

# **SANTA CLARA COUNTY**

Audit Report

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

Chapter 654, Statutes of 1996

*July 1, 2003, through June 30, 2006*



**JOHN CHIANG**  
California State Controller

June 2009



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

June 30, 2009

The Honorable Liz Kniss, President  
Santa Clara County Board of Supervisors  
70 West Hedding Street  
San Jose, CA 95110-1768

Dear Ms. Kniss:

The State Controller's Office audited the costs claimed by Santa Clara 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, 2003, through June 30, 2006.

The county claimed \$775,255 for the mandated program. Our audit disclosed that \$330,677 is allowable and \$444,578 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, claimed unsupported residential placement costs, omitted eligible residential placement costs, and applied indirect cost (administrative) rates to duplicated direct costs. The State paid the county \$495,514. The amount paid exceeds allowable costs claimed by \$164,837.

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: Lesha Luu, Division Manager-Accounting  
Controller/Treasurer Department  
Santa Clara County  
Martha Paine, Director of General Fund Financial Services  
Santa Clara Valley Health and Hospital System  
Todd Jerue, Program Budget Manager  
Corrections and General Government  
Department of Finance  
Carol Bingham, Director  
Fiscal Policy Division  
California Department of Education  
Stacey Wofford  
Special Education Program  
Department of Mental Health  
Cynthia Wong, Manager  
Special Education Division  
California Department of Education

# Contents

## **Audit Report**

<b>Summary .....</b>	<b>1</b>
<b>Background .....</b>	<b>1</b>
<b>Objective, Scope, and Methodology .....</b>	<b>2</b>
<b>Conclusion .....</b>	<b>2</b>
<b>Views of Responsible Officials .....</b>	<b>3</b>
<b>Restricted Use .....</b>	<b>3</b>
<b>Schedule 1—Summary of Program Costs.....</b>	<b>4</b>
<b>Findings and Recommendations .....</b>	<b>6</b>
<b>Attachment—County’s Response to Draft Audit Report</b>	

# Audit Report

## Summary

The State Controller's Office audited the costs claimed by Santa Clara 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, 2003, through June 30, 2006.

The county claimed \$775,255 for the mandated program. Our audit disclosed that \$330,677 is allowable and \$444,578 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, claimed unsupported residential placement costs, omitted eligible residential placement costs, and applied indirect cost (administrative) rates to duplicated direct costs. The State paid the county \$495,514. The amount paid exceeds allowable costs claimed by \$164,837.

## Background

Chapter 654, Statutes of 1996, added and amended Government Code section 7576 by allowing new fiscal and programmatic responsibilities for counties to provide mental health services to Seriously Emotionally Disturbed (SED) Pupils 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 SED pupils 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 SED pupils;
- Case management of out-of-state residential placements for SED pupils. 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 for mandated programs, 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, 2003, 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 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, Santa Clara County claimed \$775,255 for costs of the Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services Program. Our audit disclosed that \$330,677 is allowable and \$444,578 is unallowable.

For the fiscal year (FY) 2003-04 claim, the State made no payment to the county. Our audit disclosed that \$92,703 is allowable. The State will pay allowable costs claimed that exceed the amount paid, totaling \$92,703, contingent upon available appropriations.

For the FY 2004-05 claim, the State paid the county \$299,707. Our audit disclosed that \$170,601 is allowable. The State will offset \$129,106 from other mandated program payments due to the county. Alternatively, the county may remit this amount to the State.

For the FY 2005-06 claim, the State paid the county \$195,807. Our audit disclosed that \$67,373 is allowable. The State will offset \$128,434 from other mandated program payments due the county. Alternatively, the county may remit this amount to the State.

**Views of  
Responsible  
Officials**

We issued a draft audit report on February 27, 2009. Lesha Luu, Divisional Manager–Accounting, Controller/Treasurer Department, and Martha Paine, Director of General Fund Financial Services, responded by letter dated April 24, 2009 (Attachment), agreeing with the audit results except for Finding 1 (Ineligible vendor costs). This final audit report includes the county’s response.

**Restricted Use**

This report is solely for the information and use of Santa Clara 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

June 30, 2009

**Schedule 1—  
Summary of Program Costs  
July 1, 2003, through June 30, 2006**

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference <sup>1</sup>
<u>July 1, 2003, through June 30, 2004</u>				
Direct costs:				
Mental health services:				
Vendor reimbursements	\$ 247,127	\$ 92,703	\$ (154,424)	Finding 1
Case management	1,523	—	(1,523)	Finding 2
Travel	2,833	—	(2,833)	Finding 2
Subtotal	251,483	92,703	(158,780)	
Indirect costs	28,258	—	(28,258)	Finding 3
Total program costs	<u>\$ 279,741</u>	92,703	<u>\$ (187,038)</u>	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 92,703</u>		
<u>July 1, 2004, through June 30, 2005</u>				
Direct costs:				
Mental health services:				
Vendor reimbursements	\$ 247,875	\$ 170,601	\$ (77,274)	Finding 1
Case management	7,655	—	(7,655)	Finding 2
Travel	2,601	—	(2,601)	Finding 2
Subtotal	258,131	170,601	(87,530)	
Indirect costs	41,576	—	(41,576)	Finding 3
Total program costs	<u>\$ 299,707</u>	170,601	<u>\$ (129,106)</u>	
Less amount paid by the State		(299,707)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ (129,106)</u>		
<u>July 1, 2005, through June 30, 2006</u>				
Direct costs:				
Mental health services:				
Vendor reimbursements	\$ 169,583	\$ 67,373	\$ (102,210)	Finding 1
Travel	5,772	—	(5,772)	Finding 2
Subtotal	175,355	67,373	(107,982)	
Indirect costs	20,452	—	(20,452)	Finding 3
Total program costs	<u>\$ 195,807</u>	67,373	<u>\$ (128,434)</u>	
Less amount paid by the State		(195,807)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ (128,434)</u>		

## Schedule 1 (continued)

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference <sup>1</sup>
<u>Summary: July 1, 2003, through June 30, 2006</u>				
Direct costs:				
Mental health services:				
Vendor reimbursements	\$ 664,585	\$ 330,677	\$ (333,908)	
Case management	9,178	—	(9,178)	
Travel	11,206	—	(11,206)	
Subtotal	684,969	330,677	(354,292)	
Indirect costs	90,286	—	(90,286)	
Total program costs	<u>\$ 775,255</u>	330,677	<u>\$ (444,578)</u>	
Less amount paid by the State		<u>(495,514)</u>		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ (164,837)</u>		

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

# Findings and Recommendations

**FINDING 1—  
Ineligible vendor costs**

The county overstated vendor costs by \$333,908 for the audit period.

The county claimed ineligible vendor payments of \$333,654 for out-of-state residential placement of Seriously Emotionally Disturbed (SED) pupils in facilities that are owned and operated for profit. Further, the county claimed unsupported treatment costs of \$65,552 and omitted eligible residential placement costs of \$65,298 that were erroneously claimed in the mandated Handicapped and Disabled Students Program.

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.

The following table summarizes the unallowable vendor costs claimed:

	Fiscal Year			Total
	2003-04	2004-05	2005-06	
Ineligible placements	\$ (154,424)	\$ (29,520)	\$ (149,710)	\$ (333,654)
Unsupported costs	—	(65,552)	—	(65,552)
Omitted costs	—	17,798	47,500	65,298
<b>Total</b>	<b>\$ (154,424)</b>	<b>\$ (77,274)</b>	<b>\$ (102,210)</b>	<b>\$ (333,908)</b>

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 and supported residential placement costs corresponding to the authorized placement period of each eligible client.

County’s Response

The County concurs with the \$65,552 and \$65,398 adjustments. The County does not concur with the disallowance of placements

The County complied 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 by the County for SED pupil placement. When advised that the facility is nonprofit, the County obtains documentation supporting its non-profit status, e.g., an IRS tax determination letter."

Neither the federal nor the state government 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 has never before questioned their nonprofit status. Nor has the State even 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 audits' conclusions lacks the "fundamental fairness" that even minimal procedural due process requires.

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

The State's position in this matter is contrary to 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 regulation. 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 from local educational agencies 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, 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 requirements. . . .

In direct opposition to IDEA, California's regulations limit special education residential placements to nonprofit facilities. . . .

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 many 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 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 tow entities with joint responsibilities 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.

**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.**

The principles set forth 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 on January 15, 2008.

In this 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 a student with 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 Audit, 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 Heath*, 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 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 reimbursements.

#### **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 or after denial of a free appropriate public education must be reimbursed by the placing party(ies). This is true even if the parents’ unilateral 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.

**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.

Further, in one of the disallowed cases, the client was a deaf child and placements for deaf children are almost non-existent. The IEP team which included an authorized member of the residential placement team in accordance with the Individuals with Disabilities Education Act, have always been trained to select an “appropriate residential placement that can meet the students needs,” not to select an appropriate “non profit” residential placement. There were only three possible placements in the United States of America that are able to provide services for the deaf. There was no nearby local facility that had an opening at the time of placement so Desert Hills was selected. The program recognizes the unique nature of deafness and ensured us that the staff was trained in American Sign Language. The client’s foster mother was also deaf and needed to be involved in the treatment. Santa Clara Mental Health did not place emphasis on the for-profit/nonprofit status. Clearly the emphasis was on the client’s unique needs.

Based on the foregoing, the County maintains that its claimed program costs of \$333,654 remain allowable and eligible for reimbursement.

SCO’s Comments

The finding remains unchanged.

We have not conducted an audit of this program at Santa Clara County in prior years. Therefore, there are no prior findings related to the for-profit status of vendors.

We conducted substantive testing to determine if the county placed clients with eligible out-of-state vendors in accordance with the mandate and applicable regulations. In doing so, we requested supporting documentation to verify the county’s contention that all of the vendor facilities are nonprofit. Despite the county’s procedure used to ensure placement in an eligible nonprofit facility, the county did not provide documentation to support the nonprofit status of the unallowed facilities.

The residential placement issue is not unique to this county and other counties are concerned about it as well. 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. Currently, the proponents of AB 421, a bill that is similar to AB 1805, seek to change the regulations and allow payments to for-profit facilities for placement of SED Pupils. 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.

- **California for-profit placement restriction is incompatible with IDEA's "most appropriate placement" requirement and placement provisions.**

The 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 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.

- **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 is not precedent setting and has no legal bearing. 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, 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.

- **Counties face increased litigation if restricted to nonprofit residential facilities.**

Refer to previous response.

- **Federal and state laws 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 our response to argument 2, a county is not allowed to place a client in a for-profit facility under Title 2, CCR, section 60100, subdivision (h), and Welfare and Institutions Code section 11460(c)(2) through (3). Welfare and Institutions Code section 11460(c)(3) states that payment shall only be made to a group home 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.

In reference to the Desert Hills residential placement, the cost of placing a client in a for-profit facility is not reimbursable under the mandated program. Based on the documents provided by the county, the Desert Hills, New Mexico facility is a for-profit vendor. The mandated program only reimburses residential placement vendor payments made 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 for special circumstances.

**FINDING 2—  
Unallowable case  
management and  
travel costs**

The county claimed unallowable case management and travel costs of \$20,384 for the audit period.

The county claimed case management employee salary and benefit costs and travel costs in the state-mandated SED Pupils Program claims that were also included in the pool of direct costs used to compute the unit rates in the county’s cost reports submitted to the California Department of Mental Health (CDMH). Consequently, the county allocated these costs claimed under the state-mandated SED Pupils Program through the unit rates to various mental health programs, including the mandated Handicapped and Disabled Students Program. Allowing the case management costs in the state-mandated SED Pupils Program would result in duplicate reimbursement.

The parameters and guidelines specify that case management costs of out-of-state residential placements are reimbursable.

The parameters and guidelines (section IV.C.3.) specify that the mandate reimburses counties for travel costs necessary 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 specified in Title 2, CCR, section 60110.

The parameters and guidelines also state that all costs claimed must be traceable to source documents that show evidence of validity of such costs and their relationship to the state-mandated program.

The following table summarizes the unallowable case management costs claimed:

	Fiscal Year			Total
	2003-04	2004-05	2005-06	
Case management costs	\$ (1,523)	\$ (7,655)	\$ —	\$ (9,178)
Travel costs	(2,833)	(2,601)	(5,772)	(11,206)
Total audit adjustment	<u>\$ (4,356)</u>	<u>\$ (10,256)</u>	<u>\$ (5,772)</u>	<u>\$ (20,384)</u>

Recommendation

We recommend that the county use a consistent cost allocation methodology to minimize any potential duplication with other mental-health programs.

County’s Response

The county agreed with the finding.

**FINDING 3—  
Ineligible indirect  
(administrative) costs**

The county claimed unallowable indirect (administrative) costs of \$90,286 for the audit period.

The county applied its indirect cost (administrative) rates to duplicated direct costs (travel and case management). The county also expensed residential placement costs in its cost reports as part of administrative costs. The application of indirect (administrative) rates on ineligible costs and costs that were already included in the administrative pool resulted in a duplication of indirect costs.

The parameters and guidelines specify that administrative costs incurred in the performance of the mandated activities and adequately documented are reimbursable.

The parameters and guidelines further specify that to the extent that the CDMH has not already compensated reimbursable indirect costs from categorical funding sources, they may be claimed.

The following table summarizes the unallowable indirect (administrative) costs claimed:

	Fiscal Year			Total
	2003-04	2004-05	2005-06	
Indirect (administrative) costs	\$ (28,258)	\$ (41,576)	\$ (20,452)	\$ (90,286)

Recommendation

We recommend that the county prepare its claims consistent with the cost report submitted to the CDMH and that it ensures that the indirect (administrative) rate is applied only to eligible direct costs.

County's Response

The county agreed with the finding.

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

---

# County of Santa Clara

Finance Agency  
Controller-Treasurer Department



County Government Center  
70 West Hedding Street, East Wing 2<sup>nd</sup> floor  
San Jose, California 95110-1705  
(408) 299-5200 FAX 289-8629

DATE: April 24, 2009

TO: Jim L. Spano  
Chief, Compliance Audits Bureau,  
State Controller's Office, Division of audits,  
Post Office Box 942850,  
Sacramento, CA 94250-5874

FROM: Leshia Luu  
Divisional Manager, -Accounting

RE: Santa Clara County Response to state audit report on legislatively mandated program-Seriously Emotionally Disturbed Pupils Out of State Mental Health Services Program July 1, 2003, through June 30, 2006

Dear Mr. Spano,

Thank you for sending us the draft audit report regarding our claim for the abovementioned program for costs incurred from July 1, 2003 through June 30, 2006.

Attached is our responses to your audit findings in the order they were presented on your draft report. Except the matters that we have specifically accepted, we disagree to all other findings. The attached detailed response addresses our concerns. Please review our comments and make appropriate adjustments for the draft report accordingly.

We, and many other local agencies, cannot agree to those disallowances on account of placement in the for profit out of state agencies as explained in the our response. County has made every attempt to efficiently and effectively complete this SB90 claim in a fair and reasonable basis. The action of disallowing these costs based on the auditors' interpretations is not an appropriate approach, and will defeat the objectives of mandating this claim.

We appreciate the opportunity to review and comment upon this audit. We would like to meet with you and your staff to explain our various points, and to seek a reasonable settlement of the claimed costs before we explore other alternatives available to us. Please contact Ram Venkatesan, the County SB 90 Coordinator, at (408) 299-5210 if you have questions.

Regards,

  
Leshia Luu  
Divisional manager-Accounting

**Attachment:** Detailed response to the audit report draft

**Board of Supervisors:** Donald F. Gage, George Shirakawa, Dave Cortese, Ken Yeager, Liz Kniss  
**Acting County Executive:** Gary A. Graves

Dedicated to the Health  
of the Whole Community



Finance Administration  
751 South Bascom Avenue  
San Jose, California 95128  
Tel. (408) 885-6868  
Fax. (408) 885-6886

Santa Clara County  
Audit  
Seriously Emotionally Disturbed Pupils:  
Out of State Mental Health Services Program  
Chapter 654, Statutes of 1996

Findings and Recommendations

**FINDING 1 – Ineligible vendor costs**

The county claimed ineligible vendor payments of \$333,654 for out-of-state residential placement of Seriously Emotionally Disturbed (SED) pupils in facilities that are owned and operated for profit. Further, the county claimed unsupported treatment costs of \$65,552 and omitted eligible residential placement costs of \$65,298 that were erroneously claimed in the mandated Handicapped and Disabled Students 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 and supported residential placement costs corresponding to the authorized placement period of each eligible client.

Management Comments

The County concurs with the \$65,552 and \$65,298 adjustments. The County does not concur with the disallowance of placements in for profit facilities.

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 by the County 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 has never before questioned 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 audits' conclusions lacks the "fundamental fairness" that even minimal procedural due process requires.

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

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 (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 many 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.

**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 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.

#### **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 or after denial of a free appropriate public education must be reimbursed by the placing party(ies). This is true even if the parents' unilateral 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.

**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.

Further, in one of the disallowed cases, the client was a deaf child and placements for deaf children are almost non-existent. The IEP team which included an authorized member of the residential placement team in accordance with the Individuals with Disabilities Education Act, have always been trained to select an "appropriate residential placement that can meet the students needs," not to select an appropriate "non profit" residential placement. There were only three possible placements in the United States Of America that are able to provide services for the deaf. There was no nearby local facility that had an opening at the time of placement so Desert Hills was selected. The program recognizes the unique nature of deafness and ensured us that the staff was trained in American Sign Language. The client's foster mother was also deaf and needed to be involved in the treatment. Santa Clara Mental Health did not place emphasis on the for-profit/nonprofit status. Clearly the emphasis was on the client's unique needs.

Based on the foregoing, the County maintains that its claimed program costs of \$333,654 remain allowable and eligible for reimbursement.

**FINDING 2— Unallowable case management and travel costs**

The county claimed unallowable case management and travel costs of \$20,384 for the audit period.

The county claimed case management employee salary and benefit costs and travel costs in the state-mandated SED Pupils Program claims that were also included in the pool of direct costs used to compute the unit rates in the county's cost reports submitted to the California Department of Mental Health (CDMH). Consequently, the county allocated these costs claimed under the state-mandated SED Pupils Program through the unit rates to various mental health programs, including the mandated Handicapped and Disabled Students Program. Allowing the case management costs in the state-mandated SED Pupils Program would result in duplicate reimbursement.

Recommendation

We recommend that the county use a consistent cost allocation methodology to minimize any potential duplication with other mental-health programs.

Management Comments

The County concurs with this recommendation.

**FINDING 3— Ineligible indirect (administrative) costs**

The county claimed unallowable indirect (administrative) costs of \$90,286 for the audit period.

The county applied its indirect cost (administrative) rates to duplicated direct costs (travel and case management). The county also expensed residential placement costs in its cost reports as part of administrative costs. The application of indirect (administrative) rates on ineligible costs and costs that were already included in the administrative pool resulted in a duplication of indirect costs.

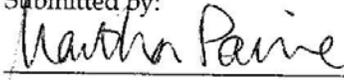
Recommendation

We recommend that the county prepare its claims consistent with the cost report submitted to the CDMH and that it ensures that the indirect (administrative) rate is applied only to eligible direct costs.

Management Comments

The County concurs with this recommendation.

Submitted by:



Martha Paine  
Director, General Fund Financial Services  
Santa Clara Valley Health & Hospital System

**State Controller's Office  
Division of Audits  
Post Office Box 942850  
Sacramento, CA 94250-5874**

**<http://www.sco.ca.gov>**