

# ORANGE COUNTY

Revised Audit Report

## **CONSOLIDATED HANDICAPPED AND DISABLED STUDENTS (HDS), HDS II, AND SEDP PROGRAM**

Chapter 1747, Statutes of 1984; Chapter 1274,  
Statutes of 1985; Chapter 1128, Statutes of 1994;  
and Chapter 654, Statutes of 1996

*July 1, 2006, through June 30, 2009*



**JOHN CHIANG**  
California State Controller

December 2012



**JOHN CHIANG**  
**California State Controller**

December 3, 2012

Honorable John M.W. Moorlach,  
CPA, CFP, Chair  
Board of Supervisors  
Orange County  
10 Civic Center Plaza  
Santa Ana, CA 92701

Dear Mr. Moorlach:

The State Controller's Office audited the costs claimed by Orange County for the legislatively mandated Consolidated Handicapped and Disabled Students (HDS), HDS II, and Seriously Emotionally Disturbed Pupils (SEDP) Program (Chapter 1747, Statutes of 1984; Chapter 1274, Statutes of 1985; Chapter 1128, Statutes of 1994; and Chapter 654, Statutes of 1996) for the period of July 1, 2006, through June 30, 2009.

This revised final report supersedes our previous report dated March 7, 2012. Subsequent to the issuance of our final report, the California Department of Mental Health finalized its Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) revenues for fiscal year (FY) 2008-09. We recalculated EPSDT revenues for FY 2008-09 and revised Finding 4 to reflect the actual funding percentage based on the final settlement. As a result, allowable costs increased by \$51,592 for the audit period.

The county claimed \$20,228,242 (\$20,248,242 less a \$20,000 penalty for filing late claims) for the mandated program. Our audit disclosed that \$16,451,818 is allowable and \$3,776,424 is unallowable. The costs are unallowable primarily because the county claimed ineligible vendor payments for out-of-state residential placement of seriously emotionally disturbed pupils in facilities that are owned and operated for profit, and overstated mental health services, administrative costs, and offsetting revenues. The State paid the county \$4,246,570. The State will pay allowable costs claimed that exceed the amount paid, totaling \$12,205,248, contingent upon available appropriations.

If you disagree with the audit findings, you may file an Incorrect Reduction Claim (IRC) with the Commission on State Mandates (CSM). The IRC must be filed within three years following the date that we notify you of a claim reduction. You may obtain IRC information at the CSM's website at [www.csm.ca.gov/docs/IRCForm.pdf](http://www.csm.ca.gov/docs/IRCForm.pdf).

If you have any questions, please contact Jim L. Spano, Chief, Mandated Cost Audits Bureau, at (916) 323-5849.

Sincerely,

*Original signed by*

**JEFFREY V. BROWNFIELD**  
Chief, Division of Audits

JVB/sk

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# Revised Audit Report

## Summary

The State Controller's Office (SCO) audited the costs claimed by Orange County for the legislatively mandated Consolidated Handicapped and Disabled Students (HDS), HDS II, and Seriously Emotionally Disturbed Pupils (SEDP) Program (Chapter 1747, Statutes of 1984; Chapter 1274, Statutes of 1985; Chapter 1128, Statutes of 1994; and Chapter 654, Statutes of 1996) for the period of July 1, 2006, through June 30, 2009.

The county claimed \$20,228,242 (\$20,248,242 less a \$20,000 penalty for filing late claims) for the mandated program. Our audit disclosed that \$16,451,818 is allowable and \$3,776,424 is unallowable. The costs are unallowable primarily because the county claimed ineligible vendor payments for out-of-state residential placement of seriously emotionally disturbed pupils in facilities that are owned and operated for profit, and overstated mental health services, administrative costs, and offsetting revenues. The State paid the county \$4,246,570. The State will pay allowable costs claimed that exceed the amount paid, totaling \$12,205,248, contingent upon available appropriations.

## Background

### Handicapped and Disabled Students (HDS) Program

Chapter 26 of the Government Code, commencing with section 7570, and Welfare and Institutions Code section 5651 (added and amended by Chapter 1747, Statutes of 1984, and Chapter 1274, Statutes of 1985) require counties to participate in the mental health assessment for "individuals with exceptional needs," participate in the expanded "Individualized Education Program" (IEP) team, and provide case management services for "individuals with exceptional needs" who are designated as "seriously emotionally disturbed." These requirements impose a new program or higher level of service on counties.

On April 26, 1990, the Commission on State Mandates (CSM) adopted the statement of decision for the HDS Program and determined that this legislation imposed a state mandate reimbursable under Government Code section 17561. The CSM adopted the parameters and guidelines for the HDS Program on August 22, 1991, and last amended them on January 25, 2007.

The parameters and guidelines for the HDS Program state that only 10% of mental health treatment costs are reimbursable. However, on September 30, 2002, Assembly Bill 2781 (Chapter 1167, Statutes of 2002) changed the regulatory criteria by stating that the percentage of treatment costs claimed by counties for fiscal year (FY) 2000-01 and prior fiscal years is not subject to dispute by the SCO. Furthermore, this legislation states that, for claims filed in FY 2001-02 and thereafter, counties are not required to provide any share of these costs or to fund the cost of any part of these services with money received from the Local Revenue Fund established by Welfare and Institutions Code section 17600 et seq. (realignment funds).

Furthermore, Senate Bill 1895 (Chapter 493, Statutes of 2004) states that realignment funds used by counties for the HDS Program “are eligible for reimbursement from the state *for all allowable costs* to fund assessments, psychotherapy, and other mental health services . . .” and that the finding by the Legislature is “declaratory of existing law” (emphasis added).

The CSM amended the parameters and guidelines for the HDS Program on January 26, 2006, and corrected them on July 21, 2006, allowing reimbursement for out-of-home residential placements beginning July 1, 2004.

#### Handicapped and Disabled Students (HDS II) Program

On May 26, 2005, the CSM adopted a statement of decision for the HDS II Program that incorporates the above legislation and further identified medication support as a reimbursable cost effective July 1, 2001. The CSM adopted the parameters and guidelines for this new program on December 9, 2005, and last amended them on October 26, 2006.

The parameters and guidelines for the HDS II Program state that “Some costs disallowed by the State Controller’s Office in prior years are now reimbursable beginning July 1, 2001 (e.g., medication monitoring). Rather than claimants re-filing claims for those costs incurred beginning July 1, 2001, the State Controller’s Office will reissue the audit reports.” Consequently, we are allowing medication support costs commencing on July 1, 2001.

#### Seriously Emotionally Disturbed Pupils (SEDP) Program

Government Code section 7576 (added and amended by Chapter 654, Statutes of 1996) allows new fiscal and programmatic responsibilities for counties to provide mental health services to seriously emotionally disturbed pupils placed in out of state residential programs. Counties’ fiscal and programmatic responsibilities include those set forth in Title 2, *California Code of Regulations*, section 60100, which provide that residential placements may be made out-of-state only when no in-state facility can meet the pupil’s needs.

On May 25, 2000, the CSM adopted the statement of decision for the Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services (SEDP) Program and determined that Chapter 654, Statutes of 1996, imposed a state mandate reimbursable under Government Code section 17561. The CSM adopted the parameters and guidelines for the SEDP Program on October 26, 2000. The CSM determined that the following activities are reimbursable:

- Payment for out-of-state residential placements;
- Case management of out-of-state residential placements. Case management includes supervision of mental health treatment and monitoring of psychotropic medications;

- Travel to conduct quarterly face-to-face contacts at the residential facility to monitor level of care, supervision, and the provision of mental health services as required in the pupil's IEP; and
- Program management, which includes parent notifications as required; payment facilitation; and all other activities necessary to ensure that a county's out-of-state residential placement program meets the requirements of Government Code section 7576.

The CSM consolidated the parameters and guidelines for the HDS, HDS II, and SEDP Programs for costs incurred commencing with FY 2006-07 on October 26, 2006, and last amended them on September 28, 2012, stating that the consolidated program is no longer mandated for counties beginning July 1, 2011. The consolidated program replaced the prior HDS, HDS II, and SEDP mandated programs. The parameters and guidelines establish the state mandate and define reimbursable criteria. In compliance with Government Code section 17558, the SCO issues claiming instructions to assist local agencies and school districts in claiming mandated program reimbursable costs.

## **Objective, Scope, and Methodology**

We conducted the audit to determine whether costs claimed represent increased costs resulting from the Consolidated HDS, HDS II, and SEDP Program for the period of July 1, 2006, through June 30, 2009.

Our audit scope included, but was not limited to, determining whether costs claimed were supported by appropriate source documents, were not funded by another source, and were not unreasonable and/or excessive.

We conducted this performance audit under the authority of Government Code sections 12410, 17558.5, and 17561. We did not audit the county's financial statements. We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We limited our review of the county's internal controls to gaining an understanding of the transaction flow and claim preparation process as necessary to develop appropriate auditing procedures.

## **Conclusion**

Our audit disclosed instances of noncompliance with the requirements outlined above. These instances are described in the accompanying Summary of Program Costs (Schedule 1) and in the Findings and Recommendations section of this report.

For the audit period, Orange County claimed \$20,228,242 (\$20,248,242 less a \$20,000 penalty for filing late claims) for costs of the Consolidated HDS, HDS II, and SEDP Program. Our audit disclosed that \$16,451,818 is allowable and \$3,776,424 is unallowable.

For the FY 2006-07 claim, the State paid the county \$4,246,570. Our audit disclosed that \$4,246,570 is allowable.

For the FY 2007-08 claim, the State made no payment to the county. Our audit disclosed that \$7,475,738 is allowable. The State will pay allowable costs claimed that exceed the amount paid, totaling \$7,475,738, contingent upon available appropriations.

For the FY 2008-09 claim, the State made no payment to the county. Our audit disclosed that \$4,729,510 is allowable. The State will pay allowable costs claimed that exceed the amount paid, totaling \$4,729,510, contingent upon available appropriations.

**Views of  
Responsible  
Official**

We issued a draft audit report on February 6, 2012. Mark A. Refowitz, Deputy Agency Director, responded by letter dated February 27, 2012 (Attachment), disagreeing with the audit results for Finding 1 and agreeing with the audit results for the remaining findings. We issued the final report on March 7, 2012.

Subsequently, we revised our audit report based on finalized Early and Periodic Screening, Diagnosis, and Treatment revenues for FY 2008-09. We recalculated offsetting revenues and revised Finding 4. As a result, allowable costs increased by \$51,592 for the audit period. On November 6, 2012, we advised Celia Diaz-Garcia, Manager, Behavioral Health Claims, Health Care Agency Accounting, of the revisions. Ms. Diaz-Garcia agreed to the revision made in Finding 4.

**Restricted Use**

This report is solely for the information and use of Orange County, the California Department of Finance, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

December 3, 2012

## Revised Schedule 1— Summary of Program Costs July 1, 2006, through June 30, 2009

Cost Elements	Actual Costs Claimed	Allowable Per Audit	Audit Adjustments	Reference <sup>1</sup>
<u>July 1, 2006, through June 30, 2007</u>				
Direct costs:				
Authorize/issue payments to providers	\$ 9,231,577	\$ 7,685,453	\$ (1,546,124)	Finding 1
Psychotherapy/other mental health costs	10,304,741	10,243,013	(61,728)	Finding 2
Participation in due process	317,554	317,554	-	
Total direct costs	19,853,872	18,246,020	(1,607,852)	
Indirect costs	3,317,317	3,263,174	(54,143)	Finding 3
Total direct and indirect costs	23,171,189	21,509,194	(1,661,995)	
Offsetting revenues	(17,270,519)	(17,252,624)	17,895	Finding 4
Subtotal	5,900,670	4,256,570	(1,644,100)	
Less late claim penalty	(10,000)	(10,000)	-	
Total program cost	<u>\$ 5,890,670</u>	4,246,570	<u>\$ (1,644,100)</u>	
Less amount paid by the State <sup>2</sup>		(4,246,570)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ -</u>		
<u>July 1, 2007, through June 30, 2008</u>				
Direct costs:				
Authorize/issue payments to providers	\$ 10,969,480	\$ 9,046,965	\$ (1,922,515)	Finding 1
Psychotherapy/other mental health costs	10,883,016	10,837,649	(45,367)	Finding 2
Participation in due process	293,969	293,969	-	
Total direct costs	22,146,465	20,178,583	(1,967,882)	
Indirect costs	2,782,305	2,750,246	(32,059)	Finding 3
Total direct and indirect costs	24,928,770	22,928,829	(1,999,941)	
Offsetting revenues	(15,523,775)	(15,453,091)	70,684	Finding 4
Subtotal	9,404,995	7,475,738	(1,929,257)	
Less late claim penalty	-	-	-	
Total program cost	<u>\$ 9,404,995</u>	7,475,738	<u>\$ (1,929,257)</u>	
Less amount paid by the State		-		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 7,475,738</u>		
<u>July 1, 2008, through June 30, 2009</u>				
Direct costs:				
Authorize/issue payments to providers	\$ 10,540,143	\$ 10,264,171	\$ (275,972)	Finding 1
Psychotherapy/other mental health costs	10,828,666	10,880,857	52,191	Finding 2
Participation in due process	278,541	278,541	-	
Total direct costs	21,647,350	21,423,569	(223,781)	
Indirect costs	2,783,471	2,811,008	27,537	Finding 3
Total direct and indirect costs	24,430,821	24,234,577	(196,244)	
Offsetting revenues:	(19,488,244)	(19,495,067)	(6,823)	Finding 4
Subtotal	4,942,577	4,739,510	(203,067)	
Less late claim penalty	(10,000)	(10,000)	-	
Total program cost	<u>\$ 4,932,577</u>	4,729,510	<u>\$ (203,067)</u>	
Less amount paid by the State		-		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 4,729,510</u>		

## Revised Schedule 1 (continued)

Cost Elements	Actual Costs Claimed	Allowable Per Audit	Audit Adjustments	Reference <sup>1</sup>
<u>Summary - July 1, 2006, through June 30, 2009</u>				
Direct costs:				
Authorize/issue payments to providers	\$ 30,741,200	\$ 26,996,589	\$ (3,744,611)	
Psychotherapy/other mental health costs	32,016,423	31,961,519	(54,904)	
Participation in due process	890,064	890,064	-	
Total direct costs	63,647,687	59,848,172	(3,799,515)	
Indirect costs	8,883,093	8,824,428	(58,665)	
Total direct and indirect costs	72,530,780	68,672,600	(3,858,180)	
Offsetting revenues	(52,282,538)	(52,200,782)	81,756	
Subtotal	20,248,242	16,471,818	(3,776,424)	
Less late claim penalty	(20,000)	(20,000)	-	
Total program cost	<u>\$ 20,228,242</u>	16,451,818	<u>\$ (3,776,424)</u>	
Less amount paid by the State		(4,246,570)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 12,205,248</u>		

<sup>1</sup> See the Findings and Recommendations section.

<sup>2</sup> County received Categorical payment from the California Department of Mental Health from the FY 2009-10 Budget.

# Revised Findings and Recommendations

## FINDING 1— Ineligible vendor costs

The county overstated vendor costs by \$3,744,611 for the audit period.

The county claimed ineligible vendor payments totaling \$3,738,045, which included treatment costs of \$1,963,381 and board-and-care costs of \$1,774,664 for out-of-state residential placement of seriously emotionally disturbed pupils in facilities that are owned and operated for profit. In addition, the county's claim for fiscal year (FY) 2006-07 included \$6,566 in board-and-care costs related to residential placements for FY 2005-06. We removed the prior year costs from the FY 2006-07 claim and applied them as additional costs in our previous audit report for FY 2005-06 claim.

The following table summarizes the ineligible costs:

	Fiscal Year			Total
	2006-07	2007-08	2008-09	
Ineligible placements:				
Treatment costs	\$ (791,853)	\$ (1,021,380)	\$ (150,148)	\$ (1,963,381)
Board-and-care costs	(747,705)	(901,135)	(125,824)	(1,774,664)
Ineligible prior year costs	(6,566)	-	-	(6,566)
Audit adjustment	<u>\$ (1,546,124)</u>	<u>\$ (1,922,515)</u>	<u>\$ (275,972)</u>	<u>\$ (3,744,611)</u>

The program's parameters and guidelines specify that the mandate is to reimburse counties for payments to vendors providing mental health services to pupils in out-of-state residential placements as specified in Government Code section 7576, and Title 2, *California Code of Regulations* (CCR), sections 60100 and 60110.

Title 2, CCR, section 60100, subdivision (h), specifies that out-of-state residential placements shall be made only in residential programs that meet the requirements of Welfare and Institutions Code section 11460, subdivision (c)(2) through (3). Welfare and Institutions Code section 11460, subdivision (c) (3), states that reimbursement shall be paid only to a group home, organized, and operated on a nonprofit basis.

The parameters and guidelines also specify that the State will reimburse only actual increased costs incurred to implement the mandated activities and supported by source documents that show the validity of such costs.

### Recommendation

The final report issued March 7, 2012, recommended the following:

We recommend that the county ensure that claims for out-of-state residential placements are made in accordance with laws and regulations. Further, we recommend that the county claim only eligible treatment and board-and-care costs corresponding to the authorized placement period for each eligible client.

On September 28, 2012, the CSM amended the parameters and guidelines, stating that Statutes of 2011, Chapter 43, “eliminated the mandated programs for counties and transferred responsibility to school districts, effective July 1, 2011. Thus, beginning July 1, 2011, these programs no longer constitute reimbursable state-mandated programs for counties.” Therefore, no recommendation is applicable for this audit.

### County’s Response

#### **1. California For-Profit Placement Restriction Is Incompatible with IDEA’s “Most Appropriate Placement” Requirement and Placement Provisions.**

Regardless of the State’s view of the validity of the residential facility contracts questioned by the Audit Reports, the State’s position in this matter is in glaring discord with the requirements of the federal Individuals and Disabilities Education Act (“IDEA”). This is because the IDEA requires that special education students are provided “the most appropriate placement,” and not the most appropriate nonprofit placement.

The stated purpose of the IDEA is “. . . to ensure that all children with disabilities have available to them. . . a free appropriate public education which emphasizes special education and related services designed to meet their unique needs. . . .” 20 U.S.C. § 1400(d)(1)(A). The “free appropriate public education” (FAPE) required by IDEA must be tailored to the unique needs of the handicapped child by means of an “individualized educational program.” 20 U.S.C. § 1401(9)(D); *Bd. of Educ. v. Rowley*, 458 U.S. 176, 181 (U.S. 1982). When a state receives funds under the IDEA, as does California, it must comply with the IDEA and its regulations. 34 C.F.R. § 300.2 (2006).

Local educational agencies (“LEAs”) initially were responsible for providing all special education services including mental health services when necessary. The passage of Assembly Bill 3632/882 transferred the responsibility for providing mental health services to the counties. In conjunction with special education mental health services, the IDEA requires that a state pay for a disabled student’s residential placement if the student, because of his or her disability, cannot reasonably be anticipated to benefit from instruction without such a placement. 34 C.F.R. § 300.302 (2006); *Indep. Schl. Dist. No. 284 v. A.C.*, 258 F.3d 769, 774 (8<sup>th</sup> Cir. 2001).

Before 1997, the IDEA required counties to place special education students in nonprofit residential placements only. In 1997, however, section 501 of the Personal Responsibility and Work Opportunity Responsibility Act of 1996 amended section 472(c)(2) of the Social Security Act (42 U.S.C. 672(c)(2)) to strike the nonprofit requirement. Section 472(c)(2) currently states:

The term “child-care institution” means a private child-care institution, or a public child-care institution which accommodates no more than twenty-five children, which is licensed by the State in which it is situated or has been approved, by the agency of such State responsible for

licensing or approval of institutions of this type, as meeting the standards established for such licensing, but the term shall not include detention facilities, forestry camps, training schools, or any other facility operated primarily for the detention of children who are determined to be delinquent.

In direct opposition to the IDEA, California's regulations limit special education residential placements to nonprofit facilities as follows:

. . . Out-of-state placements shall be made only in residential programs that meet the requirements of Welfare and Institutions Code Sections 11460(c)(2) through (c)(3). 2 C.C.R. § 60100(h).

. . . State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home organized and operated on a nonprofit basis. Welfare and Institutions Code § 11460(c)(3).

Therefore, California law is inconsistent with the requirements of IDEA and incompatible with its foremost purpose, i.e., to provide each disabled child with special education designed to meet that child's unique needs. 20 U.S.C. §1401(25). Indeed, special education students who require residential treatment are often the students with the most unique needs of all because of their need for the most restrictive level of placement. This need rules out California programs. The limited number of out-of-state residential facilities that are appropriate for special education student may not operate on a nonprofit basis. Thus, California's nonprofit requirement results in fewer appropriate services being available to the neediest children—those who can only benefit from their special education when placed in residential facilities.

It should also be noted that LEAs are not precluded by any similar nonprofit limitation. When special education children are placed in residential facilities, out-of-state LEAs can utilize education services provided by certified nonpublic, nonsectarian schools and other agencies operated on a for-profit basis. Educ. Code § 56366.1. Nonpublic schools are certified by the State of California when they meet the provisions of Education Code sections 56365 *et seq.* Nonprofit operation is *not* a requirement. Consequently, the two entities with joint responsibility for residential placement of special education students must operate within different criteria. This anomaly again leads to less available services for critically ill special education children.

## **2. California Office of Administrative Hearings Special Education Division Corroborates HCA's Contention that For-Profit Placement Restriction Is Incompatible With IDEA's "Most Appropriate Placement" Requirement and Placement Provisions.**

The principles set forth in Section 1 above were recently validated and corroborated by the State's own Office of Administrative Hearings ("OAH"), Special Education Division in OAH Case No. N 2007090403, *Student v. Riverside Unified School district and Riverside County Department of Mental Health*, decided January 15, 2008.

In the matter, the school district and mental health agency were unable to find a residential placement that could meet the student's unique mental health and communication needs. All parties agreed that a particular for-profit residential placement was the appropriate

placement for the student. Interpreting Title 2 of Cal. Code Regs., section 60100(h) and Welfare and Institutions Code section 11460(c)(2) through (c)(3) in the same fashion as the State Controller's Audits, the school district and mental health agency concluded that they could not place the student at the for-profit facility.

The OAH disagreed. In fact, it found that section 60100(h) of Title 2 of the California Code of Regulations did not prevent placement in a for-profit facility where no other appropriate placement existed for a child. *Student v. Riverside Unif. Sch. Dist. and Riverside Co. Dept. of Mental Health*, Case No. N 2007090403, January 15, 2008. Moreover, the OAH indicated such an interpretation "is inconsistent with the federal statutory and regulatory law by which California has chosen to abide." *Riverside Unif. Scho. Dist.* at p. 8.

The OAH declared that the fundamental purpose of legislation dealing with education systems is the welfare of the children. *Riverside Unif. Sch. Dist.* at p. 8, quoting *Katz v. Los Gatos-Saratoga Joint Union High School District*, 117 Cal. App. 4<sup>th</sup> 47, 63 (2004).

Like the school district and mental health agency in *Riverside*, the audits in question utilized a blanket, hard and fast rule that for-profit placements are never allowed, even when the placement itself indicates it is nonprofit, even when there is no other appropriate placement available, and even when the for-profit placement is in the best interests of the child. None of these factors were taken into consideration when the Audits determined that certain residential vendor expenses were ineligible for reimbursement.

**3. United States District Court has Affirmed the California Office of Administrative Hearings Special education division of *Student v. Riverside Unified School District and Riverside County Department of Mental Health.***

On July 20, 2009 the United States District Court, Central District of California, Eastern Division heard an appeal to reverse the Administrative Law Judge's decision in *Student v. Riverside Unified School District and Riverside County Department of Mental Health.* (See *Riverside County Department of Mental Health v. Sullivan et al*, Case No. EDCV 08-0503-SGL (RCx))

In that case, the U.S. District Court held that placement at the for-profit National Deaf Academy (NDA) was proper. The court went on to state that "California law does not prohibit placement at NDA and does not excuse compliance with IDEA." (*Id.* at 10).

In response to plaintiff arguments that California Administrative Code Section 60100(h)'s reference to WIC 11460(c)(2) through (c)(3) results in a prohibition in placing in for-profit facilities, the District court pointed out that Cal. Adm. Code Section 60000 provides that the intent of the chapter that Section 60100 appears "is to assure conformity with the federal Individuals with Disabilities Education Act or IDEA." (*Id.*) Section 60000 goes onto state, "[t]hus, provisions of this chapter shall be construed as supplemental to, and in the context of, federal and state laws and regulations relating to interagency responsibilities for providing services to pupils with disabilities." (*Id.*)

The State Controller's Office is bound by the decision of the United States District Court, discussed above. And the U.S. District Court specifically answered the question of whether out-of-state for-profit placements were prohibited under state law. That binding decision found that "California law does not prohibit placement at NDA and does not excuse compliance with IDEA."

Therefore, even assuming for argument sake, that the disallowed placements were "for-profit", the State is incorrect to disallow reimbursement for out-of-state for-profit placements for the audit periods without conducting further review as to whether an alternative nonprofit residential placement, that was able to provide FAPE, existed. Thus the State should reimburse the county for disallowed amounts.

#### **4. The County Contracted with Nonprofit Facilities**

For the audit period, the County believed, and still believes, it contracted with nonprofit facilities to provide all program services. The County cannot be held responsible if its nonprofit contractor in turn subcontracts with a for-profit entity to provide the services. This is not prohibited by California statute, regulation, or federal law.

Specifically, during the audit periods in question, the County contracted for out-of-state residential services with Mental Health Systems, Inc. (whose facilities include: Provo Canyon School and Logan River Academy), Aspen Solutions, Inc. (whose facilities include: island View, Aspen Ranch, Youth Care of Utah, and Sunhawk Academy), and Kids Behavioral Health of Alaska, Inc. (whose facility includes Copper Hills Youth Center). Each of the entities that the County contracted with are organized as nonprofit organizations. However these facilities were disallowed in the Draft Audit Report and are the subject of the County's disputes in this Draft Audit Response. The County contracted with these providers in a manner consistent with the requirements of the California Code of Regulations and Welfare and Institutions Code referenced above.

The County complies with a number of prerequisites before placing SED pupils in out-of-state residential facilities. For example, the pupil must be determined to be "emotionally disturbed" by his or her school district. In-state facilities must be unavailable or inappropriate. One of the County's procedural steps is to telephone the out-of-state facility to inquire about its nonprofit status. When advised that the facility is for-profit, that facility is no longer considered for SED pupil placement. When advised that the facility is nonprofit, the County obtains documentation of that status, e.g., an IRS tax determination letter.

Neither the federal nor the state government has provided procedures or guidelines to specify if and/or exactly how counties should determine for-profit or nonprofit status. Although counties have used many of these out-of-state residential facilities for SED student placement for years, the State only recently has begun to question their nonprofit status. Nor has the State ever provided the County with a list of facilities that it deems to be nonprofit, and therefore acceptable to the State. The State's history of paying these costs without question encouraged the County to rely upon the State's acceptance of prior claims for the very same facilities now characterized as for-profit.

Considering the foregoing, the conclusions of the Draft Audit lacks the “fundamental fairness” that even minimal procedural due process requires.

#### **5. Counties Face increased Litigation if Restricted to Nonprofit Residential Facilities.**

Under the IDEA, when parents of a special education pupil believe their child’s school district and/or county mental health agency breached their duties to provide the student with a free appropriate public education, the parents can seek reimbursement for the tuition and costs of a placement of a parents’ choice. The United States Supreme Court has ruled that parents who unilaterally withdraw their child from an inappropriate placement must be reimbursed by the placing party(ies). This is true even if the parents’ school placement does not meet state educational standards and is not state approved. *Florence County Sch. Dist. Four v. Carter by & Through Carter*, 510 U.S. 7 (U.S. 1993).

This means that in California, if there is no nonprofit placement to meet the unique needs of a special education child, his or her parents can place the child in *any* school of their choosing, regardless of educational standards, state approval, whether nonprofit or for-profit, etc., and then demand that the school district and/or mental health agency pay the bill. The California regulatory requirement for nonprofit residential placement prevents school districts and mental health agencies from selecting the most appropriate placement, regardless of tax status. Because of California’s arbitrary regulatory requirement, which is not in accord with the 1997 amendment to IDEA, school districts and mental health agencies may be forced to place a child in a less appropriate facility increasing the likelihood that the parents will choose a different facility. The placement agencies are thereafter legally required to subsidize the expenses of the parents’ unilateral choice, even if that unilateral placement does not meet the State’s nonprofit and academic standards. The decision in *Riverside* explained and cited above precisely mirrors such a situation.

#### **6. Federal and State Law Do Not Impose Tax Status Requirements on Provider Treatment Services.**

Special education mental health psychotherapy and assessment services must be conducted by qualified mental health professionals as specified in regulations developed by the State Department of Mental Health in consultation with the State Department of Education. California Government Code § 7572(c) These services can be provided directly or by contract at the discretion of county mental health agencies. 2 C.C.R. § 60020(i) Licensed practitioners include as “qualified mental health professionals” are listed in California Code of Regulations Title 2, section 60020(j). Neither section contains any requirements regarding the provider’s tax status. Because tax status has no bearing on eligibility for mental health provider services, there is no basis for disallowing these claimed treatment costs.

## **7. The State's Interpretation of WIC Section 11460(c)(3) Would Result in Higher State Reimbursement Costs.**

In conducting a review of the facilities that the State has disallowed reimbursement, it has become clear that the State's interpretation of WIC Section 11460(c)(3) would result in an overall increase in the cost of reimbursement.

This conclusion is based on a comparison between the cost of mental health services provided at residential facilities that are organized as for-profit versus the same costs at residential facilities that are organized as nonprofit. On average, we have found that nonprofit residential placements cost more than for-profit residential placements.

Clearly, it could not have been the intent of the drafters of WIC 11460(c)(3) to increase the cost of State reimbursement by limiting State reimbursement to group homes organized and operated on a nonprofit basis. The more reasonable interpretation of what the drafters intended was based on a (mistaken) assumption that nonprofit facilities are less expensive than for-profit facilities or a desire to mirror Federal IDEA law, which has since been modified to remove the nonprofit reimbursement restriction.

Therefore, to apply such an interpretation, without providing Counties any prior notice of the State's desire to enforce the code section in such a manner is clearly unfair and unreasonable, especially in light of the retroactive enforcement of the interpretation and the lack of any guidance provided by the State. Fairness requires that the state advise counties of its intent to enforce the interpretation moving forward, not retroactively. By providing counties advance notice of its intent to disallow a category of payment that has historically been reimbursed, would provide counties the ability to make adjustments and comply with the State's changed interpretation.

Thus, the State should reimburse County for all submitted amounts during the audit period.

### SCO's Comment

The finding remains unchanged. The residential placement issue is not unique to this county; other counties have voiced concerns about it as well. In 2008, the proponents of Assembly Bill (AB) 1805 sought to change California regulations and allow payments to for-profit facilities for placement of SED pupils. This legislation would have permitted retroactive application, so that any prior unallowable claimed costs identified by the SCO would be reinstated. However, the Governor vetoed this legislation on September 30, 2008. In the next legislative session, AB 421, a bill similar to AB 1805, was introduced to change the regulations and allow payments to for-profit facilities for placement of SED pupils. On January 31, 2010, AB 421 failed passage in the Assembly. Absent any legislative resolution, counties must continue to comply with the governing regulations cited in the SED Pupils: Out-of-State Mental Health Services Program's parameters and guidelines. Our response addresses each of the seven arguments set forth by the county in the order identified above.

**1. California For-Profit Placement Restriction Is Incompatible with IDEA's "Most Appropriate Placement" Requirement and Placement Provisions.**

The parameters and guidelines specify that the mandate is to reimburse counties for payments to service vendors providing mental health services to SED pupils in out-of-state residential placements as specified in Government Code section 7576 and Title 2, CCR, sections 60100 and 60110. Title 2, CCR, section 60100, subdivision (h), specifies that out-of-state residential placements shall be made only in residential programs that meet the requirements of Welfare and Institutions Code section 11460, subdivision (c)(2) through (3). Welfare and Institutions Code section 11460, subdivision (c)(3) states that reimbursement shall only be paid to a group home organized and operated on a nonprofit basis. The program's parameters and guidelines do not provide reimbursement for out-of-state residential placements made outside of California regulations.

We agree there is inconsistency between California law and federal law related to IDEA funds. Furthermore, we do not dispute the assertion that California law is more restrictive than federal law in terms of out-of-state residential placement of SED pupils. However, this is a State-mandated cost program and the county filed a claim seeking reimbursement from the State under the provisions of Title 2, CCR, section 60100.

We also agree that Education Code sections 56366.1 and 56365 do not restrict local educational agencies (LEAs) from contracting with for-profit schools for educational services. These sections specify that educational services must be provided by a school certified by the California Department of Education.

**2. California Office of Administrative Hearing Special Education Division Corroborates HCA's Contention that For-Profit Placement Restriction Is Incompatible With IDEA's "Most Appropriate Placement" Requirement and Placement Provisions.**

Office of Administrative Hearings (OAH) Case No. N 2007090403, *Student v. Riverside Unified School District and Riverside County Department of Mental Health*, is not legally binding on the SCO. In this case, the administrative law judge found that not placing the student in an appropriate facility (for-profit) was to deny the student a free, appropriate public education (FAPE) under federal regulations. The issue of funding residential placements made outside of the regulation was not specifically addressed. Nevertheless, this is a State-mandated cost program and the county filed a claim seeking reimbursement from the State under the provisions of Title 2, CCR, section 60100, and Welfare and Institutions Code section 11460, subdivision (c)(3). Residential placements made outside of the regulation are not reimbursable under the state-mandated cost program.

**3. United States District Court has Affirmed the California Office of Administrative Hearings Special Education Division of *Student v. Riverside Unified School District and Riverside County Department of Mental Health*.**

We do not dispute the decision made by the United States District Judge in *Student v. Riverside Unified School District and Riverside County Department of Mental Health v. Sullivan et al*, Case No. EDCV 08-0503-SGL (RCx). Further, we do not dispute that each student under the federal Individuals with Disabilities Education Act (IDEA) is entitled to a FAPE. However, as noted in our response to item #2, the issue of funding residential placements made outside of the regulations was not specifically addressed. Residential placements made outside of the regulation are not reimbursable under the State-mandated cost program.

**4. The County Contracted with Nonprofit Facilities.**

As noted in the finding, the mandate reimburses counties for payments to service vendors (group homes) providing mental health services to SED pupils in out-of-state residential placements that are organized and operated on a nonprofit basis. Based on documents the county provided us in the course of the audit, we determined that the county contracted with Mental Health Systems, Inc.—a California nonprofit corporation (whose facilities include: Provo Canyon School and Logan River Academy), Aspen Solutions, Inc. (whose facilities include Aspen Ranch, Youth Care of Utah, and Sunhawk Academy), and Kids Behavioral Health of Alaska, Inc. For the audit period, the county did not claim payments to Island View as noted in its response. In January 2009, Provo Canyon became a nonprofit facility. With the exception of Provo Canyon beginning January 2009, the referenced facilities are not owned and operated on a nonprofit basis.

**5. Counties Face Increased Litigation if Restricted to Nonprofit Residential Facilities.**

Refer to SCO's Comment, item 2.

**6. Federal and State Law Do Not Impose Tax Status Requirements on Provider Treatment Services.**

We do not dispute that Government Code section 7572 requires mental health services to be provided by qualified mental health professionals. As noted in the finding and our previous response, the mandate reimburses counties for payments to service vendors (group homes) providing mental health services to SED pupils in out-of-state residential placements that are organized and operated on a nonprofit basis. The treatment and board-and-care vendor payments claimed result from the placement of clients in non-reimbursable out-of-state residential facilities. The program's parameters and guidelines do not include a provision for the county to be reimbursed for vendor payments made to out-of-state residential placements made outside of the regulation.

## 7. The State's Interpretation of WIC Section 11460 (c)(3) Would Result in Higher State Reimbursement Costs.

Refer to SCO's Comment, item 2.

### FINDING 2— Overstated assessment and treatment costs

The county overstated assessment and treatment costs by \$54,904 for the audit period.

The county used preliminary unit-of-service reports, before the final reconciliation process was complete, to calculate costs. Also, the county's claim for FY 2007-08 included ineligible costs related to therapeutic behavioral services (TBS) and year-end accruals for providers. We recalculated reimbursable costs based on actual units of eligible services, and applied the appropriate cost per unit. We excluded ineligible TBS costs from the calculations.

The following table summarizes the overstated costs:

	Fiscal Year			Total
	2006-07	2007-08	2008-09	
Assessment and treatment costs:				
Preliminary units-of-service costs	\$ (61,728)	\$ (6,736)	\$ 52,191	\$ (16,273)
Year-end accruals for providers	-	(11,777)	-	(11,777)
Ineligible therapeutic behavioral services for county providers	-	(26,854)	-	(26,854)
Audit adjustment	\$ (61,728)	\$ (45,367)	\$ 52,191	\$ (54,904)

The parameters and guidelines also specify that the State will reimburse only actual increased costs incurred to implement the mandated activities and supported by source documents that show the validity of such costs.

### Recommendation

The final report issued March 7, 2012, recommended the following:

We recommend that the county use the actual units of service and claim only eligible services in accordance with the mandated program.

On September 28, 2012, the CSM amended the parameters and guidelines, stating that Statutes of 2011, Chapter 43, "eliminated the mandated programs for counties and transferred responsibility to school districts, effective July 1, 2011. Thus, beginning July 1, 2011, these programs no longer constitute reimbursable state-mandated programs for counties." Therefore, no recommendation is applicable for this audit.

### County's Response

The county agreed with the finding and recommendation.

**FINDING 3—  
Overstated indirect  
costs**

The county overstated indirect (administrative) costs by \$58,665 for the audit period.

The county's claims included due process costs as both a direct cost component and as part of the administrative pool in the indirect cost calculations. Subsequently, the county provided revised indirect cost allocations, excluding the due process costs from the administrative pool.

Using the revised allocation, we recalculated indirect costs using eligible mental health services costs and applying all relevant administrative revenues.

The following table summarizes the overstated costs:

	Fiscal Year			Total
	2006-07	2007-08	2008-09	
Indirect costs	\$ (54,143)	\$ (32,059)	\$ 27,537	\$ (58,665)
Audit adjustment	\$ (54,143)	\$ (32,059)	\$ 27,537	\$ (58,665)

The parameters and guidelines specify that the State will reimburse only actual increased costs incurred to implement the mandated activities and supported by source documents that show the validity of such costs.

The parameters and guidelines further specify that reimbursable indirect costs may be claimed to the extent that they have not already been reimbursed by the California Department of Mental Health from categorical sources.

Recommendation

The final report issued March 7, 2012, recommended the following:

We recommend that the county ensure that indirect costs incurred in implementing the mandated activities are eligible for reimbursement and claimed only once.

On September 28, 2012, the CSM amended the parameters and guidelines, stating that Statutes of 2011, Chapter 43, "eliminated the mandated programs for counties and transferred responsibility to school districts, effective July 1, 2011. Thus, beginning July 1, 2011, these programs no longer constitute reimbursable state-mandated programs for counties." Therefore, no recommendation is applicable for this audit.

County's Response

The county agreed with the finding and recommendation.

**FINDING 4—  
Overstated offsetting  
revenues**

The county overstated offsetting revenues by \$81,756 for the audit period.

The county calculated revenues using preliminary unit-of-service reports and estimated Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) rates that were not finalized during the claiming process.

In addition, the county applied Social Services Administration (SSA) realignment funds as revenue offsets for the board-and-care costs claimed for the SEDP program during FY 2006-07 and FY 2007-08. As a portion of the board-and-care costs are ineligible for reimbursement, we reduced the realignment revenue applied by a portion of the ineligible costs.

The following table summarizes the overstated offsetting revenues:

	Fiscal Year			Total
	2006-07	2007-08	2008-09	
Offsetting revenues:				
Short-Doyle/Medi-Cal FFP	\$ (22,163)	\$ 1,505	\$ 2,076	\$ (18,582)
EPSDT	(25,563)	3,636	(8,899)	(30,826)
SSA realignment	65,621	65,543	-	131,164
Audit adjustment	<u>\$ 17,895</u>	<u>\$ 70,684</u>	<u>\$ (6,823)</u>	<u>\$ 81,756</u>

The parameters and guidelines (section VII.1-4, page 13) specify that any direct payments (categorical funds, Short-Doyle/Medi-Cal FFP, EPSDT, IDEA, and other offsets such as private insurance) received from the State that are specifically allocated to the program, and/or any other reimbursement received as a result of the mandate, must be deducted from the claim.

The parameters and guidelines also specify that the State will reimburse only actual increased costs incurred to implement the mandated activities and supported by source documents that show the validity of such costs.

Recommendation

The final report issued March 7, 2012, recommended the following:

We recommend that the county ensure that it applies actual units of service against the appropriate reimbursement percentages when computing offsetting revenues.

On September 28, 2012, the CSM amended the parameters and guidelines, stating that Statutes of 2011, Chapter 43, “eliminated the mandated programs for counties and transferred responsibility to school districts, effective July 1, 2011. Thus, beginning July 1, 2011, these programs no longer constitute reimbursable state-mandated programs for counties.” Therefore, no recommendation is applicable for this audit.

County’s Response

The county agreed with the finding and recommendation.

SCO Comment

Subsequent to the issuance of our final report on March 7, 2012, the DMH issued its EPSDT settlement for FY 2008-09. We recalculated offsetting revenues and revised Finding 4 to reflect the actual funding percentage. As a result, the audit adjustment decreased by \$51,592.

**Attachment—  
County’s Response to  
Draft Audit Report**

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*Excellence  
Integrity  
Service*

## COUNTY OF ORANGE HEALTH CARE AGENCY

OFFICE OF THE DIRECTOR

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February 27, 2012

Jim L. Spano, Chief  
Mandated Cost Audits Bureau  
California State Controller's Office  
Division of Audits  
Post Office Box 942850  
Sacramento, CA 94250-5874

Re: Orange County DRAFT Audit Report, Consolidated Handicapped and Disabled Students and Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services Program for the period of July 1, 2006 through June 30, 2009

Dear Mr. Spano:

The County of Orange ("the County") Health Care Agency ("HCA") is writing in response to the letter sent to the Chief Deputy Auditor-Controller, Shaun Skelly on February 6, 2012 regarding the February 2012 DRAFT Audit Report referenced above. The County received an extension from you to submit its response to the February 2012 DRAFT Audit Report on or before February 27, 2012. The County is submitting this response in compliance with that extension.

We wish to advise you that HCA is not challenging Draft Audit Findings 2, 3, or 4. However, HCA does not agree with Draft Audit Finding 1, whereby you conclude that \$3,744,611 represents unallowable program costs.

The State alleges that the unallowable costs occurred because the County claimed ineligible vendor payments for out-of-state residential placement of Seriously Emotionally Disturbed (SED) pupils in facilities that are owned and operated for profit. The County disputes the State's findings that alleged that the County claimed ineligible vendor payments and asserts that the State has incorrectly reduced the County's claims for the audit period.

The County disputes the State's findings because they conflict with the requirements of federal law, including the Individuals with Disabilities Education Act (IDEA) and Section 472(c)(2) of the Social Security Act (42 U.S.C. 672 (c)(2)). Moreover, the State ignores the administrative decisions of its own Office of Administrative Hearings (OAH) and the affirming United States District Court decision in its disallowance of the County of Orange claims.

Please see the following arguments in support of the County's position that the State incorrectly reduced the costs claimed by the County for the audit period.

**1. California For-Profit Placement Restriction Is Incompatible With IDEA's "Most Appropriate Placement" Requirement and Placement Provisions.**

Regardless of the State's view of the validity of the residential facility contracts questioned by the Audit Reports, the State's position in this matter is in glaring discord with the requirements of the federal Individuals with Disabilities Education Act ("IDEA"). This is because the IDEA requires that special education students are provided "the most appropriate placement," and not the most appropriate nonprofit placement.

The stated purpose of the IDEA is "... to ensure that all children with disabilities have available to them . . . a free appropriate public education which emphasizes special education and related services designed to meet their unique needs. . . ." 20 U.S.C. § 1400(d)(1)(A). The "free appropriate public education" (FAPE) required by IDEA must be tailored to the unique needs of the handicapped child by means of an "individualized educational program." 20 U.S.C. § 1401(9)(D); *Bd. of Educ. v. Rowley*, 458 U.S. 176, 181 (U.S. 1982). When a state receives funds under the IDEA, as does California, it must comply with the IDEA and its regulations. 34 C.F.R. § 300.2 (2006).

Local educational agencies ("LEAs") initially were responsible for providing all special education services including mental health services when necessary. The passage of Assembly Bill 3632/882 transferred the responsibility for providing mental health services to the counties. In conjunction with special education mental health services, the IDEA requires that a state pay for a disabled student's residential placement if the student, because of his or her disability, cannot reasonably be anticipated to benefit from instruction without such a placement. 34 C.F.R. § 300.302 (2006); *Indep. Schl. Dist. No. 284 v. A.C.*, 258 F.3d 769, 774 (8<sup>th</sup> Cir. 2001).

Before 1997, the IDEA required counties to place special education students in nonprofit residential placements only. In 1997, however, section 501 of the Personal Responsibility and Work Opportunity Responsibility Act of 1996 amended section 472(c)(2) of the Social Security Act (42 U.S.C. 672(c)(2)) to strike the nonprofit requirement. Section 472(c)(2) currently states:

The term "child-care institution" means a private child-care institution, or a public child-care institution which accommodates no more than twenty-five children, which is licensed by the State in which it is situated or has been approved, by the agency of such State responsible for licensing or approval of institutions of this type, as meeting the standards established for such licensing, but the term shall not include detention facilities, forestry camps, training schools, or any other facility operated primarily for the detention of children who are determined to be delinquent.

In direct opposition to the IDEA, California's regulations limit special education residential placements to nonprofit facilities as follows:

... Out-of-state placements shall be made only in residential programs that meet the requirements of Welfare and Institutions Code Sections 11460(c)(2) through (c)(3). 2 C.C.R. § 60100(h).

... State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home organized and operated on a nonprofit basis. Welfare and Institutions Code § 11460(c)(3).

Therefore, California law is inconsistent with the requirements of IDEA and incompatible with its foremost purpose, i.e., to provide each disabled child with special education designed to meet that child's unique needs. 20 U.S.C. §1401(25). Indeed, special education students who require residential treatment are often the students with the most unique needs of all because of their need for the most restrictive level of placement. This need rules out California programs. The limited number of out-of-state residential facilities that are appropriate for a special education student may not operate on a nonprofit basis. Thus, California's nonprofit requirement results in fewer appropriate services being available to the neediest children—those who can only benefit from their special education when placed in residential facilities.

It should also be noted that LEAs are not precluded by any similar nonprofit limitation. When special education children are placed in residential facilities, out-of-state LEAs can utilize education services provided by certified nonpublic, nonsectarian schools and other agencies operated on a for-profit basis. Educ. Code § 56366.1. Nonpublic schools are certified by the State of California when they meet the provisions of Education Code sections 56365 *et seq.* Nonprofit operation is *not* a requirement. Consequently, the two entities with joint responsibility for residential placement of special education students must operate within different criteria. This anomaly again leads to less available services for critically ill special education children.

**2. California Office of Administrative Hearings Special Education Division Corroborates HCA's Contention that For-Profit Placement Restriction Is Incompatible With IDEA's "Most Appropriate Placement" Requirement and Placement Provisions.**

The principles set forth in Section 1 above were recently validated and corroborated by the State's own Office of Administrative Hearings ("OAH"), Special Education Division in OAH Case No. N 2007090403, *Student v. Riverside Unified School District and Riverside County Department of Mental Health*, decided January 15, 2008.

In that matter, the school district and mental health agency were unable to find a residential placement that could meet the student's unique mental health and communication needs. All parties agreed that a particular for-profit residential placement was the appropriate

placement for the student. Interpreting Title 2 of Cal. Code Regs., section 60100(h) and Welfare and Institutions Code section 11460(c)(2) through (c)(3) in the same fashion as the State Controller's Audits, the school district and mental health agency concluded that they could not place the student at the for-profit facility.

The OAH disagreed. In fact, it found that section 60100(h) of Title 2 of the California Code of Regulations did not prevent placement in a for-profit facility where no other appropriate placement existed for a child. *Student v. Riverside Unif. Sch. Dist. and Riverside Co. Dept. of Mental Health*, Case No. N 2007090403, January 15, 2008. Moreover, the OAH indicated such an interpretation "is inconsistent with the federal statutory and regulatory law by which California has chosen to abide." *Riverside Unif. Sch. Dist.* at p. 8.

The OAH declared that the fundamental purpose of legislation dealing with educational systems is the welfare of the children. *Riverside Unif. Sch. Dist.* at p. 8, quoting *Katz v. Los Gatos-Saratoga Joint Union High School District*, 117 Cal. App. 4<sup>th</sup> 47, 63 (2004).

Like the school district and mental health agency in *Riverside*, the audits in question utilized a blanket, hard and fast rule that for-profit placements are never allowed, even when the placement itself indicates it is nonprofit, even when there is no other appropriate placement available, and even when the for-profit placement is in the best interests of the child. None of these factors were taken into consideration when the Audits determined that certain residential vendor expenses were ineligible for reimbursement.

**3. United States District Court has Affirmed the California Office of Administrative Hearings Special Education Division of *Student v. Riverside Unified School District and Riverside County Department of Mental Health*.**

On July 20, 2009 the United States District Court, Central District of California, Eastern Division heard an appeal to reverse the Administrative Law Judge's decision in *Student v. Riverside Unified School District and Riverside County Department of Mental Health*. (See *Riverside County Department of Mental Health v. Sullivan et al*, Case No. EDCV 08-0503-SGL (RCx))

In that case, the U.S. District Court held that placement at the for-profit National Deaf Academy (NDA) was proper. The court went on to state that "California law does not prohibit placement at NDA and does not excuse compliance with IDEA." (*Id.* at 10).

In response to plaintiff arguments that California Administrative Code Section 60100(h)'s reference to WIC 11460(c)(2) through (c)(3) results in a prohibition in placing in for-profit facilities, the District court pointed out that Cal. Adm. Code Section 60000 provides that the intent of the chapter that Section 60100 appears "is to assure conformity with the federal Individuals with Disabilities Education Act or IDEA." (*Id.*) Section 60000 goes onto state, "[t]hus, provisions of this chapter shall be construed as supplemental to, and in the context of,

federal and state laws and regulations relating to interagency responsibilities for providing services to pupils with disabilities.” (*Id.*)

The State Controller’s Office is bound by the decision of the United States District Court, discussed above. And the U.S. District Court specifically answered the question of whether out-of-state for-profit placements were prohibited under state law. That binding decision found that “California law does not prohibit placement at NDA and does not excuse compliance with IDEA.”

Therefore, even assuming for argument sake, that the disallowed placements were “for-profit”, the State is incorrect to disallow reimbursement for out-of-state for-profit placements for the audit periods without conducting further review as to whether an alternative nonprofit residential placement, that was able to provide FAPE, existed. Thus the State should reimburse the county for disallowed amounts.

#### **4. The County Contracted with Nonprofit Facilities.**

For the audit period, the County believed, and still believes, it contracted with nonprofit facilities to provide all program services. The County cannot be held responsible if its nonprofit contractor in turn subcontracts with a for-profit entity to provide the services. This is not prohibited by California statute, regulation, or federal law.

Specifically, during the audit periods in question, the County contracted for out-of-state residential services with Mental Health Systems, Inc. (whose facilities include: Provo Canyon School and Logan River Academy), Aspen Solutions, Inc. (whose facilities include: Island View, Aspen Ranch, Youth Care of Utah, and Sunhawk Academy), and Kids Behavioral Health of Alaska, Inc. (whose facility includes Copper Hills Youth Center). Each of the entities that the County contracted with are organized as nonprofit organizations. However these facilities were disallowed in the Draft Audit Report and are the subject of the County’s disputes in this Draft Audit Response. The County contracted with these providers in a manner consistent with the requirements of the California Code of Regulations and Welfare and Institutions Code referenced above.

The County complies with a number of prerequisites before placing SED pupils in out-of-state residential facilities. For example, the pupil must be determined to be “emotionally disturbed” by his or her school district. In-state facilities must be unavailable or inappropriate. One of the County’s procedural steps is to telephone the out-of-state facility to inquire about its nonprofit status. When advised that the facility is for-profit, that facility is no longer considered for SED pupil placement. When advised that the facility is nonprofit, the County obtains documentation of that status, e.g., an IRS tax determination letter.

Neither the federal nor the state government has provided procedures or guidelines to specify if and/or exactly how counties should determine for-profit or nonprofit status. Although

counties have used many of these out-of-state residential facilities for SED student placement for years, the State only recently has begun to question their nonprofit status. Nor has the State ever provided the County with a list of facilities that it deems to be nonprofit, and therefore acceptable to the State. The State's history of paying these costs without question encouraged the County to rely upon the State's acceptance of prior claims for the very same facilities now characterized as for-profit.

Considering the foregoing, the conclusions of the Draft Audit lacks the "fundamental fairness" that even minimal procedural due process requires.

**5. Counties Face Increased Litigation if Restricted to Nonprofit Residential Facilities.**

Under the IDEA, when parents of a special education pupil believe their child's school district and/or county mental health agency breached their duties to provide the student with a free appropriate public education, the parents can seek reimbursement for the tuition and costs of a placement of the parents' choice. The United States Supreme Court has ruled that parents who unilaterally withdraw their child from an inappropriate placement must be reimbursed by the placing party(ies). This is true even if the parents' school placement does not meet state educational standards and is not state approved. *Florence County Sch. Dist. Four v. Carter by & Through Carter*, 510 U.S. 7 (U.S. 1993).

This means that in California, if there is no nonprofit placement to meet the unique needs of a special education child, his or her parents can place the child in *any* school of their choosing, regardless of educational standards, state approval, whether nonprofit or for-profit, etc., and then demand that the school district and/or mental health agency pay the bill. The California regulatory requirement for nonprofit residential placement prevents school districts and mental health agencies from selecting the most appropriate placement, regardless of tax status. Because of California's arbitrary regulatory requirement, which is not in accord with the 1997 amendment to IDEA, school districts and mental health agencies may be forced to place a child in a less appropriate facility increasing the likelihood that the parents will choose a different facility. The placement agencies are thereafter legally required to subsidize the expenses of the parents' unilateral choice, even if that unilateral placement does not meet the State's nonprofit and academic standards. The decision in *Riverside* explained and cited above precisely mirrors such a situation.

**6. Federal and State Law Do Not Impose Tax Status Requirements on Provider Treatment Services.**

Special education mental health psychotherapy and assessment services must be conducted by qualified mental health professionals as specified in regulations developed by the State Department of Mental Health in consultation with the State Department of Education. California Government Code § 7572(c) These services can be provided directly or by contract at the discretion of county mental health agencies. 2 C.C.R. § 60020(i) Licensed practitioners

included as “qualified mental health professionals” are listed in California Code of Regulations Title 2, section 60020(j). Neither section contains any requirement regarding the provider’s tax status. Because tax status has no bearing on eligibility for mental health provider services, there is no basis for disallowing these claimed treatment costs.

**7. The State’s Interpretation of WIC Section 11460(c)(3) Would Result in Higher State Reimbursement Costs.**

In conducting a review of the facilities that the State has disallowed reimbursement, it has become clear that the State’s interpretation of WIC Section 11460(c)(3) would result in an overall increase in the cost of reimbursement.

This conclusion is based on a comparison between the cost of mental health services provided at residential facilities that are organized as for-profit versus the same costs at residential facilities that are organized as nonprofit. On average, we have found that nonprofit residential placements cost more than for-profit residential placements.

Clearly, it could not have been the intent of the drafters of WIC 11460(c)(3) to increase the cost of State reimbursement by limiting State reimbursement to group homes organized and operated on a nonprofit basis. The more reasonable interpretation of what the drafters intended was based on a (mistaken) assumption that nonprofit facilities are less expensive than for-profit facilities or a desire to mirror Federal IDEA law, which has since been modified to remove the nonprofit reimbursement restriction.

Therefore, to apply such an interpretation, without providing Counties any prior notice of the State’s desire to enforce the code section in such a manner is clearly unfair and unreasonable, especially in light of the retroactive enforcement of the interpretation and the lack of any guidance provided by the State. Fairness requires that the state advise counties of its intent to enforce the interpretation moving forward, not retroactively. By providing counties advance notice of its intent to disallow a category of payment that has historically been reimbursed, would provide counties the ability to make adjustments and comply with the State’s changed interpretation.

Thus, the State should reimburse County for all submitted amounts during the audit period.

**Conclusion**

Based on the foregoing, the County of Orange maintains that its costs related to placements in for profit facilities for the audit period remain allowable and eligible for reimbursement.

**Jim Spano, Chief, Mandated Costs Audit Bureau**  
February 27, 2012  
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Sincerely,



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Deputy Agency Director  
Behavioral Health Services

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