

ORANGE COUNTY

Audit Report

SERIOUSLY EMOTIONALLY DISTURBED PUPILS: OUT-OF-STATE MENTAL HEALTH SERVICES PROGRAM

Chapter 654, Statutes of 1996

July 1, 2005, through June 30, 2006



JOHN CHIANG
California State Controller

September 2010



JOHN CHIANG
California State Controller

September 17, 2010

The Honorable Janet Nguyen, Chair
Orange County Board of Supervisors
333 W. Santa Ana Boulevard
Santa Ana, CA 92701

Dear Ms. Nguyen:

The State Controller's Office audited the costs claimed by Orange County for the legislatively mandated Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services Program (Chapter 654, Statutes of 1996) for the period of July 1, 2005, through June 30, 2006.

The county claimed and was paid \$4,108,407 (\$4,118,407 less a \$10,000 penalty for filing a late claim) for the mandated program. Our audit disclosed that \$2,957,802 is allowable and \$1,150,605 is unallowable. The costs are unallowable 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. The State will offset \$1,150,605 from other mandated program payments due the county. Alternatively, the county may remit this amount to the State.

If you disagree with the audit finding, 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 Web site at 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

cc: The Honorable David E. Sundstrom, CPA
Auditor-Controller
Orange County
Mark Refowitz, Deputy Agency Director
Behavioral Health Services
Orange County
Kim Engelby, HCA Accounting Manager
Behavioral Health Services
Orange County
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State Controller's Office

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Audit Report

Summary

The State Controller's Office (SCO) audited the costs claimed by Orange County for the legislatively mandated Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services Program (Chapter 654, Statutes of 1996) for the period of July 1, 2005, through June 30, 2006.

The county claimed and was paid \$4,108,407 (\$4,118,407 less a \$10,000 penalty for filing a late claim) for the mandated program. Our audit disclosed that \$2,957,802 is allowable and \$1,150,605 is unallowable. The costs are unallowable 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. The State will offset \$1,150,605 from other mandated program payments due the county. Alternatively, the county may remit this amount to the State.

Background

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 (SEDP) placed in out-of-state residential programs. Counties' fiscal and programmatic responsibilities including those set forth in California Code of Regulations section 60100 provide that residential placements for a SEDP may be made out-of-state only when no in-state facility can meet the pupil's needs.

On May 25, 2000, the Commission on State Mandates (CSM) determined that Chapter 654, Statutes of 1996, imposed a state mandate reimbursable under Government Code section 17561 for the following:

- Payment of out-of-state residential placements for SEDPs;
- Case management of out-of-state residential placements for SEDPs. 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 Individualized Education Plan;
- Program management, which includes parent notifications, as required, payment facilitation, and all other activities necessary to ensure a county's out-of-state residential placement program meets the requirements of Government Code section 7576.

The program's parameters and guidelines establish the state mandate and define reimbursement criteria. CSM adopted the parameters and guidelines on October 26, 2000. 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 Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services Program for the period of July 1, 2005, through June 30, 2006.

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 an instance of noncompliance with the requirements outlined above. This instance is described in the accompanying Summary of Program Costs (Schedule 1) and in the Finding and Recommendation section of this report.

For the audit period, Orange County claimed \$4,108,407 (\$4,118,407 less a \$10,000 penalty for filing a late claim) for costs of the Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services Program. Our audit disclosed that \$2,957,802 is allowable and \$1,150,605 is unallowable.

For the fiscal year (FY) 2005-06 claim, the State paid the county \$4,108,407. Our audit disclosed that \$2,957,802 is allowable. The State will offset \$1,150,605 from other mandated program payments due the county. Alternatively, the county may remit this amount to the State.

**Views of
Responsible
Official**

We issued a draft audit report on June 30, 2010. Mark A. Refowitz, Deputy Agency Director, Behavioral Health Services, responded by letter dated August 9, 2010 (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, 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

September 17, 2010

**Schedule 1—
Summary of Program Costs
July 1, 2005, through June 30, 2006**

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment ¹
Ongoing mental health services costs:			
Vendor reimbursements	\$ 5,736,818	\$ 4,586,213	\$ (1,150,605)
Case management	494,891	494,891	—
Net ongoing costs	6,231,709	5,081,104	(1,150,605)
Less reimbursements	<u>(2,113,302)</u>	<u>(2,113,302)</u>	<u>—</u>
Total costs	4,118,407	2,967,802	(1,150,605)
Less late claim penalty	<u>(10,000)</u>	<u>(10,000)</u>	<u>—</u>
Total program costs	<u>\$ 4,108,407</u>	2,957,802	<u>\$ (1,150,605)</u>
Less amount paid by the State		<u>(4,108,407)</u>	
Allowable costs claimed in excess of (less than) amount paid		<u>\$ (1,150,605)</u>	

¹ See the Finding and Recommendation section.

Finding and Recommendation

FINDING— Ineligible vendor costs

The county overstated vendor costs by \$1,150,605 for the audit period.

As in the prior State Controller's Office audit, the county claimed ineligible vendor payments. For the audit period, the ineligible vendor payments totaled \$1,220,071 (treatment costs of \$616,320 and board-and-care costs of \$603,751) for out-of-state residential placement of Seriously Emotionally Disturbed (SED) Pupils in facilities that are owned and operated as for profit. We issued the prior audit on November 12, 2008, for the period July 1, 2002, through June 30, 2005. In addition, the county included ineligible in-state vendor treatment costs and unallowable prior year costs and omitted eligible board-and-care costs. The county used realignment funds to reduce its board-and-care costs claimed during the year. We reduced the realignment funds applied by the portion of ineligible board-and-care costs.

The following table summarizes the unallowable vendor costs claimed:

	Fiscal Year 2005-06
Ineligible placements:	
Treatment costs	
For-profit vendors	\$ (616,320)
In-state vendor	(1,179)
Board-and-care costs	(603,751)
Realignment adjustment	66,116
Ineligible prior year costs	(2,037)
Omitted board-and-care costs	<u>6,566</u>
Total	<u>\$ (1,150,605)</u>

The program's parameters and guidelines (section IV.C.1.) 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, *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 state that all costs claimed must be traceable to source documents that show evidence of the validity of such costs and their relationship to the state-mandated program.

Recommendation

We recommend that the county implement policies and procedures to ensure that 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 of each eligible client.

County's Response

The County does not agree with the finding concerning ineligible vendor costs with the following five arguments.

1. 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.

The County complies with a number of prerequisites before placing seriously emotionally disturbed (“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 audit’s conclusion lacks the “fundamental fairness” that even minimal procedural due process requires.

2. 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 DRAFT Audit Report, 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” 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 educations 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 (8th 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 operations 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.

3. 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 Item 2 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. Scho. 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 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. 4th 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 interest of the child. None of these factors were taken into consideration when the Audits determined that certain residential vendor expenses were ineligible for reimbursement.

4. 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 no 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.

5. 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 regulation 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.

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 the 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 five arguments set forth by the county in the order identified above.

1. 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 Mental Health Systems, Inc.—a California nonprofit corporation—contracted with Charter Provo Canyon School—a Delaware for-profit limited liability company—to provide out-of-state residential placement services. The referenced Provo Canyon, Utah, residential facility is not organized and operated on a nonprofit basis.

2. 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 the regulation.

We agree there is inconsistency between the 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,

the fact remains that 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.

3. 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.

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 under federal regulations. The issue of funding residential placements made outside of the regulation was not specifically addressed. Nevertheless, the fact remains that 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.

4. Counties Face Increased Litigation if Restriction to Nonprofit Residential Facilities.

Refer to previous response.

5. 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, 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.

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



*Excellence
Integrity
Service*

**COUNTY OF ORANGE
HEALTH CARE AGENCY
BEHAVIORAL HEALTH SERVICES**

DAVID L. RILEY
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MARK A. REFOWITZ
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August 9, 2010

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, Seriously Emotionally Disturbed Pupils:
Out-of-State Mental Health Services Program for the period of July 1, 2005,
through June 30, 2006

Dear Mr. Spano:

The County of Orange ("the County") Health Care Agency ("HCA") is writing in response to the letter sent to the County Auditor-Controller, David E. Sundstrom on June 30, 2010 regarding the June 2010 DRAFT Audit Report referenced above. The County received an extension from you to submit its response to the June 2010 DRAFT Audit Report on or before August 10, 2010. The County is submitting this response in compliance with that extension.

We wish to advise you that HCA does not agree with the audit's conclusions that \$1,150,605 represents unallowable program costs identified in the DRAFT Audit Report as is discussed below. Additionally, the DRAFT Audit Report should reflect that the exit conference occurred on March 19, 2010 instead of April 19, 2010.

1. 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.

The County complies with a number of prerequisites before placing seriously emotionally disturbed ("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.

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Considering the foregoing, the audit's conclusions lacks the "fundamental fairness" that even minimal procedural due process requires.

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Regardless of the State's view of the validity of the residential facility contracts questioned by the DRAFT Audit Report, 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" 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 (8th 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.

3. 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 Item 2 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. 4th 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.

4. 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

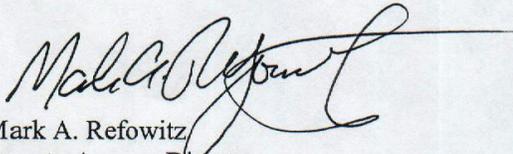
academic standards. The decision in *Riverside* explained and cited above precisely mirrors such a situation.

5. 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.

Based on the foregoing, the County of Orange maintains that its total claimed program costs of \$4,108,407 remain allowable and eligible for reimbursement. Please feel free to contact the undersigned with any questions or concerns.

Sincerely,



Mark A. Refowitz
Deputy Agency Director
Behavioral Health Services

cc: David E. Sundstrom, CPA, Auditor-Controller
Mary R. Hale, Chief, Behavioral Health Services
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