

ITEM 5
INCORRECT REDUCTION CLAIM
PROPOSED DECISION

Government Code Section 7576 as amended by Statutes 1996, Chapter 654 (AB 2726);
California Code of Regulations, Title 2, Division 9, Chapter 1, Sections 60100 and 60110¹
Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services
Fiscal Years 2003-2004, 2004-2005, and 2005-2006

12-9705-I-04

County of Los Angeles, Claimant

EXECUTIVE SUMMARY

Overview

This Incorrect Reduction Claim (IRC) challenges the Office of the State Controller's (Controller's) findings and reduction of direct and indirect costs totaling \$5,746,047 (Findings 1 and 3) claimed for fiscal years 2003-2004 through 2005-2006 by the County of Los Angeles (claimant) for the *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services* program. In Finding 1, costs relating to ineligible vendor payments for out-of-state residential placement of SED pupils in programs that are "owned and operated *for-profit*" were reduced. In Finding 3, the Controller found that the claimant used an indirect cost rate methodology that is inconsistent with other related mandate programs, and recalculated indirect costs using actual rates applicable to the appropriate fiscal year and applied the rate to eligible costs.

As explained herein, staff recommends that the Commission on State Mandates (Commission) deny this IRC.

Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services Program

On May 25, 2000, the Commission approved the *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services*, 97-TC-05 Test Claim. The test claim statute and regulations were part of the state's response to the federal Individuals with Disabilities Education Act (IDEA) that guaranteed disabled pupils, including those with mental health needs, the right to receive a free and appropriate public education, including psychological and other mental health services, designed to meet the pupil's unique educational needs. The test claim statute

¹ Note that this caption differs from the Test Claim and Parameters and Guidelines captions in that it includes only those sections that were approved for reimbursement in the Test Claim Decision. Generally, a parameters and guidelines caption should include only the specific sections of the statutes and executive orders that were approved in the test claim decision. However, that was an oversight in the Parameters and Guidelines at issue in this case.

shifted to counties the responsibility to ensure and fund mental health services required by a pupil's individualized education plan (IEP). The test claim statute and regulations address the counties' responsibilities for out-of-state placement of seriously emotionally disturbed pupils.

Parameters and Guidelines for the *SED* program were adopted on October 26, 2000,² and corrected on July 21, 2006,³ with a period of reimbursement beginning January 1, 1997. The Parameters and Guidelines, as originally adopted, authorize reimbursement for the following costs:

To reimburse counties for payments to service vendors providing mental health services to SED pupils in out-of-state residential placements as specified in Government Code section 7576 and Title 2, California Code Regulations, [sections] 60100 and 60110.⁴

The correction adopted on July 21, 2006 added the following sentence: "Included in this activity is the cost for out-of-state residential board and care of SED pupils." The correction was necessary to clarify the Commission's finding when it adopted the Parameters and Guidelines, that the term "payments to service vendors providing mental health services to SED pupils in out-of-state residential placements" includes reimbursement for "residential costs" of out-of-state placements.⁵ Section 60100(h) of the regulations, referenced in the Parameters and Guidelines, required that "[o]ut-of-state placements shall only be made in residential programs that meet the requirements of Welfare and Institutions Code sections 11460(c)(2) through (c)(3)." Welfare and Institutions Code section 11460, as amended by Statutes of 1995, chapter 724, governed the foster care program from 1996 to 2010. During those years, Welfare and Institutions Code section 11460(c)(3) provided that "State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home *organized and operated on a nonprofit basis*." (Emphasis added.) Thus, the nonprofit rule applicable to out-of-state foster care group homes was made expressly applicable to out-of-state residential placements of SED pupils.

Procedural History

On May 7, 2010, the Controller issued the Final Audit Report for fiscal years 2003-2004 through 2005-2006.⁶ On May 7, 2013, claimant filed this IRC.⁷ On October 3, 2014, the Controller filed late comments on the IRC.⁸ On November 7, 2014, the claimant filed a request for a 30-day

² Exhibit B, Controller's Late Comments on the IRC, page 53 (Parameters and Guidelines adopted October 26, 2000).

³ Exhibit B, Controller's Late Comments on the IRC, page 67 (Corrected Parameters and Guidelines, dated July 21, 2006).

⁴ Exhibit B, Controller's Late Comments on the IRC, page 56 (Parameters and Guidelines adopted October 26, 2000).

⁵ Exhibit B, Controller's Late Comments on the IRC, page 67 (Corrected Parameters and Guidelines, dated July 21, 2006).

⁶ Exhibit A, IRC, page 37.

⁷ Exhibit A, IRC, page 1.

⁸ Exhibit B, Controller's Late Comments on the IRC, page 1.

extension to file rebuttal comments, which was granted for good cause. On February 9, 2015, the claimant filed late rebuttal comments.⁹ On August 26, 2016, Commission staff issued the Draft Proposed Decision.¹⁰ On August 30, 2016, the Controller filed comments in support of the Draft Proposed Decision.¹¹ On September 15, 2016, the claimant filed comments disagreeing with the Draft Proposed Decision, asserting that the Proposed Decision adopts an inappropriate abuse of discretion standard of review of the Controller's audit decisions, and argues that the Commission must "make an independent determination of the Controller's actions in this matter."¹²

Commission Responsibilities

Government Code section 17561(d) 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 6.¹³ 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."¹⁴

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

⁹ Exhibit C, Claimant's Late Rebuttal Comments to the Controller's Late Comments on the IRC.

¹⁰ Exhibit D, Draft Proposed Decision.

¹¹ Exhibit E, Controller's Comments on the Draft Proposed Decision.

¹² Exhibit F, Claimant's Comments on the Draft Proposed Decision.

¹³ *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

¹⁴ *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.

the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.¹⁵

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.¹⁶ In addition, section 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.¹⁷

Claims

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

Issue	Description	Staff Recommendation
Reduction of costs claimed for vendor payments for board, care, and treatment services for SED pupils placed in out-of-state residential programs that are organized and operated for-profit. (Finding 1.)	The Controller found that costs claimed for board and care and treatment costs for all fiscal years audited was not allowable because, based on the documentation provided by the claimant in this case, the vendor costs claimed were for ten out-of-state <i>for-profit</i> residential programs and, thus, the costs were beyond the scope of the mandate.	<i>Correct</i> – The Parameters and Guidelines and state law required that residential and treatment costs for SED pupils placed in out-of-state residential programs be provided by nonprofit organizations and thus, costs claimed for vendor services provided by out-of-state service vendors that are organized and operated on a for-profit basis are beyond the scope of the mandate and not reimbursable as a matter of law.
Reduction of indirect costs claimed. (Finding 3.)	The Controller found that the claimant used an indirect cost rate methodology that is inconsistent with other related mandate programs. The Controller further found that the claimant, in some instances, applied a rate based on costs two years	<i>Correct</i> – The claimant does not address the Controller's reductions relating to the indirect cost rate. Thus, there is no evidence in the record that the Controller's findings

¹⁵ *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.

¹⁶ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

¹⁷ 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.

	prior and, in other instances, applied a rate based on actual claim year costs. The disparate rates were applied to expenses in the same pool of costs, resulting in significant fluctuations in rates from year to year. The Controller recalculated indirect costs using actual rates applicable to the appropriate fiscal year and applied the rate to eligible costs.	are incorrect as a matter of law, or are arbitrary, capricious, or entirely lacking in evidentiary support.
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Staff Analysis

A. The Controller’s Reduction of Costs Claimed for Vendor Services Provided by Out-Of-State Residential Programs That Are Organized and Operated on a For-Profit Basis Is Correct as a Matter of Law.

In Finding 1, costs relating to ineligible vendor payments for out-of-state residential placement of SED pupils in programs that are “owned and operated *for-profit*” were reduced. The claimant agrees with other counties that have independently filed IRCs contesting the disallowance of costs associated with out-of-state residential board and care costs. In this case, however, the claimant states that its focus is on the reductions to mental health treatment services. In this respect, claimant acknowledges that the mental health treatment services were provided by for-profit companies, but argues that the law does not restrict the program selected to provide mental health treatment services and does not require that the program be organized on a nonprofit basis.

Staff finds that the Controller’s reduction of costs claimed for vendor services provided by out-of-state residential programs that are organized and operated on a for-profit basis is correct as a matter of law. The Parameters and Guidelines for this program track the regulatory language and state that reimbursement is authorized for payments to service vendors providing mental health services to SED pupils placed in out-of-state residential facilities, as specified in California Code of Regulations, title 2, section 60100. Section 60100(h) states that out-of-state residential programs shall meet the requirements in Welfare and Institutions Code section 11460(c)(2) through (3) and 11460(c)(3) specifies that “State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home *organized and operated on a nonprofit basis*.” The July 21, 2006 correction to the Parameters and clarifies that “mental health services” provided to these students includes residential board and care. Thus, reimbursement for the mandated activity of “providing mental health services” in out-of-state facilities includes both treatment and board and care, which is conditioned on the providers meeting the requirements of Welfare and Institutions Code section 11460(c)(3), to be organized and operated on a nonprofit basis. The law does not support the claimant’s position that the mental health treatment portion of the out-of-state “residential program” be excluded from the requirement that the “program” be organized and operated on a nonprofit basis.

B. There Is No Evidence That the Controller’s Reduction of Indirect Costs Based on the Indirect Cost Rate Applied by the Claimant Is Incorrect as a Matter of Law, or Is Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

In Finding 3, the Controller found that the claimant used an indirect cost rate methodology that is inconsistent with other related mandate programs. The Controller further found that the

claimant, in some instances, applied a rate based on costs two years prior and, in other instances, applied a rate based on actual claim year costs. The disparate rates were applied to expenses in the same pool of costs, resulting in significant fluctuations in rates from year to year. The Controller recalculated indirect costs using actual rates applicable to the appropriate fiscal year and applied the rate to eligible costs. The claimant does not address the Controller's reductions relating to the indirect cost rate.

Thus, there is no evidence in the record that the Controller's findings are incorrect as a matter of law, or are arbitrary, capricious, or entirely lacking in evidentiary support.

Conclusion

Staff finds that the Controller's reductions are correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

Staff Recommendation

Staff recommends that the Commission adopt the Proposed Decision to deny this 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 Section 7576 as amended
by Statutes 1996, Chapter 654 (AB 2726);

California Code of Regulations, Title 2,
Division 9, Chapter 1, Sections 60100 and
60110¹⁸

Fiscal Years 2003-2004, 2004-2005, and
2005-2006

County of Los Angeles, Claimant

Case No.: 12-9705-I-04

*Seriously Emotionally Disturbed Pupils:
Out-of-State Mental Health Services*

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

(Adopted October 28, 2016)

DECISION

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on October 28, 2016. [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 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	
Mark Hariri, Representative of the State Treasurer, Vice Chairperson	
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	

¹⁸ Note that this caption differs from the Test Claim and Parameters and Guidelines captions in that it includes only those sections that were approved for reimbursement in the Test Claim Decision. Generally, a parameters and guidelines caption should include only the specific sections of the statutes and executive orders that were approved in the test claim decision. However, that was an oversight in the Parameters and Guidelines at issue in this case.

Summary of the Findings

This IRC challenges the Office of the State Controller's (Controller's) findings and reduction of direct and indirect costs totaling \$5,746,047 (Findings 1 and 3) claimed for fiscal years 2003-2004 through 2005-2006 by the County of Los Angeles (claimant) for the *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services* program.

In Finding 1, costs relating to ineligible vendor payments for out-of-state residential placement of SED pupils in programs that are "owned and operated *for-profit*" were reduced. The claimant agrees with other counties that have filed IRCs contesting the disallowance of costs associated with out-of-state residential board and care costs. In this case, however, the claimant states that its focus is on the reductions to mental health treatment services. In this respect, claimant that the mental health treatment services were provided by for-profit companies, but argues that the law does not restrict the program selected to provide mental health treatment services and does not require that the program be organized on a nonprofit basis.

The Commission finds that the Controller's reduction of costs claimed for vendor services provided by out-of-state residential programs that are organized and operated on a for-profit basis is correct as a matter of law. The Parameters and Guidelines for this program track the regulatory language and state that reimbursement is authorized for payments to service vendors providing mental health services to SED pupils placed in out-of-state residential facilities, as specified in California Code of Regulations, title 2, section 60100. Section 60100(h) states that out-of-state residential programs shall meet the requirements in Welfare and Institutions Code section 11460(c)(2) through (3) and 11460(c)(3) specifies that "State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home *organized and operated on a nonprofit basis.*" The July 21, 2006 correction to the Parameters and Guidelines clarifies that "mental health services" provided to these students includes residential board and care. Thus, reimbursement for the mandated activity of "providing mental health services" in out-of-state facilities includes both treatment and board and care, which is conditioned on the providers meeting the requirements of Welfare and Institutions Code section 11460(c)(3), to be organized and operated on a nonprofit basis. The law does not support the claimant's position that the mental health treatment portion of the out-of-state "residential program" be excluded from the requirement that the "program" be organized and operated on a nonprofit basis.

In Finding 3, the Controller found that the claimant used an indirect cost rate methodology that is inconsistent with other related mandate programs. The Controller further found that the claimant, in some instances, applied a rate based on costs two years prior and, in other instances, applied a rate based on actual claim year costs. The disparate rates were applied to expenses in the same pool of costs, resulting in significant fluctuations in rates from year to year. The Controller recalculated indirect costs using actual rates applicable to the appropriate fiscal year and applied the rate to eligible costs. The claimant does not address the Controller's reductions relating to the indirect cost rate. Thus, there is no evidence in the record that the Controller's findings are incorrect as a matter of law, or are arbitrary, capricious, or entirely lacking in evidentiary support.

Therefore, the Commission denies this IRC.

I. Chronology

- 12/23/2009 Controller issued the Draft Audit Report dated December 23, 2009.¹⁹
- 01/13/2010 Claimant sent a letter to the Controller dated January 13, 2010 in response to the Draft Audit Report.²⁰
- 05/07/2010 Controller issued the Final Audit Report for fiscal years 2003-2004 through 2006-2006.²¹
- 05/07/2013 Claimant filed IRC 12-9705-I-04.²²
- 10/03/2014 Controller filed late comments on IRC 12-9705-I-04.²³
- 11/07/2014 Claimant filed request for an extension of time to file rebuttal comments, which was granted for good cause.
- 02/09/2015 Claimant filed late rebuttal comments.²⁴
- 08/26/2016 Commission staff issued the Draft Proposed Decision.²⁵
- 08/30/2016 Controller filed comments on the Draft Proposed Decision.²⁶
- 09/15/2016 Claimant filed comments on the Draft Proposed Decision.²⁷

II. Background

A. Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services Program

On May 25, 2000, the Commission approved the *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services*, 97-TC-05 Test Claim as a reimbursable state-mandated program.²⁸ The test claim statute and regulations were part of the state's response to the federal Individuals with Disabilities Education Act, or IDEA, that guaranteed to disabled pupils, including those with mental health needs, the right to receive a free and appropriate public education, including psychological and other mental health services, designed to meet the pupil's

¹⁹ Exhibit A, IRC, page 51.

²⁰ Exhibit A, IRC, pages 51-53 (Letter from Wendy L. Watanabe to Jeffrey V. Brownfield, dated January 13, 2010).

²¹ Exhibit A, IRC, page 37.

²² Exhibit A, IRC, page 1.

²³ Exhibit B, Controller's Late Comments on the IRC, page 1.

²⁴ Exhibit C, Claimant's Late Rebuttal Comments to the Controller's Late Comments on the IRC.

²⁵ Exhibit D, Draft Proposed Decision.

²⁶ Exhibit E, Controller's Comments on the Draft Proposed Decision.

²⁷ Exhibit F, Claimant's Comments on the Draft Proposed Decision.

²⁸ Exhibit B, Controller's Late Comments on the IRC, pages 42-51.

unique educational needs.²⁹ As originally enacted, the statutes shifted to counties the responsibility and funding of mental health services required by a pupil's individualized education plan (IEP), but required that all services provided by the counties be provided *within* the State of California.³⁰ In 1996, the Legislature amended Government Code section 7576 to provide that the fiscal and program responsibilities of counties for SED pupils shall be the same regardless of the location of placement, and that the counties shall have fiscal and programmatic responsibility for providing or arranging the provision of necessary services for SED pupils placed in out-of-state residential facilities.³¹ In the Test Claim Statement of Decision the Commission found that:

Before the enactment of Chapter 654, counties were only required to provide mental health services to SED pupils placed in out-of-home (in-state) residential facilities. However, section 1 now requires counties to have fiscal and programmatic responsibility for SED pupils regardless of placement – i.e., regardless of whether SED pupils are placed out-of-home (in-state) or out-of-state.

Chapter 654 also added subdivision (g) to Government Code section 7576, which provides:

“Referrals shall be made to the community mental health service in the county in which the pupil lives. If the pupil has been placed into residential care from another county, the community mental health service receiving the referral shall forward the referral immediately to the community mental health service of the county of origin, which shall have fiscal and programmatic responsibility for providing or arranging for provision of necessary services. . . .” (Emphasis added.)

California Code of Regulations, sections 60100 and 60200, amended in response to section 7576, further define counties' “fiscal and programmatic responsibilities” for SED pupils placed in out-of-state residential care. Specifically, section 60100 entitled “LEA Identification and Placement of a Seriously Emotionally Disturbed Pupil” reflects the Legislature's intent behind the test claim statute by providing that residential placements for a SED pupil may be made out-of-state only when no in-state facility can meet the pupil's needs. Section 60200 entitled “Financial Responsibilities” details county mental health and LEA financial responsibilities regarding the residential placements of SED pupils.

²⁹ Former Government Code sections 7570, et seq., as enacted and amended by Statutes 1984, Chapter 1747; Statutes 1985, Chapter 1274; California Code of Regulations, title 2, sections 60000-60610 (emergency regulations filed December 31, 1985, effective January 1, 1986 (Register 86, No. 1) and refiled June 30, 1986, effective July 12, 1986 (Register 86, No. 28).

³⁰ Former California Code of Regulations, title 2, section 60200.

³¹ Statutes 1996, chapter 654.

In particular, amended section 60200 removes the requirement that LEAs be responsible for the out-of-state residential placement of SED pupils. Subdivision (c) of section 60200 now provides that the county mental health agency of origin shall be “responsible for the provision of assessments and mental health services included in an IEP in accordance with [section 60100].” Thus, as amended, section 60200 replaces the LEA with the county of origin as the entity responsible for paying the mental health component of out-of-state residential placement for SED pupils.³²

As relevant here, the Commission concluded that the following new costs were mandated by the state:

- Payment of out-of-state residential placements for SED pupils. (Gov. Code, § 7576; Cal. Code Regs., tit. 2, §§ 60100, 60110.)
- Program management, which includes parent notifications as required, payment facilitation, and all other activities necessary to ensure a county’s out-of-state residential placement program meets the requirements of Government Code section 7576 and Title 2, California Code of Regulations, sections 60000-60610. (Gov. Code, § 7576; Cal. Code of Regs., tit. 2, §§ 60100, 60110.)³³

Parameters and Guidelines for the *SED* program were adopted on October 26, 2000,³⁴ and corrected on July 21, 2006,³⁵ with a period of reimbursement beginning January 1, 1997. The Parameters and Guidelines, as originally adopted, authorize reimbursement for the following costs:

To reimburse counties for payments to service vendors providing mental health services to SED pupils in out-of-state residential placements as specified in Government Code section 7576 and Title 2, California Code Regulations, [sections] 60100 and 60110.³⁶

The correction adopted on July 21, 2006 added the following sentence: “Included in this activity is the cost for out-of-state residential board and care of SED pupils.” The correction was necessary to clarify the Commission’s finding when it adopted the Parameters and Guidelines, that the term “payments to service vendors providing mental health services to SED pupils in

³² Exhibit B, Controller’s Late Comments on the IRC, pages 44-45 (Test Claim Statement of Decision adopted May 25, 2000).

³³ Exhibit B, Controller’s Late Comments on the IRC, page 51 (Test Claim Statement of Decision adopted May 25, 2000).

³⁴ Exhibit B, Controller’s Late Comments on the IRC, page 54 (Parameters and Guidelines adopted October 26, 2000).

³⁵ Exhibit B, Controller’s Late Comments on the IRC, page 67 (Parameters and Guidelines corrected July 21, 2006).

³⁶ Exhibit B, Controller’s Late Comments on the IRC, page 56 (Parameters and Guidelines adopted October 26, 2000).

out-of-state residential placements” includes reimbursement for “residential costs” of out-of-state placements.³⁷

Thus, the Parameters and Guidelines authorize reimbursement for payments to out-of-state service vendors providing board and care and treatment services for SED pupils “*as specified* in Government Code section 7576 and Title 2, California Code Regulations, [sections] 60100 and 60110.” Former section 60100(h) required that “[o]ut-of-state placements shall only be made in residential programs that meet the requirements of Welfare and Institutions Code sections 11460(c)(2) through (c)(3).” Welfare and Institutions Code section 11460, as amended by Statutes of 1995, chapter 724, governed the foster care program from 1996 to 2010. During those years, Welfare and Institutions Code section 11460(c)(3) provided that “State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home *organized and operated on a nonprofit basis*. (Emphasis added.) Thus, the nonprofit rule applicable to out-of-state foster care group homes was made expressly applicable to out-of-state residential placements of SED pupils.

The Parameters and Guidelines also contain instructions for claiming costs. Section V. of the Parameters and Guidelines require that claimed costs for fiscal years 2000-2001 through 2005-2006 “shall be supported by” cost element information, as specified. With respect to claims for contract services, claimants are required to:

Provide the name(s) of the contractor(s) who performed the services, including any fixed contract for services. Describe the reimbursable activity(ies) performed by each named contractor and give the number of actual hours spent on the activities, if applicable. Show the inclusive dates when services were performed and itemize all costs for those services.³⁸

Section VI. of the Parameters and Guidelines requires documentation to support the costs claimed as follows:

For auditing purposes, all costs claimed shall be traceable to source documents (e.g., invoices, receipts, purchase orders, contracts, worksheets, calendars, declarations, etc.) that show the evidence and validity of such costs and their relationship to the state mandated program. All documentation in support of the claimed costs shall be made available to the State Controller’s Office, as may be requested...[T]hese documents must be kept on file by the agency submitting the claim for a period of no less than two years after the later of (1) the end of the calendar year in which the reimbursement claim is filed or last amended, or (2) if no funds are appropriated for the fiscal year for which the claim is made, the date of initial payment of the claim.³⁹

³⁷ Exhibit B, Controller’s Late Comments on the IRC, page 67 (Parameters and Guidelines corrected July 21, 2006).

³⁸ Exhibit B, Controller’s Late Comments on the IRC, page 72 (Parameters and Guidelines corrected July 21, 2006).

³⁹ Exhibit B, Controller’s Late Comments on the IRC, pages 72-73 (Parameters and Guidelines corrected July 21, 2006).

On October 26, 2006, the Commission consolidated the Parameters and Guidelines for *SED, Handicapped and Disabled Students*, CSM 4282 and 04-RL-4282-10, and *Handicapped and Disabled Students II*, 02-TC-40/02-TC-49, for costs incurred commencing with the 2006-2007 fiscal year.

Statutes 2011, chapter 43 (AB 114) eliminated the mandated programs for *Handicapped and Disabled Students*, CSM 4282 and 04-RL-4282-10, *Handicapped and Disabled Students II*, 02-TC-40/02-TC-49, and *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services*, 97-TC-05, by transferring responsibility for SED pupils to school districts, effective July 1, 2011.⁴⁰ Thus on September 28, 2012, the Commission adopted an amendment to the Parameters and Guidelines ending reimbursement for these programs effective July 1, 2011.

B. The Audit Findings of the Controller

The Controller issued the Draft Audit Report dated December 23, 2009, and provided a copy to the claimant for comment.⁴¹

In a three-page letter dated January 13, 2010, the claimant responded directly to the Draft Audit Report, agreeing with its findings, and accepted its recommendations.⁴² The first page of this three-page letter contains the following statement:

The County's response, which is attached hereto, indicated agreement with the audit findings and the actions that the County will take to implement policies and procedures to ensure that the costs claimed under SED are eligible, mandate related, and supported.⁴³

The letter also affirmatively agreed with each finding in the Draft Audit Report.⁴⁴

On May 7, 2010, the Controller issued the Final Audit Report.⁴⁵ The Controller audited and reduced the reimbursement claims for various reasons. The claimant disputes the reductions of direct and indirect costs totaling \$5,746,047 for all fiscal years in issue (Findings 1 and 3). In Finding 1, costs relating to ineligible vendor payments for out-of-state residential placement of SED pupils in programs that are "owned and operated *for-profit*" were reduced.⁴⁶ The Controller found unallowable costs claimed for ten residential facilities:

⁴⁰ Exhibit G, Assembly Bill No. 114 (2011-2012 Reg. Sess.), approved by the Governor, June 30, 2011.

⁴¹ Exhibit A, IRC, page 51 (Final Audit Report).

⁴² Exhibit A, IRC, pages 51-53 (Letter from Wendy L. Watanabe to Jeffrey V. Brownfield, dated January 13, 2010).

⁴³ Exhibit A, IRC, page 51 (Letter from Wendy L. Watanabe to Jeffrey V. Brownfield, dated January 13, 2010).

⁴⁴ Exhibit A, IRC, pages 53-54 (Letter from Wendy L. Watanabe to Jeffrey V. Brownfield, dated January 13, 2010).

⁴⁵ Exhibit A, IRC, page 37 (Final Audit Report).

⁴⁶ Exhibit A, IRC, page 45 (Final Audit Report).

- For three of the facilities (Youth Care of Utah, Logan River Academy, and Charter Provo Canyon School), the county claimed payments made to Mental Health Systems, Inc., and Aspen Solutions Inc., both California nonprofit corporations. However, the Controller found the costs not allowable because all three of these facilities that the nonprofit corporations contracted with to provide the out-of-state residential placement services are organized and operated as for-profit facilities.⁴⁷
- For three of the facilities (Aspen Ranch, New Leaf Academy and SunHawk Academy), the county asserted that the for-profit facilities has similar contractual arrangements with Aspen Solutions, Inc., (a nonprofit business incorporated in California). The county, however, did not provide any documentation to support the nonprofit status of the residential facilities providing the treatment services, or provide documentation illustrating a business relationship between the residential facilities and the California nonprofit entity.⁴⁸
- For four of the facilities (Grove School, New Haven, Spring Creek Lodge, and Vista Adolescent Treatment Center), the county did not provide any documentation in support of their nonprofit status.⁴⁹

In Finding 3, the Controller found that the claimant used an indirect cost rate methodology that is inconsistent with other related mandate programs. The Controller further found that the claimant, in some instances, applied a rate based on costs two years prior and, in other instances, applied a rate based on actual claim year costs. The disparate rates were applied to expenses in the same pool of costs, resulting in significant fluctuations in rates from year to year.⁵⁰ In comments on the IRC, the Controller further explains the finding as follows:

The county's filing does not include the reimbursement claims filed with the SCO. The exhibit includes the claims prepared by the county's mental health department that were submitted to its auditor-controller (Exhibit D.) We have included the actual claim forms filed with the SCO as part of our response (Tabs 3, 4, and 5). These forms were signed by the county's auditor-controller and submitted to the SCO for reimbursement of state-mandated costs.

Concerning the indirect cost rates, the county claimed 7.7066% for FY 2003-04, 6.8276% for FY 2004-05, and 0.2227% for FY 2005-06 on its filed mandate claims. However, in its filed IRC, the county indicated that its indirect cost rates are 8.4749% ($\$120,853 \div \$1,426,010$) for FY 2003-04, 7.5079% ($\$144,629 \div \$1,926,362$) for FY 2004-05, and 7.864% ($\$155,159 \div \$1,973,033$) for FY 2005-06. Based on our audit of the claims, we found that actual indirect cost rates were

⁴⁷ Exhibit B, Controller's Late Comments on the IRC, page 13.

⁴⁸ Exhibit B, Controller's Late Comments on the IRC, page 13.

⁴⁹ Exhibit B, Controller's Late Comments on the IRC, page 13.

⁵⁰ Exhibit A, IRC, page 47.

4.8497% for FY 2003-04, 5.0543% for FY 2004-05, and 4.7072% for FY 2005-06.⁵¹

III. Positions of the Parties

A. County of Los Angeles

Although the claimant agreed with the Draft Audit Report, the claimant now contends that the Controller's reductions are incorrect and that all costs should be reinstated.⁵² The claimant states that payment for out-of-state residential placement consists of two components; care and supervision, and mental health treatment services. The Controller reduced costs for both components. The claimant agrees with the Counties of San Diego and Orange, who have also filed IRCs contesting the disallowance of costs associated with the first component.⁵³ In this case, however, the claimant states that its focus is on the reductions to the second component of mental health treatment services.

The claimant argues Welfare and Institutions Code section 11460 applies only to the AFDC-FC rate payment for care and supervision, and not to payments made for mental health treatment services. The claimant acknowledges that Code of Regulations, title 2, section 60100(h) requires that out-of-state placements be made only in residential programs that meet the requirements of Welfare and Institutions Code section 11460(c)(2) though (c)(3), and that subdivision (c)(3) provides that "State reimbursement for an AFDC-FC rate . . . shall be paid to a group home organized and operated on a nonprofit basis." However, the claimant asserts that the nonprofit limitation in section 11460(c)(3) does not apply to mental health treatment services. Rather, the AFDC-FC rate is defined in section 11460(b) to cover the costs for "care and supervision;" i.e., food, clothing, shelter, and like services and not mental health treatment services. The claimant also cites in rebuttal comments that the "Agency Plan for Title IV-E of the Social Security Act Foster Care and Adoption Assistance for the State of California," states that "California does not claim Title IV-E funds for administrative reimbursement for mental health or social work costs in the basic rate for FFAs or Group Homes."⁵⁴

The claimant asserts that the test claim statute (Statutes 1996, chapter 654) specifically stated the legislative intent to ensure that community mental health agencies would be responsible for the mental health services required under IEPs, no matter where the pupil is placed, and contained no limitation on the placement of pupils in out-of-state residential facilities. The Legislature is charged with knowledge of Welfare and Institutions Code section 11460 and had the Legislature intended to restrict the mental health services payment to nonprofit entities only, it could have done so in AB 2726. Following the enactment of AB 2726, the State Department of Mental Health (DMH) issued Information Notice No. 98-10 on July 9, 1998, which stated that "County

⁵¹ Exhibit B, Controller's Late Comments on the IRC, page 15.

⁵² Exhibit A, IRC; Exhibit C, Claimant's Late Rebuttal Comments to the Controller's Late Comments on the IRC.

⁵³ County of San Diego IRC, 10-9705-I-01 and 13-9705-I-05, decided May 26, 2016. County of Orange IRC, 11-9705-I-02 and 12-9705-I-03, scheduled for hearing on September 23, 2016.

⁵⁴ Exhibit C, Claimant's Late Rebuttal Comments to the Controller's Late Comments on the IRC, page 4.

mental health departments are also required by this legislation to pay mental health treatment costs which out-of-state providers now break out and bill separately from costs related to education and room and board.” The claimant states that the attachment to this notice identified the rates for mental health treatment and the residential daily rates. For Los Angeles County, the attachment lists various facilities, including Mental Health Services, Inc. (Provo Canyon School), which was disallowed by the Controller in this case.⁵⁵

Moreover, school districts had no restrictions on the use of for-profit placements when school districts were responsible for providing mental health treatment services under prior law. The Education Code was consistent with federal law, which currently contains no restriction.

The claimant states that section 60100(h) of the regulations as interpreted by the Controller, therefore, is inconsistent with federal law, the Government Code, and the Education Code, in that it unlawfully restricts the rights of pupils with serious emotional or mental illness to receive a free and appropriate public education. The courts and administrative bodies applying these provisions have consistently required counties to allow the placement of pupils in the exact facilities for which the Controller has disallowed costs. The claimant further asserts that the courts have consistently sided with the parents who unilaterally place a pupil in a for-profit facility.

The claimant does not address the Controller’s reductions relating to the indirect cost rate.

Claimant disagrees with the conclusions and recommendations in the Draft Proposed Decision and reasserts it is entitled to the full amount of costs claimed for the placement of pupils in out-of-state residential facilities that are owned and operated on a non-profit basis.⁵⁶

The claimant also asserts that the Proposed Decision adopts an inappropriate abuse of discretion standard of review of the Controller’s audit decisions, and argues that the Commission must “make an independent determination of the Controller’s actions in this matter.”⁵⁷

B. State Controller’s Office

It is the Controller’s position that the audit adjustments are correct and that this IRC should be denied. The Controller found that the unallowable costs resulting from the out-of-state residential placement of SED pupils in for-profit facilities are correct because the Parameters and Guidelines only allow vendor payments for SED pupils placed in a group home organized and operated on a nonprofit basis.⁵⁸ The Controller asserts that the unallowable direct and indirect costs for mental health services treatment payments claimed result from the claimant’s placement of SED pupils in prohibited for-profit out-of-state residential facilities.⁵⁹

The Controller does not dispute the assertion that Government Code section 7572 requires mental health services to be provided by qualified mental health professionals, that there is

⁵⁵ Exhibit A, IRC, page 24.

⁵⁶ Exhibit F, Claimant’s Comments on the Draft Proposed Decision, page 1.

⁵⁷ Exhibit F, Claimant’s Comments on the Draft Proposed Decision, pages 2-3.

⁵⁸ Exhibit B, Controller’s Late Comments on the IRC, page 8.

⁵⁹ Exhibit B, Controller’s Late Comments on the IRC, page 13.

inconsistency between the federal law and California law related to IDEA funds, or that California law is more restrictive than federal law in terms of out-of-state residential placement of SED pupils. The Controller also does not dispute that the Education Code does not restrict local educational agencies from contracting with for-profit schools for educational services. However the Controller maintains that under the mandated program, costs incurred at out-of-state for-profit residential programs are not reimbursable.⁶⁰

The Controller also reduced indirect costs on the ground that the claimant overstated the indirect cost rate. The Controller found that the claimant used an indirect cost rate methodology that is inconsistent with other related mandate programs. The Controller further found that the claimant, in some instances, applied a rate based on costs two years prior and, in other instances, applied a rate based on actual claim year costs. The disparate rates were applied to expenses in the same pool of costs, resulting in significant fluctuations in rates from year to year.⁶¹

The Controller filed comments in support of the Draft Proposed Decision.⁶²

IV. Discussion

Government Code section 17561(d) 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 6.⁶³ 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."⁶⁴

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

⁶⁰ Exhibit B, Controller's Late Comments on the IRC, page 16.

⁶¹ Exhibit A, IRC, page 47 (Final Audit Report).

⁶² Exhibit E, Controller's Comments on the Draft Proposed Decision.

⁶³ *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

⁶⁴ *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.

the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.⁶⁵ 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.’ ”⁶⁶

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.⁶⁷ 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.⁶⁸

A. The Controller’s Reduction of Costs Claimed for Vendor Services Provided by Out-Of-State Residential Programs That Are Organized and Operated on a For-Profit Basis Is Correct as a Matter of Law.⁶⁹

⁶⁵ *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.

⁶⁶ *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

⁶⁷ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

⁶⁸ 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.

⁶⁹ Although claimant’s comments on the Draft Proposed Decision assert that the Commission used an “abuse of discretion” standard in reviewing the Controller’s reduction of costs, the claimant is wrong. As stated in the Decision, the Commission has independently reviewed the reduction of the out-of-state residential program costs on a de novo basis because the issue is a question of law, requiring the determination of what the regulations and the Parameters and Guidelines require, and what costs are within the scope of the mandate and are eligible for reimbursement under article XIII B, section 6 of the California Constitution. (*County of San Diego v. State of California* (1997) 15 Cal.4th 68, 109 [“The determination whether the statutes here at issue established a mandate under section 6 is a question of law...Where, as here a ‘purely legal question’ is at issue, courts ‘exercise independent judgment.’”(citations omitted)]; and *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, 801, and *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201,

1. During all of the fiscal years at issue, the Parameters and Guidelines and state law required that SED pupils placed in out-of-state residential programs be placed in nonprofit facilities and, thus, costs claimed for vendor services provided by out-of-state service programs that are organized and operated on a for-profit basis are beyond the scope of the mandate.

Reimbursement claims filed with the Controller are required as a matter of law to be filed in accordance with the parameters and guidelines adopted by the Commission.⁷⁰ Parameters and guidelines provide instructions for eligible claimants to prepare reimbursement claims for the direct and indirect costs of a state-mandated program.⁷¹ Parameters and guidelines are regulatory in nature and “APA valid, and absent a court ruling setting them aside, are binding on the parties.”⁷²

As indicated above, the Parameters and Guidelines for this program track the regulatory language and state that reimbursement is authorized for payments to service vendors providing mental health services to SED pupils placed in out-of-state residential facilities, as specified in California Code of Regulations, title 2, section 60100. Section 60100(h) states that out-of-state residential programs shall meet the requirements in Welfare and Institutions Code section 11460(c)(2) through (3) and 11460(c)(3) specifies that “State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home *organized and operated on a nonprofit basis*.” The July 21, 2006 correction to the Parameters and Guidelines clarifies that “mental health services” provided to these students includes residential board and care. Thus, reimbursement for the mandated activity of “providing mental health services” in out-of-state facilities includes both treatment and board and care, and is conditioned on the providers meeting the requirements of Welfare and Institutions Code section 11460(c)(3), to be organized and operated on a nonprofit basis. In this case, costs were reduced because the Controller found that the out-of-state services for some students were provided by for-profit companies, and that the claimant did not provide documentation to verify that costs were incurred for services provided by nonprofit organizations for other students.

Claimant acknowledges that the services were provided by for-profit companies.⁷³ Claimant argues, however, that neither the test claim statute nor federal law contained a limitation on the placement of out-of-state SED pupils, and that the nonprofit limitation in Welfare and Institutions Code section 11460(c)(3) does not apply to mental health treatment services. Rather, the AFDC-FC rate is defined in section 11460(b) to cover only the costs for care and supervision (i.e., food, clothing, shelter, and like services). The claimant also relies on DMH Information

[Parameters and guidelines are regulatory in nature and “APA valid, and absent a court ruling setting them aside, are binding on the parties.”)].

⁷⁰ Government Code sections 17561(d)(1); 17564(b); and 17571.

⁷¹ Government Code section 17557; California Code of Regulations, title 2, section 1183.7.

⁷² *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, 801; *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

⁷³ Exhibit C, Claimant’s Late Rebuttal Comments to the Controller’s Late Comments on the IRC, page 5.

Notice 98-10 issued to counties following the enactment of the test claim statute, which states in part that “[c]ounty mental health departments are also required by this legislation to pay mental health treatment costs which out-of-state providers now break out and bill for separately from costs related to education and room and board (see Attachment A [which identifies the “DMH Daily Rate” and “Residential Daily Rate” for out-of-state residential treatment agencies approved for Los Angeles County]).”⁷⁴

The Commission finds that the Controller’s reduction of costs is correct as a matter of law. As indicated above, the test claim statute was enacted to shift to counties the responsibility to ensure and fund mental health services required by a pupil’s IEP when a seriously emotionally disturbed pupil is placed in an out-of-state residential facility. Section 1 of the bill that enacted the statute states that the fiscal and program responsibilities of community mental health services shall be the same regardless of the location of placement of the pupil. The test claim statute added subdivision (g) to Government Code section 7576 to provide that the county of origin shall have “fiscal and programmatic responsibility for providing or arranging for provision of necessary services.”

Section 60100(d) of the regulations was amended to implement this change in law, and specifically required the IEP team to document the pupil’s educational and mental health treatment needs that support the recommendation for residential placement. Section 60100(d) further states that “this documentation shall identify the special education and mental health services *to be provided by a residential facility listed in Section 60025* that cannot be provided in a less restrictive environment pursuant to [federal law].” (Emphasis added.) Section 60110(b) states that the residential plan shall include provisions, as determined by the pupil’s IEP, for the care, supervision, mental health treatment, psychotropic medication monitoring, if required, and education of a SED pupil. Section 60100(e) states that the community mental health service case manager, in consultation with the IEP team’s administrative designee, shall identify a mutually satisfactory placement that is acceptable to the parent *and addresses the pupil’s education and mental health needs*. Section 60100(h) then states that residential placement may be made out of California only when no in-state facility can meet the pupil’s needs and only when the requirements of subdivisions (d) and (e) have been met [i.e., that the residential facility addresses and provides the pupil’s mental health needs]. Further, section 60100(h) expressly states that “[o]ut-of-state placements shall be made only in residential programs that meet the requirements of Welfare and Institutions Code Sections 11460(c)(2) through (c)(3).” As stated above, Welfare and Institutions Code section 11460(c)(3) specifies that “State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home *organized and operated on a nonprofit basis*.”

It is correct that the costs for care and supervision and mental health treatment services were billed separately, as asserted by the claimant and indicated in the DMH Information Notice 98-10. Payments to the facilities for board and care costs are based upon rates established by the Department of Social Services in accordance with sections 18350 through 18356 of the Welfare and Institutions Code.⁷⁵ And, pursuant to Welfare and Institutions Code section 18355, the home care payment and local administrative costs for out-of-state residential placements were

⁷⁴ Exhibit A, IRC, page 23.

⁷⁵ See also, former title 2, California Code of Regulations, section 60200(e).

funded from a *separate* appropriation in the budget of the Department of Social Services. The provision of mental health treatment services, on the other hand, was historically the responsibility of the Department of Mental Health, and appropriations for the program were made by the Legislature based on cost sharing formulas between state and counties under the California community mental health provisions of the Short-Doyle Act and the Bronzan-McCorquodale Act.⁷⁶ Thus, the services were billed separately because they were historically managed and funded under different parts of the State Budget.

However, nowhere in the law does it support the claimant's position that the mental health treatment portion of the out-of-state "residential program" be excluded from the requirement that the "program" be organized and operated on a nonprofit basis. The plain language of section 60100 of the regulations expressly requires that the "residential programs," which by law must include the provision of mental health services, shall meet the requirements in Welfare and Institutions Code section 11460(c)(3) and be organized and operated on a nonprofit basis.

Moreover, during the regulatory process for the adoption of California Code of Regulation section 60100, comments were filed by interested persons with concerns that referencing Welfare and Institutions Code section 11460 in section 60100 of the regulations to provide that "[o]ut-of-state placements shall only be made in residential programs that meet the requirements of Welfare and Institutions Code sections 11460(c)(2) through (c)(3)" was not clear since state reimbursement for special education residential placements is not an AFDC-Foster Care program. The Departments of Education and Mental Health responded as follows:

Board and care rates for children placed pursuant to Chapter 26.5 of the Government Code are linked in statute to the statutes governing foster care board and care rates. The foster care program and the special education pupils program are quite different in several respects. This creates some difficulties which must be corrected through statutory changes, and cannot be corrected through regulations. Rates are currently set for foster care payments to out-of-state facilities through the process described in WIC Sections 11460(c)(2) through (c)(3). The rates cannot exceed the current level 14 rate *and the program must be non-profit, and because of the requirements contained in Section WIC 18350, placements for special education pupils must also meet these requirements.* The Departments believe these requirements are clearly stated by reference to statute, but we will handbook WIC Sections 11460(c)(2) through (c)(3) for clarity.⁷⁷

⁷⁶ The cost sharing formula for funding the provision of mental health services under the Short-Doyle Act was required by former Welfare and Institutions Code section 5651 (Statutes 1985, chapter 1274), and former California Code of Regulations, title 2, section 60200 (Register No. 87, No. 30). In 1991, the Legislature enacted realignment legislation that repealed the Short-Doyle Act and replaced the sections with the Bronzan-McCorquodale Act (Stats. 1991, chapter 89, §§ 63 and 173). Beginning in fiscal year 2001-2002, Statutes 2002, chapter 1167 and Statutes 2004, chapter 493, required the state to pay the full share of allowable mental health treatment costs for Handicapped and Disabled and SED pupils.

⁷⁷ Exhibit G, Final Statement of Reasons for Joint Regulations for Pupils with Disabilities, page 127 (emphasis added).

In addition, the departments specifically addressed the issue of “out-of-state group homes which are organized as for profit entities, but have beds which are leased by a non-profit shell corporation.” The departments stated that the issue may need further legal review of documentation of group homes that claim to be nonprofit, but nevertheless “[t]he statute in WIC section 11460 states that state reimbursement shall only be paid to a group home organized and operated on a non-profit basis.”⁷⁸

Legislation was later introduced to address the issue of payment for placement of SED pupils in out-of-state for profit facilities in light of the fact that the federal government eliminated the requirement that a facility be operated as a non-profit in order to receive federal funding. However, as described below, the legislation was not enacted and the law applicable to the reimbursement claims at issue in this IRC remained unchanged.

In the 2007-2008 legislative session, Senator Wiggins introduced SB 292, which would have authorized payments to out-of-state, for-profit residential facilities that meet applicable licensing requirements in the state in which they operate, for placement of SED pupils. The committee analysis for the bill explained that since 1985, California law has tied the requirement for a SED pupil placed out-of-home pursuant to an IEP, to state foster care licensing and rate provisions. However, the analysis notes that the funds for placement of SED pupils are not AFDC-FC funds. California first defined the private group homes that could receive AFDC-FC funding as non-profits to parallel the federal funding requirement. Because of the connection between foster care and SED placement requirements, this prohibition applies to placements of SED pupils as well. The committee analysis further recognized that the federal government eliminated the requirement that a facility be operated as a nonprofit in order to receive federal funding in 1996.⁷⁹ However, the bill did not pass the assembly.⁸⁰

In 2008, AB 1805, a budget trailer bill, containing identical language to SB 292 was vetoed by the Governor.⁸¹ In his veto message he wrote, “I cannot sign [AB 1805] in its current form because it will allow the open-ended reimbursement of claims, including claims submitted and denied prior to 2006-07. Given our state's ongoing fiscal challenges, I cannot support any bill that exposes the state General Fund to such a liability.”⁸²

Subsequently, during the 2009-2010 legislative session, Assembly Member Beall introduced AB 421, which authorized payment for 24-hour care of SED pupils placed in out-of-state, for-profit residential facilities. The bill analysis for AB 421 cites the Controller’s disallowance of \$1.8 million in mandate claims from San Diego County based on the placement of SED pupils in out-of-state, for-profit residential facilities. The analysis states that the purpose of the proposed

⁷⁸ Exhibit G, Final Statement of Reasons for Joint Regulations for Pupils with Disabilities, page 128.

⁷⁹ Exhibit G, Assembly Committee on Human Services, analysis of SB 292, June 17, 2009, page 2.

⁸⁰ Exhibit G, Complete Bill History, Senate Bill No. 292.

⁸¹ Exhibit G, Assembly Committee on Appropriations, analysis of AB 421, May 20, 2009, page 3.

⁸² Exhibit G, Governor’s Veto Message, AB 1885, September 30, 2008.

legislation was to incorporate the allowance made in federal law for reimbursement of costs of placement in for-profit group homes for SED pupils.⁸³ Under federal law, for-profit companies were originally excluded from receiving federal funds for placement of foster care children because Congress feared repetition of nursing home scandals in the 1970s, when public funding of these homes triggered growth of a badly monitored industry.⁸⁴ The bill analysis suggests that the reasoning for the current policy in California, limiting payments to nonprofit group homes, ensures that the goal of serving children's interests is not mixed with the goal of private profit. For these reasons, California has continually rejected allowing placements in for-profit group home facilities for both foster care and SED pupils.⁸⁵ The authors and supporters of the legislation contended that out-of-state, for-profit facilities are sometimes the only available placement to meet the needs of the child, as required by federal law.⁸⁶ The author notes the discrepancy between California law and federal law, which allows federal funding of for-profit group home placements.⁸⁷ However, the bill did not pass the Assembly and therefore did not move forward.⁸⁸

Thus, during the entire reimbursement period for this program, reimbursement was authorized only for out-of-state residential programs organized and operated on a nonprofit basis. Although the claimant contends that state law conflicted with federal law during this time period, there is no law or evidence in the record that the nonprofit requirement for out-of-state residential programs conflicts with federal law or results in a failure for a pupil to receive a free and appropriate education. Absent a decision from the courts on this issue, the Commission is required by law to presume that the statutes and regulations for this program, which were adopted in accordance with the Administrative Procedures Act, are valid.⁸⁹

Accordingly, pursuant to the law and the Parameters and Guidelines, reimbursement is required only if the out-of-state service vendor operates on a nonprofit basis. As indicated above, the Parameters and Guidelines are binding.⁹⁰ Therefore, costs claimed for out-of-state service

⁸³ Exhibit G, Assembly Committee on Appropriations, analysis of AB 421, May 20, 2009, page 2.

⁸⁴ Exhibit G, Assembly Committee on Appropriations, analysis of AB 421, May 20, 2009, page 1.

⁸⁵ Exhibit G, Assembly Committee on Appropriations, analysis of AB 421, May 20, 2009, page 2.

⁸⁶ Exhibit G, Assembly Committee on Appropriations, analysis of AB 421, May 20, 2009, page 2.

⁸⁷ Exhibit G, Assembly Committee on Appropriations, analysis of AB 421, May 20, 2009.

⁸⁸ Exhibit G, Complete Bill History, AB 421.

⁸⁹ California Constitution, article III, section 3.5; *Robin J. v. Superior Court* (2004) 124 Cal.App.4th 414, 425.

⁹⁰ *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, 801; *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

vendors that are organized and operated on a for-profit basis are beyond the scope of the mandate.

2. Claimant's reference to decisions issued by the courts and administrative bodies allowing placement in for-profit residential programs is misplaced.

The claimant argues that:

[t]he courts and administrative bodies in applying these various provisions have consistently required public agencies, including the County of Los Angeles, in conjunction with the local education agency to allow the placement of pupils in the exact facilities for which the SCO is disallowing the costs and these courts and administrative bodies have consistently sided with the parents after the parents made unilateral placements of a pupil in a for-profit facility.⁹¹

While the claimant does not specify which decisions it is referring to in its assertion, the Commission's recently adopted decisions for *SED* IRCs 10-9705-I-01 and 13-9705-I-05 addressed this issue and analyzed decisions issued by the Office of Administrative Hearings (OAH) and the United States Supreme Court raised by the claimants in those IRCs.

The OAH decision relied upon by claimants in those IRCs, involved a *SED* pupil who was deaf, had impaired vision and an orthopedic condition, was assessed as having borderline cognitive ability, and had a long history of social and behavioral difficulties. His only mode of communication was American Sign Language. The parties agreed that the National Deaf Academy would provide the student with a free and appropriate public education, as required by federal law. The facility accepted students with borderline cognitive abilities and nearly all service providers are fluent in American Sign Language. However, the school district and county mental health department took the position that they could not place the student at the National Deaf Academy because it is operated by a for-profit entity. OAH found that the state was not prohibited from placing the student at this out-of-state for-profit facility because the facility was the only one identified as an appropriate placement.⁹² Upon appeal, the District Court affirmed the OAH order directing the school district and the county mental health department to provide the student with compensatory education consisting of immediate placement at the National Deaf Academy and through the 2008-2009 school year.⁹³

The claimants in the other IRCs on this program also relied on the U.S. Supreme Court decision in *Florence County School District Four v. Carter*,⁹⁴ for the proposition that local government will be subject to increased litigation with the Controller's interpretation. In the *Florence* case, the court held that parents can be reimbursed under IDEA when they unilaterally withdraw their child from an inappropriate placement in a public school and place their child in a private school,

⁹¹ Exhibit C, Claimant's Late Rebuttal Comments to the Controller's Late Comments on the IRC, page 4.

⁹² Exhibit G, *Student v. Riverside Unified School District and Riverside County Department of Mental Health*, OAH Case No. 2007090403, dated January 15, 2008.

⁹³ Exhibit G, *Riverside County Department of Mental Health v. Sullivan* (E.D.Cal. 2009) EDCV 08-0503-SGL.

⁹⁴ *Florence County School District v. Carter* (1993) 510 U.S. 7.

even if the placement in the private school does not meet all state standards or is not state-approved. Although the court found that parents are entitled to reimbursement under such circumstances only if a federal court concludes both that the public placement violated IDEA and the private school placement was proper under IDEA, the court's decision in such cases is *equitable*. "IDEA's grant of equitable authority empowers a court 'to order school authorities to reimburse parents for their expenditures on private special education for a child if the court ultimately determines that such placement, rather than a proposed IEP, is proper under the Act.'"⁹⁵ Unlike the court's equitable powers under IDEA, the reimbursement requirements of article XIII B, section 6, must be strictly construed and not applied as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."⁹⁶

In this case, the claimant has provided no documentation or evidence that the costs claimed were incurred as a result of a court order finding that no other alternative placement was identified for a SED pupil during the audit years in question. Thus, the Commission does not need to reach the issue of whether reimbursement under article XIII B, section 6 would be required in such cases. Therefore, these decisions do not support the claimant's right to reimbursement.

Accordingly, the Commission finds that the Controller's reduction of costs for vendor service payments for treatment and board and care for SED pupils placed in out-of-state residential programs organized and operated for-profit, is consistent with the Commission's Parameters and Guidelines and is correct as a matter of law.

3. The documentation in the record supports the Controller's findings that services were provided by for-profit residential programs.

The claimant makes no argument disputing the Controller's findings that the facilities providing treatment and board and care services for its SED pupils are for-profit. In fact, the claimant acknowledges that fact.⁹⁷

Specifically, the Controller found that the county claimed vendor costs for Aspen Solutions, Inc., and Mental Health Systems, Inc., California nonprofit entities but that these nonprofit entities contracted with for-profit facilities where the out-of-state placements occurred (Youth Care of Utah, Logan River Academy LLC, and Charter Provo Canyon Schools, LLC). Copies of the contracts for the provision of mental health services to SED pupils between Aspen Solutions Inc., and Youth Care of Utah Inc. (Youth Care contract),⁹⁸ Mental Health Services, Inc. (MHS), and Logan River Academy, LLC (Logan River contract),⁹⁹ and Mental Health Services, Inc., and

⁹⁵ *Florence County School District, supra*, 510 U.S. 5, 12 (citing its prior decision in *School Comm. of Burlington v. Department of Ed. of Mass.* (1985) 471 U.S. 359, 369.)

⁹⁶ *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281 (citing *City of San Jose v. State* (1996) 45 Cal.App.4th 1802, 1817).

⁹⁷ Exhibit C, Claimant's Late Rebuttal Comments to the Controller's Late Comments on the IRC, page 5.

⁹⁸ Exhibit B, Controller's Late Comments on the IRC, page 88 (Tab 12, Contract between Aspen Solutions Inc., and Youth Care of Utah, Inc.).

⁹⁹ Exhibit B, Controller's Late Comments on the IRC, pages 98-99 (Tab 13, Contract between Mental Health Services, Inc., and Logan River Academy, LLC).

Charter Provo Canyon School (Charter Canyon contract),¹⁰⁰ are in the record. These agreements demonstrate that the vendor payments to the nonprofit entities were for services provided by for-profit programs.

In the Youth Care contract, Youth Care of Utah, Inc., is described as a Delaware corporation and the contract states:

Youth has the sole responsibility for provision of therapeutic services.
ASI...shall not exercise control over or interfere in any way with the exercise of professional judgment by Youth or Youth's employees in connection with Youth's therapeutic services.¹⁰¹

In the Logan River contract, Logan River Academy is described as a Utah for-profit limited liability company providing mental health services "to children and adolescents residing in California and desires to contract with MHS for the purpose of obtaining certain funds distributed by California State Social Services and California County Mental Health Departments."¹⁰²

In the Provo Canyon contract, Charter Provo Canyon School, LLC is described as a Delaware for-profit limited liability company providing mental health services "to children and adolescents residing in California and desires to contract with MHS for the purpose of obtaining certain funds distributed by California State Social Services and California County Mental Health Departments."¹⁰³

Therefore, reimbursement is not required for the costs incurred for Youth Care of Utah, Logan River Academy, and Charter Provo Canyon School.

The claimant similarly claimed that it had contractual agreements with Aspen Solutions, Inc., for placement of SED pupils in three other facilities: Aspen Ranch, New Leaf Academy, and SunHawk Academy. However, the claimant did not provide any documentation to support the nonprofit status of the programs that provided the services, or show the business relationship between the programs and the California nonprofit organization.¹⁰⁴ In addition, the claimant did not provide any documentation in support of the programs' nonprofit status for Grove School, New Haven, Spring Creek Lodge,

¹⁰⁰ Exhibit B, Controller's Late Comments on the IRC, page 111 (Tab 14, Contract between Mental Health Services, Inc. and Charter Provo Canyon School).

¹⁰¹ Exhibit B, Controller's Late Comments on the IRC, page 88 (Tab 12, Contract between Aspen Solutions Inc., and Youth Care of Utah, Inc.).

¹⁰² Exhibit B, Controller's Late Comments on the IRC, page 99 (Tab 13, Contract between Mental Health Services, Inc., and Logan River Academy, LLC).

¹⁰³ Exhibit B, Controller's Late Comments on the IRC, page 111 (Tab 14, Contract between Mental Health Services, Inc. and Charter Provo Canyon School).

¹⁰⁴ Exhibit B, Controller's Late Comments on the IRC, page 13.

and Vista Adolescent Treatment Center.¹⁰⁵ Section VI. of the Parameters and Guidelines requires the claimant to provide documentation to support the costs claimed as follows:

For auditing purposes, all costs claimed shall be traceable to source documents (e.g., invoices, receipts, purchase orders, contracts, worksheets, calendars, declarations, etc.) that show the evidence and validity of such costs and their relationship to the state mandated program. All documentation in support of the claimed costs shall be made available to the State Controller's Office, as may be requested...[T]hese documents must be kept on file by the agency submitting the claim for a period of no less than two years after the later of (1) the end of the calendar year in which the reimbursement claim is filed or last amended, or (2) if no funds are appropriated for the fiscal year for which the claim is made, the date of initial payment of the claim.¹⁰⁶

Thus, the claimant did not comply with the documentation requirements of the Parameters and Guidelines, or meet its burden of proof to verify that the costs claimed for Aspen Ranch, New Leaf Academy, SunHawk Academy, Grove School, New Haven, Spring Creek Lodge, and Vista Adolescent Treatment Center were within the scope of the mandate.

Accordingly, the evidence in the record supports the Controller's finding that the services were provided by for-profit entities and are outside the scope of the mandate.

B. There No Evidence That the Controller's Reduction of Indirect Costs Based on the Indirect Cost Rate Applied by the Claimant Is Incorrect as a Matter of Law, or Is Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller also reduced indirect costs on the ground that the claimant overstated the indirect cost rate. The Controller found that the claimant used an indirect cost rate methodology that is inconsistent with other related mandate programs. The Controller further found that the claimant, in some instances, applied a rate based on costs two years prior and, in other instances, applied a rate based on actual claim year costs. The disparate rates were applied to expenses in the same pool of costs, resulting in significant fluctuations in rates from year to year.¹⁰⁷ In comments on the IRC, the Controller explains the finding as follows:

Concerning the indirect cost rates, the county claimed 7.7066% for FY 2003-04, 6.8276% for FY 2004-05, and 0.2227% for FY 2005-06 on its filed mandate claims. However, in its filed IRC, the county indicated that its indirect cost rates are 8.4749% ($\$120,853 \div \$1,426,010$) for FY 2003-04, 7.5079% ($\$144,629 \div \$1,926,362$) for FY 2004-05, and 7.864% ($\$155,159 \div \$1,973,033$) for FY 2005-06. Based on our audit of the claims, we found that actual indirect cost rates were 4.8497% for FY 2003-04, 5.0543% for FY 2004-05, and 4.7072% for FY 2005-06.¹⁰⁸

¹⁰⁵ Exhibit B, Controller's Late Comments on the IRC, page 13.

¹⁰⁶ Exhibit B, Controller's Late Comments on the IRC, pages 72-73.

¹⁰⁷ Exhibit A, IRC, page 47 (Final Audit Report).

¹⁰⁸ Exhibit B, Controller's Late Comments on the IRC, page 15.

Thus, the Controller recalculated indirect costs using actual rates applicable to the appropriate fiscal year and applied the rate to eligible costs.

Although the claimant seeks reinstatement of all costs reduced in Findings 1 and 3, the claimant does not address the Controller's reductions relating to the indirect cost rate in its narrative.

Thus, there is no evidence in the record that the Controller's findings are incorrect as a matter of law, or are arbitrary, capricious, or entirely lacking in evidentiary support.

V. Conclusion

Based on the foregoing, the Commission denies this IRC.