27, 2015, the Controller filed comments on the proposed decision.¹⁶

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.

⁵ Exhibit B, IRC 10-4425-I-18, page 43 [Revised Audit Report]; p. 19 [Claim Adjustment Notice].

⁶ Exhibit B, IRC 10-4425-I-18, page 11.

⁷ Exhibit A, IRC 09-4425-I-17, page 8.

⁸ Exhibit A, IRC 09-4425-I-17, page 2.

⁹ Exhibit B, IRC 10-4425-I-18, page 4.

¹⁰ Exhibit B, IRC 10-4425-I-18, page 1.

¹¹ Exhibit C, Draft Proposed Decision.

¹² Exhibit D, Claimant Comments.

¹³ Exhibit E, Controller's Comments.

¹⁴ Exhibit F, Proposed Decision.

¹⁵ Exhibit G, Controller's Request for Postponement.

¹⁶ Exhibit H, Controller's Comments.

The Commission must review questions of law, including interpretation of parameters and guidelines, de novo, without consideration of 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 6.¹⁷ 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.”¹⁸

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.¹⁹

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 the claimant.²⁰ In addition, sections 1185.2(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.²¹

Claims

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

Issue	Description	Staff Recommendation
Statutory deadline applicable to the audit of claimant’s 2002-2003	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 the initiation of an audit by the Controller no	<i>The audit was timely initiated</i> – Staff presumes that the plain language of section 17558.5 is valid and enforceable, and finds that because the fiscal year 2002-2003

¹⁷ *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

¹⁸ *County of Sonoma*, supra, 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

¹⁹ *Johnston v. Sonoma County Agricultural* (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.

²⁰ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

²¹ 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.

through 2005-2006 reimbursement claims.	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, <i>the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.</i> ” As of January 1, 2005, section 17558.5 also provided: “In any case, an audit shall be completed not later than two years after the date that the audit is commenced.”	reimbursement claim was not paid until October 30, 2006, the statutory deadline to initiate an audit was tolled until October 30, 2009. The audit was initiated no later than April 12, 2007, and is therefore timely initiated as to all subject fiscal years. However, staff further finds that the audit was not completed until April 17, 2009. The audit was therefore not completed within the two year requirement of section 17558.5. Additionally, the revised audit, issuing August 25, 2010, was not timely, because it was completed later than two years after the audit was commenced. Because staff finds that the audit was not timely completed, all reductions must be reinstated, and the incorrect reductions alleged will not be considered.
---	--	---

Staff Analysis

The Controller Met the Statutory Deadline for the Initiation of the Final Audit Report but the Audit Report was not Completed Within the Two Year Statutory Deadline, and the Audit is Therefore Void.

Staff finds that the audit report was timely initiated, but was not timely completed. Government Code section 17558.5 provides that if no funds are appropriated “or no payment is made to a claimant...the time for the Controller to initiate an audit [three years] shall commence to run from the date of initial payment of the claim.”²² Here, the claimant’s fiscal year 2002-2003 claim was first paid October 30, 2006, while the remaining years were not paid until at least September 9, 2010. Therefore, the time period subject to audit, for the earliest of the relevant claim years, was extended until October 30, 2009, and the audit was initiated no later than April 12, 2007, based on the latest independently verifiable date that the audit entrance conference letter from the Controller dated April 3, 2007 was sent to claimant. The claimant asserts that the provision of section 17558.5 that tolls the deadline to initiate an audit in the case no payment is made to a claimant is void because it is vague and ambiguous. Staff finds that the Commission

²² Government Code section 17558.5 (Stats. 2002, ch. 1128, (AB 2834)).

is required to presume the statute is valid and enforceable under article III, section 3.5. Staff therefore concludes that the original audit was timely initiated.

However, section 17558.5 also requires that an audit be completed “not later than two years after the date that the audit is commenced.” Based on the independently verifiable date that the entrance conference letter dated the April 3, 2007 was sent (no later than April 12, 2007), the April 17, 2009 audit report (the first “final” audit report) was not timely completed. In addition, the “revised final audit report” issued August 25, 2010, fell outside the two year completion requirement, and was therefore not timely. Based on the foregoing, staff concludes that neither the first “final” audit report, nor the revised audit report, was timely completed in accordance with section 17558.5. The audit of the subject reimbursement claims is therefore void. Because staff concludes that the audit is void, all reductions made must be reinstated, and the Commission need not consider the remaining incorrect reductions alleged.

Conclusion

Based on the foregoing, staff recommends that the Commission approve this IRC, and request that the Controller reinstate all reductions, as follows:

- Reduction of \$12,116 based on unallowable salaries and benefits for fiscal year 2002-2003.

Staff Recommendation

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

BEFORE THE
COMMISSION ON STATE MANDATES
STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM
ON:

Government Code Sections 3540-3549.9

Statutes 1975, Chapter 961 ; Statutes 1991,
Chapter 1213

Fiscal Years 2002-2003 through 2005-2006

Sierra Joint Community College District,
Claimant.

Case Nos.: 09-4425-I-17 and 10-4425-I-18

*Collective Bargaining and Collective
Bargaining Agreement Disclosure*

DECISION PURSUANT TO
GOVERNMENT CODE SECTION 17500 ET
SEQ.; CALIFORNIA CODE OF
REGULATIONS, TITLE 2, DIVISION 2,
CHAPTER 2.5. ARTICLE 7

(Adopted March 27, 2015)

DECISION

The Commission on State Mandates (Commission) heard and decided this consolidated incorrect reduction claim (IRC) during a regularly scheduled hearing on March 27, 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] the IRC at the hearing by a vote of [vote count will be included in the adopted decision].

Summary of the Findings

This consolidated IRC was filed by Sierra Joint Community College District (claimant) in response to the State Controller's Office (Controller's) audit of the claimant's annual reimbursement claims for fiscal years 2002-2003 through 2005-2006, which resulted in a total reduction of \$12,116 for fiscal year 2002-2003.²³

The Commission finds that both the first final audit report, issued April 17, 2009, and the *revised* audit report issued August 25, 2010, fall outside the two year deadline to complete an audit with respect to *all* relevant claim years, based on the independently verifiable date that an entrance conference letter from the Controller dated April 3, 2007 was sent (no later than April 12, 2007), which is determined to be the date the audit commenced. Because the Commission finds that the audit was not timely completed, it is void, and all reductions must be reinstated. All remaining

²³ Exhibit A, IRC 09-4425-I-17, pages 8-9.

findings of the audit are not analyzed below, in accordance with the Commission's determination.

Accordingly, the Commission approves this IRC, and directs the Controller to reinstate all costs reduced as follows:

- Reduction of \$12,116 based on unallowable salaries and benefits for fiscal year 2002-2003.

COMMISSION FINDINGS

I. Chronology

01/15/2004	Claimant filed its fiscal year 2002-2003 annual reimbursement claim. ²⁴
01/10/2005	Claimant filed its fiscal year 2003-2004 annual reimbursement claim. ²⁵
01/17/2006	Claimant filed its fiscal year 2004-2005 annual reimbursement claim. ²⁶
10/30/2006	Controller paid the 2002-2003 reimbursement claim. ²⁷
12/21/2006	Claimant filed its fiscal year 2005-2006 annual reimbursement claim. ²⁸
06/9/2008	Controller issued the draft audit report. ²⁹
07/03/2008	Claimant notified Controller of disputed adjustments. ³⁰
04/17/2009	Controller issued the final audit report. ³¹
08/04/2009	Claimant filed the first of two consolidated IRCs. ³²
08/10/2009	Commission staff deemed the IRC complete and issued it for comment.
08/25/2010	Controller issued the revised final audit report. ³³
09/09/2010	Controller issued adjustment letters and a "results of review" letter. ³⁴

²⁴ Exhibit B, IRC 10-4425-I-18, page 11.

²⁵ *Ibid.*

²⁶ *Ibid.*

²⁷ Exhibit B, IRC 10-4425-I-18, page 43 [Revised Audit Report]; p. 19 [Claim Adjustment Notice].

²⁸ Exhibit B, IRC 10-4425-I-18, page 11.

²⁹ Exhibit A, IRC 09-4425-I-17, page 8.

³⁰ Exhibit A, IRC 09-4425-I-17, page 8.

³¹ Exhibit A, IRC 09-4425-I-17, page 8.

³² Exhibit A, IRC 09-4425-I-17, page 2.

³³ Exhibit B, IRC 10-4425-I-18, page 4.

³⁴ Exhibit B, IRC 10-4425-I-18, page 4.

02/04/2011	Claimant filed the second of two consolidated IRCs. ³⁵
02/10/2011	The executive director deemed the second IRC complete, and consolidated the two IRCs and issued them for comments.
11/14/2014	Commission staff issued the draft proposed decision. ³⁶
11/26/2014	Claimant filed comments on the draft proposed decision. ³⁷
12/02/2014	Controller filed comments on the draft proposed decision. ³⁸
01/09/2015	Commission staff issued the proposed decision. ³⁹
01/09/2015	Controller requested postponement of the hearing. ⁴⁰
02/27/2015	Controller filed comments on the proposed decision. ⁴¹

II. Background

Collective Bargaining and Collective Bargaining Agreement Disclosure Mandates

On July 17, 1978, the Board of Control, predecessor to the Commission, found that Statutes 1975, chapter 961 imposed a reimbursable state mandate. Then, on March 26, 1998, the Commission adopted a second test claim decision finding that Statutes 1991, chapter 1213 imposed a reimbursable state mandate. Parameters and guidelines for the two programs were consolidated on August 20, 1998, and have since been amended again, on January 27, 2000.

At the time the reimbursement claims at issue were prepared and submitted to the Controller, the amended parameters and guidelines, adopted on January 27, 2000, were applicable. These parameters and guidelines authorize reimbursement for costs incurred to comply with sections 3540 through 3549.1 of the Government Code, and “regulations promulgated by the Public Employment Relations Board,” including:

- Determination of appropriate bargaining units for representation and determination of the exclusive representation and determination of the exclusive representatives;
- Elections and decertification elections of unit representatives are reimbursable in the event the Public Employment Relations Board determines that a question of representation exists and orders an election held by secret ballot;

³⁵ Exhibit B, IRC 10-4425-I-18, page 2.

³⁶ Exhibit C, Draft Proposed Decision.

³⁷ Exhibit D, Claimant Comments on Draft Proposed Decision.

³⁸ Exhibit E, Controller’s Comments on Draft Proposed Decision.

³⁹ Exhibit F, Proposed Decision.

⁴⁰ Exhibit G, Request for Postponement.

⁴¹ Exhibit H, Controller’s Comments on Proposed Decision.

- Negotiations: reimbursable functions include – receipt of exclusive representative’s initial contract proposal, holding of public hearings, providing a reasonable number of copies of the employer’s proposed contract to the public, development and presentation of the initial district contract proposal, negotiation of the contract, reproduction and distribution of the final contract agreement;
- Impasse proceedings, including mediation, fact-finding, and publication of the findings of the fact-finding panel;
- Collective bargaining agreement disclosure before the adoption of the agreement by the governing body;
- Contract administration and adjudication of contract disputes either by arbitration or litigation, including grievances and administration and enforcement of the contract; and
- Unfair labor practice adjudication process and public notice complaints.⁴²

Controller’s Audit and Summary of the Issues

The Controller’s reductions of direct salary and benefit costs are based on an asserted lack or insufficiency of supporting documentation for costs claimed. In addition, the Controller found that the claimant failed to obtain federal approval for its indirect cost rates for at least two of the four audited years, and underclaimed its indirect costs by \$103,032.⁴³ However, despite finding that the claimant underclaimed its indirect costs, the Controller determined that the underclaimed amount cannot be paid in full, because “only the total costs included in the initial or amended claim may be reimbursed within one year of the filing deadline...” and section 17561 “allows the SCO to adjust the payment to correct for any underpayments or overpayments based on allowable costs claimed.”⁴⁴

III. Positions of the Parties

Sierra Joint Community College District

As described below, claimant alleges that the Controller incorrectly reduced the costs claimed for salaries and benefits in the amount of \$6,944, and requests that the Commission direct the Controller to reinstate this amount, plus the amount of indirect costs that were underclaimed.

The portion of reduced salaries and benefits that the claimant disputes is attributed to “inaccurate productive hourly rates, resulting in costs that were overstated by \$9,186 for [fiscal year] 2002-03 and understated by \$2,242 for [fiscal year] 2004-05, leaving a net audit adjustment of

⁴² Exhibit A, IRC, page 24 (Exhibit B to the IRC, Parameters and Guidelines amended January 27, 2000).

⁴³ See Exhibit A, IRC 09-4425-I-17, pages 53-72 [Controller’s Final Audit Report, Issued April 17, 2009]; Exhibit B, IRC 10-4425-I-18, pages 25-44 [Controller’s Revised Final Audit Report, Issued August 25, 2010].

⁴⁴ Exhibit B, IRC 10-4425-I-18, page 43 [Revised Final Audit Report].

\$6,944.”⁴⁵ The claimant states that “[n]o explanation was provided for any of these adjustments, and there is no indication as to why the payroll information reported by the District needed to be adjusted for purposes of the productive hourly rate computation.”⁴⁶

For fiscal years 2003-2004 through 2005-2006, the Controller found *underclaimed* indirect costs, which were offset against all other adjustments for those years, and the net reduction in claimed costs for those years was zero.⁴⁷ The claimant disputes the Controller’s findings that “the District improperly determined and applied the indirect cost rate.” The claimant argues that the “difference in the claimed and audited rates is the determination of which of those cost elements are direct costs and which are indirect costs.” The claimant maintains that “federally ‘approved’ rates, which the Controller will accept without further action prior to [fiscal year] 2004-05, are ‘negotiated’ rates calculated by the District and submitted for approval, indicating that the process is not an exact science, but a determination of the relevance and reasonableness of the cost allocation assumptions made for the method used.”⁴⁸

In addition, the claimant argues that the Controller is applying an incorrect auditing standard, in part relying on Government Code 12410, and also failing to make express findings that the claimant’s reimbursement claims were unreasonable or excessive.⁴⁹

Finally, the claimant points out that after recalculating the claimed indirect cost rates by the alternative state method “[t]he final audit report concludes that the District failed to claim \$6,515 for [fiscal year] 2002-03, \$20,662 for [fiscal year] 2003-04, \$18,431 for [fiscal year] 2004-05, and \$49,210 for [fiscal year] 2005-06.” The claimant concludes that “[t]his results in \$94,818 in total unclaimed costs that are due to the District not applying its indirect cost rate to contract services costs in accordance with the claiming instructions.”⁵⁰ In the revised audit report, the total underclaimed amount is determined to be \$103,032.⁵¹

However, the claimant states that “the final audit report concludes that this amount cannot be paid to the District because it exceeds the amount originally claimed.”⁵² The claimant argues that the Controller “does not have the discretion to unilaterally determine that it will require reimbursement for audit adjustments in favor of the State and simply ignore audit adjustments in

⁴⁵ Exhibit A, IRC 09-4425-I-17, pages 8-9 [The claimant states that the first “final” audit report, issued April 17, 2009, finds overstated costs for unallowable salaries and benefits totaling \$14,489, not including indirect costs. That amount includes \$4,468 in unsupported hours, which the claimant does not dispute; and \$3,077 in ineligible expenses for two District administrators to attend a manager’s conference, which the claimant does not dispute.].

⁴⁶ Exhibit A, IRC 09-4425-I-17, page 9.

⁴⁷ Exhibit A, IRC 09-4425-I-17, page 5.

⁴⁸ Exhibit A, IRC 09-4425-I-17, page 11.

⁴⁹ Exhibit A, IRC 09-4425-I-17, pages 11-13.

⁵⁰ Exhibit A, IRC 09-4425-I-17, page 13.

⁵¹ Exhibit B, IRC 10-4425-I-18, page 7.

⁵² Exhibit A, IRC 09-4425-I-17, page 14.

favor of the claimants.” The claimant cites section 17561, which provides that the Controller may audit and reduce claims that are excessive or unreasonable, and “shall adjust the payment to correct for any underpayment or overpayments that occurred in previous fiscal years.” The claimant concludes that the Controller “has the obligation to pay claimants any unclaimed allowable mandate cost it discovers as the result of an audit.”⁵³ Finally, the claimant argues that “the adjustment from Finding 1 was mitigated by \$3,159 attributed to the District’s understated productive hourly rate for [fiscal year] 2004-05,” and that there is “no practical difference between allowing an understated cost to mitigate one of the Controller’s adjustments and reimbursing the District for their total actual costs.”⁵⁴

The claimant also raises the statute of limitations for auditing annual reimbursement claims pursuant to Government Code section 17558.5, and argues that the audit of the earliest fiscal year at issue (2002-2003) and the revised audit are barred.⁵⁵ The claimant asserts that the statute of limitations applicable to the Controller’s audit of its 2002-2003 claim, filed January 15, 2004, expired January 15, 2007, pursuant to section 17558.5, as amended by Statutes 2002, chapter 1128. The audit entrance conference was held on April 17, 2007, which the claimant argues is not a timely initiation of an audit. In addition, the final audit report was issued on April 17, 2009, which the claimant asserts is two years and one day after the audit was initiated and therefore not timely.⁵⁶ And, the claimant asserts that the revised audit report “appear[s] to have been initiated as a result of the original incorrect reduction claim filed on August 3, 2009,” but “was not noticed to the District until the revised audit report was published on August 25, 2010, which is more than three years after the last annual claim was filed...” Finally, the claimant asserts that “the date of the revised audit report is more than two years after the original audit.”⁵⁷

In comments on the draft proposed decision, the claimant now concedes that the audit was timely initiated, but argues that the audit was not timely completed, based on additional documentation and evidence attached to the claimant’s comments.⁵⁸ With respect to the remaining findings in the draft proposed decision, the claimant agrees with the reinstatement of \$6,944 in salaries and benefits, but argues that the Controller’s decision to reimburse the full amount of indirect costs, which exceeded the amounts claimed for fiscal years 2003-2004 through 2005-2006, is itself an incorrect reduction.⁵⁹

State Controller’s Office

The Controller did not submit comments on the consolidated IRCs. However, with respect to the statute of limitations, the Controller argues, in both the original and the revised audit report, that section 17558.5 provides that when no funds are appropriated in the claim year, or payment to

⁵³ Exhibit A, IRC 09-4425-I-17, page 14.

⁵⁴ Exhibit A, IRC 09-4425-I-17, pages 14-15.

⁵⁵ See Exhibit A, IRC 09-4425-I-17, pages 71; 77; Exhibit B, IRC 10-4425-I-18, pages 13-14.

⁵⁶ Exhibit B, IRC 10-4425-I-18, pages 13-14.

⁵⁷ Exhibit B, IRC 10-4425-I-18, page 15.

⁵⁸ Exhibit D, Claimant Comments, pages 2-3; 6; 8.

⁵⁹ Exhibit D, Claimant Comments, pages 4-5.

the claimant is not promptly made, “the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.”⁶⁰ The Controller states that “[t]he district filed its initial FY 2002-03 claims on January 15, 2004, and received the initial claim payment on October 30, 2006.”⁶¹ The Controller argues that “[t]herefore, this claim was subject to the initiation of an SCO audit until October 30, 2009.” The Controller asserts that the audit entrance conference conducted on April 17, 2007 was therefore timely.⁶²

In comments on the draft proposed decision, the Controller admits that it did not maintain documentation to support the reduction of salaries and benefits totaling \$6,944. The Controller further states that although the draft proposed decision found there was no jurisdiction over the reduction of indirect costs, the Controller believes the reduction is valid, based on the claimant’s failure to obtain federal approval for its indirect cost rates.⁶³

In response to the proposed decision issued for the January 2015 Commission hearing, the Controller requested postponement of the hearing and submitted additional comments. The Controller now argues that the findings on the initiation of an audit in the proposed decision issued for the January 2015 hearing were not sufficiently supported, and the issue “deserves a more thorough statutory interpretation analysis.”⁶⁴ The Controller argues that the entrance conference does not constitute the initiation of an audit: “we believe that the formal audit letter should constitute the initiating act, and the date thereon, the date of initiation of an audit.” Here, that date would be April 3, 2007.⁶⁵

Additionally, the Controller disputes the findings in the proposed decision that the Controller must reimburse in full the underclaimed indirect costs that were recalculated in accordance with the Controller’s methodology and based on allowable direct costs. The Controller argues that section 17561 gives the Controller power only to reduce a claim, not to adjust it, and that to require the Controller to reimburse in excess of the total amount claimed “cannot be said to be legally required.”⁶⁶

IV. Discussion

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

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to the local agency or school district. If the

⁶⁰ Exhibit A, IRC 09-4425-I-17, page 71 [Controller’s Final Audit Report, citing Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128, AB 2834))].

⁶¹ Exhibit A, IRC 09-4425-I-17, page 71; Exhibit B, IRC 10-4425-I-18, page 43.

⁶² *Ibid.*

⁶³ Exhibit E, Controller’s Comments, page 1.

⁶⁴ Exhibit H, Controller’s Comments, page 2.

⁶⁵ Exhibit H, Controller’s Comments, pages 3-4; Exhibit D, Claimant’s Comments, page 6.

⁶⁶ Exhibit H, Controller’s Comments, pages 5-6.

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 6.⁶⁷ 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."⁶⁸

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.⁶⁹ Under this standard, the courts have found that:

When reviewing the exercise of discretion, "[t]he scope of review is limited, out of deference to the agency's authority and presumed expertise: 'The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]'" ... "In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . ." [Citations.] When making that inquiry, the " "court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "⁷⁰

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 the claimant.⁷¹ In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertion of

⁶⁷ *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

⁶⁸ *County of Sonoma, supra*, 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

⁶⁹ *Johnston v. Sonoma County Agricultural* (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.

⁷⁰ *American Bd. of Cosmetic Surgery, Inc, supra*, 162 Cal.App.4th at 547-548.

⁷¹ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

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.⁷²

The Controller Met the Statutory Deadline for the Initiation of the Audit, but the Audit Report for the 2002-2003 through 2005-2006 Fiscal Year Reimbursement Claims was not Completed Within the Two Year Statutory Deadline, and the Audit is Therefore Void.

The claimant raises a statute of limitations argument based on the dual requirements of Government Code section 17558.5.⁷³ Section 17558.5, as applicable to the claim years here at issue, requires a valid audit to be initiated no later than three years after the date that the reimbursement claim is filed or last amended. However, the section also provides that 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."⁷⁴ "In any case," section 17558.5 requires the audit to be completed no later than two years after it is commenced.⁷⁵

1. The Audit was Timely Initiated, Pursuant to Government Code Section 17558.5.

The claimant asserts that the audit of the 2002-2003 claim was not timely initiated, based on the filing date of the claim (January 15, 2004), and the dates that the audit entrance conference took place (April 17, 2007), or the date on the earlier entrance conference letter (April 3, 2007), and the audit report issued April 17, 2009. However, the Controller points out that the fiscal year 2002-2003 claim was not paid until October 30, 2006, and that therefore section 17558.5 provides for a timely audit to be initiated as late as October 30, 2009.⁷⁶

⁷² 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.

⁷³ The Controller's Final Audit Report, issued April 17, 2009, states that the claimant raised the statute of limitations in its response to the draft audit, but the claimant did not reiterate its allegation in IRC 09-4425-I-17. (See IRC 09-4425-I-17, page 71.) The claimant reiterated and expanded upon its statute of limitations argument in IRC 10-4425-I-18, pages 13-14, and then in comments on the draft proposed decision (Exhibit D, Claimant Comments, pages 1-3).

⁷⁴ Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

⁷⁵ Government Code section 17558.5 (as amended, Stats. 2004, ch. 890 (AB 2856)).

⁷⁶ Government Code section 17558.5 (as amended, Statutes 2004, ch. 890 (AB 2856)). Neither the filing date of the subject reimbursement claims, nor the date the audit was commenced, controls whether the later-amended version(s) of section 17558.5 are applicable. See *Scheas v. Robertson* (1951) 38 Cal.2d 119, 126 ["It is settled that the Legislature may enact a statute of limitations 'applicable to existing causes of action or shorten a former limitation period...']; *California Employment Stabilization Commission v. Payne* (1947) 31 Cal.2d 210, 215 ["...the power of the Legislature to lessen a statute of limitations is subject to the restriction that an existing right cannot be cut off summarily without giving a reasonable time after the act becomes effective to exercise such right. [citation] This principle, however, does not apply where the state gives up a right previously possessed by it or by one of its agencies. Except where such an

Government Code section 17558.5 states that “[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” However, if funds are not appropriated or no payment is made to the claimant for a given year, section 17558.5 states the “time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.”⁷⁷

The claimant argues that this provision “is void because it is impermissibly vague”,⁷⁸ and that the filing date of the claim should control. But article III, section 3.5 of the California Constitution states that an administrative agency has no power “[t]o declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional...”⁷⁹ Here, the fiscal year 2002-2003 reimbursement claim was filed on January 15, 2004, but was not paid, based on the evidence in the record, until October 30, 2006.⁸⁰ Therefore, the time to initiate an audit, in this case, commenced to run from October 30, 2006, and an audit initiated before October 30, 2009 would be timely.

The proposed decision issued for the Commission’s January 2015 hearing found that the audit was initiated on April 17, 2007, the date the entrance conference was held.⁸¹ That finding was supported by an analysis of the plain language of the entrance conference letter, which stated in relevant part that “audit fieldwork *will begin* after the entrance conference”⁸² and the definition of an audit, which includes the review of documents. However, upon further review, the Commission finds that there is no issue as to whether the audit was timely initiated. Whether the audit was initiated April 3, 2007, the date of the entrance conference letter, or April 17, 2007, the date of the entrance conference itself, or some date in between, is not dispositive of whether the audit was timely initiated. Indeed, based on the evidence in the record, the audit was *completed* April 17, 2009, more than six months before the three-year limitation period of section 17558.5 expired. Therefore, the Commission finds that the audit was timely initiated, with respect to the fiscal year 2002-2003 reimbursement claim.

The Commission further finds that the initiation of the audit with respect to the remaining reimbursement claims for fiscal years 2003-2004, 2004-2005, and 2005-2006, was also timely.

agency is given powers by the Constitution, it derives its authority from the Legislature, which may add to or take away from those powers and therefore a statute which adversely affects only the right of the state is not invalid merely because it operates to cut off an existing remedy of an agency of the state.”].

⁷⁷ Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

⁷⁸ Exhibit B, IRC 10-4425-I-18, page 11.

⁷⁹ California Constitution, article III, section 3.5 (added June 6, 1978, by Proposition 5).

⁸⁰ Exhibit B, IRC 10-4425-I-18, page 43 [Revised Audit Report]; p. 19 [Claim Adjustment Notice].

⁸¹ Exhibit F, Proposed Decision issued January 9, 2015, page 21.

⁸² Exhibit D, Claimant Comments, page 6.

The annual claim for 2003-2004 was filed January 10, 2005, and therefore an audit initiated on or before January 10, 2008 would have been timely, based solely on the filing date of the claim. Moreover, notices from the Controller dated September 9, 2010, and pertaining to fiscal years 2003-2004 through 2005-2006, indicate that *no claims* had yet been paid for those audit years,⁸³ and therefore “the time for the Controller to initiate an audit,” pursuant to section 17558.5, had not commenced to run as of that date.⁸⁴ Based on the foregoing, the audit was timely initiated with respect to all successive audit years.

2. The Audit was not Timely Completed, Pursuant to Government Code Section 17558.5, and Therefore Must be Held Void.

The claimant also argues that the audit was not timely *completed*, based on the entrance conference letter, dated April 3, 2007, and the issuance of the final audit report on April 17, 2009.⁸⁵ The Controller does not express an opinion whether the audit was timely *completed*, but strenuously argues that the audit was *initiated* by the entrance conference letter dated April 3, 2007.⁸⁶

Effective January 1, 2005, Government Code section 17558.5(a) requires that “an audit shall be completed not later than two years after the date that the audit is commenced.”⁸⁷ Since the audits for the reimbursement claims at issue in this case were still pending in January 2005, the time for completing an audit specified in Government Code section 17558.5(a) applies.⁸⁸

The Legislature did 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

⁸³ Exhibit B, IRC 10-4425-I-18, pages 21-23.

⁸⁴ Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

⁸⁵ Exhibit D, Claimant Comments, page 3.

⁸⁶ Exhibit H, Controller’s Comments, pages 2-3.

⁸⁷ Statutes 2004, chapter 890.

⁸⁸ The California Supreme Court in *Scheas v. Robertson* (1951) 38 Cal.2d 119, 126 held: “It is settled that the Legislature may enact a period of limitation ‘applicable to existing causes of action or shorten a former limitation period...’ The completion requirement of section 17558.5 is not exactly a statute of limitations, but rather more akin to a procedural requirement attached to the Controller’s authority to audit, not unlike the requirement in Code of Civil Procedure section 583.310 that an action must be brought to trial within five years or be dismissed. In *People v. Kings County Development Co.* (1920) 48 Cal.App. 72, 75-76, the court explained that “[t]hose statutes which merely restrict a statutory or other right do not come under [the heading of ‘statutes of limitation’], but rather are in the nature of conditions put by the law on the right given.” The purpose of such limitations is “obviously, to compel reasonable diligence in the prosecution of an action after it has been commenced...” Here, the “condition” put upon the Controller’s audit authority is that it must be completed within two years of the date commenced, or be held void. However, there is no reason in law to presume that the Legislature’s power to impose a limiting period on the Controller’s authority to audit should be interpreted differently.

audits and have adopted formal regulations to make it clear when the audit begins (which can be viewed as the controlling interpretation of a statute) the Controller has not adopted a regulation for the audits of state-mandate reimbursement claims.⁸⁹ Nor has the Controller's position been clear in this case. Under these circumstances, the Commission is not required to give the Controller's assertions about when an audit is initiated any weight. In this respect, the courts have stated the following:

Courts must, in short, independently judge the text of the statute, taking into account and respecting the agency's interpretation of its meaning, of course, whether embodied in a formal rule or less formal representation. Where the meaning and legal effect of a statute is the issue, an agency's interpretation is one among several tools available to the court. Depending on the context, it may be helpful, enlightening, even convincing. It may sometimes be of little worth. Considered alone and apart from the context and circumstances that produce them, agency interpretations are not binding or necessarily even authoritative. To quote the statement of the Law Revision Commission in a recent report, "The standard for judicial review of agency interpretation of law is the independent judgment of the court, giving deference to the determination of the agency appropriate to the circumstances of the agency action."⁹⁰

In addition, the Commission cannot read words into a statute that are not there or clearly part of the Legislature's intent.⁹¹ Since section 17558.5 is silent with respect to the act or event that constitutes an initiation of an audit, the Commission cannot, as a matter of law, state the act or event that initiates an audit in all cases.

However, for purposes of applying the two-year completion requirement of section 17558.5, the Commission must determine whether the audit was initiated (or commenced) more than two years prior to its completion, based on the evidence in the record. This presents an issue of first impression for the Commission. Prior IRCs have relied on a finding that the audit was initiated "no later than..." a date certain, or have not been required to squarely address the question when an audit was initiated at all, either because the audit was completed well within the two year deadline, or well outside the two year deadline, irrespective of the date applied.⁹² In this IRC, the Commission is called upon to make a finding whether the entrance conference itself or some earlier occurrence constitutes the initiation of an audit for purposes of section 17558.5, because the difference between whether it was before April 17, 2007 or on or after April 17, 2007 is

⁸⁹ 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").

⁹⁰ *Yamaha Corp. of America v. State Board of Equalization* (1998) 19 Cal.4th 1, 7-8 [Citing *Traverso v. People ex rel. Dept. of Transportation* (1996) 46 Cal.App.4th 1197, 1206 as an example of an agency interpretation "of little worth," and quoting *Judicial Review of Agency Action* (Feb.1997) 27 Cal. Law Revision Com. Rep. (1997) p. 81].

⁹¹ *Department of Corrections v. Workers' Comp. Appeals Bd.* (1999) 76 Cal.App.4th 810, 815.

⁹² See, e.g., *Health Fee Elimination Decisions*, 05-4206-I-03; 05-4206-I-05; 05-4206-I-04 and 08; *Collective Bargaining Decisions* 08-4425-I-15; 08-4425-I-16.

dispositive of the question whether the Controller met the two-year completion deadline of section 17558.5.

The draft proposed decision assumed that the April 17, 2007 entrance conference constitutes the initiation of the audit, and based on that date, the April 17, 2009 audit report constitutes timely completion.⁹³ In comments on the draft proposed decision, the claimant asserts that “the audit commenced on April 3, 2007, or perhaps a few days earlier for the initial phone contact, based on the date of the entrance conference letter (Attachment A).”⁹⁴ The claimant asserts that the Commission must make a legal finding on the issue of what constitutes initiation of an audit.⁹⁵ The claimant asserts that “[t]he Controller considers the audit commencement date to be the date of first contact made by Controller to the claimant.”⁹⁶ Accordingly, the claimant provides a copy of an email relating to IRCs on another program that was addressed to Nancy Patton, former Assistant Executive Director of the Commission, from Jim Spano, Bureau Chief of the Division of Audits at the Controller’s Office, which states, in pertinent part:

We consider the event that initiates an audit pursuant to Government Code section 17558.5 to be the date of the initial contact by the SCO to the auditee (generally a telephone contact) to inform them and put them on notice of the SCO’s intention to perform the audit. In addition, we consider this same date as the event that commences the two-year period to complete an audit pursuant to Government Code section 17558.5.⁹⁷

The claimant thus concludes, based on the Controller’s interpretation of section 17558.5 provided in the email, that the entrance conference letter, dated April 3, 2007,⁹⁸ or “a few days earlier for the initial phone contact...”⁹⁹ commences the audit, for purposes of the statutory deadlines of Government Code section 17558.5, and the April 17, 2009 audit report was therefore not timely.

However, in the proposed decision issued for the January 2015 hearing, Commission staff concluded, based on the plain language of the entrance conference letter stating that an audit was “scheduled”, and that audit fieldwork would begin after the entrance conference,¹⁰⁰ that the entrance conference itself, on April 17, 2007, constitutes the initiation of an audit, and the completion April 17, 2009 was therefore timely.¹⁰¹

⁹³ Exhibit C, Draft Proposed Decision, page 16.

⁹⁴ Exhibit D, Claimant Comments, page 3.

⁹⁵ Exhibit D, Claimant Comments, page 3.

⁹⁶ Exhibit D, Claimant Comments, page 3.

⁹⁷ Exhibit D, Claimant Comments, page 8.

⁹⁸ Exhibit D, Claimant Comments, page 6.

⁹⁹ Exhibit D, Claimant Comments, page 3.

¹⁰⁰ Exhibit D, Claimant Comments, page 6.

¹⁰¹ Exhibit F, Proposed Decision issued January 9, 2015, page 22 [“Based on the foregoing analysis, and assigning to the Controller’s email only that weight appropriate to its context in

The Controller now argues strenuously for an interpretation that the entrance conference letter dated April 3, 2007 constitutes, as a matter of law, the initiation of an audit. Specifically, the Controller argues that the key purpose of a statute of limitations provision is “to promote justice by preventing surprises through the revival of claims...” and to “require diligent prosecution of known claims so that legal affairs can have their necessary finality and predictability...”¹⁰² The Controller further argues that the notice provided by an entrance conference letter promotes the goals of finality and predictability, and that “relying on the entrance conference is misplaced”, because the entrance conference can be delayed or continued and “is only certain once it occurs.”¹⁰³ The Controller further states the following:

Use of the entrance conference is even more questionable when we compare the application of the statutes of limitation in other areas of the law. In civil and criminal law (misdemeanor), the event that ends the running of the statute is the filing of a complaint. For administrative law, the Continuing Education of the Bar, California Administrative Hearing Guide states that “[i]n practice, the accusation or statement of issues is considered filed on the date when it was signed and dated by the executive officer or other employee of an agency.” (§3.26, page 3-19.) Each of these processes relies at its core on a written document, not a face to face meeting between the parties. Another characteristic in common is that the filing is accomplished by a unilateral act of the plaintiff/complainant, no contact or coordination with the opposing party is required. The conclusion of the PD would create a statute of limitations procedure that is unlike any other, essentially requiring the consent of the auditee and a face to face meeting, before an audit could be initiated. There is nothing in Section 17558.5(a) that suggests such a departure from other statute of limitation procedures. In light of the purposes of statutes of limitations, as well as the common characteristics of other statutes of limitation schemes, we believe that the formal audit letter should constitute the initiating act, and the date thereon, the date of initiation of the audit. In this case the audit letter was dated April 3, 2007, which should be the date the audit is considered initiated.¹⁰⁴

In addition, the Controller contends that it actually begins reviewing reimbursement claims and the supporting documentation before the Controller contacts the claimant to schedule an entrance conference. In this respect, the Controller submits a declaration from Jim Spano, Bureau Chief for the Controller, identifying the steps taken to by the Controller before the initial contact with the claimant occurs.¹⁰⁵

light of the evidence in the record, the Commission finds that in this case, the audit entrance conference constitutes the initiation and commencement of the audit, on April 17, 2007.”].

¹⁰² Exhibit H, Controller’s Comments on Proposed Decision, page 3 [citing *Romano v. Rockwell International, Inc.* (1996) 14 Cal.4th 479, 488; *Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison* (1998) 18 Cal.4th 739, 756].

¹⁰³ Exhibit H, Controller’s Comments on Proposed Decision, page 3.

¹⁰⁴ Exhibit H, Controller’s Comments on Proposed Decision, pages 3-4.

¹⁰⁵ Exhibit H, Controller’s Comments on Proposed Decision, pages 7-8.

Upon further review of the statute, relevant case law, and evidence in the record, the Commission finds that the Controller's audit of the claimant's reimbursement claims for fiscal years 2002-2003 through 2005-2006 was not timely completed.

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."¹⁰⁶ The audit initiation provisions of section 17558.5 require the Controller to initiate an audit within two years after the end of the calendar year in which the reimbursement claim is filed or last amended, or within two years of the date the claim is first paid. These alternate triggering events are unrelated to the accrual of any cause of action, or the discovery of wrongdoing by the claimant. The requirement to initiate an audit within two calendar years from the date the reimbursement claim is filed requires a unilateral act of the Controller. And failure to timely initiate the audit within the two-year deadline is a jurisdictional bar to any reductions made by the Controller of claimant's reimbursement claims.¹⁰⁷ 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.

The court in *Giest v. Sequoia Ventures, Inc.*, described a statute of repose as follows:

Unlike an ordinary statute of limitations which begins running upon accrual of the claim, [the] period contained in a statute of repose begins when a *specific event occurs*, regardless of whether a cause of action has accrued or whether any injury has resulted." [citations] A statute of repose thus is harsher than a statute of

¹⁰⁶ *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. Eu, supra* (finding statutes of limitations inapplicable to administrative agency disciplinary proceedings)].

¹⁰⁷ 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.

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.¹⁰⁸

Described by another court in *Inco Development Corp. v. Superior Court*,¹⁰⁹ 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...”

However, 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 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.¹¹⁰ For purposes of the determination at issue here, whether the audit was timely completed, the act that ends the running of the statutory period to timely initiate an audit is also the event that begins running the period to complete the audit, and for that reason only, the initiation date is in issue here.

Here, the claimant has provided a copy of an email expressing the opinion of Jim Spano, Bureau Chief of the Division of Audits at the Controller’s Office, stating that “[w]e consider the event that initiates an audit pursuant to Government Code section 17558.5 to be the date of the initial contact by the SCO to the auditee (generally a telephone contact)...” In addition, the email goes on: “we consider this same date as the event that commences the two-year period to complete an audit...”¹¹¹ However, the email is in reference to a number of outstanding *Health Fee Elimination* IRCs, and does not refer to this or any other *Collective Bargaining* IRC. Secondly, the email is not a statement of duly adopted policy, but a statement of the audit bureau chief’s interpretation of the law.

Conversely, the plain language of the “entrance conference letter” on which claimant also relies, suggests that the letter is not intended to commence the audit. The letter states that members of the Controller’s audit staff have “scheduled an audit”, and that “[a]udit fieldwork *will begin after* the entrance conference.”¹¹² Black’s Law Dictionary defines an audit as “[a] formal examination of an individual’s or organization’s accounting records...” The letter that the claimant provides requests that the claimant make available “the necessary records,” and announces a “formal examination.” Therefore, the letter suggests that the entrance conference constitutes the initiation of the audit, rather than the letter itself.

¹⁰⁸ *Giest v. Sequoia Ventures, Inc.* (2000) 83 Cal.App.4th 300, 305

¹⁰⁹ *Inco Development Corp. v. Superior Court* (2005), 131 Cal.App.4th 1014.

¹¹⁰ *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)].

¹¹¹ Exhibit D, Claimant Comments, page 8.

¹¹² Exhibit D, Claimant Comments, page 6.

The Controller argues that the purpose of a statute of limitations, generally, is “to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared.”¹¹³ The Controller further cites *Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison*,¹¹⁴ in which the Court explained that the “legislative goal underlying limitation statutes is to require diligent prosecution of known claims so that legal affairs can have their necessary finality and predictability and so that claims can be resolved while evidence remains reasonably available and fresh.” Both of these statements by the Court are consistent with the approach taken by the parameters and guidelines with respect to document retention (i.e., the preservation of evidence for the claim). The parameters and guidelines for many programs, including *Collective Bargaining*, provide substantially as follows:

All documents used to support the reimbursable activities, as described in Section G, must be retained during the period subject to audit. If the Controller has initiated an audit during the period subject to audit, the retention period is extended until the ultimate resolution of any audit findings.¹¹⁵

The Controller further argues that, like a statute of limitations to file a civil action, the act or event that must occur before the expiration of the statutory period must be one that can be completed by the party affected alone, and without the consent or cooperation of the auditee. This view is consistent with the plain language of section 17558.5, in that it clearly requires the *Controller* to initiate an audit, and does not expressly require the action or cooperation of any other party.

The Controller therefore reasons that the goals of finality and predictability, and the preservation of evidence; and the intent that a limitation period may be ended by a unilateral act of the party affected, are served best by applying section 17558.5 to the entrance conference letter, rather than the entrance conference itself.

The Commission agrees. Based on the evidence in this case, the goals of finality and predictability in the operation of a limiting statute are best served by applying section 17558.5 to the Controller’s entrance conference letter dated April 3, 2007 to the extent that that the execution of that letter can be verified, and not the entrance conference on April 17, 2007. The letter does not contain a proof of service, certificate of mailing, or an affidavit by the Controller’s Office to verify the date of mailing. The letter, alone, is an out of court document being used for the truth of the matter asserted (i.e., that the date of the letter provides evidence that the Controller timely initiated the audit) and is considered unreliable hearsay.¹¹⁶ Nor can the declaration of Jim Spano of the Controller’s Office, which generally describes the Controller’s audit procedures and states that “[t]he Auditor-in-Charge processed a formal start letter, dated

¹¹³ Exhibit H, Controller’s Comments, page 3 [quoting *Romano v. Rockwell International, Inc.* (1996) 14 Cal.4th 479, 488].

¹¹⁴ *Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison* (1998) 18 Cal.4th 739, 756,

¹¹⁵ *Collective Bargaining and Collective Bargaining Agreement Disclosure*, Parameters and Guidelines, amended January 29, 2010 (05-PGA 48, CSM 97-TC-08, 98-4425-PGA-12).

¹¹⁶ *People v. Zunis* (2005) 134 Cal.App.4th Supp. 1, 5.

April 3, 2007,” be used to authenticate the letter and verify the initiation of the audit on that date since the entrance conference letter was not signed or prepared by Mr. Spano, and there is no indication that Mr. Spano witnessed the writing being made.¹¹⁷

However, the initiation of the audit can be verified by extrinsic evidence in the record. The entrance conference letter was first entered into the record by the claimant, and although the date that the letter was stamped received by the claimant is illegible, another date, apparently evincing a fax transmission to the claimant’s representative, is legible along the top edge of the letter: “Apr 12 07”. Additionally, the substance of the letter “confirms” the scheduling of an entrance conference to proceed with an audit,¹¹⁸ and a declaration provided by the Controller states that the Auditor-in-Charge contacted the district prior to the making of the letter, which the claimant acknowledges.¹¹⁹ Based on the foregoing, the Commission can find that the claimant had actual notice of the audit, and of existence of the letter, no later than April 12, 2007.

The entrance conference letter represents a unilateral act by the Controller to exercise its audit authority before that authority is barred, which is consistent with the plain language of section 17558.5. 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 meet or fail to meet the deadline imposed. To the extent an entrance conference letter exists and was sent to the claimant, that letter provides verification to a claimant that an audit is in progress, and that the claimant may be required to produce documentation to support its claims. In this way, the entrance conference letter serves the goals of finality and predictability, and ensures that a claimant will not prematurely dispose of needed evidence to support its claim.

The Controller’s comments suggest that the goals of finality and predictability necessitate notice to the claimant that an audit has been initiated before the statutory period expires.¹²⁰ Indeed the Controller’s comments suggest that *written notice* may be required. In this IRC, the Commission is not required to make findings regarding whether actual notice may be required; however, even if actual notice to the claimant is required, based on evidence in the record in this case claimant received actual notice no later than April 12, 2007. For now, the Commission only notes that it is not clear what the outcome would be if only a desk audit were commenced before the expiration of the statutory period, but no notice was given to the claimant, or whether a verifiable

¹¹⁷ Evidence Code section 1401 states that “authentication of a writing is required before it may be received in evidence.” Evidence Code sections 1411 and 1413 provide that the subscribing witness is not required to authenticate the writing, but that the writing may be authenticated by anyone who saw the writing made or executed.”

The declaration of Jim Spano is in Exhibit E, Controller’s Comments on Draft Proposed Decision, p. 6. The entrance conference letter was signed by Chris Prasad, Audit Manager, (Exhibit A, IRC, p. 88.)

¹¹⁸ Exhibit D, Claimant’s Comments, page 6.

¹¹⁹ Exhibit D, Claimant’s Comments, page 3.

¹²⁰ Exhibit H, Controller’s Comments on Proposed Decision, page 3. Additionally, the Spano declaration indicates that the issuance of an audit letter “is consistent with the protocol for all audits of mandated cost claims.”

phone call or other contact with a person with capacity to receive notice on behalf of a local agency is sufficient to initiate an audit for purposes of Government Code section 17558.5 in cases where no written notice is provided.

As stated above, section 17558.5 requires the Controller to complete an audit within two years of the date commenced. 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.

[T]he intent must be gathered from the terms of the statute construed as a whole, from the nature and character of the act to be done, and from the consequences which would follow the doing or the failure to the particular act at the required time. (Citation.) When the provision is to serve some public purpose, the provision may be held directory or mandatory as will best accomplish that purpose (citation)....¹²¹

The California Supreme Court specifically rejected the notion that a statute could only be mandatory if it included a means of enforcement. Rather, the Court ruled that the important analysis is whether the purpose of the statute is to require an act.¹²²

Here, the plain language of section 17558.5 provides that "[i]n any case, an audit shall be completed not later than two years after the date that the audit is commenced." Because the structure and purpose of the statute suggests that it is mandatory, an audit not conforming to the deadline must be held void.

Based on the foregoing, the Commission finds that section 17558.5 must be treated as mandatory, rather than directory, and that the remedy for the Controller's failure to initiate or to complete an audit within the timeframes described is to hold the audit void.

Here, the Commission finds that the audit was initiated no later than the date that the entrance conference letter dated April 3, 2007 was *sent* to claimant (no later than April 12, 2007). The execution of the letter can be confirmed through extrinsic evidence to have occurred no later than the date transmitted by the claimant to its representative, April 12, 2007. Because an audit completed (completion being measured by the issuance of a final audit report) could not be timely if the audit is initiated any earlier than April 17, 2007, the Commission must find that this audit was not timely completed, in accordance with section 17558.5, and is void.

V. Conclusion

Based on the foregoing, the Commission approves this IRC and requests that the Controller reinstate all costs reduced, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission regulations, as follows:

- Reduction of \$12,116 based on unallowable salaries and benefits in fiscal year 2002-2003.

¹²¹ *People v. McGee* (1977) 19 Cal.3d 948, 962, citing *Morris v. County of Marin* (18 Cal.3d 901, 909-910).

¹²² *Id.*