ORANGE COUNTY
Audit Report
HANDICAPPED AND DISABLED
STUDENTS PROGRAM
Chapter 1747, Statutes of 1984,
and Chapter 1274, Statutes of 1985
July 1, 2000, through June 30, 2002

JOHN CHIANG
California State Controller
March 2007
Honorable David E. Sundstrom, CPA  
Auditor-Controller  
Orange County  
12 Civic Center Plaza, Room 202  
Santa Ana, CA  92702

Dear Mr. Sundstrom:

The State Controller’s Office audited the costs claimed by Orange County for the legislatively mandated Handicapped and Disabled Students Program (Chapter 1747, Statutes of 1984, and Chapter 1274, Statutes of 1985) for the period of July 1, 2000, through June 30, 2002.

The county claimed $32,132,972 for the mandated program. Our audit disclosed that $26,241,767 is allowable and $5,891,205 is unallowable. The unallowable costs occurred because the county overstated administrative costs, understated offsetting revenues, and understated assessment and treatment costs. The State paid the county $18,222,464. Allowable costs claimed exceed the amount paid by $8,019,303.

If you disagree with the audit findings, you may file an Incorrect Reduction Claim (IRC) with the Commission on State Mandates (COSM). 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 COSM’s Web site, at www.csm.ca.gov (Guidebook link); you may obtain IRC forms by telephone, at (916) 323-3562, or by e-mail, at csminfo@csm.ca.gov.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

JVB/vb
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**Audit Report**

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Audit Report

Summary

The State Controller’s Office (SCO) audited the costs claimed by Orange County for the legislatively mandated Handicapped and Disabled Students Program (Chapter 1747, Statutes of 1984, and Chapter 1274, Statutes of 1985) for the period of July 1, 2000, through June 30, 2002. The last day of fieldwork was April 28, 2005.

The county claimed $32,132,972 for the mandated program. Our audit disclosed that $26,241,767 is allowable and $5,891,205 is unallowable. The unallowable costs occurred because the county overstated administrative costs, understated offsetting revenues, and understated assessment and treatment costs. The State paid the county $18,222,464. Allowable costs claimed exceed the amount paid by $8,019,303.

Background

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 (COSM) determined that this legislation imposed a state mandate reimbursable under Government Code Section 17561.

Parameters and Guidelines establishes the state mandate and defines reimbursement criteria. The COSM adopted the Parameters and Guidelines for the Handicapped and Disabled Students Program on August 22, 1991, and last amended it on August 29, 1996. In compliance with Government Code Section 17558, the SCO issues claiming instructions for mandated programs, to assist local agencies and school districts in claiming reimbursable costs.

Parameters and Guidelines for the Handicapped and Disabled Students 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 Handicapped and Disabled Students 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.)

On May 26, 2005, the COSM adopted a Statement of Decision for the Handicapped and Disabled Students II Program that incorporates the above legislation and further identifies medication support as a reimbursable cost effective July 1, 2001. The COSM adopted the Parameters and Guidelines for this new program on December 9, 2005, and made technical corrections to it on July 21, 2006. Parameters and Guidelines for the Handicapped and Disabled Students II Program states 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.

Objective, Scope, and Methodology

We conducted the audit to determine whether costs claimed represent increased costs resulting from the Handicapped and Disabled Students Program for the period of July 1, 2000, through June 30, 2002.

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 the audit according to Government Auditing Standards, issued by the Comptroller General of the United States, and under the authority of Government Code Sections 12410, 17558.5, and 17561. We did not audit the county’s financial statements. We limited our audit scope to planning and performing audit procedures necessary to obtain reasonable assurance that costs claimed were allowable for reimbursement. Accordingly, we examined transactions, on a test basis, to determine whether the costs claimed were supported.

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 $32,132,972 for costs of the Handicapped and Disabled Students Program. Our audit disclosed that $26,241,767 is allowable and $5,891,205 is unallowable.

For the FY 2000-01 claim, the State paid the county $9,511,041. Our audit disclosed that $6,940,136 is allowable. The State will offset $2,570,905 from other mandated program payments due to the county. Alternatively, the county may remit this amount to the State.
For the FY 2001-02 claim, the State paid the county $8,711,423. Our audit disclosed that $19,301,631 is allowable. The State will pay allowable costs claimed that exceed the amount paid, totaling $10,590,208, contingent upon available appropriations.

**Views of Responsible Officials**

We issued a draft audit report on October 27, 2006. Benjamin P. de Mayo, County Counsel, responded by letter dated November 14, 2006 (Attachment), disagreeing with the audit results. This final audit report includes the county’s response.

**Restricted Use**

This report is solely for the information and use of Orange County, 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
## Schedule 1—
### Summary of Program Costs
### July 1, 2000, through June 30, 2002

<table>
<thead>
<tr>
<th>Cost Elements</th>
<th>Actual Costs Claimed</th>
<th>Allowable per Audit</th>
<th>Audit Adjustment</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>July 1, 2000, through June 30, 2001</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assessment/case management costs</td>
<td>$5,426,476</td>
<td>$4,895,673</td>
<td>$530,803</td>
<td>Finding 3</td>
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<tr>
<td>Administrative costs</td>
<td>2,516,904</td>
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<td>867,960</td>
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<tr>
<td><strong>Offsetting revenues:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State categorical funds</td>
<td>(329,822)</td>
<td>(409,436)</td>
<td>(79,614)</td>
<td>Finding 2</td>
</tr>
<tr>
<td>Short-Doyle/Medi-Cal funds</td>
<td>—</td>
<td>624,993</td>
<td>(624,993)</td>
<td>Finding 2</td>
</tr>
<tr>
<td>Other</td>
<td>—</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net assessment/case management costs</strong></td>
<td>7,613,558</td>
<td>5,510,188</td>
<td>(2,103,370)</td>
<td></td>
</tr>
<tr>
<td><strong>Treatment costs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative costs</td>
<td>9,223,879</td>
<td>6,933,272</td>
<td>(2,290,607)</td>
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</tr>
<tr>
<td><strong>Offsetting revenues:</strong></td>
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<tr>
<td>State general/realignment funds</td>
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<td></td>
</tr>
<tr>
<td>State categorical funds</td>
<td>(699,001)</td>
<td>(885,473)</td>
<td>(186,472)</td>
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</tr>
<tr>
<td>Short-Doyle/Medi-Cal funds</td>
<td>(625,439)</td>
<td>(580,278)</td>
<td>45,161</td>
<td>Finding 2</td>
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<tr>
<td>Other</td>
<td>(92,549)</td>
<td>(92,549)</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td><strong>Net treatment costs</strong></td>
<td>5,217,783</td>
<td>1,429,948</td>
<td>(3,787,835)</td>
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</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>$12,831,341</td>
<td>6,940,136</td>
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<tr>
<td><strong>Less allowable costs that exceed claimed costs</strong></td>
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<td></td>
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</tr>
<tr>
<td><strong>Total program costs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Less amount paid by the State</strong></td>
<td></td>
<td></td>
<td>(9,511,041)</td>
<td></td>
</tr>
<tr>
<td><strong>Allowable costs claimed in excess of (less than) amount paid</strong></td>
<td></td>
<td></td>
<td>(2,570,905)</td>
<td></td>
</tr>
<tr>
<td><strong>July 1, 2001, through June 30, 2002</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assessment/case management costs</td>
<td>$5,407,140</td>
<td>$7,021,087</td>
<td>1,613,947</td>
<td>Finding 3</td>
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<tr>
<td>Administrative costs</td>
<td>3,209,823</td>
<td>2,549,043</td>
<td>(660,780)</td>
<td>Finding 1</td>
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<tr>
<td><strong>Offsetting revenues:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State general/realignment funds</td>
<td>(933,938)</td>
<td>(533,817)</td>
<td>400,121</td>
<td>Finding 2</td>
</tr>
<tr>
<td>State categorical funds</td>
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<td>(745,974)</td>
<td>(745,974)</td>
<td>Finding 2</td>
</tr>
<tr>
<td>Short-Doyle/Medi-Cal funds</td>
<td>—</td>
<td>(745,974)</td>
<td>(745,974)</td>
<td>Finding 2</td>
</tr>
<tr>
<td>Other</td>
<td>—</td>
<td>(92,549)</td>
<td>—</td>
<td></td>
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<td><strong>Net assessment/case management costs</strong></td>
<td>7,683,025</td>
<td>8,290,339</td>
<td>607,314</td>
<td></td>
</tr>
<tr>
<td><strong>Treatment costs</strong></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative costs</td>
<td>9,544,249</td>
<td>11,710,936</td>
<td>2,166,687</td>
<td>Finding 3</td>
</tr>
<tr>
<td><strong>Offsetting revenues:</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>State general/realignment funds</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>State categorical funds</td>
<td>(699,001)</td>
<td>(1,193,541)</td>
<td>(494,540)</td>
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<td>Short-Doyle/Medi-Cal funds</td>
<td>(1,660,639)</td>
<td>(928,157)</td>
<td>732,482</td>
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<tr>
<td>Other</td>
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<td>(92,549)</td>
<td>—</td>
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</table>
### Schedule 1 (continued)

<table>
<thead>
<tr>
<th>Cost Elements</th>
<th>Actual Costs Claimed</th>
<th>Allowable per Audit</th>
<th>Audit Adjustment</th>
<th>Reference 1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>July 1, 2001, through June 30, 2002 (continued)</strong></td>
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</tr>
<tr>
<td>Net treatment costs</td>
<td>11,618,606</td>
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<td>1,593,177</td>
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</tr>
<tr>
<td>Subtotal</td>
<td>$ 19,301,631</td>
<td>21,502,122</td>
<td>$ 2,200,491</td>
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</tr>
<tr>
<td>Less allowable costs that exceed claimed costs 2</td>
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<td></td>
<td>(2,200,491)</td>
<td></td>
</tr>
<tr>
<td>Total program costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less amount paid by the State</td>
<td></td>
<td></td>
<td>(8,711,423)</td>
<td></td>
</tr>
<tr>
<td>Allowable costs claimed in excess of (less than) amount paid</td>
<td>$ 10,590,208</td>
<td>$ 10,590,208</td>
<td>$ 10,590,208</td>
<td></td>
</tr>
</tbody>
</table>

**Summary: July 1, 2000, through June 30, 2002**

<table>
<thead>
<tr>
<th>Cost Elements</th>
<th>Actual Costs Claimed</th>
<th>Allowable per Audit</th>
<th>Audit Adjustment</th>
<th>Reference 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessment/case management costs</td>
<td>$ 10,833,616</td>
<td>$ 11,916,760</td>
<td>$ 1,083,144</td>
<td>Finding 3</td>
</tr>
<tr>
<td>Administrative costs</td>
<td>5,726,727</td>
<td>4,197,987</td>
<td>(1,528,740)</td>
<td>Finding 1</td>
</tr>
<tr>
<td>Offsetting revenues:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State categorical funds</td>
<td>(1,263,760)</td>
<td>(943,253)</td>
<td>320,507</td>
<td>Finding 2</td>
</tr>
<tr>
<td>Short-Doyle/Medi-Cal funds</td>
<td>—</td>
<td>(1,370,967)</td>
<td>(1,370,967)</td>
<td>Finding 2</td>
</tr>
<tr>
<td>Other</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Net assessment/case management costs</td>
<td>15,296,583</td>
<td>13,800,527</td>
<td>(1,496,056)</td>
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</tr>
<tr>
<td>Treatment costs</td>
<td>18,768,128</td>
<td>18,644,208</td>
<td>(123,920)</td>
<td>Finding 3</td>
</tr>
<tr>
<td>Administrative costs</td>
<td>7,935,865</td>
<td>5,768,496</td>
<td>(2,167,369)</td>
<td>Finding 1</td>
</tr>
<tr>
<td>Offsetting revenues:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State general/realignment funds</td>
<td>(5,998,426)</td>
<td>(5,998,426)</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>State categorical funds</td>
<td>(1,398,002)</td>
<td>(2,079,014)</td>
<td>(681,012)</td>
<td>Finding 2</td>
</tr>
<tr>
<td>Short-Doyle/Medi-Cal funds</td>
<td>(2,286,078)</td>
<td>(1,508,435)</td>
<td>777,643</td>
<td>Finding 2</td>
</tr>
<tr>
<td>Other</td>
<td>(185,098)</td>
<td>(185,098)</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Net treatment costs</td>
<td>16,836,389</td>
<td>14,641,731</td>
<td>(2,194,658)</td>
<td></td>
</tr>
<tr>
<td>Subtotal</td>
<td>$ 32,132,972</td>
<td>28,442,258</td>
<td>(3,690,714)</td>
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</tr>
<tr>
<td>Less allowable costs that exceed claimed costs 2</td>
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<td></td>
<td>(2,200,491)</td>
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</tr>
<tr>
<td>Total program costs</td>
<td>26,241,767</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less amount paid by the State</td>
<td>(18,222,464)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Allowable costs claimed in excess of (less than) amount paid</td>
<td>$ 8,019,303</td>
<td>$ 8,019,303</td>
<td>$ 8,019,303</td>
<td></td>
</tr>
</tbody>
</table>

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1. See the Findings and Recommendations section.

2. Government Code Section 17561 stipulates that the State will not reimburse any claim more than one year after the filing deadline specified in the SCO’s claiming instructions. That deadline has expired for FY 2000-01 and FY 2001-02.
Findings and Recommendations

FINDING 1—
Overstated
administrative costs

The county miscalculated its administrative costs. The county used incorrect unit information from preliminary reports to allocate administrative costs to the mandate. The county also did not apply any administrative revenues, even though it received Short Doyle/ Medi-Cal Federal Financing Participation funds.

We recalculated the administrative costs allocation using the correct units of service and applying all relevant administrative revenues. The recalculation resulted in an overstatement of administrative costs of $2,223,877 and $1,472,232 for fiscal year (FY) 2000-01 and FY 2001-02, respectively.

Parameters and Guidelines for the program specifies that administrative costs incurred in the performance of the mandated activities and adequately documented are reimbursable.

Parameters and Guidelines further specifies that reimbursable indirect costs may be claimed to the extent that they have not already been reimbursed by the State Department of Mental Health from categorical funding sources.

Audit adjustments result from the use of actual units and the application of offsetting revenues as follows.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>2000-01</th>
<th>2001-02</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessment</td>
<td>(867,960)</td>
<td>(660,780)</td>
<td>(1,528,740)</td>
</tr>
<tr>
<td>Treatment</td>
<td>(1,355,917)</td>
<td>(811,452)</td>
<td>(2,167,369)</td>
</tr>
<tr>
<td>Audit adjustment</td>
<td>$ (2,223,877)</td>
<td>$ (1,472,232)</td>
<td>$ (3,696,109)</td>
</tr>
</tbody>
</table>

Recommendation

We recommend that, when preparing its administrative cost allocation, the county ensures that the correct units of service are used and that all relevant offsetting revenues are applied to reduce administrative costs.

County’s Response

The county did not respond to this finding.

SCO’s Comment

The finding remains unchanged.
The county used preliminary reports to compute offsetting revenues. The county used the units from these preliminary reports to compute offsetting revenues. Once the reconciliation was finalized, the information was not corrected on the claims. Additionally, the county did not include Early Periodic Screening Diagnosis and Treatment (EPSDT).

We recalculated the offsetting revenues by using the correct units and costs per unit, including all relevant revenues. The county understated offsetting revenues by $845,918 and $107,911 in FY 2000-01 and FY 2001-02, respectively. The overstatement relative to treatment in the last fiscal year is due to the overstatement of units and the application of an incorrect funding percentage for Short Doyle/Medi-Cal Federal Financing Participation. The calculations exclude revenues related to the unallowable costs discussed in Finding 3.

Parameters and Guidelines specifies that any direct payments received from the State that are specifically allocated to the program, and any other reimbursement received as a result of the mandate from any source, must be deducted from the claim.

By excluding EPSDT funds and not allocating revenues based on actual services provided, the county misstated its offsetting revenues as follows.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>2000-01</th>
<th>2001-02</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessment</td>
<td>$ (704,607)</td>
<td>$ (345,853)</td>
<td>$ (1,050,460)</td>
</tr>
<tr>
<td>Treatment</td>
<td>$ (141,311)</td>
<td>$ 237,942</td>
<td>$ 96,631</td>
</tr>
<tr>
<td>Audit adjustment</td>
<td>$ (845,918)</td>
<td>$ (107,911)</td>
<td>$ (953,829)</td>
</tr>
</tbody>
</table>

Recommendation

We recommend that the county implement policies and procedures to ensure that all applicable reimbursements are offset against reimbursable costs incurred for this program. Further, we recommend that the county calculate applicable reimbursements based on actual units of service provided for a particular program.

County’s Response

The county did not respond to this finding.

SCO’s Comment

The finding remains unchanged.
FINDING 3—
Understated assessment and treatment costs

The claimed costs were not based on actual costs to implement the mandated program. The county used preliminary unit reports to prepare its claims. The county produced the unit reports while the cost report reconciliation was in process. These amounts remained uncorrected once the finalization of the cost reports was complete. In some cases, the county applied an incorrect cost per unit to determine costs. The county also included ineligible medication monitoring services (FY 2000-01 only), crisis intervention, and therapeutic behavioral services. Audit adjustments reflect the changes due to the adoption of the Handicapped and Disabled Students II Program.

We determined allowable costs based on actual units of eligible services, using the appropriate unit cost representing the actual cost to the county. Our calculation resulted in an overstatement of $2,821,410 and an understatement of $3,780,634 for FY 2000-01 and FY 2001-02, respectively.

Parameters and Guidelines for the program specifies that only actual increased costs incurred in the performance of the mandated activities and adequately documented are reimbursable.

Parameters and Guidelines specifies that only the following treatment services are reimbursable: individual therapy, collateral therapy and contacts, group therapy, day treatment, and the mental health portion of residential treatment in excess of California Department of Social Services payments for residential placement.

On December 9, 2005, the COSM adopted the Parameters and Guidelines for the Handicapped and Disabled Students II Program. Under this program, medication support is a reimbursable cost. The reimbursement period for the program begins FY 2001-02; therefore, the audit adjustments below do not include medication support costs for FY 2001-02.

Because the county claimed costs that are not based on actual units and costs per unit and claimed ineligible services, it misstated its claims as follows.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>2000-01</th>
<th>2001-02</th>
<th>Total</th>
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Recommendation

We recommend that the county implement policies and procedures to ensure that it utilizes the actual unit-of-service cost per unit and claims only eligible services in accordance with the mandated program.

County’s Response

The county did not respond to this finding.

SCO’s Comment

The finding remains unchanged.
FINDING 4—
Lawsuit-Related Issue

In its response, the county stated that it will not return the $2,570,905 in audit adjustments as a result of a lawsuit it brought against the State. The county believes that the unreimbursed mandated costs it is due from the State for FY 1995-96 through and including FY 2003-04 have been set by the court. Therefore, the county believes that the audit has no legal bearing. The county’s response and the SCO’s comment are as follows.

County’s Response

This office is writing on behalf of the Orange County Auditor-Controller, David E. Sundstrom, in response to the October 27, 2006, correspondence from Jeffrey V. Brownfield and the above referenced Audit Report. Mr. Brownfield’s letter indicates any response to the audit should be directed to your attention. We wish to advise you that the Auditor-Controller will not be returning $2,570,905 to the State as recommended in the “Conclusion” of the Audit Report.

You may or may not be aware of a lawsuit that the County of Orange instituted against the State of California, the State Controller, and the State Treasurer in April 2004. The County of Orange was a Plaintiff as was the County of San Diego in the case of County of San Diego and County of Orange v. State of California et al., San Diego Superior Court case number GIC 825109 (consolidated with GIC 827845). At issue in the lawsuit were unreimbursed mandated costs for fiscal years 1995-96 through and including 2003-04. After a trial on the merits in December 2005, judgment was entered in favor of the Counties. The judgment set the sum total of unreimbursed mandated costs owing the County of Orange in the amount of $72,755,977. See attachment A, a true and correct copy of the judgment.

The $72,755,977 is comprised of 41 different state mandated programs including the program that is the subject of the Audit Report. Attachment B is a true and correct copy of what was an Exhibit at trial, reflecting the various state mandated programs and corresponding amounts to which the Attorney General’s Office, on behalf of the State Defendants, stipulated were due and owing the County of Orange, and not in dispute at trial. As item 30 on page three of Attachment B reflects, the Court’s judgment set the amount owing the County of Orange for “Handicapped and Disabled Students Program” at $3,320,300 for fiscal year 2000-01 and $10,590,208 for fiscal year 2001-02. Attachment C is a true and correct copy of relevant pages from the “Joint Trial Readiness Conference Report” that was filed with the Court in November 2005, demonstrating the stipulation of the parties. Attachment D is a true and correct copy of relevant pages of the Court’s statement of decision which formed the basis for the judgment in favor of the Counties. As Attachments C and D reflect, the State’s attorneys agreed to the amounts reflected in Attachment B as due and owing the County of Orange, and Judgment was entered accordingly.

Since the amount of money that the County of Orange is due from the State for unreimbursed state mandated program costs has been set by a court of law, the issue is res judicata and the audit has no legal bearing. Therefore, the County of Orange will not be returning $2,570,905 to the State. Please feel free to contact the undersigned with any questions or concerns. If you prefer to discuss the issue with the State’s attorney, Leslie Lopez, Deputy Attorney General was the trial attorney — (916) 327-0973.
SCO’s Comment

We believe that the audit is valid and has legal bearing.

During the discovery for the aforementioned case, the State admitted that the county filed claims in a given amount and that the State has made partial payment. Neither the State nor the court stated that the claims were final and not subject to an SCO audit pursuant to Government Code Sections 12410, 17558.5, and 17561. Further, the matter is currently in appeal and, therefore, is not res judicata.

For the FY 2000-01 claim, we updated the conclusion section of this report to indicate that the State will offset $2,570,905 from other mandated program payments due to the county. We further stated that, as an alternative, the county may remit the amount to the State. Previously, the report stated that the county should return $2,579,905 to the State.
Attachment—
County’s Response to
Draft Audit Report
Re: Orange County Audit Report Handicapped and Disabled Students Program
July 1, 2000 - June 30, 2002

Dear Mr. Spano:

This office is writing on behalf of the Orange County Auditor-Controller, David E. Sundstrom, in response to the October 27, 2006, correspondence from Jeffrey V. Brownfield and the above referenced Audit Report. Mr. Brownfield’s letter indicates any response to the audit should be directed to your attention. We wish to advise you that the Auditor-Controller will not be returning $2,570,905 to the State as recommended in the “Conclusion” of the Audit Report.

You may or may not be aware of a lawsuit that the County of Orange instituted against the State of California, the State Controller, and the State Treasurer in April 2004. The County of Orange was a Plaintiff as was the County of San Diego in the case of County of San Diego and County of Orange v. State of California et al., San Diego Superior Court case number GIC 825109 (consolidated with GIC 827845). At issue in the lawsuit were unreimbursed mandated costs for fiscal years 1995-96 through and including 2003-04. After a trial on the merits in December 2005, judgment was entered in favor of the Counties. The judgment set the sum total of unreimbursed mandated costs owing the County of Orange in the amount of $72,755,977. See attachment A, a true and correct copy of the judgment.

The $72,755,977 is comprised of 41 different state mandated programs including the program that is the subject of the Audit Report. Attachment B is a true and correct copy of what was an Exhibit at trial, reflecting the various state mandated programs and corresponding amounts to which the Attorney General’s Office, on behalf of the State Defendants, stipulated were due and owing the County of Orange, and not in dispute at trial. As Item 30 on page three of Attachment B reflects, the Court’s judgment set the amount owing the County of Orange for “Handicapped and Disabled Students Program” at $3,320,300 for fiscal year 2000-01 and

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$10,590,208 for fiscal year 2001-02. Attachment C is a true and correct copy of relevant pages from the "Joint Trial Readiness Conference Report" that was filed with the Court in November 2005, demonstrating the stipulation of the parties. Attachment D is a true and correct copy of relevant pages of the Court's statement of decision which formed the basis for the judgment in favor of the Counties. As Attachments C and D reflect, the State's attorneys agreed to the amounts reflected in Attachment B as due and owing the County of Orange, and Judgment was entered accordingly.

Since the amount of money that the County of Orange is due from the State for unreimbursed state mandated program costs has been set by a court of law, the issue is res judicata and the audit has no legal bearing. Therefore, the County of Orange will not be returning $2,570,905 to the State. Please feel free to contact the undersigned with any questions or concerns. If you prefer to discuss the issue with the State's attorney, Leslie Lopez, Deputy Attorney General was the trial attorney – (916) 327-0973.

Very truly yours,

BENJAMIN P. DE MAYO
COUNTY COUNSEL

By

Wendy L. Phillips, Deputy

WJP:mill

cc: David Sundstrom, Orange County Auditor-Controller
Alice Sworder, Senior Manager, HCA Accounting, Office of the Auditor-Controller
Leslie Lopez, Deputy Attorney General

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IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA
IN AND FOR THE COUNTY OF SAN DIEGO

COUNTY OF SAN DIEGO, Plaintiff/Petitioner,

v.

STATE OF CALIFORNIA; STEVE WESTLY in his official capacity as California State Controller; PHIL ANGELIDES in his official capacity as California State Treasurer; DONNA ARDUIN in her official capacity as Director of the California State Department of Finance; and DOES 1 through 50, inclusive,

Defendants/Respondents.

JUDGMENT (PROPOSED)

Trial Date: November 28, 2005
Time: 10:30 a.m.
Dept: 70
V/C Judge: Honorable Jay M. Bloom
Actions filed: 2/3/04 and 4/1/04

JUDGMENT (PROPOSED)
COUNTY OF ORANGE,

Plaintiff/Petitioner,

v.

STATE OF CALIFORNIA; STEVE WESTLY in his official capacity as California State Controller; PHIL ANGELIDES in his official capacity as California State Treasurer; DONNA ARDUIN in her official capacity as Director of the California State Department of Finance; and DOES 1 through 50, inclusive,

Defendants/Respondents.

Plaintiffs/Petitioners County of San Diego’s and County of Orange’s consolidated complaints for declaratory relief and petitions for issuance of a writ of mandate came on for trial on November 28, 2005, at 10:30 a.m., in Department 70 of the above-entitled court, the Honorable Jay M. Bloom, judge presiding. The County of San Diego was represented by John J. Sansone, County Counsel, by Timothy M. Barry, Senior Deputy. The County of Orange was represented by Benjamin P. de Mayo, County Counsel, by Wendy J. Phillips, Deputy County Counsel. The State of California, California State Controller, California State Treasurer, and Director of the California State Department of Finance, were represented by William Lockyer, Attorney General, by Leslie R. Lopez, Deputy Attorney General.

Having heard and considered the evidence both written and oral and the oral arguments of counsel for the parties it is hereby ORDERED, AJUDGED and DECREED as follows:

1. The State of California is obligated to reimburse the County of San Diego and the County is entitled to judgment in the total principal sum of $41,652,974 for the balance due on its claims for costs incurred in providing State mandated programs and services from fiscal year 1994-95 through fiscal year 2003-04, together with interest thereon at the legal rate of seven percent.

JUDGMENT (PROPOSED)
percent (7%) per annum from February 3, 2004. Interest on the $41,652,974 at the legal rate
from February 3, 2004, through May 10, 2006 (826 days), the date of entry of this judgment, is
$6,328,236 for a total judgment of $47,981,210.

2. The State of California is obligated to reimburse the County of Orange and the
County is entitled to judgment in the total principal sum of $72,755,977 for the balance due on
its claims for costs incurred in providing State mandated programs and services from fiscal year
1994-95 through fiscal year 2003-04, together with interest at the legal rate of seven percent
(7%) per annum from April 1, 2004. Interest on the $72,755,977 at the legal rate from April 1,
2004, through May 10, 2006 (770 days), the date of entry of this judgment, is $9,982,132 for a
total judgment of $82,738,109.

3. The Counties request for pre-petition interest is denied.

4. A writ of mandate pursuant to Code of Civil Procedure section 1084, et seq. shall
issue commanding respondents, State of California, State Controller, State Treasurer, and
Director of the California State Department of Finance to pay the amount of the judgment plus
interest to the County of San Diego and the County of Orange over the fifteen year period
required by Government Code section 17617 (or a shorter period if the Legislature enacts a
shorter period, elects to pay the debt off earlier or is otherwise required by law to pay the debt
off over a shorter period) in equal annual installments beginning with the budget for the 2006-07
fiscal year and annually thereafter each successive budget until paid.

5. Respondents will file a return on the writ with the court within 90 days of the
enactment of the State budget for each fiscal year commencing with the 2006-07 fiscal year
demonstrating compliance with the writ until the amounts owed have been fully paid.

/JUDGMENT (PROPOSED)/
6. This court will retain jurisdiction to enforce the writ in the event respondents fail to comply with the writ.

7. Petitioners/plaintiffs are awarded costs of suit in the amount of $_______

DATED: MAY 12, 2006

JAY M. BLOOM
JUDGE OF THE SUPERIOR COURT

APPROVED AS TO FORM AND CONTENT,

BILL LOCKYER, Attorney General

By LESLIE R. LOPEZ, Deputy Attorney General
for Defendants State Of California, Steve Westly,
Phil Angelides, and Tom Campbell

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**BUDGET SUMMARY - ORANGE COUNTY**

**DEPARTMENT:**

**TOTAL:**
JOHN J. SANSONE, County Counsel
County of San Diego
By TIMOTHY M. BARRY, Senior Deputy (SBN 089919)
C. ELLEN PILBECKER, Senior Deputy (SBN 154241)
THOMAS D. BUNTON, Senior Deputy (SBN 193560)
1600 Pacific Highway, Room 355
San Diego, California 92101
Telephone: (619) 531-6259

Attorneys for Plaintiff/Petitioner County of San Diego

BENJAMIN P. de MAYO, County Counsel
County of Orange
By JOHN H. ABBOTT, Senior Deputy (SBN 150788)
WENDY J. PHILLIPS, Deputy (SBN 178422)
10 Civic Center Plaza, 4th Floor
Post Office Box 1379
Santa Ana, California 92702-1379
Telephone: (714) 834-2319
Facsimile: (714) 834-2359

ATTorneys for Plaintiff/Petitioner County of Orange

IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA
IN AND FOR THE COUNTY OF SAN DIEGO

COUNTY OF SAN DIEGO,
Plaintiff/Petitioner,

v.

STATE OF CALIFORNIA; STEVE
WESTLY in his official capacity as California
State Controller; PHIL ANGELIDES in his
official capacity as California State Treasurer;
DONNA ARDUIN in her official capacity as
Director of the California State Department of
Finance; and DOES 1 through 50, inclusive,

Defendants/Respondents.

Case No. GIC 825109 (consolidated with
Case No. GIC 827845
[Actions filed: 2/3/04 and 4/1/04]

JOINT TRIAL READINESS
CONFERENCE REPORT

Trial Readiness Conference
Date: November 18, 2005
Time: 1:30 p.m.
Dept: 70

Trial Date: November 23, 2005
Trial Time Estimate:
Jury Requested: No
Jury Fee Deposited: N/A
Court Reporter Requested: Yes

I/C Judge: Honorable Jay M. Bloom
Actions filed: 2/3/04 and 4/1/04

Joint Trial Readiness Conference Report
COUNTY OF ORANGE,

Plaintiff/Petitioner,

v.

STATE OF CALIFORNIA; STEVE WESTLY in his official capacity as California State Controller; PHIL ANGELIDES in his official capacity as California State Treasurer; DONNA ARDUIN in her official capacity as Director of the California State Department of Finance; and DOES 1 through 50, inclusive,

Defendants/Respondents.

A. The parties to the above case, by their attorneys: plaintiffs/petitioners, County of San Diego, County Counsel John J. Sansone, by Timothy M. Barry, Senior Deputy; County of Orange, County Counsel Benjamin P. de Mayo, by Wendy J. Phillips, Deputy; and defendants/respondents by Deputy Attorneys Generals Michelle Mitchell Lopez and Leslie Lopez conferred and discussed settlement but could not settle the case. They are prepared for trial.

B. Nature of Case:

Plaintiffs/Petitioners, County of San Diego and County of Orange ("the Counties"), seek reimbursement of costs incurred in relation to providing various State mandated programs at the local level. The California Constitution requires the State to reimburse counties for costs incurred in relation to providing mandated programs. Between the two counties, reimbursement for 50 different mandated programs are at issue, totaling more than $110 million. The Counties seek a writ of mandate compelling Defendants/Respondents: State of California, Phil Angelides (Treasurer), Steve Westly (Controller) and Tom Campbell (Director of Finance), (collectively "the State"), to pay the Counties as required by the California Constitution. The Counties are requesting the court to order the State to pay the mandated costs from funds within the State's budget that are appropriated but unencumbered.

C. Legal issues which are not in dispute:

1. In November of 2004, the Court granted the Counties' joint motion for judgment

Joint Trial Readiness Conference Report
on the pleadings. In that Order, the Court granted Counties declaratory relief stating that the
State “failed to reimburse costs incurred in providing state mandated services and programs for
fiscal years 2002-2004 in violation of the State’s constitutional and statutory obligations.”

2. The State does not dispute that the Counties are owed reimbursement for costs
incurred in relation to providing state mandated services.

3. The State agrees that the amounts set forth on Exhibits “A” and “B”
accurately reflect the amount of the Counties claims, that the State has not disputed the
amount of the claims as reflected on Exhibits “A” except for Item 22, FY 03-04, Item 28,
FY 99-00, and Item 46, FY 94-95 and 95-96 and on Exhibit “B” except for Items _____,
and that the State has not paid the Counties’ claims.

D. Legal issues which are in dispute:

1. The State disputes that this court may issue a writ of mandate requiring the State
reimburse the Counties. The State asserts that, as a result of section 6 being amended in
November 2004 and because of Government Code section 17617, it has no “clear, present, and
ministerial duty” to reimburse the Counties. The State asserts that article XIII B, section 6(b)(2)
of the California Constitution and Government Code section 17617 control the State’s duty to
reimburse the specific mandated costs at issue in this case and thus, the State has 12 years,
commencing in fiscal year 2006-07, to reimburse the Counties.

2. The State also disputes that there are “appropriated but unencumbered funds” from
which the Court may order the State to pay the obligation owing the Counties. At issue for the
trial is whether there are funds in the State’s Fiscal Year 2005-06 Budget that have been
appropriated by the Legislature for specific departments and programs from which the Court
may legally order, in conformity with applicable case law, the State to pay the Counties to
satisfy the reimbursement obligation.

E. Exhibits: See Attachments “E-1” and “E-2”
F. Plaintiff’s standard jury instructions: Not Applicable
G. Defendant’s standard jury instructions: Not Applicable
H. Special verdict form: Not Applicable

Joint Trial Readiness Conference Report
found the passage of Proposition 1A in November of 2004 did not render the writ moot. By stipulation, amended complaints were filed alleging defendants’ failure to fully pay the mandates from 1994 through 2004. Beginning in the 2002-2003 budget year, some mandates were suspended while the Legislature funded the remaining mandates in the amount of $1,000. See Government Code section 17581.

The State’s motion for Summary Adjudication was denied. The Court of Appeal denied the application for a Writ of Mandate, and court trial commenced on November 28, 2005.

III. Facts

A. Plaintiffs’ Case

Plaintiffs and the State agreed before trial the State owed all the money sought by plaintiff except for about $22,000. Plaintiffs proved they were owed the additional sum of about $22,000 that relates to Mandate 22. (SIDS-Contact by Local Officers) During closing argument, defendant agreed it owed plaintiffs all the money sought by plaintiffs in accord with California Constitution, Article XIII B, section 6. Thus, San Diego County is owed $41,652, 974 and Orange County is owed $72,755,977. Plaintiffs are seeking a total judgment of $114,408,951.

In order to have a court order the immediate embargo of State budget funds owed to pay a State debt, California Courts have required the funds in the state budget be generally related to the funds missing. See Butt v. State of California (1992) 4 Cal.4th 668, 699-700. To make this connection, plaintiffs called Mr. William Hamm, the former Legislative Analyst for the State of California. In response to questions regarding different mandates he used terms such as reasonably related, generally related, similar purpose, and similar. For purposes of simplicity, the court has given him the benefit of the doubt and construed his testimony as being the funds sought to reimburse the counties, were