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September 1, 2011

Drew Bohan, Executive Director
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814

Dear Mr. Bohan:

RE: 1/84 Health Fee Elimination
Education Code Section 76355

CSM 09-4206-I-19 Citrus Community College District
Fiscal Years: 2002-03 through 2006-07

CSM 09-4206-I-20 Cerritos Community College District
Fiscal Years: 2002-03 through 2006-07

CSM 09-4206-I-23 Los Rios Community College District #3
Fiscal Years: 2005-06 through 2007-08

CSM 09-4206-I-26 Redwoods Community College District
Fiscal Years: 2002-03 through 2006-07

CSM 09-4206-I-28 Rancho Santiago Community College District #2
Fiscal Years: 2005-06 through 2008-09

CSM 09-4206-I-30 Pasadena Area Community College District #3
Fiscal Years: 2004-05 through 2005-06

I have received the Commission Draft Staff Analysis (DSA) dated July 20, 2011, for the above-referenced consolidated incorrect reduction claim, to which I respond on behalf of the six Districts listed above. Issues raised by the DSA, but not responded to by this letter, are not waived.

A. COMMISSION REMAND AUTHORITY

The DSA (42) recommends that the Commission remand to the Controller certain adjustments to determine the portion of total program cost attributable to athlete and employee physicals and reinstate those costs. The DSA does not establish the statutory authority for the Commission to remand adjustments for the purpose of correction. The statutory subject matter jurisdiction (Government Code section 17551, subdivision (d)) is to determine whether "the Controller has incorrectly reduced payments to the local agency or school district pursuant to paragraph (2) of subdivision (d) of Section 17561." If there is no authority to remand, the scope of the Commission authority may be only to declare the entire relevant adjustment incorrect and not just a portion thereof. Also, even if the Commission determines that it can remand a portion of an adjustment for correction, there is the related issue of whether the Controller can correct adjustments for fiscal periods that are now past the statute of limitations for an audit due to the passage of time since the audit report was issued. Claimants have no statutory standing to correct expired annual claims.

B. STATUTE OF LIMITATIONS FOR AN AUDIT

The statute of limitations for an audit is a threshold issue because adjustments made to annual claims past the statute of limitations for an audit are void. The Districts asserted that Government Code section 17558.5, subdivision (a), is impermissibly vague, and thus unenforceable. The DSA (35) has concluded that the "State Controller's Office has met the statute of limitations to initiate and complete the audits." The DSA (36) also asserts that it cannot address the issue of vagueness. This is all consistent with the Statement of Decision adopted July 28, 2011, for the incorrect reduction claim filed by the San Diego Unified School District, 01-4241-I-03, Emergency Procedures, Earthquake and Disasters for the same issue. Therefore, for its purposes, the Commission considers the issue settled.

However, the staff analysis is not complete. The DSA (35) states:

> "The statute of limitations for the State Controller's Office to initiate an audit is set forth in Government Code section 17558.5(a). As applicable to reimbursement claims filed before January 1, 2005, Government Code section 17558.5(a) provided in relevant part:
>
> (a) A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than three years after the date that the actual reimbursement claim is filed or last amended, whichever is later. However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the claim is filed, the time for the Controller to initiate an audit shall commence to run from the date of initial

payment of the claim."

Based on this Section, the Controller establishes the expiration date of the three-year audit period for the FY 2002-03 and FY 2003-04 annual claims to be October 25, 2009, based on the October 25, 2006, date of first payment. The DSA (36) concurs, based on the "plain language of the statute," that "the State Controller's Office has met the statute of limitations set forth in the second sentence of subdivision (a)."

However, the second sentence of Government Code section 17558.5, subdivision (a) references two actions: the appropriation of funds and the payment to claimants from that appropriation. An appropriation of funds for payment of the mandate program by the Legislature and the date of payment of that appropriation by the Controller to the claimants are independent acts. The DSA analysis makes no provision for those fiscal years in which there is an appropriation from which the Controller does not make a payment to the claimant. The Controller can confirm that there were fiscal years relevant to this incorrect reduction claim in which the Legislature appropriated funds (including the notorious $1,000 "placeholder" amounts) for the Health Fee Elimination mandate, but for which no payments were made to the Districts.

The issue still to be addressed is the legal effect to the commencement date of the statute of limitations based on a date of *appropriation* without subsequent *timely* or *any* payment action by the Controller. There are statutory time period requirements (Government Code section 17561, subdivision (d)) for the Controller to make timely payments to claimants from mandate appropriations that were not met and for which the Commission cannot hold the Controller harmless for the purpose of determining the start date for the statute of limitations for an audit. The failure of the Controller to meet these time periods is a failure of a statutory duty and should not benefit the Controller by extending the commencement date of the audits. The subject matter of the audit is the claimed costs, not the payments received. The purpose of the statute of limitations is to define a specific date that the claimed costs are subject to audit, not the period in which the Controller can make payments. The decision to appropriate funds belongs to the Legislature. The Legislature has ordered the Controller to make payment within sixty days of appropriation or by October 15, whichever is later. The delay in payment, or ultimate nonpayment, is based on unilateral action or inaction by the Controller, not by any delay by claimant or the Legislature.

There is a related issue not addressed by the DSA. The Controller later added additional fiscal years to the findings of some of the District's reviews that were not included in the original notice, or never noticed. Since the date of notice of the review is integral to determining the start and expiration of the time period for audit, the staff analysis needs to address the legal effect of the fiscal years added later to the findings, but never or not timely noticed to the Districts.

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C. GOVERNMENT CODE SECTION 17558.5 (c) COMPLIANCE

Government Code section 17558.5, subdivision (c), requires the Controller to provide a written explanation of the reason for adjustments within thirty days of issuing the payment action notice. The Districts asserted that the Controller's failure to do so impacts the filing of a comprehensive incorrect reduction claim. However, the DSA (37) holds the Controller harmless for this failure to comply with law because:

> "After a claimant has filed an incorrect reduction claim, the claimant has the ability to amend its incorrect reduction claim and is provided multiple opportunities to submit comments to respond to comments or issues raised during the Commission's incorrect reduction claims process. Additionally, if the State Controller's Office fails to provide a needed explanation of adjustments made to a reimbursement claim, the Commission maintains subpoena power. Here, the State Controller's Office provided detailed analyses to all of the claim reductions on October 20, 2009 and October 21, 2009, to which the Districts responded on January 11, 2011. Thus, the actions of the State Controller's Office have not denied the Districts the opportunity to comprehensively contest adjustments made to the reimbursement claims."

It would appear, because the claimant and Commission staff have the opportunity to expend the effort and cost of subsequent and duplicate responses, and that the Commission has subpoena power, the Controller's failure to provide timely statutory notice of findings, or to respond to the incorrect reduction claim within ninety days without benefit of a continuance, that claimants and the Commission are merely inconvenienced and not harmed by the Controller's delay which affects the availability of documentation and institutional memory. The more appropriate approach would be for the Commission to treat the failure of statutory compliance and unexcused delays as a default.

D. STANDARD OF REVIEW

The Districts do not dispute the Controller's authority to audit claims for mandated costs and to reduce those costs that are excessive or unreasonable. This authority is stated in Government Code section 17561. Section 17561(d)(2) requires the Controller to pay claims, provided that the Controller may audit the records of any school district to verify the actual amount of the mandated costs, and may reduce any claim that the Controller determines is excessive or unreasonable. However, the Controller did not audit the District enrollment or program costs. The Controller does not assert that the claimed costs were excessive or unreasonable. The DSA (34, 35) concludes *only* that since the Controller properly applied the Health Fee Rule utilizing the Chancellor's Office enrollment data, the standard was met. Therefore, if the Health Fee Rule was not properly applied and if the use of the Chancellor's enrollment data was inappropriate, the stated basis in the DSA for concluding that the standard was met is vacated, that is,

the Controller has not acted reasonably. As described below, the Health Fee Rule was not properly applied and the universal use of unvalidated Chancellor's Office enrollment data was inappropriate.

E. PROPER APPLICATION OF THE *CLOVIS* "HEALTH FEE RULE"

The Districts assert that the Health Fee Rule cobbled together by the *Clovis* Appellate Court establishes a new standard ("basic principle") for mandate cost accounting never articulated by the Legislature: "To the extent a local agency or school district 'has the authority' to charge for the mandated program or increased level of service, that charge cannot be recovered as a state-mandated cost." The Court characterizes this as a "fundamental legal principle underlying state mandated costs." The Districts asserted that the declaration of this new legal maxim proceeded without a complete analysis of the issue of underground rulemaking and includes reliance on a factually incompatible court decision. The Districts asserted that Education Code section 76355 requires the district governing board to exercise its legislative power, both in whether to charge the fee and to determine the amount of the fee, so the Section is not self-implementing.

Notwithstanding, the DSA (25) concludes: "Thus, pursuant to the court's decision the Health Fee Rule used by the State Controller's Office to adjust reimbursement claims filed by the Districts for the *Health Fee Elimination* program is valid. The Commission is bound by the court's decision in *Clovis*." The DSA, at footnote 86, asserts that the question has been "deliberatively examined and decided" and "should be considered as settled and closed to further argument." However, the argument cannot be closed as to how the Health Fee Rule was applied in these audits since there are factual issues not considered by the *Clovis* court.

1. Increases to the Authorized Fee Amounts

The DSA (25) concludes that the Health Fee Rule also "includes any automatic increases in fee *authority* resulting from the calculation set forth by the plain language in Education Code section 76355(a)(2)," and that the Controller can "use Education Code section 76355(a)(2) to determine the maximum health service fee authority for purposes of adjusting reimbursement claims." The determination that the *authority* for fee increases exists for audit purposes does not answer the question of the appropriate *calculation* of the authorized increased fee amount. Education Code section 76355 does not specify the application of the deflator. It does not specify which deflator components are relevant to college district or health services costs. It does not specify when the additional dollar increases may be assessed. The language of Section 76355 is insufficient to make the application of the cited deflator self-implementing and the DSA does not respond to this issue.

Further, although the DSA concludes that the Controller can rely upon the authorized fee increases, it does not address the issue of the Controller's apparent reliance on the

Board of Governor's letter as the source of the appropriate amount. The audit reports have cited this letter, or the Chancellor's Office, as the source of these increased fee amounts. This would seem to merit the same analysis as that for the utility of the enrollment data since both are third party data. There is no evidence on the record that the fee increases in the Chancellor's letter are properly timed or properly calculated. Therefore, any state agency wishing to enforce Section 76355 would be required to comply with the Administrative Procedure Act, and the Controller has not. The Controller's use of the Chancellor's letter, for audit purposes, for the calculation of the collectible amount, is a rule of general application without benefit of rulemaking and the DSA does not respond to this issue.

2. Student Access to Health Service Centers

The Districts have asserted that many community colleges have academic "learning centers" located significant distances away from the main campus location of the student health service center and that there are categories of students that cannot access the student health services. It would be unreasonable for the district to charge students for services that will not be provided because they are not practically accessible. The Controller's calculation of collectible fees includes all students except those statutorily exempted. The result is that the Controller is offsetting the cost of services provided to other students for students from whom the district does not collect a revenue or incur a program cost. The *Clovis* decision has concluded that if a charge can be made, then a cost is not incurred. However, no charge can reasonably be made for students that cannot access the services and for whom no services are provided, so the total program costs should not be reduced by student health service fees never collected from those students.

The DSA (27) concludes that "[u]nless the students referenced in the Districts' argument above fall into any of the three categories of exempt students, the Districts have the authority to charge the students the health service fee." Which is to say, there is legal authority to charge students for services that cannot possibly or practically be provided. The *Clovis* decision did not state that the claimants could charge students for services that the district could not or did not provide. Regardless of the legal or ethical propriety of the DSA interpretation of the Health Fee Rule, it must be remembered that current period cost reimbursement is limited to the scope of student health services offered in the FY 1986-87 base year. The scope of services provided in FY 1986-87 was a matter of discretion at that time to the governing board, but is no longer since the scope of reimbursable services was subsequently locked-in by the parameters and guidelines.

Similarly, the category of students not assessed the student health service fee (beyond the statutory exemptions) for the base year was determined by the governing boards prior to the effective date of the fee authority. The *Clovis* court determined that the claimants can choose not to require these fees, but not at state expense. It did not

conclude that claimants have an affirmative duty to forego a reduction of a portion of the reimbursement for the scope of services subsequently and retroactively mandated to the FY 1986-87 level that results when fees are imputed in subsequent years by the state but not collected from the students without access to the student health services. The governing board's choice of students from whom fees were to be collected in 1986-87 could not have been influenced by any possible state reimbursement consequences, that is, a desire to burden the state, since the fee authority was not established until January 1, 1988.

Just as the scope of reimbursable services is limited to the base year, the scope of nonexempt students to be included in the collectible fees offset should be limited to the base year. This would mitigate the cost reimbursement penalty to claimants for not collecting fees from students attending remote learning centers for which the district did not provide student health services then or now, or for those students in types of programs, such as non-credit programs, for which student health service fees were and are not collected. The Commission should decide that fees not collected from students without access to the health center services in the base year and afterwards should be excluded from the calculation of collectible fees.

3. Students Exempt From the Health Service Fee

Education Code section 76355, subdivision (c), states that the districts cannot charge a student health service fee to apprenticeship students or students that request a religion-based exemption. Until January 1, 2006, students receiving BOGG fee waivers (perhaps as much as 30% of the total enrollment) were also exempted from paying the fee. The Controller's collectible fee calculation excludes these three types of exempted students from the calculation of the offsetting revenue, but does not specifically determine the cost of the services to these exempt students. The *Clovis* decision has concluded that if a charge can be made, then a cost is not incurred. Since no charge can be made for exempted students, these costs should be reimbursed without regard to any reduction by the health service fees collected from other students not exempted. This is a basic accounting principle of matching of revenues to costs. The Controller has the burden of going forward on this issue of properly applying the *Clovis* rule and has not done so on this matching issue.

The DSA (39) concludes that the audit "properly accounted for students exempt from the health service fee." The DSA (39) states:

> "The Districts' argument suggests that the State Controller's Office is required to determine the costs of the services to students exempt from the health services fee. However, it is a claimant's responsibility to claim total reimbursable costs in its reimbursement claims filed with the State Controller's Office. Here, the total reimbursable costs claimed by the Districts should have included the reimbursable costs of health services provided to all students, including students

> exempt from the health service fee. It is unclear if, or why, the Districts excluded the cost of health services provided to students exempted from the health service fee from the total reimbursable claim amounts submitted by the Districts to the State Controller's Office. To the extent that reimbursable costs under the *Health Fee Elimination* program have not been claimed, it is the responsibility of the claimants (the Districts) to claim these costs, not that of the State Controller's Office"

Contrary to the DSA conclusion, the Districts *did* report the total cost of providing health services to all students. The cost of services provided to exempt students was not omitted from the annual claim. It appears that the DSA misunderstands the issue presented and how the collectible fee offset works in the annual claim. The DSA (39) also erroneously concludes that the audit did not reduce the cost of the services to exempt students:

> "Ultimately, the cost of health services provided to students exempt from the health service fee is irrelevant for purposes of the consolidated incorrect reduction claims because the State Controller's Office did not make any reduction to the reimbursement claims on the basis of the Districts including the cost of providing health services to students exempt from the health service fee. The *only* basis upon which the State Controller's Office reduced the Districts' reimbursement claims, was for understating offsetting revenue resulting from the health service fees that the Districts' had the *authority* to charge. Thus, staff finds that the State Controller's Office properly accounted for students exempt from the health service fee."

The Controller's reimbursement calculation subtracts the fees collectible from nonexempt students from total program costs. To the extent that the authorized fees collected from nonexempt students reduce the cost of services to exempt students, the calculation is reducing reimbursement for those services provided to exempt students, from whom a fee cannot be charged, and is thus contrary to the *Clovis* decision. To properly implement the Health Fee Rule would require the Controller to pro-rate the total program costs between exempt and nonexempt students based on enrollment or similar data, and then apply the calculated authorized fees as a reduction only to the portion of the total cost of services applicable to the nonexempt students. The Controller has performed similar revenue matching calculations in other audits. See the Enrollment Fee Collection and Waivers audit reports for Contra Costa CCD and Gavilan CCD posted on the Controller's website. The Health Fee Elimination audits that are the subject of this consolidated incorrect reduction claim did not match the revenue, so the collectible fees reduction adjustments are incorrect.

The Commission should deny the collectible fees adjustment in total or remand all of the annual claims for all of the Districts with directions to the Controller to pro-rate the program costs between exempt and nonexempt students and limit the offset of

collectible fees to the program costs applicable to nonexempt students. The Controller should also be directed to modify the claiming instructions to provide a mechanism to pro-rate the costs of services provided to exempt students and remove these costs

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underground rulemaking. The DSA did not address this issue.

The Controller did not audit the Districts' enrollment documentation. Instead, the Controller utilized enrollment data from the Chancellor's Office for the calculation of collectible fees. The Controller has consistently utilized this Chancellor's enrollment data for audits for several years, so it is being used as a rule of general application. This enrollment information was collected, processed, and reported by a separate state agency for other purposes. A district's compliance with the MIS data system is a condition of receiving grant funds, not of reimbursement for state mandates. Since the MIS data was used by the Controller to calculate the collectible offsetting revenues, the data must be proved relevant by the Controller. The Controller did not validate the data, so the adjustments are without foundation. The DSA attempts to validate the data on behalf of the Controller, but without success due to lack of critical information.

The DSA (30) states that the standard for determining whether the discretion was properly applied is that of an ordinary mandate, that is, with deference to the Controller's audit authority and expertise, to determine whether the Controller's reliance upon the Chancellor's enrollment data was not arbitrary or capricious. Since the standard cited in the DSA is essentially the lowest general standard in law, it is arguable that it was met and the Districts could consider the issue moot had the Chancellor's MIS data been properly validated. However, neither the Controller nor the DSA completely validates the Chancellor's data. Instead, the DSA focuses on what information was not provided in the annual claims and essentially awards the Controller ownership, or at least custody, of the Chancellor's MIS system almost by default.

The DSA (31) notes that most of the Districts did not include enrollment numbers in their annual claims. Although requested by the claiming instructions (which do not have the force of law) this information is not required by the parameters and guidelines, and was irrelevant until the *Clovis* decision became final. Further, the Controller's subsequent requests for this information preceded the effective date of the *Clovis* decision. Regardless, the Districts provided the requested enrollment information even though the Districts appropriately continued the legal position that actual revenue was the appropriate offset and not collectible fees since *Clovis* had not become final. The DSA (32) notes that most of the responses to the Controller's request did not separately identity the number of students exempt from the student health service fee, but provided the number of nonexempt students, which is the number needed for the *Clovis* calculation. Because the DSA could not correlate this information and was not satisfied with the scope of original reporting by the District, the DSA concluded that the Districts response was "unclear," providing a further basis to adopt the Chancellor's MIS date by default.

However, the DSA (33) concludes that the MIS data is a "reasonable and reliable source for enrollment data" because the claimants stated that the original annual claim data or subsequently reported enrollment data was from the MIS system and that the Controller ostensibly selected the relevant data elements to establish the number of

nonexempt students. The DSA accepted the prima facie relevance of the data elements selected by the Controller. What neither the Controller nor the Commission staff has validated is *the source of the data provided by the districts* to the Chancellor's MIS system, and until that is accomplished, the MIS reports are only presumptively valid. The DSA merely infers that the data provided by the districts to the MIS system is both accurate and relevant. The MIS system data output directly depends upon the district input. There is no evidence on the record that the data inputs are satisfactory. For example, it appears that the MIS system relies upon "headcount" which is an enrollment statistic reported by the districts on various dates. The total number of students subject to payment of health fees throughout a semester would be different based on date of enrollment or subsequent departure from college and refund of fees before and after the headcount. The DSA does not consider that the data available at the time the annual claim is prepared may not be the same data available or used for the MIS input. The validity of the input data would seem to require evidence from the Chancellor's Office as to how the Chancellor's staff validates the submitted data. The parameters and guidelines do not require MIS data. The Districts never asserted the need for MIS enrollment data because the Districts reported actual revenue, so the burden is on the state agencies using or approving the use of the MIS data for purposes of the audit to validate the data. That burden has not yet been met.

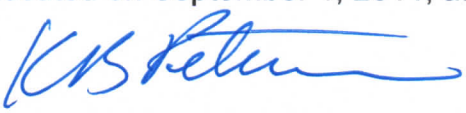
Validated or not, the DSA does not respond to the corollary issue of underground rulemaking by the Controller as a result of the Controller's universal and consistent use of the Chancellor's data. The DSA has concluded that the use of the Chancellor's data was not arbitrary and capricious, which is the standard applicable "when an agency is not required to hold an evidentiary hearing." (DSA 30) However, the universal and consistent use of the Chancellor's data, validated or not, by the Controller for purposes of an audit is a rule of general application and the evidentiary standard is different and requires administrative rulemaking. The use of the Chancellor's MIS is not permitted by the parameters and guidelines so the state agency, the Controller, asserting its universal and continued application must perform the rulemaking process.

The Commission should reject the Controller's use of the MIS enrollment data as underground rulemaking or without foundation due to lack of validation of the data for the annual claims that are the subject of this incorrect reduction claim. The Commission should also direct the Controller to discontinue use of the Chancellor's MIS data for purposes of audit until the necessary rulemaking is performed or until amended parameters and guidelines are adopted, as was done on January 29, 2010, for the contemporaneous source documentation rule for this mandate. (The *Clovis* court determined the contemporaneous source documentation rule as applied by the Controller was underground rulemaking.) However, either or both the rulemaking and amended parameters and guidelines would be prospective only in effect.

CERTIFICATION

By my signature below, I hereby declare, under penalty of perjury under the laws of the State of California, that the information in this submission is true and complete to the best of my own knowledge or information or belief, and that any attached documents are true and correct copies of documents received from or sent by the District or state agency which originated the document.

Executed on September 1, 2011, at Sacramento, California, by



Keith B. Petersen, President
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