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December 11, 2014

Mr. Keith B. Petersen
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Ms. Jill Kanemasu
State Controller's Office
Accounting and Reporting
3301 C Street, Suite 700
Sacramento, CA 95816

And Parties, Interested Parties, and Interested Persons (See Mailing List)

Re: **Decision**
Health Fee Elimination, 05-4206-I-05
Education Code Section 76355
Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118
Fiscal Years 1999-2000, 2000-2001, and 2001-2002
State Center Community College District, Claimant

Dear Mr. Petersen and Ms. Kanemasu:

On December 5, 2014, the Commission on State Mandates adopted the decision on the above-entitled matter.

Sincerely,

Heather Halsey
Executive Director

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Former Education Code Section 72246 (Renumbered as 76355)[1] Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB 1) and Statutes 1987, Chapter 1118 (AB 2336) Fiscal Years 1999-2000, 2000-2001, and 2001-2002 State Center Community College District, Claimant.	Case No.: 05-4206-I-05 *Health Fee Elimination* DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5. ARTICLE 7 (*Adopted December 5, 2014*) (*Served December 11, 2014*)

DECISION

The Commission on State Mandates (Commission) heard and decided this incorrect reduction claim (IRC) during a regularly scheduled hearing on December 5, 2014. Keith Petersen appeared on behalf of the claimant. Jim Spano and Jim Venneman appeared on behalf of the State Controller's Office (Controller).

The law applicable to the Commission's determination of a reimbursable state-mandated program is article XIII B, section 6 of the California Constitution, Government Code section 17500 et seq., and related case law.

The Commission adopted the proposed decision to deny the IRC by a vote of six to zero.

Summary of the Findings

This analysis addresses reductions made by the Controller to State Center Community College District's (claimant's) reimbursement claims for fiscal years 1999-2000 through 2001-2002 under the *Health Fee Elimination* program. Over the three fiscal years in question, reductions totaling $385,753 were made based on understated offsetting health fee authority, and additional reductions totaling $415,502 were made based on disallowed indirect costs rates.

The Commission denies this IRC, finding that the Controller's audit of the 1999-2000 and 2000-2001 reimbursement claims was timely pursuant to Government Code section 17558.5 . The Commission further finds that the reduction of indirect costs based on the claimant's failure to obtain federal approval for its indirect cost rate proposals, and the Controller's reduction of costs based on the claimant's underreporting of health service fee revenue authorized by statute, are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support.

[1] Statutes 1993, chapter 8.

COMMISSION FINDINGS

I. Chronology

01/13/2001	Claimant, State Center Community College District, filed its fiscal year 1999-2000 reimbursement claim.[2]
12/27/2001	Claimant filed its fiscal year 2000-2001 reimbursement claim.[3]
12/20/2002	Claimant signed and dated its fiscal year 2001-2002 reimbursement claim.[4]
05/12/2003	An entrance conference for the audit of all three fiscal years was held.[5]
09/17/2004	The Controller issued a final audit report.[6]
09/01/2005	Claimant filed this IRC.[7]
02/8/2008	The Controller filed comments on the IRC.[8]
09/09/2014	Commission staff issued a draft proposed decision.[9]
09/22/2014	Claimant filed comments on the draft proposed decision.[10]
09/30/2014	The Controller filed comments on the draft proposed decision.[11]

II. Background

Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts that voluntarily provided health supervision and services, direct and indirect medical and hospitalization services, or operation of student health centers, to charge almost all students a health service fee not to exceed $7.50 for each semester or $5 for each quarter or summer session, to fund these services.[12] In 1984, the Legislature repealed the community colleges' fee

[2] Exhibit A, Incorrect Reduction Claim, page 19.

[3] *Ibid*.

[4] Exhibit A, Incorrect Reduction Claim, page 96.

[5] Exhibit A, Incorrect Reduction Claim, page 19.

[6] Exhibit A, Incorrect Reduction Claim, pages 19; 42.

[7] Exhibit A, Incorrect Reduction Claim, page 1.

[8] Exhibit B, Controller's Comments.

[9] Exhibit C, Draft Proposed Decision.

[10] Exhibit D, Claimant's Comments on Draft Proposed Decision.

[11] Exhibit E, Controller's Comments on Draft Proposed Decision.

[12] Former Education Code section 72246 (Stats. 1981, ch. 763) [Low-income students, students that depend upon prayer for healing, and students attending a college under an approved apprenticeship training program, were exempt from the fee.].

authority for health services.[13] However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, to reauthorize the fee, at $7.50 for each semester (or $5 for quarter or summer semester).[14]

In addition to temporarily repealing community college districts' authority to levy a health services fee, the 1984 enactment required any district that provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.[15] As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987,[16] the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.[17] In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than $7.50 for each semester, or $5 for each quarter or summer semester.[18] As a result, beginning January 1, 1988 all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services. In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.[19]

On November 20, 1986, the Commission determined that Statutes 1984, chapter 1 imposed a reimbursable state-mandated new program upon community college districts. On August 27, 1987, the Commission adopted parameters and guidelines for the Health Fee Elimination program. On May 25, 1989, the Commission amended the parameters and guidelines for the Health Fee Elimination program to reflect amendments made by Statutes1987, chapter 1118.

The parameters and guidelines generally provide that eligible community college districts shall be reimbursed for the costs of providing a health services program, and that only services specified in the parameters and guidelines and provided by the community college in the 1986-1987 fiscal year may be claimed.

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[13] Statutes 1984, 2nd Extraordinary Session, chapter 1, section 4 [repealing Education Code section 72246].

[14] Statutes 1984, 2nd Extraordinary Session, chapter 1, section 4.5.

[15] Education Code section 72246.5 (Stats. 1984, 2d. Ex. Sess., ch. 1, § 4.7).

[16] Statutes 1987, chapter 1118.

[17] Education Code section 72246 (as amended, Stats. 1987, ch. 1118). See also former Education Code section 72246.5 (Stats. 1984, 2d Ex. Sess., ch. 1, § 4.7).

[18] Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

[19] Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355. (Stats. 1993, ch. 8)

The Controller's Audit and Summary of the Issues

Over the three fiscal years in question (1999-2000, 2000-2001, and 2001-2002), reductions totaling $385,753 were made based on alleged understated offsetting health fees authorized to be collected and additional reductions totaling $415,502 were made based on disallowed indirect costs rates.

This IRC addresses the following issues:

- The statutory deadlines applicable to audits of reimbursement claims by the Controller pursuant to Government Code section 17558.5;
- Reduction of costs based on asserted faults in the development and application of indirect cost rates; and
- The amount of offsetting revenue to be applied from health service fee authority.

III. Positions of the Parties

State Center Community College District

Claimant asserts that the Controller incorrectly reduced costs claimed for fiscal years 1999-2000 through 2001-2002, totaling $801,255. Specifically, claimant asserts that the reduction of $415,502 on grounds that "the district did not obtain federal approval for its [indirect cost rates,]" was incorrect. Claimant argues that "[c]ontrary to the Controller's ministerial preferences, there is no requirement in law that the district's indirect cost rate must be 'federally' approved," and the Controller did not make findings that claimant's rate was excessive or unreasonable.[20] And, claimant asserts that a reduction of its total claim in the amount of $385,753, based on understated authorized health service fees was incorrect, because the parameters and guidelines require claimants to state offsetting savings "experienced," and claimant did not experience offsetting savings for fees that it did not charge to students.[21] In addition, claimant asserts that the statute of limitations applicable to the Controller's audits of reimbursement claims barred auditing its fiscal year 1999-2000 and 2000-2001 reimbursement claims.[22]

Claimant does not dispute the Controller's findings with respect to unallowable services and supplies and unallowable salary costs.[23]

In comments on the draft proposed decision, the claimant reiterates its view that the applicable statute of limitations, with respect to the 1999-2000 and 2000-2001 fiscal year reimbursement claims, required the Controller to complete the audit on or before December 31, 2003, and that the audit is therefore not timely with respect to those fiscal years.

[20] Exhibit A, Incorrect Reduction Claim, page 14.

[21] Exhibit A, Incorrect Reduction Claim, pages 15-19.

[22] Exhibit A, Incorrect Reduction Claim, pages 19-23.

[23] Exhibit A, Incorrect Reduction Claim, pages 11; 50-51.

State Controller's Office

The Controller asserts that claimant overstated its indirect costs, because claimant did not obtain federal approval for its indirect cost rate proposals, as required by the Controller's claiming instructions. The Controller explains that the auditors "calculated indirect cost rates using the alternate methodology" provided in the claiming instructions, which "did not support the rates that the district claimed."[24] In addition, the Controller states that it "is not responsible for identifying the district's responsible federal agency" authorized to approve indirect cost rates.[25]

The Controller further found that claimant understated its health service fee authority for the audit period in the amount of $385,753. Using enrollment and exemption data, the Controller recalculated the health fees that claimant was authorized to collect, and reduced the claim by the amount not stated as offsetting revenues.[26] The Controller argues that "[t]he relevant amount [of offsetting savings] is not the amount charged, nor the amount collected, rather, it is the amount authorized."[27]

Finally, the Controller argues that claimant "incorrectly applies the 1996 version of [the statute of limitations.]" The Controller explains that the prior version of section 17558.5 provided that a reimbursement claim is "subject to audit" for two years after the end of the calendar year in which the claim is filed, meaning that claimant's 1999-2000 claim, filed January 13, 2001, would be "subject to audit" through December 31, 2003. The Controller asserts that the audit in dispute in this IRC was initiated no later than "when the entrance conference was held,"[28] which claimant asserts was on May 12, 2003.[29] The Controller argues that there is no support for the theory that "subject to audit" requires the Controller to issue a final audit report before the two year period expires.[30] Moreover, the Controller argues that as of January 1, 2003 section 17558.5 was amended to provide that a reimbursement claim "is subject to the initiation of an audit by the Controller no later than three years after the reimbursement claim is filed or last amended, whichever is later…" The Controller argues that "the phrase 'initiation of an audit' implies the first step taken by the Controller," in this case, the entrance conference.[31]

On September 30, 2014, the Controller submitted written comments expressing support of staff's conclusions in the draft proposed decision.[32]

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[24] Exhibit B, Controller's Comments on IRC, pages 12-13.

[25] Exhibit B, Controller's Comments on IRC, page 14.

[26] Exhibit B, Controller's Comments on IRC, page 15; 18.

[27] Exhibit B, Controller's Comments on IRC, page 2.

[28] Exhibit B, Controller's Comments on IRC, page 2.

[29] Exhibit A, Incorrect Reduction Claim, page 19.

[30] Exhibit B, Controller's Comments on IRC, page 20.

[31] *Ibid.*

[32] Exhibit E, Controller's Comments on Draft Proposed Decision.

IV. Discussion

Government Code section 17561(b) authorizes the Controller to audit the claims filed by local agencies and school districts and to reduce any claim for reimbursement of state mandated costs that the Controller determines is excessive or unreasonable.

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the SCO has incorrectly reduced payments to a local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9 of the Commission's regulations requires the Commission to send the statement of decision to the SCO and request that the costs in the claim be reinstated.

The Commission must review questions of law, including interpretation of the parameters and guidelines, *de novo*, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[33] The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."[34]

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.[35] Under this standard, the courts have found that:

> When reviewing the exercise of discretion, "[t]he scope of review is limited, out of deference to the agency's authority and presumed expertise: 'The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]'" ... "In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . ." [Citations.] When making that inquiry, the " ' "court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "[36]

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[33] *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

[34] *County of Sonoma, supra,* 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

[35] *Johnston v. Sonoma County Agricultural* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

[36] *American Bd. of Cosmetic Surgery, Inc, supra,* 162 Cal.App.4th 534, 547-548.

The Commission must review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with claimant. [37] In addition, section 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[38]

A. The Statutory Deadlines Found in Government Code Section 17558.5 do not Bar the Controller's Audit of Claimant's 1999-2000 and 2000-2001 Reimbursement Claims.

Claimant asserts that "the audit adjustments for Fiscal Year 1999-00 and 2000-01 are barred by the statute of limitations…" in Government Code section 17558.5.[39] Claimant submitted the reimbursement claims for fiscal years 1999-2000 and 2000-2001 on January 13, 2001, and December 27, 2001.[40] At that time, Government Code section 17558.5, as added in 1995, stated the following:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller *no later than two years after the end of the calendar year* in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[41] (Emphasis added.)

Since the 1999-2000 and 2000-2001 reimbursement claims were submitted on January 13, 2001, and December 27, 2001, those claims were "subject to audit" by the plain language of the statute until December 31, 2003. The audit was initiated no later than May 12, 2003, when an audit entrance conference was held, less than two years after the end of the calendar year in which they were filed. Therefore, the initiation of the audit was timely.

Claimant, however, interprets "subject to audit" to require the *completion* of an audit within the two year period, and therefore concludes that an audit report issuing September 17, 2004 is not timely, and "[t]he audit findings are therefore void for those two claims."[42] The Controller argues that "the Legislature modified the previous language to clarify its intent." The Controller states that the plain language of "subject to" does not require the Controller to issue its final audit

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[37] *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

[38] Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission's decision is not supported by substantial evidence in the record.

[39] Exhibit A, Incorrect Reduction Claim, page 17.

[40] Exhibit A, Incorrect Reduction Claim, page 19.

[41] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)).

[42] Exhibit A, Incorrect Reduction Claim, pages 19-23.

report before the two years expires; rather, the Controller "exercised its authority to audit the district's claims by conducting the audit entrance conference within the statute of limitations."[43]

As amended by Statutes 2002, chapter 1128 (AB 2834), effective January 1, 2003, section 17558.5 stated the following:

> 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 ~~two~~ three years after the ~~end of the calendar year in which~~ 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 ~~made~~ filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[44]

Effective January 1, 2003, section 17558.5 clarified that when funds are appropriated, the claim is subject "to *the initiation of an audit*…" for the statutory period. The 2002 statute also changed the requirement to initiate the audit from *two years after the end of the calendar year* in which the reimbursement claim is filed or last amended, to *three years after the date that the actual reimbursement claim is filed* or last amended. Any enlargement of the statutory period that is made by a statutory amendment that becomes effective after a reimbursement claim is filed, but the audit period is still pending and not already barred, applies to those claims already filed. In *Douglas Aircraft*, the court stated the general rule as follows:

> The extension of the statutory period within which an action must be brought is generally held to be valid if made before the cause of action is barred. (*Weldon v. Rogers*, 151 Cal. 432.) The party claiming to be adversely affected is deemed to suffer no injury where he was under an obligation to pay before the period was lengthened. This is on the theory that the legislation affects only the remedy and not a right. (*Mudd v. McColgan*, 30 Cal.2d 463; *Davis & McMillan v. Industrial Acc. Com.*, 198 Cal. 631; 31 Cal.Jur.2d 434.) An enlargement of the limitation period by the Legislature has been held to be proper in cases where the period had not run against a corporation for additional franchise taxes (*Edison Calif. Stores, Inc. v. McColgan*, 30 Cal.2d 472), against an individual for personal income taxes (*Mudd v. McColgan, supra*, 30 Cal.2d 463), and against a judgment debtor (*Weldon v. Rogers, supra*, 151 Cal. 432). It has been held that unless the statute expressly provides to the contrary any such enlargement applies to matters pending but not already barred. (*Mudd v. McColgan, supra*, 30 Cal.2d 463.)[45]

Based only upon the plain language of the 1995 version of section 17558.5, the reimbursement claims in issue would be "subject to audit" until the end of the calendar year 2003, for the reimbursement claims filed in 2001. Based on the plain language as amended in 2002 (effective January 1, 2003), the reimbursement claims in issue would be "subject to the initiation of an audit" until three years after the claims were filed, or January 13, 2004, for the 1999-2000

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[43] Exhibit B, Controller's Comments on IRC, pages 19-20.

[44] Government Code section 17558.5 (Stats. 2002, ch. 1128 (AB 2834)).

[45] *Douglas Aircraft Co. v. Cranston* (1962) 58 Cal.2d 462, 465.

reimbursement claim. Because an entrance conference was held May 12, 2003, the audit was initiated prior to the running of the statutory period. And, because the 2002 statute expanded the statutory period while it was still pending, the Controller receives the benefit of the additional time.

The only reading of these facts and of section 17558.5 that could bar the subject audits would be to hold that section 17558.5 requires an audit to be *completed* within two years of filing, in which case the final audit report issued September 17, 2004 would be barred for the 1999-2000 and 2000-2001 reimbursement claims. This is the interpretation urged by the claimant, but this reading of the code is not supported by the plain language of the statute, and would ignore the expansion of the limitation period effected by the 2002 amendment to the statute, in direct conflict with *Douglas Aircraft, supra*. At the time the first two claims were filed, section 17558.5 did not expressly fix the time in which an audit must be completed. Nevertheless, the Controller was still required under common law to complete the audit within a reasonable period of time. Under appropriate circumstances, the defense of laches may operate to bar an audit by a public agency if there is evidence of unreasonable delay by the agency and resulting prejudice to the claimant.[46] In this case, the audit was completed when the final audit report was issued on September 17, 2004, approximately 16 months after the audit was initiated. Thus, there is no evidence of an unreasonable delay in the completion of the audit.

In its comments on the draft proposed decision, the claimant continues to argue that "the FY 1999-00 (filed January 13, 2001) and FY 2000-01 (filed December 27, 2001) annual claims were beyond the statute of limitations for completion of the audit (December 31, 2003) when the Controller completed its audit on September 17, 2004." The claimant continues: "The Commission cites no cases contradicting the practical requirement that completion is measured by the date of the audit report."[47]

The claimant's comments do not alter the above analysis. The 1995 version of the statute, as shown above, does not require an audit to be completed within a certain time, and if interpreted as a whole, there is no reason to read "subject to audit" in the first sentence differently from "the time for the Controller to initiate an audit" in the second sentence. Moreover, the 2002 amendment supports that construction, providing that a claim is "subject to the initiation of an audit" for a specified time from the date the claim is filed (expanded to three years). And, even if the 2002 amendment were interpreted as a substantive amendment, rather than a clarifying change, the amendment applies as of its effective date to any actions (here, potential audits) pending but not already barred. Once initiated, the 2002 version of section 17558.5 does not provide for a specific time frame to complete an audit, but a reasonableness test could be applied. Here, there is no basis to find that the completion of the audit was not reasonable, based on an entrance conference of May 12, 2003 and a final audit report issued September 17, 2004, approximately sixteen months elapsing between.

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[46] *Cedar-Sinai Medical Center v. Shewry* (2006) 137 Cal.App.4th 964, 985-986. In that case, the court determined that the hospital failed to establish an unreasonable delay in audits conduct by Department of Health Services, since the Department conducted audits two years or less after the end of the fiscal period that it was auditing, which was less than the three-year period permitted by statute.

[47] Exhibit D, Claimant's Comments on Draft Proposed Decision, pages 1-2.

Based on the foregoing, the Commission finds that the audit of the subject reimbursement claims is timely and not barred by the statutory deadlines in Government Code section 17558.5.

B. The Controller's Reduction and Recalculation of Claimed Indirect Costs is Correct as a Matter of Law, and is not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced indirect costs claimed by a total of $415,502 for all three fiscal years, on grounds that claimant did not utilize a federally approved indirect cost rate.[48] Claimant disputes that federal approval is required, and challenges the Controller's substitution of the alternative state method and the resulting disallowance.

The Commission finds that the parameters and guidelines require claimants to adhere to the claiming instructions when claiming indirect costs, and that the claimant here did not do so. Therefore, the reduction was correct as a matter of law. The Commission further finds that the Controller's use of the other authorized method in the claiming instructions to calculate indirect costs was not arbitrary, capricious, or entirely lacking in evidentiary support.

1. *The parameters and guidelines expressly require claimants to claim indirect costs in the manner described in the Controller's claiming instructions, which in turn provide that an indirect cost rate may be developed in accordance with federal OMB guidelines or by using the state Form FAM-29C.*

The claimant argues that "[n]o particular indirect cost rate calculation is required by law," and that the parameters and guidelines "do not require that indirect costs be claimed in the manner described by the Controller." Claimant recognizes that the parameters and guidelines plainly state that "indirect costs *may be claimed in the manner described by the State Controller*," but claimant argues that the word "may" is permissive, and that therefore the parameters and guidelines do not require that indirect costs be claimed in the manner described by the Controller.[49]

Claimant's argument is unsound: the parameters and guidelines provide that "[i]ndirect costs may be claimed in the manner described by the State Controller in his claiming instructions."[50] The interpretation that is consistent with the plain language of the parameters and guidelines is that "indirect costs may be claimed," or may not, but if a claimant chooses to claim indirect costs, the claimant must adhere to the Controller's claiming instructions.[51]

The claiming instructions specific to the *Health Fee Elimination* mandate, revised in September 1997[52] state that "college districts have the option of using a *federally approved rate* (i.e., utilizing the cost accounting principles from the Office of Management and Budget Circular A-21), or the State Controller's methodology outlined in "Filing a Claim" of the Mandated Cost

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[48] Exhibit A, Incorrect Reduction Claim, page 11.

[49] Exhibit A, Incorrect Reduction Claim, pages 11-12.

[50] Exhibit B, Controller's Comments, page 40 [Parameters and Guidelines, Adopted August 27, 1987].

[51] Exhibit B, Controller's Comments, page 14.

[52] Exhibit F, Health Fee Elimination Claiming Instructions.

Manual for Schools." In addition, the School Mandated Cost Manual, revised each year, and containing instructions applicable to all school and community college mandated programs,[53] provides as follows:

> A college has the option of using a federally approved rate, utilizing the cost accounting principles from Office of Management and Budget Circular A-21 "Cost Principles for Educational Institutions," or the Controller's methodology outlined in the following paragraphs. If the federal rate is used, it must be from the same fiscal year in which the costs were incurred.
>
> The Controller allows the following methodology for use by community colleges in computing an indirect cost rate for state mandates. The objective of this computation is to determine an equitable rate for use in allocating administrative support to personnel that performed the mandated cost activities claimed by the community college. This methodology assumes that administrative services are provided to all activities of the institution in relation to the direct costs incurred in the performance of those activities. Form FAM-29C has been developed to assist the community college in computing an indirect cost rate for state mandates.[54]

Claimant argues that "[c]ontrary to the Controller's ministerial preferences, there is no requirement in law that the district's indirect cost rate must be 'federally' approved, and neither the Commission nor the Controller has ever specified the federal agencies which have the authority to approve indirect cost rates."[55]

The reference in the parameters and guidelines to the Controller's claiming instructions necessarily includes the general provisions of the School Mandated Cost Manual (and later the Mandated Cost Manual for Community Colleges), and the manual provides ample notice to claimants as to how they may properly claim indirect costs. Claimant's assertion that "[n]either applicable law nor the Parameters and Guidelines made compliance with the Controller's claiming instructions a condition of reimbursement"[56] is therefore in error. The parameters and guidelines, which were duly adopted at a Commission hearing, require compliance with the claiming instructions.

Claimant also argues that "the Controller's claiming instructions were never adopted as law, or regulations pursuant to the Administrative Procedure Act," and therefore, claimant argues, "the claiming instructions are merely a statement of the ministerial interests of the Controller and not law."[57] In *Clovis Unified*, the Controller's contemporaneous source document rule, or CSDR, was held to be an unenforceable underground regulation because it was applied generally against school districts and had never been adopted as a regulation under the APA.[58] Here, claimant

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[53] Exhibit F, School Mandated Cost Manual Excerpt 1999-2000, page 4.

[54] Exhibit F, School Mandated Cost Manual Excerpt, 1999-2000, Revised October 1998, page 11.

[55] Exhibit A, Incorrect Reduction Claim, at page 11.

[56] Exhibit C, Claimant Rebuttal Comments, page 7.

[57] Exhibit A, Incorrect Reduction Claim, page 13.

[58] *Clovis Unified School District v. State Controller* (2010) 188 Cal.App.4th 794, 807.

alleges, somewhat indirectly, the same fault in the claiming instructions with respect to indirect cost rates.

More importantly, the claimant had notice of the requirement in the parameters and guidelines to comply with the claiming instructions and notice of the claiming instructions' requirements for claiming indirect costs, both prior to and during the claim years in issue, and the claimant did not challenge the parameters and guidelines or the claiming instructions when they were adopted.[59]

Based on the foregoing, the Commission finds that the parameters and guidelines expressly require claimants to claim indirect costs in the manner described in the Controller's claiming instructions, which in turn provide that an indirect cost rate may be developed in accordance with federal OMB guidelines or by using the state Form FAM-29C; and that the claimant had notice of the parameters and guidelines and the claiming instructions, and did not challenge them when they were adopted.

2. *Claimant did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rates. Therefore, the Controller's reduction and recalculation of costs based on applying the Form FAM-29C calculation to provide an indirect cost rate is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.*

In the audit of claimant's 1999-2000 through 2001-2002 reimbursement claims, the Controller concluded that the claimed indirect costs were based on a rate that was not federally approved, and that the Controller's calculated rates did not support the indirect cost rates claimed.[60] Claimant filed indirect cost rates of 38.74 percent, 37.73 percent, and 35.06 percent for the three audit years. The Controller reduced the claimed indirect cost rates, based on the alternative state method, to 14.07 percent, 14.38 percent, and 13.86 percent.[61]

The Controller maintains that the claimant "should obtain federal approval when it prepares ICRPs using OMB Circular A-21."[62] In addition, the Controller states that it is "not responsible for identifying the district's responsible federal agency." The Controller cites OMB Circular A-21:

> [Cognizant agency responsibility] is assigned to the Department of Health and Human Services (HHS) or the Department of Defense's Office of Naval Research (DOD), normally depending on which of the two agencies (HHS or DOD) provides more funds to the educational institution for the most recent three years... In cases where neither HHS nor DOD provides Federal funding to an educational institution, the cognizant agency assignment shall default to HHS.[63]

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[59] Exhibit F, School Mandated Cost Manual Excerpt, 1999-2000; School Mandated Cost Manual Excerpt, 2000-2001; School Mandated Cost Manual Excerpt, 2001-2002.

[60] Exhibit A, Incorrect Reduction Claim, page 52 [Controller's Audit Report].

[61] *Ibid.*

[62] *Ibid.*

[63] Exhibit B, Controller's Comments, page 14.

As discussed above, the Commission's duly adopted parameters and guidelines require compliance with the Controller's claiming instructions. Thus, the Commission finds that the claimant did not comply with the parameters and guidelines and claiming instructions and the reduction is correct as a matter of law.

Therefore, the Controller, concluding that the rate was not approved, and therefore not supported consistently with the parameters and guidelines and the claiming instructions, recalculated the indirect cost rate using the alternative state procedure, the "FAM-29C method," outlined in the Schools Mandated Cost Manual.[64] Claimant argues that the Controller "made no determination as to whether the method used by the District was reasonable, but, merely substituted its FAM-29C method for the method reported by the District [*sic*]."[65] In addition, claimant argues that "there is no mention of the Controller's FAM-29C method in the parameters and guidelines adopted for *this* mandate program."[66]

Claimant's argument is not persuasive. The absence of a direct "mention of the Controller's FAM-29C method in the parameters and guidelines adopted for this mandate program" is not dispositive. As discussed above, the parameters and guidelines require claimants to comply with the Controller's claiming instructions, and the claiming instructions applicable to all mandated programs state that community colleges may use either the OMB method (with federal approval) or the FAM-29C method.[67] The Commission finds that because claimant failed to obtain federal approval of its OMB Circular A-21 indirect cost rate, the Controller acted reasonably in recalculating the rate using one of the options provided for in the claiming instructions.

Moreover, as claimant points out, "both the District's method and the Controller's method utilized the same source document, the CCFS-311 annual financial and budget report required by the state."[68] Therefore, the Controller's selection of the alternative state method was effectively the only valid alternative available, given that claimant failed to obtain federal approval in accordance with the other (OMB) option.

In its comments on the draft proposed decision, claimant continues to argue that the claiming instructions are an unenforceable underground regulation, and that therefore the Controller's recalculation and reduction of indirect costs on the basis of the claimant's failure to abide by the claiming instructions is arbitrary, capricious, and entirely lacking in evidentiary support.[69] The claimant's comments do not alter the above analysis.

Accordingly, the Commission finds that the Controller's reduction and recalculation of costs, applying the Form FAM-29C to provide an indirect cost rate, is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

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[64] See Exhibit B, Controller's Comments, page 15.

[65] Exhibit A, Incorrect Reduction Claim, page 14.

[66] Exhibit C, Claimant Rebuttal Comments, page 6.

[67] See Exhibit B, Controller's Comments, pages 23-26.

[68] Exhibit A, Incorrect Reduction Claim, page 12.

[69] Exhibit D, Claimant's Comments on Draft Proposed Decision, pages 5-9.

C. The Controller's Reduction for Understated Offsetting Revenues Pursuant to the Health Fee Rule is Correct as a Matter of Law.

The Controller reduced the reimbursement claims filed by claimant in the amount of $385,753 for the three years at issue.[70] These reductions were made on the basis of the fee authority available to claimant, multiplied by the number of students subject to the fee, less the amount of offsetting revenue claimed.

Claimant disputed the reduction in its IRC filing, arguing that the relevant Education Code provisions permit, but do not require, a community college district to levy a health services fee, and that the parameters and guidelines require a community college district to deduct from its reimbursement claims "[a]ny offsetting savings that the claimant experiences as a direct result of this statute…" Claimant argued that "[i]n order for the district to 'experience' these 'offsetting savings' the district must actually have collected these fees." Claimant concluded that "[s]tudent fees actually collected must be used to offset costs, but not student fees that could have been collected and were not."[71]

The Commission finds that the correct calculation and application of offsetting revenue from student health fees has been resolved by the *Clovis Unified* decision, and that the reduction is correct as a matter of law.

After claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge students, whether or not a district chooses to charge its students those fees. As cited by the court, the Health Fee Rule states in pertinent part:

> Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.[72]

The Health Fee Rule relies on Education Code section 76355(a), which provides in relevant part:

> (a)(1) The governing board of a district maintaining a community college may require community college students to pay a fee in the total amount of not more than ten dollars ($10) for each semester, seven dollars ($7) for summer school, seven dollars ($7) for each intersession of at least four weeks, or seven dollars ($7) for each quarter for health supervision and services, including direct or indirect medical and hospitalization services, or the operation of a student health center or centers, or both.
>
> (a)(2) The governing board of each community college district may increase [the health service fee] by the same percentage increase as the Implicit Price Deflator for State and Local Government Purchase of Goods and Services. Whenever that

[70] Exhibit A, Incorrect Reduction Claim, page 15.

[71] Exhibit A, Incorrect Reduction Claim, page 16.

[72] *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 811.

> calculation produces an increase of one dollar ($1) above the existing fee, the fee may be increased by one dollar ($1).

Pursuant to the plain language of Education Code section 76355(a)(2), the fee authority given to districts automatically increases at the same rate as the Implicit Price Deflator; when that calculation produces an increase of one dollar above the existing fee, the fee may be increased by one dollar.[73] The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered.[74] Here, the Controller asserts that claimant had the authority to increase its fee in accordance with the notices periodically issued by the Chancellor of the California Community Colleges, stating that the Implicit Price Deflator Index had increased enough to support a one dollar increase in student health fees.[75] The Controller argues that the claimant was required to claim offsetting fees in the amount authorized. Claimant argues that the actual increase of the fee imposed upon students requires action of the community college district governing board, and that "the Controller cannot rely on the Chancellor's notice as a basis to adjust the claim for 'collectible' student health services fees,"[76] because the fees levied on students are raised by action of the governing board of the community college district. But the *authority* to impose the health service fees increases with the Implicit Price Deflator, as noticed by the Chancellor, and without any legislative action by a community college district, or any other entity (state or local). Moreover, the court in *Clovis Unified* upheld the Controller's use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. In making its decision the court notes that the concept underlying the state mandates process that Government Code sections 17514 and 17556(d) embody is:

> 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.[77]

The court also notes that, "this basic principle flows from common sense as well. As the Controller succinctly puts it, 'Claimants can choose not to require these fees, but not at the state's expense.'"[78] Additionally, in responding to the community college districts' argument

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[73] See Education Code section 76355 (Stats. 1995, ch. 758 (AB 446)). The Implicit Price Deflator for State and Local Purchase of Goods and Services is a number computed annually (and quarterly) by the United States Department of Commerce as part of its statistical series on measuring national income and product, and is used to adjust government expenditure data for the effect of inflation.

[74] See, e.g., Exhibit A, Incorrect Reduction Claim [Letter from Chancellor, page 66].

[75] See Exhibit B, Controller's Comments, at page 17; Exhibit A, Incorrect Reduction Claim, pages 66-67.

[76] Exhibit A, Incorrect Reduction Claim, pages 17-18.

[77] *Clovis Unified School Dist. v. Chiang*, *supra*, 188 Cal.App.4th 794, 812.

[78] *Ibid.*

that, "since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission's P&G's,"[79] the court held:

> To accept this argument, though, we would have to ignore, and so would the Controller, the fundamental legal principles underlying state-mandated costs. We conclude *the Health Fee Rule is valid*.[80] (Italics added.)

Thus, pursuant to the court's decision in *Clovis Unified*, the Health Fee Rule used by the Controller to adjust reimbursement claims filed by claimants for the *Health Fee Elimination* program is valid. Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.[81] In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.[82] Collateral estoppel applies when (1) the issue necessarily decided in the previous proceeding is identical to the one that is currently being decided; (2) the previous proceeding terminated with a final judgment on the merits; (3) the party against whom collateral estoppel is asserted is a party to or in privity with a party in the previous proceeding; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue.[83] Here, the claimant was a party to the *Clovis* action, and under principles of collateral estoppel, the court's decision is binding on the claimant with respect to these reimbursement claims.[84]

In its comments on the draft proposed decision, the claimant "agrees that claimants and state agencies are bound to apply the Health Fee Rule as decided law and that this extends to retroactive fiscal years still within the Commission's or Controller's jurisdiction."[85] However, the claimant argues that the sources for enrollment data used by the Controller have not been approved by the Commission, and therefore the calculations and reduction are arbitrary and lacking in evidentiary support.[86] The claimant cites to the Commission's October 27, 2011

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[79] *Ibid.* (Original italics.)

[80] *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 812.

[81] *Fenske v. Board of Administration* (1980) 103 Cal.App.3d 590, 596.

[82] The petitioners in the *Clovis* case included Clovis Unified School District, El Camino Community College District, Fremont Unified School District, Newport-Mesa Unified School District, Norwalk-La Mirada Unified School District, Riverside Unified School District, San Mateo Community College District, Santa Monica Community College District, State Center Community College District, and Sweetwater Union High School District.

[83] *Roos v. Red* (2006) 130 Cal.App.4th 870, 879-880.

[84] *Roos v. Red* (2006) 130 Cal.App.4th 870, 879-880. Collateral estoppel applies when (1) the issue necessarily decided in the previous proceeding is identical to the one that is currently being decided; (2) the previous proceeding terminated with a final judgment on the merits; (3) the party against whom collateral estoppel is asserted is a party to or in privity with a party in the previous proceeding; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue.

[85] Exhibit D, Claimant's Comments on Draft Proposed Decision, page 10.

[86] Exhibit D, Claimant's Comments on Draft Proposed Decision, page 11.

decision on seven consolidated Health Fee Elimination IRCs. In that decision, the Commission found that the "Chancellor's Office MIS is a reasonable and reliable source for enrollment data of community college districts, and the Controller's use of the MIS for enrollment data for auditing the Districts' claims is not arbitrary or capricious." [87] Based on the findings of that prior decision, the claimant here argues that it was improper to instead use student enrollment and exemption data provided by the "district's Institutional Research Office."[88]

The claimant's argument does not alter the above analysis. The Commission made findings in the October 27, 2011 decision on seven consolidated *Health Fee Elimination* IRCs which identified *one* reasonable and reliable source for the necessary enrollment data. The Commission did not make findings that *only* the chancellor's MIS data could be used to calculate the health fees collectible, and the claimant has not presented any evidence or argument that its own Institutional Research Office is or was incapable of producing reliable evidence from which to calculate offsetting revenues.

Based on the foregoing, the Commission finds that the Controller's reduction of reimbursement to the extent of the fee authority found in Education Code section 76355 is correct as a matter of law.

V. Conclusion

Pursuant to Government Code section 17551(d) and section 1185.7 of the Commission's regulations, the Commission concludes that the reductions to the following costs are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support:

- The reduction of $415,502 in indirect costs claimed, based on the claimant's failure to comply with the claiming instructions in the development of its indirect cost rate, and the Controller's use of an alternative method to calculate indirect costs authorized by the parameters and guidelines and claiming instructions.
- The reduction of $385,753based on understated health fee revenues.

Based on the foregoing, the Commission denies this IRC.

[87] Adopted Decision, *Health Fee Elimination*, 09-4206-I-19, page 25.

[88] Exhibit D, Claimant's Comments on Draft Proposed Decision, page 10.

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RE: **Decision**

Health Fee Elimination, 05-4206-I-05
Education Code Section 76355
Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118
Fiscal Years 1999-2000, 2000-2001, and 2001-2002
State Center Community College District, Claimant

On December 5, 2014, the foregoing decision of the Commission on State Mandates was adopted in the above-entitled matter.

Dated: December 11, 2014

Heather Halsey, Executive Director

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

I am a resident of the County of Solano and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On December 11, 2014, I served the:

Decision
Health Fee Elimination, 05-4206-I-05
Education Code Section 76355
Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118
Fiscal Years 1999-2000, 2000-2001, and 2001-2002
State Center Community College District, Claimant

by making it available on the Commission's website and providing notice of how to locate it to the email addresses provided on the attached mailing list.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on December 11, 2014 at Sacramento, California.

Heidi J. Palchik
Commission on State Mandates
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COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 11/19/14

Claim Number: 05-4206-I-05

Matter: Health Fee Elimination

Claimant: State Center Community College District

TO ALL PARTIES, INTERESTED PARTIES, AND INTERESTED PERSONS:

Each commission mailing list is continuously updated as requests are received to include or remove any party or person on the mailing list. A current mailing list is provided with commission correspondence, and a copy of the current mailing list is available upon request at any time. Except as provided otherwise by commission rule, when a party or interested party files any written material with the commission concerning a claim, it shall simultaneously serve a copy of the written material on the parties and interested parties to the claim identified on the mailing list provided by the commission. (Cal. Code Regs., tit. 2, § 1181.3.)

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