

Don't Give Up So Fast: Appealing Annual School District Audit Findings to the Education Audit Appeals Panel

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I. INTRODUCTION

Each year, every school district in California is required to conduct an audit of all funds to ensure that the district is meeting State requirements.¹ Intended to “encourage sound fiscal management . . . by strengthening fiscal accountability at the district, county and state levels,”² these audits can result in requiring thousands or millions of dollars to be repaid to the State. However, a statutory procedure exists whereby districts can seek reductions or eliminations of audit findings and their associated repayments.

The Education Audit Appeals Panel (the Panel) was created in 1999.³ Consisting of three members,⁴ it is charged with deciding appeals of audit findings.⁵ In addition to the authority to overturn findings based on errors of law or fact⁶ and approve settlements resolving appeals,⁷ it also possesses the ability to reduce audit findings where a district has substantially complied with program requirements.⁸ This article is an overview of the Panel's authority,⁹ procedures and connection to the annual audit process.

II. REQUIRED ANNUAL SCHOOL DISTRICT AUDIT

Pursuant to the Education Code, school districts must contract with an approved auditor to perform an annual fiscal and compliance audit.¹⁰ The only exception is when a district is under the administration of the Superintendent of Public Instruction, in which case the Office of the State Controller (Controller) has been given responsibility for carrying out the audits.¹¹ Any exceptions or variances identified during this audit can carry large financial consequences for the district.¹²

In performing the audit, auditors rely on the requirements of the Education Code¹³ as well as the procedures outlined in the “Audit Guide,” a set of regulations promulgated annually by the Panel.¹⁴ When an audit reveals

an exception or variance, the auditor must report the amount of funding which is recommended to be returned to the State.¹⁵ The final Audit Report itself, containing all audit findings, must then be reviewed by the Controller.¹⁶ Any required repayment is accomplished through the withholding of future funding to a district by the Controller and Department of Education.¹⁷

III. APPEALS TO THE PANEL

After the Audit Report is reviewed by the Controller and received by the district, the district may request either summary review or a formal appeal of the finding under the procedures which govern the Panel. Both of these procedures have strict deadlines considered jurisdictional by the Panel, both triggered by the receipt of the certified Audit Report by the district. Any summary review request must be received by the Panel within 30 days from the date the district received the final Audit Report.¹⁸ Any formal appeal request must be received by the Panel within 60 days from the date the district received the final Audit Report.¹⁹

A. SUMMARY REVIEW

A district may opt to request summary review of an audit finding where it believes it can demonstrate that its actions “clearly constitute substantial compliance.”²⁰ The summary review process is a “voluntary [and] informal” review of negative audit exceptions by the Executive Director of the Panel.²¹ Following the presentation of information that the district believes supports its claim of substantial compliance, the Executive Director will reach a decision on the request.²² For appeals where the amount in question is less than \$750,000, the Executive Director may order reduced reimbursement; where the amount in question is larger than \$750,000, such a reduction can only be ordered with the consent of the Department of Finance and the Superintendent

of Public Instruction.²³ If the Executive Director denies the summary review request, a district has 30 days to file a formal appeal.²⁴

B. FORMAL APPEAL

If the district prefers to proceed directly to a formal appeal, or request formal appeal after the denial of summary review, the district must file the formal appeal with the Panel within the timelines noted above.²⁵ Formal appeals are conducted pursuant to the California Administrative Procedure Act (APA).²⁶ Pursuant to statute, the Controller is a party to every appeal and the Department of Finance and Department of Education may intervene.²⁷ Traditionally, the Panel delegates the hearing of evidence to an Administrative Law Judge with the Office of Administrative Hearings.

At the hearing, districts have the opportunity to present evidence and argue that either (a) the auditors made an error of fact or an error in interpreting the law that led them to an improper audit result or (b) that the district was in “substantial compliance” with the requirements of law.²⁸ At the conclusion of the proceedings the Administrative Law Judge will issue a proposed decision which is sent to the Panel for its adoption, rejection or modification within 100 days.²⁹

Traditionally, the Panel places the proposed decision on its closed session agenda. Its practice has been not to allow oral argument on any proposed decision prior to the closed session. Pursuant to the APA, the Panel may then adopt the proposed decision as its decision in the appeal,³⁰ reduce the proposed penalty and adopt the remainder of the proposed decision,³¹ make technical or clarifying changes and adopt it as the decision in the appeal,³² or reject the proposed decision.³³ If it chooses to reject the proposed decision, it may then refer the case to the same Administrative Law Judge,³⁴ allow additional evidence or issue its own decision

on the appeal within 100 days based on the record created in the administrative hearing.³⁵

C. SUBSTANTIAL COMPLIANCE

Perhaps the most unique and important feature of the Panel’s authority lies in its ability to reduce or eliminate a required repayment based on a district’s substantial compliance. Even where a district has failed to completely satisfy the requirements of the Education Code, or where it made inadvertent or minor mistakes, the Panel has the authority to reduce reimbursement or penalty amounts. While promising, the application of the substantial compliance standard is ambiguous at best.

Enacted in 2002, section 41344.1, subdivision (c) defines “substantial compliance” for purposes of the Panel:

“Substantial compliance” means nearly complete satisfaction of all material requirements of a funding program that provide an educational benefit substantially consistent with the program’s purpose. A minor or inadvertent noncompliance may be grounds for a finding of substantial compliance provided that the local educational agency can demonstrate it acted in good faith to comply with the conditions established in law or regulation necessary for apportionment of funding.³⁶

From its statutory definition, it becomes clear that substantial compliance for purposes of the Panel is a much more forgiving standard than the substantial compliance common law doctrine. Developed by the Legislature specifically for the unique circumstances presented by complicated and comprehensive school funding programs and the audit procedures used to determine compliance with them, this standard differs from the substantial compliance standard of general application.³⁷ It moderates absolute perfection by a district in its requirement that there be “nearly complete satisfaction” of regulatory provisions so long as the district provides program benefits that are “substantially consistent” with their purpose.

While defined by section 41344.1, districts, administrative law judges and the Panel have struggled to apply the standard. As the Panel has noted, it “has not further defined substantial compliance by regulation or precedential decisions.”³⁸ Instead, districts must rely on these non-precedential decisions

to determine how this standard is applied.

Recent Panel decisions shed light on the application of the standard. While non-precedential, they indicate that the Panel understands the standard to apply in two separate situations. First, where a district’s actions amount to “nearly complete satisfaction of all material requirements of a funding program that provide an education benefit substantially consistent with the program’s purpose.” Second, where district non-compliance was “minor or inadvertent,” but in “good faith.”³⁹ Outside of this guidance, the decisions of the Panel avoid establishing a standard against which cases will be measured for substantial compliance.⁴⁰

IV. RECENT PANEL DECISIONS

Recent decisions by the Panel illustrate the different paths appeals can take. While not precedential, they do illuminate the potential benefits of the appeal process for school districts and the analysis of the decisions.⁴¹

A. EMERY UNIFIED SCHOOL DISTRICT (2004–05 FISCAL YEAR)⁴²

Following the annual audit of the district by a private auditor, the district faced a \$50,000 penalty for its failure to purchase textbooks by the statutory deadline.⁴³ At hearing, district officials explained that they delayed the purchase because the impending textbook adoption would make the books obsolete in six months. The Administrative Law Judge issued a proposed decision denying the appeal. On review, the Panel rejected the proposed decision. Instead it found that the district had substantially complied with the Education Code and reduced the penalty to \$10,000.

B. LOS ANGELES UNIFIED SCHOOL DISTRICT (2003–04 FISCAL YEAR)⁴⁴

The annual audit by a private auditor discovered a deficiency in the district’s compliance with the Class Size Reduction program. Based on this finding, the audit recommended that the district return over \$3.5 million to the state. After filing a formal appeal but before the administrative hearing convened, the district, the Department of Finance and the Controller agreed to a settlement reducing the repayment to just over \$700,000. The Panel then adopted the agreement as its decision in the matter.

C. OAKLAND UNIFIED SCHOOL DISTRICT (2003–04 FISCAL YEAR)⁴⁵

Following its annual audit performed by the Controller, the district was asked to repay the state approximately \$7.5 million for several audit findings. The district chose a combination of formal appeals and a waiver request filed with the State Board of Education to reduce the findings. Following an extensive hearing, the Administrative Law Judge issued a mixed proposed decision. It found that the audit incorrectly calculated the repayments, failed to account for revised attendance reports submitted by the district and in one finding failed to identify a statute or regulation upon which a penalty could be assessed, but denied the appeal of other findings. The Panel then adopted the proposed decision as its decision. The combination of the appeal and successful waiver request reduced the repayment due by approximately \$6.5 million.

D. VALLEJO CITY UNIFIED SCHOOL DISTRICT (2003–04 FISCAL YEAR)⁴⁶

Following the certification of its annual audit by the Controller, the district chose to file a formal appeal of several findings totaling almost \$4 million. By the time the appeal reached hearing, only two findings relating to instructional minutes and the Instructional Time and Staff Development Reform program remained. Following several days of hearing and post-hearing briefing, the Administrative Law Judge issued a proposed decision granting both appeals and proposing that the district not be required to repay any funds. However, the Panel rejected the proposed decision, instead drafting its own decision which found substantial compliance in relation to the instructional minutes finding and denied the other appeal, resulting in a repayment of roughly \$800,000. Dissatisfied with this outcome, the district asked a superior court for review. Following the filing of a petition for writ of administrative mandamus, the district, the Department of Finance and Controller (named as Real Parties in Interest) negotiated a settlement reducing the repayment to \$440,000 (\$125,000 to be reinvested in the district). The Panel did not play a part in the negotiations of the substantive portions of the settlement, nor was it required to approve the settlement, but did stipulate to vacate its previous decision.

V. CONCLUSION

Appealing adverse findings from an annual audit can be an involved process for any district. Although the Panel’s statutory guidance and procedures are meant to streamline the process, the assistance of informed counsel can aid in navigating a successful procedure. Most essential, however, is the notion that school districts must be aware of the ability to challenge negative audit findings through the appeals process to ensure that the law is applied to them in an accurate, appropriate and fair manner.

ENDNOTES

1. Ed. Code, § 41020. All subsequent statutory references are to the Education Code unless otherwise indicated.
2. § 41020, subd. (a).
3. While the Panel was first created in 1999 by (Stats. 1999, ch. 78) major amendments to the statutory scheme in 2002 (Stats. 2002, ch. 1128) are responsible for the current structure of the Panel and its procedures.
4. *Ibid.*
5. § 41344.1, subd. (b).
6. § 41344.1, subd. (d).
7. *Ibid.*
8. § 41344.1, subd. (c).
9. While this article only examines the Panel’s involvement in the appeal of findings in annual audits under section 41020, the language of sections 41344 and 41344.1 provide that the Panel may hear the appeal of any “final audit report resulting from an audit or review,” it further defines “audit or review” to include “an audit conducted by the Controller’s office, an annual audit conducted . . . pursuant to Section 41020, and an audit or review conducted by a government agency that provided the local educational agency with an opportunity to provide a written response.” (§ 41344, subd. (e).)
10. § 41020, subd. (f)(1).
11. See Stats. 2003, ch. 14, § 9, subd. (d) (placing auditing responsibility for the Oakland Unified School District with the Controller as one condition of receiving an emergency loan), and Stats. 2004, ch. 53, § 9, subd. (d) (placing auditing responsibility for the Vallejo

- Unified School District with the Controller as one condition of receiving an emergency loan).
12. For example, a finding that a district failed to comply with the requirements to receive instructional materials funding can result in a loss of all funding provided for that program for the year. For many districts this amount can reach over \$5 million.
 13. § 41020.
 14. The Audit Guide regulations are found at California Code of Regulations, title 5, sections 19810–19854. Current, as well as previous year’s Audit Guides can be found online at: <<http://www.eaap.ca.gov/NewWebSite0804/AuditGuide.htm>>.
 15. Cal. Code Regs., tit. 5, § 19816, subd. (1).
 16. § 14504.
 17. § 41344, subd. (a)(1)-(3).
 18. § 41344.1, subd. (d).
 19. § 41344, subd. (d).
 20. § 41344.1, subd. (d).
 21. *Ibid.* “To request summary review, a local education agency shall . . . identify each finding for which summary review is requested; and set forth the basis for the local education agency’s claim, as to each disputed finding.” (Cal. Code Regs., tit. 5, § 19803, subd. (a).)
 22. § 41344.1, subd. (d).
 23. § 41344.1, subd. (d)(2)-(3).
 24. § 41344.1, subd. (d)(1). The right to request summary review is independent of the right to file a formal appeal. As a matter of practice, the decision of the Executive Director in a summary review, or the facts on which it is based, do not become part of the record in a formal appeal.
 25. “To present an appeal to the Panel, a local agency shall . . . file a written Notice of Appeal with the Executive Officer of the Panel, identifying each finding being appealed.” (Cal. Code Regs., tit. 5, § 19804, subd. (a).)
 26. § 41344.1, subd. (b).
 27. *Ibid.*
 28. § 41344.1, subd. (b)(c).
 29. Gov. Code, § 11517, subd. (b)(3).
 30. Gov. Code, § 11517, subd. (c)(2)(A).
 31. Gov. Code, § 11517, subd. (c)(2)(B).
 32. Gov. Code, § 11517, subd. (c)(2)(C).

33. Gov. Code, § 11517, subd. (c)(2)(D)-(E).
34. Gov. Code, § 11517, subd. (c)(2)(D).
35. Gov. Code, § 11517, subd. (c)(2)(E). The decisions of the Panel are subject to judicial review pursuant to the APA and Code of Civil Procedure section 1094.5.
36. § 41344.1, subd. (c).
37. For a discussion of the common law standard, see *Goehring v. Chapman University* (2004) 121 Cal.App.4th 353, 384 rev. denied [Oct. 27, 2004] (“excus[ing] technical imperfections *only after the statutory objective has been achieved*”) emphasis added.
38. *In the Matter of Emery Unified School District* (06–13), p.5
39. *In the Matter of the Audit Appeal of Mesa Union Elementary School District* (06–14), p. 6. Prior to this decision it was unclear if the Panel believed that substantial compliance could be established in either situation or if the “minor and inadvertent” and “good faith” requirement had to be met in *addition* to the “nearly complete satisfaction” requirement.
40. It is worth noting that beginning with the *Emery* decision, the Panel appears to be more willing to exercise its ability to reduce penalties or repayment through substantial compliance findings. Since the *Emery* decision, more than half the decisions adopted by the Panel have included a substantial compliance finding.
41. Most of the Panel’s recent decisions are available for download on their website located at <http://eaap.ca.gov/NewWebSite0804/EAAPAppeals.htm>.
42. *In the Matter of Emery Unified School District* (06–13).
43. The instructional material requirements at issue are found in section 60119.
44. *In the Matter of Los Angeles Unified School District* (06–16).
45. *In the Matter of Oakland Unified School District* (06–01).
46. *In the Matter of Vallejo City Unified School District* (05–23).

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