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December 9, 2015

Mr. Keith B. Petersen
SixTen and Associates
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Sacramento, CA 95834-0430

Ms. Jill Kanemasu
State Controller's Office
Accounting and Reporting
3301 C Street, Suite 700
Sacramento, CA 95816

And Parties, Interested Parties, and Interested Persons (See Mailing List)

Re: **Decision**
Notification of Truancy, 10-904133-I-10 and 13-904133-I-12
Education Code Section 48260.5
Statutes 1983, Chapter 498
Fiscal Years: 2003-2004, 2004-2005, 2005-2006, and 2006-2007
Riverside Unified School District, Claimant

Dear Mr. Petersen and Ms. Kanemasu:

On December 3, 2015, the Commission on State Mandates adopted the decision on the above-entitled matter.

Sincerely,

for
Heather Halsey
Executive Director

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Education Code Section 48260.5 Statutes 1983, Chapter 498 Fiscal Years 2003-2004, 2004-2005, 2005-2006, and 2006-2007 Riverside Unified School District, Claimant	Case Nos.: 10-904133-I-10 and 13-904133-I-12 *Notification of Truancy* DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5. ARTICLE 7 (*Adopted December 3, 2015*) (*Served December 9, 2015*)

DECISION

The Commission on State Mandates (Commission) heard and decided this consolidated incorrect reduction claim (IRC) during a regularly scheduled hearing on December 3, 2015.

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 the proposed decision to partially approve the IRC on consent, with Commission members Chivaro, Hariri, Morgan, and Ortega voting to adopt the consent calendar. Commission members Olsen, Ramirez, and Saylor were not present at the hearing.

Summary of the Findings

This IRC addresses reductions made by the State Controller's Office (Controller) to reimbursement claims filed by Riverside Unified School District (claimant) for fiscal years 2003-2004 through 2006-2007, for the *Notification of Truancy* program.

Pursuant to Government Code section 17551(d), the Commission partially approves this IRC. The Commission finds that the following reductions are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support:

- Reductions in Finding 1 based on the ground that the claimant provided no documentation to support the number of notifications distributed.
- Reductions in Finding 2 based on notifications issued for pupils under age six or age 18 or over.
- Reductions in Finding 2 for notifications issued for pupils who accumulated *fewer than three* unexcused absences or instances of tardiness.

- Reduction in Finding 2 of one pupil's notification for which the Controller found insufficient documentation.
- The Controller's sampling and extrapolation methodology to calculate the reductions is not arbitrary, capricious, or entirely lacking in evidentiary support, to the extent that the underlying reasons for reduction are valid.

The following reductions, including any extrapolation of these reductions to costs claimed by the district, however, are incorrect as a matter of law, or are arbitrary, capricious, and entirely lacking in evidentiary support:

- Reductions in Finding 2 based on notifications issued for pupils who accumulated *three but not four* unexcused absences or instances of tardiness.
- The extrapolation of additional reductions based on one pupil's notification for which the Controller found insufficient documentation.

Pursuant to Government Code section 1185.9 of the Commission's regulations, the Commission requests costs incorrectly reduced be reinstated by the Controller in accordance with this decision.

COMMISSION FINDINGS

I. Chronology

02/05/2010	Controller issued the final audit report.[1]
11/01/2010	The claimant filed IRC 10-904133-I-10.[2]
08/24/2012	The Controller issued a revised final audit report.[3]
11/15/2015	Claimant filed a revised IRC, 13-904133-I-12.[4]
10/03/2014	The Controller filed late comments on the IRCs.[5]
09/21/2015	Commission staff issued the draft proposed decision.[6]
10/09/2015	Claimant filed comments on the draft proposed decision.[7]
10/13/2015	Controller filed late comments on the draft proposed decision.[8]

[1] Exhibit A, IRC 10-904133-I-10, page 59.

[2] Exhibit A, IRC 10-904133-I-10, page 1.

[3] Exhibit B, IRC 13-904133-I-12, page 14.

[4] Exhibit B, IRC 13-904133-I-12, page 1.

[5] Exhibit C, Controller's Late Comments on IRC.

[6] Exhibit D, Draft Proposed Decision.

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

[8] Exhibit F, Controller's Late Comments on Draft Proposed Decision.

II. Background

The *Notification of Truancy* Program

Under California's compulsory education laws, children between the ages of six and 18 are required to attend school full-time, with a limited number of specified exceptions.[9] Once a pupil is designated a truant, as defined, state law requires schools, districts, counties, and the courts to take progressive intervention measures to ensure that parents and pupils receive services to assist them in complying with the compulsory attendance laws.

The first intervention is required by Education Code section 48260.5, as added by the test claim statute.[10] As originally enacted, section 48260.5 specified:

> (a) Upon a pupil's initial classification as a truant, the school district shall notify the pupil's parent or guardian, by first-class mail or other reasonable means, of the following:
>
> (1) That the pupil is truant.
>
> (2) That the parent or guardian is obligated to compel the attendance of the pupil at school.
>
> (3) That parents or guardians who fail to meet this obligation may be guilty of an infraction and subject to prosecution pursuant to Article 6 (commencing with Section 48290) of Chapter 2 of Part 27.
>
> (b) The district also shall inform parents or guardians of the following:
>
> (1) Alternative educational programs available in the district.
>
> (2) The right to meet with appropriate school personnel to discuss solutions to the pupil's truancy.

On November 29, 1984, the Board of Control, the predecessor to the Commission, determined that Education Code section 48260.5, as added by Statutes 1983, chapter 498, imposed a reimbursable state-mandated program to develop notification forms and provide written notice to the parents or guardians of the truancy. The decision was summarized as follows:

> The Board determined that the statute imposes costs by requiring school districts to develop a notification form, and provide written notice to the parents or guardians of students identified as truants of this fact. It requires that notification contain other specified information and, also, to advise the parent or guardian of their right to meet with school personnel regarding the truant pupil. The Board found these requirements to be new and not previously required of the claimant.[11]

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[9] Education Code section 48200.

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

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

The original parameters and guidelines were adopted on August 27, 1987, and authorized reimbursement for the one-time activities of planning implementation, revising school district policies and procedures, and designing and printing the notification forms. Reimbursement was also authorized for ongoing activities to identify pupils to receive the initial notification and prepare and distribute the notification by first class mail or other reasonable means.

The Commission amended the parameters and guidelines on July 22, 1993, effective July 1, 1992, to add a unit cost of $10.21, adjusted annually by the Implicit Price Deflator, for each initial notification of truancy distributed in lieu of requiring the claimant to provide documentation of actual costs to the Controller. The parameters and guidelines further provide that "school districts incurring unique costs within the scope of the reimbursable mandated activities may submit a request to amend the parameters and guidelines to the Commission for the unique costs to be approved for reimbursement."[12] These are the parameters and guidelines applicable to this claim.[13]

The Legislature enacted Statutes 2007, chapter 69, effective January 1, 2008, which was sponsored by the Controller's Office to require the Commission to amend the parameters and guidelines, effective July 1, 2006, to modify the definition of a truant and the required elements to be included in the initial truancy notifications in accordance with Statutes 1994, chapter 1023, and Statutes 1995, chapter 19.[14] These statutes required school districts to add the following information to the truancy notification: that the pupil may be subject to prosecution under Section 48264, that the pupil may be subject to suspension, restriction, or delay of the pupil's driving privilege pursuant to Section 13202.7 of the Vehicle Code, and that it is recommended that the parent or guardian accompany the pupil to school and attend classes with the pupil for one day. The definition of truant was also changed from a pupil with unexcused instances of absence or tardiness for "more than three days" to a pupil with unexcused instances of absence or tardiness on three occasions in one school year. In 2008, the Commission amended the parameters and guidelines, for costs incurred beginning July 1, 2006, as directed by the Legislature. However, reimbursement for the program under the amended parameters and guidelines remained fixed at a unit cost of $10.21, adjusted annually by the Implicit Price Deflator ($19.63 for fiscal year 2013-14).

The Controller's Audit and Summary of the Issues

The February 5, 2010 audit report determined that $659,793 in claimed costs was allowable and $326,088 was unallowable.[15]

In Finding 1, the Controller found 57 truancy notifications issued in fiscal years 2003-2004 and 2004-2005 that were not supported by attendance records, resulting in a reduction of $799.[16]

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[12] Exhibit G, Parameters and Guidelines, amended July 22, 1993.

[13] The parameters and guidelines as amended in 2008 are not applicable to this IRC.

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

[15] Exhibit A, IRC 10-904133-I-10, page 51.

[16] Exhibit A, IRC 10-904133-I-10, page 66.

In Finding 2 the Controller projected, based on statistical sampling and extrapolation methods, that 6,853 unallowable truancy notifications were issued during the audit period, resulting in a reduction of $104,103.[17] The Controller found that the unallowable notifications were not reimbursable either because pupils were under six or over 18, and thus not subject to compulsory education under state law and not by definition a truant; or, because pupils did not accumulate the required number of absences to be classified a truant under the mandated program.[18] The Controller also found that one notice was not supported by sufficient documentation showing that the pupil had the required number of absences to be classified as a truant.[19] The Controller calculated the dollar amount reduced by sampling approximately 300 initial truancy notifications for each audit year, out of approximately 15,600 to 19,100 claimed, and determining the rate at which the district issued initial truancy notifications for pupils who did not accumulate four or more absences during the school year, or issued notifications for pupils under age six or age 18 or over. The Controller found rates of unallowable notifications claimed, based on its sampling, of 24.32 to 27.03 percent for elementary schools, and 1.35 to 2.04 percent for middle and high schools during the audit period.[20] Those error rates were applied to the whole number of notifications claimed for the respective grade levels for each fiscal year, in order to project a total number of unallowable notifications for each fiscal year. In addition, the Controller found that the claimant's attendance records supported 454 more initial truancy notifications than were claimed for two elementary schools within the district for fiscal year 2005-2006.[21] The Controller applied the 25.85 percent error rate calculated for fiscal year 2005-2006 for elementary schools, and found that 337 of 454 unclaimed notifications were allowable, resulting in a net increase of $5,237.[22] All this resulted in a net reduction of $98,866 for the audit period.[23]

Other reductions were made in Finding 3, for fiscal year 2006-2007 only, which the claimant disputed. In the revised audit, the Controller pro-rated reimbursement for previously disallowed truancy notifications and the claimant states in its second IRC that the pro-rated reduction "is satisfactory to the District," and withdraws the dispute with respect to Finding 3.[24] This decision, therefore, does not address the issues raised in Finding 3.

III. Positions of the Parties

Riverside Unified School District

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[17] Exhibit A, IRC 10-904133-I-10, page 68.

[18] Exhibit A, IRC 10-904133-I-10, page 67.

[19] Exhibit A, IRC 10-904133-I-10, page 20.

[20] Exhibit A, IRC 10-904133-I-10, page 68.

[21] Exhibit A, IRC 10-904133-I-10, page 67.

[22] Exhibit A, IRC 10-904133-I-10, page 68.

[23] Exhibit A, IRC 10-904133-I-10, pages 67-69.

[24] Exhibit B, IRC 13-904133-I-12, page 9.

The claimant argues, with respect to the 57 notifications disallowed in Finding 1 because they were not supported by attendance records, that "[t]he audit report does not indicate in what factual or legal manner the District documentation was insufficient, so it is not possible to determine if the adjustment is inappropriate."[25] The claimant argues that it has complied with the parameters and guidelines for claiming the number of initial notifications of truancy, and the audit does not articulate "why the source documentation was deficient."[26] The claimant points out that the parameters and guidelines "do not specify the form of supporting documentation required…" and "do not require claimants to maintain a copy of each notification."[27] Therefore, the claimant concludes that "the Controller's selection of the attendance records as the only source of support for the number of notifications claimed…is an unenforceable policy preference."[28] The claimant further argues that "It is unknown at this time, twelve years hence, what other business records were offered to support that missing slim 1%, but it is clear that the auditor would not have considered these records because they were not attendance records."[29] The claimant concludes that "the Controller's insistence on specific documentation not required by the parameters and guidelines…creates the threshold error of law."[30]

With respect to the 454 understated notifications for Harrison and Hawthorne Elementary Schools, the claimant argues that those notifications "should be included in Finding 1 to increase the number of claimable notifications before the extrapolation of the statistical sampling findings, similar to how the FY 2003-04 and FY 2004-05 reductions have been treated."[31]

The audit disallowed 122 of the 886 notifications evaluated for fiscal years 2003-2004 through 2005-2006, based on insufficient documentation (1 notification); pupils under- or over-age and not subject to compulsory education (63); and pupils with fewer than four absences (58).[32] With respect to the one notification disallowed on documentation grounds, the claimant no longer disputes this issue.[33] Regarding the 63 notifications disallowed because pupils were under- or over-age and not subject to compulsory education, the claimant no longer disputes this issue.[34] Finally, with respect to the 57 notifications in the audit sample disallowed because the pupils accumulated fewer than four absences, the claimant acknowledges that the "original parameters and guidelines were based on this definition of a truant, that is, a pupil with more than three

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[25] Exhibit A, IRC 10-904133-I-10, page 10.

[26] Exhibit A, IRC 10-904133-I-10, page 11.

[27] Exhibit A, IRC 10-904133-I-10, page 11. See also, Exhibit A, pages 47-48.

[28] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 1.

[29] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 2.

[30] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 2.

[31] Exhibit A, IRC 10-904133-I-10, page 12.

[32] Exhibit A, IRC 10-904133-I-10, page 20.

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

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

unexcused absences or tardy for more than three periods."[35] However, the claimant notes that Education Code section 48260 was amended to require only *three* absences or instances of tardiness prior to the fiscal years subject to this audit, and that therefore the claimant "properly complied with state law when it issued truancy notifications after three absences, rather than waiting for a fourth absence as required by the parameters and guidelines."[36] Therefore, the claimant agrees with the draft proposed decision, concluding that claimed costs for notifications issued upon a pupil's third absence or instance of tardiness should be reinstated.[37] With respect to pupils who did not accrue three or more absences or instances of tardiness, the claimant no longer disputes the reduction.[38] The claimant notes that its "agreement with these three Commission findings is limited to the extent of the actual number of samples notices involved, but not as to the extrapolation of these sampled notices."[39]

With respect to the reduction for non-reimbursable truancy notifications in Finding 2, the claimant first notes that "this finding is based on a statistical sample of 886 truancy notifications actually examined from a universe of 52,722 notices for the three fiscal years." The claimant argues that whether the Controller can adjust mandate reimbursement based on statistical sampling "is a threshold issue in that if the methodology used is rejected, as it should be, the extrapolation is void and the audit findings can only pertain to documentation actually reviewed, that is, the 886 notifications examined for the criteria of whether there were a sufficient number of absences or tardies to justify the initial notification of truancy and the age of the student."[40] Accordingly, the claimant argues that there is no legal basis or justification to apply statistical sampling to mandate reimbursement claims, and no published audit manual or program which allows this method. The claimant argues that adjusting claimed costs using extrapolation and sampling "is utilizing a standard of general application without the benefit of compliance with the Administrative Procedure Act…" and is therefore an underground regulation.[41]

Moreover, the claimant argues that statistical sampling is misused and inappropriate because of the risk that extrapolated findings "may not be representative of the universe," and because a sampling and extrapolation methodology cannot ascertain actual costs: "It ascertains probable costs within an interval."[42] The claimant thus concludes that because the statistical sampling and extrapolation methodology "fails for legal, qualitative, and quantitative reasons, the remaining audit findings are limited to the 886 notices actually investigated."[43]

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[35] Exhibit A, IRC 10-904133-I-10, page 26.

[36] Exhibit A, IRC 10-904133-I-10, pages 26-28.

[37] Exhibit E, Claimant's Comments on Draft Proposed Decision, pages 3-4.

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

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

[40] Exhibit A, IRC 10-904133-I-10, page 13.

[41] Exhibit A, IRC 10-904133-I-10, pages 13-16.

[42] Exhibit A, IRC 10-904133-I-10, page 19.

[43] Exhibit A, IRC 10-904133-I-10, page 20.

State Controller's Office

Answering the claimant's argument regarding Finding 1 that the audit does not explain what documentation of truancy notifications was "insufficient," the Controller states:

> We disagree; the findings clearly identifies [*sic*] the facts. The district claimed 17,943 and 19,134 initial truancy notifications distributed for FY 2003-04 and FY 2004-05, respectively. However, the district provided records that documented only 17,919 and 19,101 initial truancy notifications distributed for FY 2003-04 and FY 2004-05, respectively. Therefore, the district overstated the number of initial truancy notifications that its records support.[44]

The Controller argues that the parameters and guidelines do require supporting documentation, stating: "Each claim…must be timely filed and provide documentation in support of the reimbursement claimed…" The Controller reasons that the claimant "provided documentation that supported fewer initial truancy notifications than the number claimed," and therefore the reduction was correct.[45] Additionally, the Controller disputes the claimant's position that attendance records are not required to support the notifications for which reimbursement is claimed; the Controller argues that supporting documentation is necessary, and "must show that the claimed costs are reimbursable in accordance with the parameters and guidelines."[46] With respect to the single disallowance within the sample on the grounds of insufficient documentation, the Controller states, "[b]ecause the district provided attendance record documentation for 885 of the 886 sampled students, we believe that the district is well-versed on the documentation criterion."[47]

With respect to the claimant's argument that the 454 unclaimed notifications should be included in the total number of claimed notifications before extrapolating the rate of disallowance, the Controller argues that the audit adjustment would be the same "whether the report accounts for the 454 unclaimed initial truancy notifications in Finding 2 alone or Findings 1 and 2 together." The Controller states that either calculation results in a net understatement of $5,237.[48]

Regarding disallowances based on under- or over-age students not subject to compulsory education, the Controller argues that the claimant "confuses students' statutory requirement to attend school between ages six and eighteen with students' entitlement to attend outside of that age range." The Controller holds that absences occurring before a pupil's sixth birthday or after a pupil's eighteenth birthday "are irrelevant when determining whether a student is a truant."[49]

And, with respect to disallowances based on an insufficient number of unexcused absences or instances of tardiness, the Controller maintains that the parameters and guidelines control

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[44] Exhibit C, Controller's Late Comments on IRC, page 10.

[45] Exhibit C, Controller's Late Comments on IRC, page 11.

[46] Exhibit C, Controller's Late Comments on IRC, page 12.

[47] Exhibit C, Controller's Late Comments on IRC, page 21.

[48] Exhibit C, Controller's Late Comments on IRC, page 13.

[49] Exhibit C, Controller's Late Comments, page 22.

whether initial notifications are reimbursable, notwithstanding the amendments to the Education Code (which were eventually incorporated into the parameters and guidelines). The Controller recognizes the distinction, saying:

> We agree that Education Code section 48260.5 requires the district to issue an initial truancy notification upon a student's third unexcused absence or tardiness occurrence. We disagree that the parameters and guidelines require the district to "wait" for a fourth absence before issuing the notification…The district confuses the difference between its statutory responsibility versus mandate-related reimbursable costs identified by the parameters and guidelines.[50]

In addition, the Controller argues that the draft proposed decision is inconsistent with the Legislature's intent and the plain language of AB 1698, which directed the amendment of the parameters and guidelines. The Controller argues that AB 1698 directs the Commission to amend the parameters and guidelines, including with respect to the definition of truancy, and to make those amendments effective on July 1, 2006. "Despite this clear language the DPD proceeds to retroactively amend the definition of truant to some date prior to the fiscal years audited, presumably 1995." The Controller continues, "[h]ad the Legislature desired to make the changes retroactive to 1995, they could have easily done so, but they chose not to." And, the Controller argues that the analysis in the draft proposed decision "renders portions of AB 1698 surplusage, a result that is to be disfavored."[51] The Controller argues that the distinction made in the draft proposed decision between a "definitional" and a "mandatory" provision is meaningless and unsupported; and that the draft proposed decision ignores the basic requirements of the mandates process, including the burden placed on local government to establish that a requirement is a reimbursable mandate.[52]

With respect to the claimant's challenge to the Controller's sampling and extrapolation methodology used in Finding 2, the Controller argues that the Government Code and the Government Auditing Standards do not prohibit sampling,[53] and that the Controller "properly used estimation sampling to establish the frequency of occurrence of non-reimbursable initial truancy notifications."[54] With respect to the quantitative challenge as to the accuracy of sampling, the Controller argues that it applied a 95 percent confidence interval,[55] and that the absolute size of a sample, rather than its relative size, is sufficient to ensure accuracy.[56] The Controller also asserts that the claimant misconstrues the meaning of confidence intervals and

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[50] Exhibit C, Controller's Late Comments on IRC, page 23.

[51] Exhibit F, Controller's Late Comments on Draft Proposed Decision, page 10.

[52] Exhibit F, Controller's Late Comments on Draft Proposed Decision, page 10.

[53] Exhibit C, Controller's Late Comments on IRC, pages 14-17.

[54] Exhibit C, Controller's Late Comments on IRC, page 17.

[55] Exhibit C, Controller's Late Comments on IRC, page 13.

[56] Exhibit C, Controller's Late Comments on IRC, page 20.

expected error rates.[57] While the district argues that the adjustment amount "is really just a number exactly between $49,433 (50%) and $148,299 (150%)…" the Controller states that the range is in fact "$63,807 to $133,922." And, the Controller states, "[w]hile a statistical sample evaluation identifies a range for the population's true error rate, the point estimate provides the best, and thus *reasonable*, single estimate of the population's true error rate."[58]

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 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

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[57] The Controller explains that an "expected error rate" in this context is an assumption used to determine the appropriate sample size, rather than a measure of the ultimate accuracy of the result. In addition, the desired accuracy of the result, which might be called a "margin of error," may be determined by the Controller before calculating the sample size. Therefore, the "margin of error" of the Controller's resulting percentage is a known value. The Controller provides the following formula:

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

n = sample size

p = percent of occurrence in population (expected error rate)

SE = desired sample precision

t = confidence level factor

N = population size

The formula above, when applied with a 50 percent expected error rate and a desired eight percent margin of error, shows that an appropriate sample size is between 147 and 148 pupils for populations ranging from 7,562 notifications (elementary and special education pupils for fiscal year 2005-2006) to 9,706 notifications (middle and high school pupils for fiscal year 2004-2005). (Exhibit C, Controller's Comments, page 20.)

[58] Exhibit C, Controller's Late Comments on IRC, page 20 [emphasis in original]. See also, Exhibit A, IRC 10-904133-I-10, page 19 [The claimant mischaracterizes the phrase "expected error rate."].

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.[59] 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."[60]

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.[61] 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.]' "[62]

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.[63] 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.[64]

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

[60] *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

[61] *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.

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

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

[64] 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.

A. The Controller's Reductions in Finding 1 on the Basis of Insufficient Documentation Are Correct as a Matter of Law, and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced costs claimed for fiscal years 2003-2004 and 2004-2005 totaling $799, based on its determination in Finding 1 of the audit report that "attendance records did not support the number of initial truancy notifications claimed." The Controller found that the "overstated number of truancy notifications totaled 57."[65] The Controller further asserts that "the program's parameters and guidelines require the district to provide documentation that supports the total number of initial notifications of truancy distributed."[66] The claimant argues that the audit report "does not describe the nature of the perceived documentation deficiency…" and "[t]he parameters and guidelines do not specify the form of supporting documentation required." Indeed, the claimant argues that the parameters and guidelines "do not require claimants to maintain a copy of each notification…" and "do not require attendance records to support the number of notifications distributed."[67] The claimant reasons that "[t]he truancies were recorded and the notices were distributed, therefore, actual costs were incurred, and the Controller does not state that the work was not performed."[68]

The documentation requirements in the parameters and guidelines for this mandated program do not specifically require attendance records to support the costs claimed. However, the parameters and guidelines do require claimants to provide supporting documentation to indicate the number of truancy notifications distributed. As amended July 22, 1993, the parameters and guidelines state that claimants are to be reimbursed for: "Identifying the truant pupils to receive the notification, preparing and distributing by mail or other method the forms to parents/guardians, and associated recordkeeping." In addition, the parameters and guidelines provide that when claiming under the uniform cost allowance ($10.21 per notification, adjusted each year by the Implicit Price Deflator), claimants must "[r]eport the *number of initial notifications of truancy distributed* during the year." And under "Supporting Data," the parameters and guidelines state: "For auditing purposes, documents must be kept on file for a period of 3 years from the date of final payment by the State Controller, unless otherwise specified by statute…" Claimants requesting reimbursement under the "uniform allowance" are required to retain: "Documentation which *indicates the total number* of initial notifications of truancy distributed."[69] In addition, all claimants are required to "provide *documentation in support of the reimbursement claimed* for this mandated program." The parameters and guidelines do not specify the type of supporting documentation required.

The Controller interprets the parameters and guidelines to require a claimant to retain attendance records that demonstrate that each and every one of the initial truancy notifications distributed was distributed upon the pupil's initial classification as a truant, and not before. Attendance

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[65] Exhibit A, IRC 10-904133-I-10, page 66.

[66] Exhibit A, IRC 10-904133-I-10, page 66.

[67] Exhibit A, IRC 10-904133-I-10, pages 10-11.

[68] Exhibit A, IRC 10-904133-I-10, page 12.

[69] Exhibit A, IRC 10-904133-I-10, pages 45-48.

records are not the only documentation that would suffice under the plain language of the parameters and guidelines, but there is no evidence in the record that any documentation at all was provided for the 57 notifications in issue.

Based on the foregoing, the Commission finds that the Controller's reduction in Finding 1 of the costs to issue a total of 57 initial truancy notifications for fiscal years 2003-2004 and 2004-2005, based on a lack of any documentation, is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

B. The Controller's Reductions in Finding 2 on the Basis of Notifications Issued for Pupils Who Were Not Subject to Compulsory Education Requirements of the Education Code For All or Part of the School Year Are Correct as a Matter of Law.

The Controller found, in Finding 2 of the audit report, 63 notifications within the audit sample that were issued to pupils who, due to their age, were not subject to the compulsory education requirements of the Education Code or the *Notification of Truancy* mandate for the entire school year, and did not accumulate the requisite number of absences while between the ages of six and 18.[70] The claimant asserts that notifications of truancy issued for students under age six or age 18 or over should be reimbursable because the Education Code provides that those students are statutorily entitled to attend school. The claimant further contends that school districts are required by Education Code section 46000 to record, keep attendance, and report absences of all pupils in accordance with California State Board of Education regulations.[71] These regulations provide that records of attendance of every pupil shall be kept for apportionment of state funds and to ensure general compliance with the compulsory education law.

The Commission finds that providing truancy notices to pupils who did not accumulate the required number of unexcused absences between the ages of six and 18 goes beyond the scope of the mandate and is not eligible for reimbursement. Therefore these reductions are correct as a matter of law.

The claimant is correct that at the time these reimbursement claims were filed, school districts were required by state law to admit a child to kindergarten if the child would have his or her fifth birthday on or before December 2 of that school year.[72] School districts are also required by state and federal law to provide special education services to "individuals with exceptional needs" through age 21 if required by a pupil's individualized education plan (IEP).[73] And schools are required by state law to record the attendance of every pupil enrolled in school for apportionment of state funds and "to ensure the *general* compliance with the compulsory

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[70] Exhibit A, IRC 10-904133-I-10, page 20.

[71] Exhibit A, IRC 10-904133-I-10, pages 21-25.

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

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

education law, and performance by a pupil of his duty to attend school regularly as provided in [California Code of Regulations, title 5] section 300."[74]

However, the truancy laws apply *only* to those pupils who are subject to compulsory full-time education. Education Code section 48260(a), as it read during the period at issue in this IRC, defines a truant as:

> *Any pupil subject to compulsory full-time education or to compulsory continuation education* who is absent from school without valid excuse three full days in one school year or tardy or absent for more than any 30-minute period during the schoolday without a valid excuse on three occasions in one school year, or any combination thereof, is a truant and shall be reported to the attendance supervisor or to the superintendent of the school district.[75]

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

> Each person *between the ages of 6 and 18 years* not exempted under the provisions of this chapter or Chapter 3 (commencing with Section 48400) is subject to compulsory full-time education. Each person subject to compulsory full-time education and each person subject to compulsory continuation education not exempted under the provisions of Chapter 3 (commencing with Section 48400) shall attend the public full-time day school or continuation school or classes and for the full time designated as the length of the schoolday [*sic*] by the governing board of the school district in which the residency of either the parent or legal guardian is located and each parent, guardian, or other person having control or charge of the pupil shall send the pupil to the public full-time day school or continuation school or classes and for the full time designated as the length of the schoolday [*sic*] by the governing board of the school district in which the residence of either the parent or the legal guardian is located.[76]

Education Code 48260(b) further states that "[n]otwithstanding subdivision (a) [which defines a truant as a pupil subject to compulsory full-time education], it is the intent of the Legislature that school districts shall not change the method of attendance accounting provided for in existing law."[77] Therefore, even though schools are required by state law to report the attendance of all enrolled pupils, the truancy laws, including the first notice of initial truancy required by this mandated program, apply only to pupils between the ages of six and 18.

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

[75] Education Code section 48260 (as amended, Stats. 1994, ch. 1023; Stats. 1995, ch. 19).

[76] Education Code section 48200 (Stats. 1987, ch. 1452).

[77] Education Code section 48260 (as amended, Stats. 1994, ch. 1023; Stats. 1995, ch. 19).

Therefore, the Controller's reduction of costs for truancy notices provided to students who did not accumulate the required number of unexcused absences while between the ages of six and 18 is correct as a matter of law.

C. The Controller's Reductions in Finding 2 Based on the Former Definition of Truant Are Inconsistent with the Education Code, and Are Incorrect as a Matter of Law.

In addition, Finding 2 of the audit report identifies 58 notifications within the sample issued for pupils who accumulated fewer than four absences.[78] Based on the analysis herein, the Commission finds that the Controller's disallowance of notifications issued for pupils who did not accumulate four or more absences is incorrect as a matter of law, because it relies on the former definition of a truant.

The Controller protests, in comments filed on the draft proposed decision, that this result is inconsistent with the plain language of Statutes 2007, chapter 69, which directed the Commission to amend the parameters and guidelines, effective July 1, 2006. The Controller argues that applying the current definition of "truant" in this incorrect reduction claim amounts to a retroactive amendment of the parameters and guidelines, which is not called for or permitted by Statutes 2007, chapter 69.[79] In addition, the Controller challenges the distinction made between "definitional" and "mandatory" provisions.[80] And finally, the Controller argues that applying the current definition of an initial truant "ignores the basic concepts and procedures of the mandate process," in that the burden to establish reimbursement is on the claimant, and "there may often be discrepancies between what a local [agency] is legally obligated to do, and what they are reimbursed for doing."[81] The Controller argues that the amendment to Education Code section 48260 constitutes a new program or higher level of service, and that "the only way for the claimant's to receive reimbursement therefore, would have been for them to file a test claim, which no school district ever did."[82]

The Commission disagrees. The Controller's interpretation is untenable, and inconsistent with the intent of the Legislature and the terms of the parameters and guidelines. The parameters and guidelines provide for a uniform cost allowance "based on the number of initial notifications of truancy distributed pursuant to Education Code Section 48260.5, as added by Chapter 498, Statutes of 1983."[83] As enacted in 1976, and as analyzed by the Board of Control in its November 29, 1984 decision, Education Code section 48260 stated that a pupil who is absent or tardy from school without valid excuse for *more than three days* in one school year is a truant, as follows:

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[78] Exhibit A, IRC 10-904133-I-10, page 20.

[79] Exhibit F, Controller's Comments on Draft Proposed Decision, pages 9-10.

[80] Exhibit F, Controller's Comments on Draft Proposed Decision, page 10.

[81] Exhibit F, Controller's Comments on Draft Proposed Decision, page 10.

[82] Exhibit F, Controller's Late Comments on Draft Proposed Decision, page 11.

[83] Exhibit G, Parameters and Guidelines, amended July 22, 1993.

> Any pupil subject to compulsory full-time education or to compulsory continuation education who is absent from school without valid excuse *more than three days* or tardy in excess of 30 minutes on each of *more than three days* in one school year is a truant and shall be reported to the attendance supervisor or to the superintendent of the school district.[84]

Accordingly, the parameters and guidelines as originally adopted, and as amended July 22, 1993, included the then-current definition of a "truant" under Section I., Summary of Mandate:

> A truancy occurs when a student is absent from school without valid excuse *more than three* (3) days or is tardy in excess of thirty (30) minutes on each of more than three (3) days in one school year. (Definition from Education Code Section 48260).[85]

Subsequent to the adoption and 1993 amendment of parameters and guidelines for this program, section 48260, defining truancy, was amended by Statutes 1994, chapter 1023 (SB 1728) and Statutes 1995, chapter 19 (SB 102) to lower the threshold for classifying a pupil as a truant, as follows:

> Any pupil subject to compulsory full-time education or to compulsory continuation education who is absent from school without valid excuse *three full days* in one school year or *tardy or absent* for more than any 30-minute period during the schoolday without a valid excuse *on three occasions* in one school year, *or any combination thereof*, is a truant and shall be reported to the attendance supervisor or to the superintendent of the school district.[86,87]

No test claim or request to amend parameters and guidelines was ever submitted by a school district on the 1994 and 1995 statutes. However, section 48260 is definitional and was never found to impose any mandated activities on school districts in the Board of Control's decision, or in the adoption of parameters and guidelines. Accordingly, the section 48260 definition of truancy was not included as a reimbursable activity under the "Reimbursable Costs" section of the parameters and guidelines, but rather in the Summary of Mandate section, as noted above. Moreover, the 1994 and 1995 statutes do not require school districts to perform any new activities; the same activity of distributing initial truancy notifications is still required. In addition, the unit cost for reimbursing the mandated activities to send notices to parents or guardians was not increased when the parameters and guidelines were eventually amended to

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[84] Education Code section 48260 (Stats. 1976, ch. 1010) [Emphasis added].

[85] Exhibit G, Parameters and Guidelines, amended July 22, 1993.

[86] Education Code section 48260 (as amended, Stats. 1995, ch. 19 (SB 102)) [Emphasis added].

[87] The 1994 statute also changed the content of the notice required by the test claim statute to require school districts to also notify the pupil's parent or guardian that the pupil may be subject to prosecution; or may be subject to suspension or restriction of driving privileges; and that "it is recommended that the parent or guardian accompany the pupil to school…for one day." (Ed. Code § 48260.5 (as amended, Stats. 1994, ch. 1023 (SB 1728)).)

reflect the changes made by the 1994 and 1995 statutes, on January 31, 2008, pursuant to legislative direction enacted in Statutes 2007, chapter 69.[88]

As explained, the 1994 and 1995 amendments to Education Code section 48260 created a discrepancy between what triggered the mandated activities under law and what the parameters and guidelines in effect during that period stated was the triggering event under the Summary of Mandate. The inconsistency was corrected by an amendment to the parameters and guidelines adopted January 31, 2008 (an amendment made retroactive to July 1, 2006), but for over a decade the requirements of the Education Code and the language included in the Summary of Mandate section of the parameters and guidelines were at odds. In 2007, the Legislature acted to correct the discrepancy at the request of the State Controller's Office, recognizing that: "The school districts must adhere to the state statute, nevertheless, the State Controller uses the commission's parameters and guidelines to conduct the audits." The discrepancy, the Legislature found, "forces the State Controller's Office to request school districts to return the reimbursements even though the districts have been following the law."[89] As a result, the Legislature directed the Commission to amend the parameters and guidelines, the committee analysis noting that "[t]he commission is no longer able to update the definition of truancy due to one-year statute of limitations on revisions following amending statute."[90]

When an amendment to a code section or regulation imposes a new program or higher level of service that increases the costs of a local government, a test claim must be filed within one year of the effective date of the amendment or subsequent statute in order for the local government to exercise its right to reimbursement under the Constitution, as alluded to by the committee analysis comments on AB 1698.[91] But here, the amendment to section 48260 did not impose a new activity, let alone a new program or higher level of service that increased costs and required the adoption of a higher uniform cost allowance; the amendment affected only the *definition* of truancy. Education Code section 48260 is definitional, and does not contain any mandatory or directory language. [92] And no change has been made to the mandated activities by the subsequent legislation. However, under Controller's interpretation of the parameters and

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[88] Statutes 2007, chapter 69 (AB 1698) states:

> Notwithstanding any other provision of law, by January 31, 2008, the Commission on State Mandates shall amend the parameters and guidelines regarding the notification of truancy, test claim number SB-90-4133, and modify the definition of a truant and the required elements to be included in the initial truancy notifications to conform reimbursable activities to Chapter 1023 of the Statutes of 1994 and Chapter 19 of the Statutes of 1995…Changes made by the commission to the parameters and guidelines shall be deemed effective on July 1, 2006.

[89] Exhibit G, Assembly Bill 1698 (2007), Education Committee Analysis.

[90] Exhibit G, Assembly Bill 1698 (2007), Education Committee Analysis.

[91] See, generally, Government Code section 17551.

[92] An amendment to the definition of truancy may have also necessitated altering the text or content of the notice, but section 48260 made no such express requirement.

guidelines, a school district complying with the law would be foreclosed from reimbursement. As explained above, reimbursement is required by article XIII B, section 6 of the California Constitution to issue notification upon the pupil's *initial* classification as a truant (i.e., on or after the third unexcused absence or instance of tardiness, as defined). This activity has been approved as a reimbursable state-mandated activity, and the activity continues to be mandated by the state. Thus, the Commission's finding is not tantamount to a retroactive amendment to the parameters and guidelines. Therefore, section 48260 was amended without altering the scope of the mandated activities, and reimbursement under the terms of the approved code section (48260.5) for sending a notice "upon a pupil's initial classification as a truant," does not require a new test claim finding, or even an amendment to the parameters and guidelines based on changes to section 48260. This interpretation is consistent with the Board of Control's original test claim decision, which found that section 48260.5, and not section 48260, imposed the mandate. This reasoning is also consistent with the prior parameters and guidelines, in which the definition of truancy was not included as a reimbursable activity under the "Reimbursable Costs" section.

The Controller's auditors in this case reasonably relied on the outdated definition of truancy included in the "Summary of Mandate" section of the 1993 parameters and guidelines (*i.e., more than three* absences or instances of tardiness). The Controller correctly asserts that "[t]he parameters and guidelines as adopted on July 22, 1993, are the applicable audit criteria for the purposes of this audit."[93] And here, the parameters and guidelines, which "helpfully" included the text of a definition (which was *not* the subject of the mandate finding) in the Summary of Mandate, rather than citing to the code section where the definition could be found, were understandably a source of confusion for the auditors.

However, the Commission finds that because the amendment to section 48260 affected only the definition of truancy, and not the mandated program required to be performed by school districts, neither a new test claim nor parameters and guidelines amendment was necessary for the districts to continue to be reimbursed for complying with section 48260.5; that "upon a pupil's initial classification as a truant, the school district shall notify the pupil's parent or guardian…"

Based on the forgoing, the Commission finds that the Controller's reduction based on notices provided for pupils who accumulated three, but not four, unexcused instances of tardiness or absence is incorrect as a matter of law. All costs reduced on this basis should be reinstated to the claimant.

D. The Controller's Reductions in Finding 2 for Notifications Claimed for Pupils with Fewer Than Three Unexcused Absences or Tardy Occurrences Are Correct as a Matter of Law and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller stated in Finding 2 that a small portion of the notifications claimed were issued for students who did not accumulate even *three* absences or instances of tardiness.[94] In those cases, the pupils at issue did not meet the definition of a truant under the Education Code, and the claimant's issuance of a notification was not mandated by the state.

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[93] Exhibit C, Controller's Late Comments on IRC, page 11.

[94] Exhibit A, IRC 10-904133-I-10, page 67.

The audit report determination relies on "unallowable initial truancy notifications for students who accumulated fewer than four unexcused absences or tardiness occurrences…" and states that "[s]ome of these students accumulated fewer than three unexcused absences or tardiness occurrences." However, neither the IRC, nor the audit report, identifies the number of pupils who accumulated fewer than three unexcused absences or tardiness occurrences. For fiscal years 2003-2004 through 2005-2006, the audit report simply identifies 122 unallowable truancy notifications.

As discussed above, Education Code section 48260, during the fiscal years here at issue, defined a truant as "any pupil subject to compulsory full-time education or to compulsory continuation education who is absent from school without valid excuse *three full days* in one school year or tardy or absent for more than any 30-minute period during the schoolday without a valid excuse *on three occasions* in one school year, or any combination thereof."[95]

The Commission's 1993 parameters and guidelines require a school district to issue a notification of truancy "upon a pupil's initial classification as a truant…"[96] If a pupil cannot be classified as a truant, as defined in section 48260, a notification is not required, and any notification sent to that pupil's parent or guardian, whether or not intentional, is not reimbursable. Therefore, to the extent the Controller reduced the claims based on notifications issued for pupils who were not by definition truant (i.e., pupils that did not accumulate at least three unexcused absences or instances of tardiness, or any combination thereof), those reductions are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.[97]

Based on the foregoing, the Commission finds that reductions based on pupils who did not accumulate three unexcused absences or instances of tardiness during the school year are correct as a matter of law.

E. Extrapolated Reductions in Finding 2 Based on a Single Instance of Insufficient Documentation Within the Controller's Sample Are Entirely Lacking in Evidentiary Support.

The claimant identifies in its IRC a single instance within the sample of notifications analyzed which the Controller found was not supported by documentation.[98] It is unclear from the audit report or the IRC narrative whether the lack or insufficiency of documentation pertains to the number of absences that that pupil accumulated, or the pupil's age, or whether the notification

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[95] Education Code section 48260 (as amended, Stats. 1995, ch. 19 (SB 102)) [emphasis added].

[96] See, e.g., Exhibit C, Controller's Late Comments on IRC, page 9 [quoting the Commission's 1993 parameters and guidelines]. See also, former Education Code section 48260.5 (Stats. 1983, ch. 498) ["Upon a pupil's initial classification as a truant, the school district shall notify…"].

[97] As discussed below, the number of pupils who did not accumulate a given number of unexcused absences or instances of tardiness within the sample was extrapolated to a total dollar amount reduction, and the Controller will be required to adjust that reduction consistent with this finding.

[98] Exhibit A, IRC 10-904133-I-10, pages 20-21.

itself was issued as reported. The draft proposed decision concluded that because the Commission is unable to make findings on this single instance of "insufficient documentation," due to a lack of evidence in the record, this disallowance must be remanded to the Controller and reinstated absent an adequate explanation of the reduction supported by some evidence in the record.

In response to the draft proposed decision, the Controller submitted additional information and explanation, including the auditor's notation that there was no attendance information in the system at all for one of the students within the sample.[99] The Controller explains that the auditor emailed requesting more information on the pupils that were found to have accrued an insufficient number of absences, including the one for whom no information was found. When the claimant failed to provide any additional information concerning that pupil, "we based our audit finding for that student on 'insufficient documentation' provided by the district to support that the student accumulated the required number of absences…"[100]

Furthermore, as discussed below, each of the asserted legal grounds for disallowance identified within the Controller's sample of the total population of notifications issued is calculated as an error rate and extrapolated to the whole to estimate the number of notifications that suffer from the same flaw and determine a dollar amount reduction. Because this single instance within the sample of "insufficient documentation" concerns a pupil for whom no attendance records were present in the claimant's computer systems, and for whom no additional documentation could be provided, it is impossible to determine, and the Commission cannot presume, whether the asserted error is likely to be uniformly repeated within the population. Therefore, unlike the extrapolation of error rates for notifications issued to pupils under or over-age, or notifications issued to pupils who did not accumulate the requisite number of absences, there is not sufficient evidence in the record to support adding this instance of "insufficient documentation" to the error rates calculated by the Controller.

Based on the foregoing, the Commission finds the reduction for the single pupil identified in the audit for whom no attendance information could be found or produced, is not arbitrary, capricious, or entirely lacking in evidentiary support. However, absent some evidence that this documentation issue is of a type likely to be uniformly repeated within the population, the Controller's decision to extrapolate an error rate from this single instance of insufficient documentation is entirely lacking in evidentiary support.

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

In its audit of 2003-2004, 2004-2005, and 2005-2006 reimbursement claims, the Controller examined a random sample of initial truancy notices distributed by the claimant for each year to determine the proportion of notifications that were unallowable for the Controller's asserted legal reasons. The Controller's sample for fiscal years 2003-2004, 2004-2005, and 2005-2006 totaled 886 notifications distributed by elementary and secondary schools, out of a total of 53,119

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[99] Exhibit F, Controller's Late Comments on Draft Proposed Decision, page 16.

[100] Exhibit F, Controller's Late Comments on Draft Proposed Decision, page 3.

"supported" notifications.[101] The Controller selected its sample "based on a 95% confidence level, a precision rate of ± 8%, and an expected error rate of 50%."[102] The number of unallowable notifications within the sample for each fiscal year was then calculated as an error percentage, and extrapolated to the total number of notifications issued and identified by the claimant in each fiscal year to approximate the total number of unallowable notifications (totaling 7,325 for three years). The number of unallowable notices was then multiplied by the unit cost for each fiscal year to calculate the total reduction for the three fiscal years at $98,866.[103]

Since the Controller has not actually reviewed all 53,119 "supported" notifications, the Controller's methodology results in an estimate based on statistical probabilities of the amount of costs claimed beyond the scope of the mandate and that the Controller has determined to be excessive or unreasonable. The Controller states that the estimated reduction of costs has an "adjustment range" with a 95 percent confidence level for all three fiscal years between $63,807 and $133,922, and that the total reduction taken ($98,866) for three years "provides the best, and thus *reasonable*, single estimate of the population's true error rate."[104] The Controller asserts that sampling and extrapolation is an audit tool commonly used to identify error rates; that there is no law or regulation prohibiting that method; and, that the claimant misstates and misunderstands the meaning of an expected error rate and confidence interval. The Controller argues that its method is reasonable, and "the Administrative Procedures Act [sic] is not applicable."[105]

Claimant asserts that the use of statistical sampling should be rejected, that the extrapolation of findings is void, and that the audit findings can only pertain to documentation actually reviewed; that is, the 886 notifications examined.[106] The claimant attacks the statistical reliability and accuracy of the Controller's methodology, arguing that "[t]esting to detect the rate of error within tolerances is the purpose of sampling, but it is not a tool to assign an exact dollar amount to the amount of the error, which the Controller has inappropriately done so here."[107] The claimant further states that the risk of extrapolating findings from a sample is that the

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[101] This figure excludes the "unsupported" notifications in Finding 1. The sample sizes for elementary schools and the sample sizes for secondary schools that were reviewed by the Controller each fiscal year ranged from 147 to 148. The sample sizes for elementary and secondary schools were separately calculated because elementary schools took daily attendance and secondary schools took period attendance. (Exhibit A, IRC, page 67 (final audit report).)

[102] Exhibit A, IRC 10-904133-I-10, page 67 (final audit report).

[103] This figure includes the $5,237 adjusted for understated truancy notifications for two of the district's elementary schools. (See Exhibit A, IRC, pages 68-69 (final audit report).)

[104] Exhibit C, Controller's Late Comments on IRC, page 20.

[105] Exhibit C, Controller's Late Comments on IRC, page 20.

[106] Exhibit A, IRC 10-904133-I-10, page 13.

[107] Exhibit A, IRC 10-904133-I-10, page 17.

conclusions obtained from the sample may not be representative of the universe. In this respect, the claimant states the following:

> For example, kindergarten students present in the sample are more likely to be excluded because of the under-age issue, which makes these samples nonrepresentative of the universe. Also, if any of the notices excluded for being under-age or over-age are for students who are special education students, these samples would also not be representative of the universe since the possibility of a special education student being under-age or over-age is greater than the entire student body. The audit report states that the District "provides no evidence showing that the audit sample included a disproportionate number of kindergarten or special education students compared to the truancy population." This misses the point entirely. The District does not assert that the incidence of kindergarten students or special education students is either proportionate or disproportionate, rather that a kindergarten pupil is more likely to be under-age and a special education pupil is more likely to be over-age than other students sampled, and thus not representative.[108]

The claimant further contends that the sampling technique used by the Controller is also quantitatively non-representative because fewer than two percent of the total number of notices were audited, the stated precision rate was plus or minus eight percent even though the sample size (ranging from 147 to 148) is essentially identical for all three fiscal years, and that the audited number of notices claimed for fiscal year 2004-2005 (19,101) is twenty-two percent larger than the number of notices claimed for fiscal year 2005-2006 (15,645). The claimant concludes by stating that "[t]he expected error rate is stated to be 50%, which means the total amount adjusted of $98,866 is really just a number exactly between $49,433 (50%) and $148,299 (150%)" and that "[t]he midrange of an interval cannot be used as a finding of absolute actual cost."[109]

And finally, claimant strenuously asserts that the Controller's failure to adopt statistical sampling as a regulation renders its use void under the APA:[110]

> The incorrect reduction claims assert that the sampling and extrapolation process is a standard of general application without appropriate state agency rulemaking and is therefore unenforceable (Government Code Section 11340.5). The formula is not an exempt audit guideline (Government Code Section 11340.9 (e)). State agencies are prohibited from enforcing underground regulations. If a state agency issues, enforces, or attempts to enforce a rule without following the Administrative Procedure Act, when it is required to, the rule is called an "underground regulation." Further, the audit adjustment is a financial penalty against the District, and since the adjustment is based on an underground

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[108] Exhibit A, IRC 10-904133-10, pages 17-18.

[109] Exhibit A, IRC 10-904133-I-10, page 19.

[110] Exhibit A, IRC 10-904133-I-10, page 19.

> regulation, the formula cannot be used for the audit adjustment (Government Code Section 11425.50 (c)).[111]

Based on the analysis herein, the Commission finds that the reductions in this case, determined based on the sampling method used and lack of any evidence to the contrary, are not arbitrary, capricious, or entirely lacking in evidentiary support.

1. The evidence in the record does not support claimant's argument that the statistical sampling and extrapolation method used in the audit of the claimant's reimbursement claims constitutes an underground regulation.

The claimant has challenged the statistical sampling methodology applied in this case as a regulation not adopted pursuant to the APA, to which the Controller responds that the "'requirements' [of the Government Auditing Standards] are applicable to auditors, not claimants; therefore, state agency rulemaking is irrelevant."[112] Based on the analysis below, the Commission finds that the evidence in the record does not support the argument that the statistical sampling and extrapolation method applied here is a "regulation" within the meaning of the APA, and therefore was required to be adopted pursuant to the APA's public notice and comment requirements.

The relevant portions of the APA include Government Code sections 11340.5 and 11342.600. Government Code Section 11340.5 provides, in pertinent part:

> No state agency shall issue, utilize, enforce, or attempt to enforce any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a regulation as defined in Section 11342.600, unless [the rule] has been adopted as a regulation and filed with the Secretary of State pursuant to this chapter.

Section 11342.600, in turn, defines a regulation to mean "…every rule, regulation, order, or standard of general application or the amendment, supplement, or revision of any rule, regulation, order, or standard adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure."[113] Finally, Government Code section 11346 provides that "[e]xcept as provided in Section 11346.1, the provisions of this chapter are applicable to the exercise of any quasi-legislative power conferred by any statute heretofore or hereafter enacted, but nothing in this chapter repeals or diminishes additional requirements imposed by any statute." Section 11346 continues: "This chapter shall not be superseded or modified by any subsequent legislation except to the extent that the legislation shall do so expressly."[114] Therefore, if the Controller's challenged audit methods constitute a regulation not adopted pursuant to the APA, the Commission cannot uphold the reductions.

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[111] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 5.

[112] Exhibit C, Controller's Late Comments on IRC, page 16.

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

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

The seminal authority on so-called "underground regulations" is the California Supreme Court's opinion in *Tidewater Marine Western v. Bradshaw*,[115] in which a group of shipping companies and associations challenged the application of the Industrial Welfare Commission's (IWC's) wage orders to their businesses and employees as an invalid underground regulation, not adopted under the APA.

Tidewater Marine Western, Inc. (Tidewater) and Zapata Gulf Pacific, Inc. (Zapata) were two of the petitioners whose principal business was transporting workers and supplies between oil-drilling platforms in the Santa Barbara Channel and coastal ports. The employees at the center of the dispute were California residents, working 12 hour shifts with intermittent break or rest periods, at a flat daily rate without overtime pay, which the employers explained was reasonable because: "the demands of work are inconstant, and crew members may spend part of this duty period engaged in leisure activities."[116] The IWC had existing wage orders for transportation employees and for technical and mechanical employees, which required an overtime pay rate when an employee worked more than eight hours in any twenty-four hour period. Beginning in 1978, maritime employees had begun filing claims under these wage orders with the Division of Labor Standards Enforcement (DLSE), which examined those claims on a case-by-case basis, "considering such factors as the type of vessel, the nature of its activities, how far it traveled from the California coast, how long it was at sea, and whether it left from and returned to the same port…"[117] After an unstated number of these claims, "DLSE eventually replaced this case-by-case adjudication with a written enforcement policy, which provides: 'IWC standards apply to crews of fishing boats, cruise boats, and similar vessels operating exclusively between California ports, or returning to the same port, if the employees in question entered into employment contracts in California and are residents of California.'"[118] Initially, this written policy was contained in a "draft policy manual" that DLSE created to guide its deputy labor commissioners, but in 1989, DLSE formalized the policy in its "Operations and Procedures Manual," which was available to the public upon request. The manual, prepared internally and without public input, "reflected 'an effort to organize…interpretive and enforcement policies' of the agency and 'achieve some measure of uniformity from one office to the next.'"[119]

In 1987, the DLSE began applying the IWC's wage order requiring overtime pay to the maritime workers in the Santa Barbara Channel, including those of Tidewater and Zapata, which were among the entities that brought suit to challenge the application of the order on several grounds, including the theory that application of the order constituted an underground regulation.

The Court noted that while "DLSE's primary function is enforcement, not rulemaking," DLSE does have power to promulgate "regulations and rules of practice and procedure."[120] The Court

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

[116] *Id.,* page 561.

[117] *Id.,* page 562.

[118] *Ibid.*

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

[120] *Id.,* page 570.

further noted that the Labor Code does not include special rulemaking procedures for DLSE, "nor does it expressly exempt the DLSE from the APA."[121] The Court analyzed the underground regulation challenge raised by Tidewater, beginning with the requirements and underlying purpose of the APA, as follows:

> The APA establishes the procedures by which state agencies may adopt regulations. The agency must give the public notice of its proposed regulatory action (Gov. Code, §§ 11346.4, 11346.5); issue a complete text of the proposed regulation with a statement of the reasons for it (Gov. Code, § 11346.2, subds. (a), (b)); give interested parties an opportunity to comment on the proposed regulation (Gov. Code, § 11346.8); respond in writing to public comments (Gov. Code, §§ 11346.8, subd. (a), 11346.9); and forward a file of all materials on which the agency relied in the regulatory process to the Office of Administrative Law (Gov. Code, § 11347.3, subd. (b)), which reviews the regulation for consistency with the law, clarity, and necessity (Gov. Code, §§ 11349.1, 11349.3).
>
> One purpose of the APA is to ensure that those persons or entities whom a regulation will affect have a voice in its creation (*Armistead v. State Personnel Board* (1978) 22 Cal.3d 198, 204-205 (*Armistead*)), as well as notice of the law's requirements so that they can conform their conduct accordingly (*Ligon v. State Personnel Bd.* (1981) 123 Cal.App.3d 583, 588 (*Ligon*)). The Legislature wisely perceived that the party subject to regulation is often in the best position, and has the greatest incentive, to inform the agency about possible unintended consequences of a proposed regulation. Moreover, public participation in the regulatory process directs the attention of agency policymakers to the public they serve, thus providing some security against bureaucratic tyranny. (See *San Diego Nursery Co. v. Agricultural Labor Relations Bd.* (1979) 100 Cal.App.3d 128, 142-143.)[122]

The Court in *Tidewater* found that the APA "defines 'regulation' very broadly." The Court explained that a regulation has two principal characteristics:

> First, the agency must intend its rule to apply generally, rather than in a specific case. The rule need not, however, apply universally; a rule applies generally so long as it declares how a *certain class of cases* will be decided. Second, the rule must "implement, interpret, or make specific the law enforced or administered by [the agency], or ... govern [the agency's] procedure."[123]

The Court acknowledged that "interpretations that arise in the course of case-specific adjudication are not regulations, though they may be persuasive as precedents in similar

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[121] *Id.*, page 570 [Citing Labor Code § 98.8].

[122] *Id.*, pages 568-569 [Italics supplied].

[123] *Tidewater*, *supra*, 14 Cal.4th 557, 571 (emphasis added) [Citing *Roth v. Department of Veteran Affairs* (1980) 110 Cal.App.3d 622, 630; Gov. Code § 11342(g)].

subsequent cases;"[124] and, "[s]imilarly, agencies may provide private parties with advice letters, which are not subject to the rulemaking provisions of the APA."[125] And, the Court reasoned that "if an agency prepares a policy manual that is no more than a restatement or summary, without commentary, of the agency's prior decisions in specific cases and its prior advice letters, the agency is not adopting regulations."[126]

The Court cited a number of examples in which a policy or rule was or was not held to be a regulation,[127] but applying the above reasoning, the Court concluded that the application of the challenged wage orders to the plaintiffs was indeed an invalid underground regulation:

> The policy at issue in this case was expressly intended as a rule of general application to guide deputy labor commissioners on the applicability of IWC wage orders to a particular type of employment. In addition, the policy interprets the law that the DLSE enforces by determining the scope of the IWC wage orders. Finally, the record does not establish that the policy was, either in form or substance, merely a restatement or summary of how the DLSE had applied the IWC wage orders in the past. Accordingly, the DLSE's enforcement policy appears to be a regulation within the meaning of Government Code section

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[124] *Id.,* page 571 [Citing *Bendix Forest Products Corp. v. Division of Occupational Safety and Health* (1979) 25 Cal.3d 465, 471; *Carmona v. Division of Industrial Safety* (1975) 13 Cal.3d 303, 309-310; *Taye v. Coye* (1994) 29 Cal.App.4th 1339, 1345; *Aguilar v. Association for Retarded Citizens* (1991) 234 Cal.App.3d 21, 28].

[125] *Id.,* page 571 [citing Government Code sections 11343; 11346.1].

[126] *Tidewater*, *supra*, 14 Cal.4th 571 [citing Labor Code section 1198.4].

[127] *Tidewater*, *supra*, 14 Cal.4th 557, 571-572 ["Examples of policies that courts have held to be regulations subject to the rulemaking procedures of the APA include: (1) an informational "bulletin" defining terms of art and establishing a rebuttable presumption (*Union of American Physicians & Dentists v. Kizer*, [(*UAPD*) (1990)] 223 Cal.App.3d [490,] 501); (2) a "policy of choosing the most closely related classification" for determining prevailing wages for unclassified workers (*Division of Lab. Stds. Enforcement v. Ericsson Information Systems, Inc.* (1990) 221 Cal.App.3d 114, 128); and (3) a policy memorandum declaring that work performed outside one's job classification does not count toward qualifying for a promotion (*Ligon, supra,*123 Cal.App. [583,] 588). In contrast, examples of policies that courts have held not to be regulations include: (1) a Department of Justice checklist that officers use when administering an intoxilyzer test (*People v. French* (1978) 77 Cal.App.3d 511, 519); (2) the determination whether in a particular case an employer must pay employees whom it requires to be on its premises and on call, but whom it permits to sleep (Aguilar [*v. Association for Retarded Citizens* (1991)] 234 Cal.App.3d [21,] 25-28); (3) a contractual pooling procedure whereby construction tax revenues are allocated among a county and its cities in the same ratio as sales tax revenues (*City of San Joaquin v. State Bd. of Equalization* (1970) 9 Cal.App.3d 365, 375); and (4) resolutions approving construction of the Richmond-San Rafael Bridge and authorizing issuance of bonds (*Faulkner v. Cal. Toll Bridge Authority* (1953) 40 Cal.2d 317, 323-324)."] (Italics supplied).

11342, subdivision (g), and therefore void because the DLSE failed to follow APA procedures.[128]

The Court went on to distinguish or disapprove prior cases finding that a challenged policy or position of the DLSE was not an underground regulation,[129] and pointed out that if the current interpretation were the only reasonable interpretation, as argued by DLSE, it would not be necessary to state in a policy manual in order to achieve uniformity in enforcement, which DLSE claimed to be part of its initial motivation for articulating the policy.[130]

In addition to the Court's thorough examination in *Tidewater* of the APA and case law pertaining to underground regulations generally, and specifically in the labor standards enforcement context, three court of appeal decisions have addressed underground regulation challenges to an auditing methodology: *Grier v. Kizer*[131] (*Grier*); *Union of American Physicians and Dentists v. Kizer*[132] (*UAPD*); and *Taye v. Coye*[133](*Taye*).

In *Grier* and *UAPD* "the Department conducted audits of Medi-Cal providers by taking a small random sample [to determine the frequency and extent of over- or under-claiming for services provided], then extrapolating that error rate over the total amount received by the provider during the period covered by the audit."[134] The courts found the sampling and extrapolation methodology in that case invalid, solely because of the failure of the Department of Health Services to adopt its methodology in accordance with the APA. The court in *Grier*, *supra*, concurred with the OAL's determination, made in a parallel administrative proceeding, that the challenged method constituted a regulation, and should have been duly adopted. The court observed that "the definition of a regulation is broad, as contrasted with the scope of the internal management exception, which is narrow."[135] And, the court rejected the Department's argument that sampling and extrapolation was the only legally tenable interpretation of its audit authority: "While sampling and extrapolation may be more feasible or cost-effective,...[a] line by line audit is an alternative tenable interpretation of the statutes."[136] The court also noted that the Department "acquiesced" in that determination and in the time between the trial court's determination and the hearing on appeal, it adopted a regulation providing expressly for

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[128] *Id.,* page 572.

[129] *Skyline Homes, Inc. v. Department of Industrial Relations* (1985) 165 Cal.App.3d 239, 253; *Bono Enterprises, Inc. v. Bradshaw* (1995) 32 Cal.App.4th 968, 978.

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

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

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

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

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

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

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

statistical sampling and extrapolation in the conduct of Medi-Cal audits.[137] Accordingly, the court in *Union of American Physicians and Dentists* assumed, without deciding, that having satisfied the APA, the statistical methodology could be validly applied to pending audits, or remanded audits.[138] Now, with respect to Medi-Cal audits, a statistical sampling methodology is provided for in *both* the Welfare and Institutions Code and in the Department's implementing regulations.[139]

In *Taye*, another health care provider seeking reimbursement under Medi-Cal for services and products supplied to patients was audited, this time by the State Controller's Office.[140] Taye argued that the method of conducting the audit, and in particular the decision to exclude "opening inventory" when calculating the difference between the amount of product purchased by Taye during the audit period and the amount of product he billed for during the same period, constituted a "regulation" within the meaning of the APA, and as such could not be applied or enforced until duly adopted as a regulation and filed with the Secretary of State.[141] The court distinguished *Grier* as follows:

> In *Grier*, cited here by Taye, the court found that a challenged method of conducting an audit by extrapolating from a small, select, sample of claims submitted was in fact a regulation. The court concurred in the reasoning of the Office of Administrative Law, determining that the method was a regulation *because it was a standard of general application applied in every Medi-Cal case reviewed by the Department audit teams* and used to determine the amount of the overpayment. [Citation] The auditing method used by LaPlaunt here, in contrast, was not a standard of general application used in all Medi-Cal cases. Thus, LaPlaunt declared: "The audit procedures used to conduct the audit of Pride Home Care Medical were designed to fit the particular conditions that were encountered upon the arrival at the audit site. [¶] ... While all audits are performed along generally accepted audit principles, these principles are not intended to be steadfast rules from which deviation is prohibited. In the twelve years that I have been employed as an auditor for the California State Controller's Office, I have been involved in numerous audits varying in subject and complexity. In these endeavors, I have found that the flexibility to adopt auditing principles to unique situations, including treatment of inventory, is imperative in the successful

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

[138] *UAPD, supra*, 223 Cal.App.3d 490, 504-505 [finding that the statistical audit methodology did not have retroactive effect because it did not alter the legal significance of past events (i.e., the amount of compensation to which a Medi-Cal provider was entitled)].

[139] See, e.g., Welfare and Institutions Code section 14170(b) (added, Stats. 1992, ch. 722 (SB 485); Code of Regulations, title 22, section 51458.2 (Register 1988, No. 17).

[140] *Taye*, *supra*, 29 Cal.App.4th 1339, 1342.

[141] *Id.,* page 1344.

> completion of an audit." It follows that the method was not a "regulation," and no error attended its employment.[142]

This analysis and conclusion was cited approvingly in *Tidewater*, *supra*, as one of several examples of "interpretations that arise in the course of case-specific adjudication" and not subject to the regulatory process.[143]

And finally, in *Clovis Unified*, the court held that the Controller's contemporaneous source document rule (CDCR), which was contained solely in the Controller's claiming instructions and not adopted in the regulatory parameters and guidelines, was applied *generally* to audits of all reimbursement claims for certain programs, in that individual auditors had no discretion to judge on a case-by-case basis whether to apply the rule.[144] As to the second criterion, the court found that the CSDR was more specific, and in some ways inconsistent with the parameters and guidelines for the subject mandated programs. Specifically, the court found that the CSDR defined "source documents" differently and more specifically than the parameters and guidelines, including relegating employee declarations to "corroborating documents, not source documents…," and failing to recognize the appropriate use of a time study.[145] The court therefore held, "[g]iven these substantive differences…we conclude that the CSDR implemented, interpreted, or made specific…" the parameters and guidelines and the Controller's audit authority and was, therefore, an underground regulation.[146]

The necessary inquiry, then, is whether the challenged audit policy or practice is applied "generally," and used to decide a class of cases; and whether the rule "implement[s], interpret[s], or make[s] specific" the law administered by the Controller. Here, that presents a close question, which turns on the issue of general applicability: if it is the Controller's policy that *all audits* of the *Notification of Truancy* program be conducted using the statistical sampling and extrapolation methods here challenged, then perhaps that meets the standard of a rule applied "generally, rather than in a specific case."[147] On the other hand, if statistical sampling and extrapolation is only one of an auditor's tools, and happens to be the most practical method for auditing claims involving a unit cost with many thousands of units claimed, and it is within the discretion of each auditor to use the challenged methods, then the APA does not bar the exercise of that discretion.[148]

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

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

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

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

[146] *Id.*, page 805.

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

[148] See *Taye*, *supra*, 29 Cal.App.4th 1339, 1345 [Finding that an auditor's decision was not an underground regulation where it was "designed to fit the particular conditions that were encountered upon arrival at the audit site."].

As explained in *Tidewater*, an agency may provide an advice letter to a party, which is not subject to the APA, or may prepare a policy manual that is "*no more than* a restatement or summary, without commentary, of the agency's prior decisions…" without implicating the public notice and comment requirements of the APA.[149] However, in *Tidewater*, and later in *Clovis Unified*, where a written policy was applied generally to a class of cases, the courts have held that the APA is implicated, and the application of the policy is void.

Here, the Controller argues that the auditor "conducted appropriate statistical samples that identified a reasonable estimate of the non-reimbursable initial truancy notifications, thus properly reducing the claims for the unreasonable claimed costs," and that therefore "the Administrative Procedures Act [sic] is not applicable." But that argument essentially rests on the theory that the auditors acted appropriately, and therefore the APA could not have been violated. This conclusion does not follow. Looking no further than *Clovis Unified*, and especially in light of *Grier* and *UAPD*, it is clear that an audit practice may be reasonable and otherwise permissible, yet still constitute an illegal underground regulation.

However, the Commission finds that the evidence in the record does not support the assertion that the audit methodology as applied in this case rises to the level of a rule of general application, and no clear "class of cases" to which it applied has been defined. In *Tidewater*, the Court held that a "rule need not, however, apply universally; a rule applies generally so long as it declares how a certain class of cases will be decided."[150] And in *Clovis Unified*, *supra*, the court explained that in the context of the Controller's audits of mandate reimbursement claims:

> As to the first criterion—whether the rule is intended to apply generally—substantial evidence supports the trial court's finding that the CSDR was "applie[d] generally to the auditing of reimbursement claims ...; the Controller's auditors ha[d] no discretion to judge on a case[-]by[-]case basis whether to apply the rule."[151]

Therefore, a "class of cases" must be identifiable; in *Grier*, as noted above, the court concurred with OAL's determination that "this particular audit method was a standard of general application 'applied in *every Medi-Cal case* reviewed by [Department] audit teams…'"[152] Here, of the 44 completed audits of the Notification of Truancy mandate, some do not apply a statistical sampling and extrapolation methodology to calculate a reduction;[153] others apply a sampling and extrapolation method to determine whether the notifications issued complied with

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

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

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

[152] *Grier*, *supra*, 219 Cal.App.3d 422, 434-435.

[153] See, e.g., Exhibit G, Audit of Sweetwater Union High School District, *Notification of Truancy*, fiscal years 2006-2007 through 2009-2010 [In this audit report the Controller reduced based on the claimant's failure to comply with the notification requirements of section 48260.5, rather than performing a sampling and estimation audit to determine whether notifications were issued in compliance with section 48260.].

the eight required elements under section 48260.5;[154] and still others use sampling and extrapolation methods to determine the proportion of notifications issued that were supported by documentation, including attendance records, rather than the proportion unallowable based on absences, as here.[155] The claimant has argued that these examples are not factually relevant, and that "[i]t is not that every audit must be a *Tidewater* 'case' to support the concept of generality…but more logically it is that if the *factual circumstances* are present that are amenable to the use of sampling and whether sampling was used, rather than another audit method…"[156] The Commission disagrees. In *Taye*, *supra*, the court gave substantial weight to the declaration of the auditor, LaPlaunt, who explained:

> While all audits are performed along generally accepted audit principles, these principles are not intended to be steadfast rules from which deviation is prohibited. In the twelve years that I have been employed as an auditor for the California State Controller's Office, I have been involved in numerous audits varying in subject and complexity. In these endeavors, I have found that the flexibility to adopt auditing principles to unique situations, including treatment of inventory, is imperative in the successful completion of an audit.[157]

The Controller has explained here, along similar lines, that "Government Auditing Standards," issued by the Comptroller General of the United States, provide "professional standards and guidance…" which includes recommendations for the use of a statistical sampling approach, as needed.[158]

Moreover, the sampling and extrapolation method is not published in the claiming instructions for this mandate, as was the case in *Clovis Unified*; to the extent the sampling and extrapolation methodology implements, interprets, or makes specific the law enforced or administered by the Controller, a published policy might well be dispositive of the issue. In *Tidewater*, *supra*, the DLSE policy at issue was formalized in its "Operations and Procedures Manual," and was "expressly intended as a rule of general application to guide deputy labor commissioners on the applicability of IWC wage orders to a particular type of employment." There is no evidence in this record of any formalized policy, or any intent to require all field auditors to perform their audits in a particular manner.

Therefore, because the evidence in the record does not reflect the formalization in written policy or guidance for field auditors of the challenged sampling and extrapolation methodology; and

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[154] See, e.g., Exhibit G, Audit of Colton Joint Unified School District, *Notification of Truancy*, fiscal years 1999-2000 through 2001-2002, issued November 26, 2003 [In this audit report the Controller found, based on examining a small sample, that the letters distributed did not contain the five required elements.].

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

[156] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 5.

[157] *Taye*, *supra*, 29 Cal.App.4th 1339, 1345.

[158] Exhibit C, Controller's Late Comments on IRC, page 16.

because there is no evidence that auditors were deprived of discretion whether to use the challenged methodology, the record does not support a finding by the Commission that the sampling and extrapolation methodology constitutes a regulation generally applied to a class of cases. Moreover, the Commission takes official notice, as discussed above, that sampling and extrapolation has not be used in every audit of the *Notification of Truancy* program, and where it has been used, it has been applied in a number of different ways, to justify a number of different reductions.[159]

Based on the case law discussed above, and the evidence in the record, the Commission finds that the Controller's sampling and extrapolation method, as applied in this case, is not a regulation within the meaning of the APA.

2. The Controller's audit conclusions must be upheld absent evidence that the Controller's reductions are arbitrary, capricious, or entirely lacking in evidentiary support.

The claimant argues that there is no statutory or regulatory authority for the Controller to reduce claimed costs based on extrapolation from a statistical sample. The Controller counters that the law does not prohibit the audit methods used by the Controller. The Controller relies on Government Code section 12410, which requires the Controller to audit all claims against the state and "may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment."[160] The Controller also relies on Government Code section 17561, which permits the Controller to reduce any claim that is determined to be excessive or unreasonable: "The SCO conducted appropriate statistical samples that identified a *reasonable* estimate of the non-reimbursable initial truancy notifications, thus properly reducing the claims for the *unreasonable* claimed costs."[161]

Based on the analysis herein, the Commission finds that the Controller's audit conclusions must be upheld absent evidence that the Controller's reductions are arbitrary, capricious, or entirely lacking in evidentiary support.

The Controller correctly states that there is no express prohibition in law or regulation of statistical sampling and extrapolation methods being used in an audit. The Controller's authority to audit is commonly described in the broadest terms: article XVI, section 7 states that "Money may be drawn from the Treasury only through an appropriation made by law and upon a Controller's duly drawn warrant."[162] Government Code section 12410 provides that the

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[159] See Exhibit G, Audit Reports for the *Notification for Truancy* program. Under the Commission's regulations, the Commission has the authority to take official notice of any fact which may be judicially noticed by the courts. (Cal. Code Regs., tit. 2, § 1187.5(c); Gov. Code, § 11515.) Evidence Code section 452(c) authorizes the court to take judicial notice of the official records and files of the executive branch of state government, including the official records of the State Controller's Office. (See also, *Chas L. Harney, Inc. v. State* (1963) 217 Cal.App.2d 77, 86.)

[160] Government Code section 12410 (Stats. 1968, ch. 449).

[161] Exhibit C, Controller's Late Comments on IRC, page 20 [emphasis in original].

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

Controller "shall superintend the fiscal concerns of the state…" and "shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment."[163]

With respect to mandate reimbursement, the Controller's audit authority is more specifically articulated. Article XIII B, section 6 provides that "the State shall provide a subvention of funds to reimburse…local government for the costs of the program or increased level of service…" whenever the Legislature or a state agency mandates a new program or higher level of service.[164] Government Code section 17561, accordingly, provides that the state "shall reimburse each local agency and school district for *all* 'costs mandated by the state,' as defined in Section 17514…" Section 17561 also provided, at the time the audit of the subject claims was conducted, in 2009 and 2010, the following:

> In subsequent fiscal years each local agency or school district shall submit its claims as specified in Section 17560. The Controller shall pay these claims from funds appropriated therefor except as follows: (A) The Controller may audit any of the following: (i) Records of any local agency or school district to verify the actual amount of the mandated costs. (ii) The application of a reasonable reimbursement methodology. (iii) The application of a legislatively enacted reimbursement methodology under Section 17573. (B) The Controller may reduce any claim that the Controller determines is excessive or unreasonable. (C) The Controller shall adjust the payment to correct for any underpayments or overpayments that occurred in previous fiscal years.[165]

The parameters and guidelines for the *Notification of Truancy* mandate predate the statutory authorization for a "reasonable reimbursement methodology," as defined in sections 17518.5 and 17557; however, a unit cost, which was adopted for this program, is included within the definition of a "reasonable reimbursement methodology."[166] Thus the Controller's audit authority pursuant to section 17561 expressly authorizes an audit of a claim based on a unit cost reimbursement scheme. The statutes, however, do not address how the Controller is to audit and verify the costs mandated by the state.

Accordingly, the Controller cites to Government Auditing Standards, issued by the Comptroller General of the United States, to argue that it properly conducted the audit. "These audit standards," the Controller asserts, "specify that auditors may use professional judgment in 'selecting the methodology, determining the type and amount of evidence to be gathered, and choosing the tests and procedures for their work.'"[167] While the standards cited do not provide

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[163] Statutes 1968, chapter 449.

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

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

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

[167] Exhibit C, Controller's Late Comments on IRC, page 17.

for statistical sampling and extrapolation to be applied to mandate reimbursement, they do provide for statistical methods to be used to establish the sufficiency, or validity of evidence generally.[168] The Controller also cites the "Handbook of Sampling for Auditing and Accounting," by Herbert Arkin, for the proposition that a sampling methodology to determine the frequency of errors in the population (i.e., notifications that were not reimbursable for an asserted legal reason) is a widely used approach to auditing.[169]

In accordance with the Controller's audit authority and duties under the Government Code, it is not the Commission's purview to direct the Controller to employ a specific audit method, including when the audit pertains to the application of a unit cost, as here. The Commission's consideration is limited to whether the Controller's reduction of costs based on audit decisions is arbitrary, capricious, or entirely lacking in evidentiary support.[170] Based on the standards and texts cited by the Controller, statistical methods are an appropriate and commonly-used tool in auditing. The claimant, too, concedes that "[a] statistically valid sample methodology is a recognized audit tool for some purposes."[171]

In fact, statistical sampling methods such as those employed here are used in a number of other contexts and have not been held, in themselves, to be arbitrary and capricious, or incorrect as a matter of law. As discussed above, when the Department of Health Services used statistical sampling and extrapolation to determine the amount of over- or under-payment in the context of Medi-Cal reimbursement to health care providers in *Grier v. Kizer*[172] and *Union of American Physicians and Dentists v. Kizer*[173] (*UAPD*), those methods were disapproved by the courts only on the ground that they constituted a regulation not adopted in accordance with the APA, rather than on the substantive question whether statistical sampling and extrapolation was a permissible methodology for auditing.[174] Once the Department adopted a regulation in accordance with the APA – a reaction to the proceedings in *Grier* – the court in *UAPD* had no objection to the methodology on its merits.[175] Thus, after *Grier*, the Department of Health Services has both regulatory and statutory authority for its sampling and extrapolation audit process.[176]

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[168] Exhibit G, Excerpt from Government Auditing Standards, 2003, page 13.

[169] Exhibit C, Controller's Late Comments on IRC, page 17.

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

[171] Exhibit A, IRC 10-904133-I-10, page 16.

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

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

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

[175] *Union of American Physicians and Dentists, supra*, 223 Cal.App.3d 490, 504-505 [finding that the statistical audit methodology did not have retroactive effect because it did not alter the legal significance of past events (i.e., the amount of compensation to which a Medi-Cal provider was entitled)].

[176] See, e.g., Welfare and Institutions Code section 14170(b) (added, Stats. 1992, ch. 722 (SB 485); Code of Regulations, title 22, section 51458.2 (Register 1988, No. 17).

In addition to the Medi-Cal reimbursement context, the courts have declined to reject the use of statistical sampling and extrapolation to calculate damages due to plaintiffs in a class action or other mass tort action.[177] And, in a case addressing audits of county welfare agencies, the court declined to consider whether the sampling and extrapolation procedures were legally proper, instead finding that counties were not required to be solely responsible for errors "which seem to be inherent in public welfare administration."[178]

On that basis, and giving due consideration to the discretion of the Controller to audit the fiscal affairs of the state,[179] the Commission finds that it must uphold the Controller's auditing decisions absent evidence that the audit reductions are arbitrary, capricious, or entirely lacking in evidentiary support.

3. There is no evidence in the record that the Controller's findings using the sampling and extrapolation methodology are not representative of all notices claimed during the audit period or that the findings are arbitrary, capricious, or entirely lacking in evidentiary support.

In addition to challenging the legal sufficiency of the Controller's sampling and extrapolation methodology, the claimant also challenges the qualitative and quantitative reliability and fairness of using statistical sampling and extrapolation to evaluate reimbursement. The claimant further states that the risk of extrapolating findings from a sample is that the conclusions obtained from the sample may not be representative of the universe. In this respect, the claimant asserts that a kindergarten pupil is more likely to be under-age and a special education pupil is more likely to be over-age, and, thus, the extrapolation from the samples would not be representative of the universe.[180] The claimant further contends that the sampling technique used by the Controller is also quantitatively non-representative because less than two percent of the total number of notices were audited, the stated precision rate was plus or minus eight percent even though the sample size (ranging from 147 to 148) is essentially identical for all fiscal years, and that the audited number of notices claimed for fiscal year 2004-2005 (19,101) is twenty-two percent larger than the number of notices claimed for fiscal year 2005-2006 (15,645). The claimant concludes by stating that "[t]he expected error rate is stated to be 50%, which means the total amount adjusted of $98,866 is really just a number exactly between $49,433 (50%) and $148,299 (150%)" and that "[t]he midrange of an interval cannot be used as a finding of absolute actual cost."[181]

The Controller disagrees with the claimant's assertions that the sampling is non-representative of all notices claimed. The Controller states that "the fact that a particular student's initial truancy notification might more likely be identified as non-reimbursable is irrelevant to the composition of the audit sample itself. It has no bearing on evaluating whether the sample selection is

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

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

[179] Government Code section 12410 (Stats. 1968, ch. 449).

[180] Exhibit A, IRC 10-904133-I-10, pages 17-18.

[181] Exhibit A, IRC 10-904133-I-10, page 19.

representative of the population."[182] The Controller cites to Arkin's *Handbook of Sampling for Auditing and Accounting*, page 9:

> Since the [statistical] sample is objective and unbiased, it is not subject to questions that might be raised relative to a judgment sample. Certainly a complaint that the auditor had looked only at the worst items and therefore biased the results would have not standing. This results from the fact that an important feature of this method of sampling is that all entries or documents have an equal opportunity for inclusion in the sample.[183]

The Controller further states that the district apparently reached the conclusion that the sampling was quantitatively non-representative because the sample sizes were essentially consistent, while the applicable population size varied. The Controller argues that the absolute size of the sample, not the relative size, is more important under "basic statistical sampling principles." The Controller explains that an "expected error rate" in this context is an assumption used to determine the appropriate sample size, rather than a measure of the ultimate accuracy of the result. In other words, when "the auditor has no idea whatsoever of what to expect as the maximum rate of occurrence or does not care to make an estimate…" an expected error rate of 50 percent as the beginning assumption will provide "the most conservative possible sample size estimate" in order to achieve the precision desired.[184] In addition, the desired accuracy of the result, which might be called a "margin of error," is determined by the auditor before calculating the sample size (shown below as "SE = desired sample precision"). Therefore, the "margin of error" of the Controller's resulting percentage is a known value. The Controller relies on the following formula outlined in Arkin's *Handbook of Sampling for Auditing and Accounting* to calculate the sample size:

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

n = sample size

p = percent of occurrence in population (expected error rate)

SE = desired sample precision

t = confidence level factor

N = population size[185]

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[182] Exhibit C, Controller's Late Comments on IRC, page 18.

[183] Exhibit C, Controller's Late Comments on IRC, page 18 [Citing Herbert Arkin, *Handbook of Sampling for Auditing and Accounting*, Third Edition, Prentice Hall, New Jersey, 1984, page 9].

[184] Exhibit C, Controller's Late Comments on IRC, page 20 [Citing Herbert Arkin, *Handbook of Sampling for Auditing and Accounting*, Third Edition, Prentice Hall, New Jersey, 1984, page 89].

[185] *Ibid.*

Thus, applying the formula above to the population of elementary and secondary notices in this case, with a 50 percent expected error rate (the "most conservative sample size estimate" when an error rate is not known) and a desired eight percent margin of error, as stated in the audit report, shows that an appropriate sample size for each level of elementary and secondary schools is between 147 and 148 notices for populations ranging from 7,562 to 9,706 notifications issued either by elementary or secondary schools during the audit period.[186]

Moreover, there is no evidence in the record that the results are biased or unrepresentative "because a kindergarten pupil is more likely to be under-age and a special education pupil is more likely to be over-age," as asserted by claimant. There is no dispute that the samples were randomly obtained and reviewed by the Controller. According to the *Handbook of Sampling for Auditing and Accounting* (Arkin), all notices randomly sampled have an equal opportunity for inclusion in the sample and, thus, the result is statistically objective and unbiased.[187] Moreover, absent evidence, the Commission and the Controller must presume that the schools within the claimant's district complied with the mandate in the same way.

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

V. Conclusion

The Commission finds that the following reductions are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support:

- Reductions in Finding 1 based on the ground that the claimant provided no documentation to support the number of notifications distributed.
- Reductions in Finding 2 based on notifications issued for pupils who did not accrue three or more unexcused absences or instances of tardiness while between ages six and 18.
- Reductions in Finding 2 for notifications issued for pupils who accumulated *fewer than three* unexcused absences or instances of tardiness.
- Reduction in Finding 2 of one pupil's notification for which the Controller found insufficient documentation.
- The Controller's sampling and extrapolation methodology to calculate the reductions is not arbitrary, capricious, or entirely lacking in evidentiary support, to the extent that the underlying reasons for reduction are valid.

The following reductions, including any extrapolation of these reductions to costs claimed by the district, however, are incorrect as a matter of law, and are arbitrary, capricious, or entirely lacking in evidentiary support:

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[186] Exhibit C, Controller's Late Comments on IRC, page 20.

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

- Reductions in Finding 2 based on notifications issued for pupils who accumulated *three but not four* unexcused absences or instances of tardiness.
- The Extrapolation of additional reductions based on one pupil's notification for which the Controller found insufficient documentation.

Pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, the Commission requests that costs incorrectly reduced be reinstated by the Controller in accordance with this decision.

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RE: **Decision**

Notification of Truancy, 10-904133-I-10 and 13-904133-I-12
Education Code Section 48260.5
Statutes 1983, Chapter 498
Fiscal Years: 2003-2004, 2004-2005, 2005-2006, and 2006-2007
Riverside Unified School District, Claimant

On December 3, 2015, the foregoing decision of the Commission on State Mandates was adopted on the above-entitled matter.

Baddill for
Heather Halsey, Executive Director

Dated: December 9, 2015

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

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

On December 9, 2015, I served the:

Decision
Notification of Truancy, 10-904133-I-10 and 13-904133-I-12
Education Code Section 48260.5
Statutes 1983, Chapter 498
Fiscal Years: 2003-2004, 2004-2005, 2005-2006, and 2006-2007
Riverside Unified School District, Claimant

By making it available on the Commission's website and providing notice of how to locate it to the email addresses provided on the attached mailing list.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on December 9, 2015 at Sacramento, California.

Jill Magee

Jill L. Magee
Commission on State Mandates
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COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 10/29/15

Claim Number: 10-904133-I-10 and 13-904133-I-12

Matter: Notification of Truancy

Claimant: Riverside Unified School District

TO ALL PARTIES, INTERESTED PARTIES, AND INTERESTED PERSONS:

Each commission mailing list is continuously updated as requests are received to include or remove any party or person on the mailing list. A current mailing list is provided with commission correspondence, and a copy of the current mailing list is available upon request at any time. Except as provided otherwise by commission rule, when a party or interested party files any written material with the commission concerning a claim, it shall simultaneously serve a copy of the written material on the parties and interested parties to the claim identified on the mailing list provided by the commission. (Cal. Code Regs., tit. 2, § 1181.3.)

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