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COMMISSION ON STATE MANDATES
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September 9, 2014

Mr. Keith B. Petersen
SixTen & Associates
P.O. Box 340430
Sacramento, CA 95834-0430

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: **Draft Proposed Decision, Schedule for Comments, and Notice of Hearing**
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:

The draft proposed decision for the above-named matter is enclosed for your review and comment.

Written Comments

Written comments may be filed on the draft proposed decision by **September 30, 2014**. You are advised that comments filed with the Commission are required to be simultaneously served on the other interested parties on the mailing list, and to be accompanied by a proof of service. However, this requirement may also be satisfied by electronically filing your documents. Please see http://www.csm.ca.gov/dropbox.shtml on the Commission's website for instructions on electronic filing. (Cal. Code Regs., tit. 2, § 1181.3.)

If you would like to request an extension of time to file comments, please refer to section 1187.9(a) of the Commission's regulations.

Hearing

This matter is set for hearing on **Friday, December 5, 2014**, at 10:00 a.m., State Capitol, Room 447, Sacramento, California. The proposed decision will be issued on or about November 21, 2014. Please let us know in advance if you or a representative of your agency will testify at the hearing, and if other witnesses will appear. If you would like to request postponement of the hearing, please refer to section 1187.9(b) of the Commission's regulations.

Please contact Matthew Jones at (916) 323-3562 if you have any questions.

Sincerely,

Heather Halsey
Executive Director

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Hearing Date: December 5, 2014
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ITEM __

INCORRECT REDUCTION CLAIM

DRAFT

PROPOSED DECISION

Former Education Code Section 72246 (Renumbered as 76355)[1]

Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.); Statutes 1987, Chapter 1118

Health Fee Elimination

Fiscal Years 1999-2000, 2000-2001, and 2001-2002

05-4206-I-05

State Center Community College District, Claimant

EXECUTIVE SUMMARY

Overview

This analysis addresses an incorrect reduction claim (IRC) filed by State Center Community College District (Claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during 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 alleged understated offsetting health fees authorized to be collected and additional reductions totaling $415,502 were made based on disallowed indirect costs rates.

The following issues are in dispute in this IRC:

- The statute of limitations applicable to audits of reimbursement claims by the Controller;
- The amount of offsetting revenue to be applied from health service fee authority; and
- Reduction of indirect costs claimed based on asserted faults in claimant's development and application of indirect cost rates.

Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts to charge almost all students a general fee (health service fee) for th**e** purpose of voluntarily providing health supervision and services, direct and indirect medical and hospitalization services, and operation of student health centers.[2] In 1984, the Legislature repealed the

[1] Statutes 1993, chapter 8.

[2] 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.]

community colleges' fee authority for health services.[3] However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, in order to reauthorize the fee, at $7.50 for each semester (or $5 for quarter or summer semester).[4]

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.[5] 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,[6] 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.[7] 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.[8] 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.[9]

Procedural History

On January 13, 2001, claimant filed its fiscal year 1999-2000 reimbursement claim with the Controller. On December 27, 2001, claimant filed its fiscal year 2000-2001 reimbursement claim. On December 20, 2002, claimant's fiscal year 2001-2002 reimbursement claim was signed and dated. On May 12, 2003, an audit entrance conference was held. On September 17, 2004, the Controller's audit report was issued. On September 6, 2005, claimant filed this IRC.[10] On February 13, 2008, the Controller submitted comments on the IRC.[11]

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

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

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

[6] Statutes 1987, chapter 1118.

[7] 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).

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

[9] 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).

[10] Exhibit A, Incorrect Reduction Claim, at pp. 1-2; 19.

[11] Exhibit B, Controller's Comments on State Center CCD IRC.

Commission staff issued a draft proposed decision on the IRC on September 9, 2014.

Commission Responsibilities

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 Controller has incorrectly reduced payments to the 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 decision to the Controller and request that the costs in the claim be reinstated.

The Commission must review questions of law, including interpretation of parameters and guidelines, de novo, without consideration of 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.[12] 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."[13]

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.[14] The Commission must also 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.[15] 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.[16]

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

[13] *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.

[14] *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.

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

[16] 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.

Claims

The following chart provides a brief summary of the claims and issues raised and staff's recommendation.

Issue	Description	Staff Recommendation
Statute of limitations applicable to the audit of claimant's 1999-2000 and 2000-2001 annual reimbursement claims.	At the time the underlying reimbursement claims were filed, Government Code section 17558.5 stated: 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. Claimant asserts that the claim was no longer *subject to audit* at the time the final audit report was issued.	Deny – Staff finds that the plain language of section 17558.5, at the time the reimbursement claims were filed, did not require the Controller to complete an audit within any specified period of time, and that a subsequent amendment to the statute demonstrates that "subject to audit" means "subject to the initiation of an audit." Therefore, staff finds that the subject audits are not barred.
Reductions based on asserted flaws in the development of indirect cost rates.	Claimant asserts that the Controller incorrectly reduced indirect costs claimed, because claimant did not obtain federal approval for its indirect cost rate proposals calculated under the OMB Circular A-21 method. Claimant argues that there is no requirement that an indirect cost rate proposal be federally approved. Claimant further argues that the use of the alternative state method, the FAM-29C was arbitrary and capricious.	Deny – Staff finds that claimant did not comply with the requirements in the parameters and guidelines and claiming instructions in developing and applying its indirect cost rate. Claimant used the OMB A-21 method, but did not obtain federal approval for its indirect costs, as required by the OMB Circular A-21 method. Thus, the reduction is correct as a matter of law. Staff further finds that the Controller's recalculation of indirect costs using the Form FAM-29C was consistent with the parameters and guidelines and the claiming instructions and, thus, the Controller's recalculation of indirect costs was not arbitrary, capricious,

		or entirely lacking in evidentiary support.
Reductions based on understated offsetting revenues from student health fees.	Claimant asserts that the Controller incorrectly reduced costs claimed based on the Controller's application of health service fees that claimant was authorized to collect, but did not as offsetting revenue.	Deny – Staff finds that the reduction is correct as a matter of law. This issue has been conclusively decided by *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, in which the court held that local government could choose not to exercise statutory fee authority to its maximum extent, but not at the state's expense.

Staff Analysis

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

Government Code section 17558.5, as added by Statutes 1995, chapter 945 (operative July 1, 1996), provides that a reimbursement claim "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."[17] Claimant asserts that the fiscal year 1999-2000 and 2000-2001 claims were no longer *subject to audit* at the time the final audit report was issued on September 17, 2004, based on filing dates of January 13, 2001 and December 27, 2001. The audit entrance conference was held on May 12, 2003, less than two years after the end of the calendar year in which the claims were filed. However, claimant argues that "subject to audit" means subject to completion of an audit. The Controller argues that section 17558.5 does not require an audit to be *completed* within two years; "subject to audit," the Controller holds, means subject to *initiation* of an audit.[18] Staff agrees with the Controller's interpretation. A 2002 amendment, which supports this interpretation, clarifies that reimbursement claims are subject to "the initiation of an audit" within a specified time.[19]

The 2002 amendment also expanded the statute of limitations to *initiate an audit* to "three years after the date that the actual reimbursement claim is filed or last amended."[20] An expansion of a statute of limitations generally applies to matters pending but not yet barred,[21] and therefore the 2002 amendment to section 17558.5 applies.

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

[18] Exhibit B, Controller's Comments on State Center IRC, at pp. 19-20.

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

[20] Statutes 2002, chapter 1128 (AB 2834) (effective January 1, 2003).

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

Based on the plain language of the statute, and the Legislature's subsequent clarifying amendment to the statute, staff finds that the plain language of section 17558.5, at the time the reimbursement claims were filed, did not require the Controller to complete an audit within any specified period of time, and that a subsequent amendment to the statute demonstrates that "subject to audit" means "subject to the initiation of an audit." In this case, the deadline to initiate the audit would have been December 31, 2003 under the 1995 statute. However, under the 2002 amendment the deadlines are January 13, 2004 and December 27, 2004, respectively, for the 1999-2000 and 2000-2001 claims. The audit was initiated on May 12, 2003, before the deadline expired under either statute. Therefore, the statute of limitations found in section 17558.5 does not bar the audit of the 1999-2000 and 2000-2001 reimbursement claims.

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 the three audited fiscal years, on the ground that claimant did not utilize a federally approved indirect cost rate.[22]

Claimant disputes the Controller's findings that the indirect cost rate proposal was incorrectly applied, and was required to be federally approved, charging that the Controller's conclusions are without basis in the law.

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 (which require federal approval), or by using the state Form FAM-29C.[23]

Staff finds that claimant did not comply with the requirements in the parameters and guidelines and claiming instructions in developing and applying its indirect cost rate, since it did not obtain federal approval for the rate. Therefore, the reduction is correct as a matter of law. Staff further finds that the Controller's use of the Form FAM-29C was consistent with the parameters and guidelines and the claiming instructions. Therefore, the Controller's reduction of claimant's indirect costs was not arbitrary, capricious, or entirely lacking in evidentiary support.

C. The Controller's Reductions for Understated Offsetting Revenues Pursuant to *Clovis Unified* and the Health Fee Rule are Correct as a Matter of Law.

The Controller reduced the reimbursement claims by a total of $385,753 for the three audited fiscal years.[24] These reductions were made on the basis of claimant's fee authority, multiplied by the number of students subject to the fee, less any amount of offsetting revenue claimed.

Claimant argues that the parameters and guidelines only require a claimant to declare offsetting revenues that the claimant "experiences," and that while the fee amount that community college districts were authorized to impose may have increased during the applicable audit period, nothing in the Education Code made the increase of those fees mandatory.

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[22] Exhibit A, Incorrect Reduction Claim, at p. 11.

[23] Exhibit A, Incorrect Reduction Claim, at p. 34 [Parameters and Guidelines].

[24] Exhibit A, Incorrect Reduction Claim, at p. 15.

Staff finds that the reductions are correct as a matter of law. After claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which 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 declared:

> 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.[25]

The court also noted 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.'"[26] 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.[27]

Based on the foregoing, staff finds that the Controller's reduction of reimbursement to the extent of the fee authority found in Education Code section 76355 is legally correct.

Conclusion

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

- The reduction of $385,753 based on understated health fee revenues; and
- The reduction of indirect costs claimed by $415,502, 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.

Staff Recommendation

Staff recommends that the Commission adopt the proposed decision to deny the IRC, and authorize staff to make any technical, non-substantive changes following the hearing.

[25] *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 812.

[26] *Ibid.*

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

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Former Education Code Section 72246 (Renumbered as 76355)[28] 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* STATEMENT OF 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*)

DECISION

The Commission on State Mandates (Commission) heard and decided this incorrect reduction claim (IRC) during a regularly scheduled hearing on December 5, 2014. [Witness list will be included in the adopted decision.]

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/modified] the proposed decision to [approve/partially approve/deny] this IRC at the hearing by a vote of [vote count will be included in the adopted decision].

Summary of the Findings

This analysis addresses an IRC filed by State Center Community College District (Claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during 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 alleged understated offsetting health fees authorized to be collected, and additional reductions totaling $415,502 were made based on disallowed indirect costs rates.

The Commission denies this IRC, finding that the statute of limitations pursuant to Government Code section 17558.5 does not bar the subject audit. The Commission further finds that the reduction of indirect costs based on the District's failure to obtain federal approval for its indirect cost rate proposals, and the Controller's reduction of costs based on the District'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.

[28] 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.
12/27/2001	Claimant filed its fiscal year 2000-2001 reimbursement claim.
12/20/2002	Claimant signed and dated its fiscal year 2002-2003 reimbursement claim.
05/12/2003	An entrance conference for the audit of all three fiscal years was held.
09/17/2004	The Controller issued a final audit report.
09/06/2005	Claimant filed this IRC.
02/13/2008	The Controller filed comments on the IRC.
09/09/2014	Commission staff issued a draft proposed decision.

II. Background

Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts to charge almost all students a general fee (health service fee) for th**e** purpose of voluntarily providing health supervision and services, direct and indirect medical and hospitalization services, and operation of student health centers.[29] In 1984, the Legislature repealed the community colleges' fee authority for health services.[30] However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, in order to reauthorize the fee, at $7.50 for each semester (or $5 for quarter or summer semester).[31]

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.[32] 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,[33] 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

[29] 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.].

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

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

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

[33] Statutes 1987, chapter 1118.

section 72246.5, which became inoperative by its own terms as of January 1, 1988.[34] 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.[35] 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.[36]

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 adopted amendments to 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.

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 statute of limitations applicable to audits of reimbursement claims by the Controller;
- 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 in overstated indirect costs on the basis that "the district did not obtain federal approval for its [indirect cost rates,]" was incorrect. Claimant argues that "[c]ontrary to the Controller's

[34] 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).

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

[36] 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)

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.[37] 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.[38] 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.[39]

Claimant does not dispute the Controller's findings with respect to unallowable services and supplies and unallowable salary costs.[40]

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."[41] In addition, the Controller states that it "is not responsible for identifying the district's responsible federal agency" authorized to approve indirect cost rates.[42]

The Controller further found that claimant understated its authorized health service fees 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.[43] 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."[44]

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,"[45] which

[37] Exhibit A, Incorrect Reduction Claim, at p. 14.

[38] Exhibit A, Incorrect Reduction Claim, at pp. 15-19.

[39] Exhibit A, Incorrect Reduction Claim, at pp. 19-23.

[40] Exhibit A, Incorrect Reduction Claim, at pp. 11; 50-51.

[41] Exhibit B, Controller's Comments on IRC, at pp. 12-13.

[42] Exhibit B, Controller's Comments on IRC, at p. 14.

[43] Exhibit B, Controller's Comments on IRC, at pp. 15; 18.

[44] Exhibit B, Controller's Comments on IRC, at p. 2.

[45] Exhibit B, Controller's Comments on IRC, at p. 2.

claimant asserts was on May 12, 2003.[46] 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.[47] 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.[48]

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.[49] 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."[50]

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.[51] Under this standard, the courts have found that:

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[46] Exhibit A, Incorrect Reduction Claim, at p. 19.

[47] Exhibit B, Controller's Comments on IRC, at p. 20.

[48] *Ibid.*

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

[50] *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.

[51] *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.

> 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.]' "[52]

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. [53] 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.[54]

A. The Statute of Limitations Found in Government Code Section 17558.5 does 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…"[55] When claimant incurred costs for fiscal years 1999-2000 and 2000-2001, 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.[56] (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 on 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.

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

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

[54] 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.

[55] Exhibit A, Incorrect Reduction Claim, p. 17.

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

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."[57] 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 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."[58]

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.[59]

Effective January 1, 2003, Statutes 2002, chapter 1128, amended the statute of limitations for audits again by clarifying 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 a statute of limitations 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 rules 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

[57] Exhibit A, Incorrect Reduction Claim, at pp. 19-23.

[58] Exhibit B, Controller's Comments on IRC, at pp. 19-20.

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

> expressly provides to the contrary any such enlargement applies to matters pending but not already barred. (*Mudd v. McColgan, supra,* 30 Cal.2d 463.)[60]

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 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. This is the interpretation urged by the District, but this reading of the code is not supported by the plain language of the statute. At the time the costs were incurred in this case, section 17558.5 did not expressly fix the time for 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 a claim by a public agency if there is evidence of unreasonable delay by the agency and resulting prejudice to the claimant.[61] 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.

Based on the foregoing, the Commission finds that the audit of the subject reimbursement claims is timely and not barred by the statute of limitations.

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.[62] 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.

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

[61] *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.

[62] Exhibit A, Incorrect Reduction Claim, at p. 11.

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 parameters and guidelines provide that "[i]ndirect costs may be claimed in the manner described by the State Controller in his claiming instructions."[63] The claiming instructions specific to the *Health Fee Elimination* mandate, included in the submissions of both claimant and of the Controller,[64] do not discuss specific rules or guidelines for claiming indirect costs with respect to this mandate. However, the School Mandated Cost Manual contains *general instructions* for school districts and community college districts seeking to claim indirect costs, and those instructions provide guidance to claimants for *all mandates*, absent specific provisions to the contrary.[65] The claiming instructions applicable to all community college district reimbursement claims in effect at the time this reimbursement claim was filed (*i.e.*, the Mandated Cost Manual) specified the option of using a federally approved rate using the OMB A-21 or using the Form FAM 29C method 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 Principals for Educational Institutions," or the Controller's methodology outlined in the following paragraphs.[66] If a 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.[67]

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[63] Exhibit B, Controller's Comments, at p. 40 [Parameters and Guidelines, Adopted August 27, 1987].

[64] Exhibit A, Incorrect Reduction Claim, at pp. 37-39 [Health Fee Elimination Claiming Instructions]; Exhibit B, Controller's Comments, at pp. 95-97 [Health Fee Elimination Claiming Instructions].

[65] See Exhibit X, Mandated Cost Manual General Instructions Excerpt 1999-2000.

[66] Note that the methodology later outlined is the state *Form FAM-29C.*

[67] See Exhibit B, Controller's Comments, at p. 23 [General Claiming Instructions, Revised September 2002].

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." 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.[68] Claimant's argument is unsound: 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.[69]

More recently the manuals for school districts and community college districts have been printed separately.[70] The Mandated Cost Manual for Community Colleges now contains general instructions for claiming under all mandates, with the suggestion that claimants refer to the parameters and guidelines and specific claiming instructions, as follows:

> This manual is issued to assist claimants in preparing mandated cost claims for submission to the State Controller's Office (SCO). The information contained in this manual is based on the State of California's statutes, regulations, and the parameters and guidelines (P's & G's) adopted by the Commission on State Mandates (CSM). Since each mandate is unique, it is imperative that claimants refer to the claiming instructions and P's & G's of each program for updated data on established policies, procedures, eligible reimbursable activities, and revised forms.[71]

Therefore, 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. The Controller submitted an excerpt of the School Mandated Cost Manual addressing indirect cost rates, revised September 2002, in response to the IRC.[72] And both claimant and the Controller submitted an excerpt of the School Mandated Cost Manual revised September 1997, which contained the

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[68] Exhibit A, Incorrect Reduction Claim, at pp. 11-12.

[69] Exhibit B, Controller's Comments, at p. 14.

[70] See, e.g., Exhibit X, Schools Mandated Cost Manual General Instructions revised September 29, 2000, and Mandated Cost Manual for Community Colleges, September 30, 2003.

[71] Exhibit X, Community College Mandated Cost Manual Foreword Revised 07/12.

[72] Exhibit B, Controller's Comments, at pp. 23-26 [General Claiming Instructions, Revised September 2002].

program-specific instructions for the *Health Fee Elimination* Mandate.[73] The program-specific instructions do not address indirect cost rates, and so claimants are required to adhere to the general instructions for indirect cost claiming, shown in pertinent part above.

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"[74] 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."[75] 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.[76] Here, claimant alleges, somewhat indirectly, the same fault in the claiming instructions with respect to indirect cost rates. But the distinction is that here the parameters and guidelines, which *were* duly adopted at a Commission hearing, require compliance with the claiming instructions on indirect cost rates. Furthermore, the Commission is not in a position to declare the Controller's claiming instructions an underground regulation; the Commission assumes that duly-adopted claiming instructions are valid and enforceable, absent a contrary ruling by the courts.

Therefore, 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.

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 reimbursement claims for the period of July 1, 1999 through June 30, 2002, 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.[77] Claimant filed indirect cost rates of 38.74 percent, 37.73 percent, and 35.06

[73] Exhibit A, Incorrect Reduction Claim, at pp. 37-39 [Health Fee Elimination Claiming Instructions]; Exhibit B, Controller's Comments, at pp. 95-97 [Health Fee Elimination Claiming Instructions].

[74] Exhibit C, Claimant Rebuttal Comments, at p. 7.

[75] Exhibit A, Incorrect Reduction Claim, at p. 13.

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

[77] Exhibit A, Incorrect Reduction Claim, at p. 52 [Controller's Audit Report].

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.[78]

The Controller maintains that the claiming instructions "require that districts obtain federal approval of ICRPs prepared according to Office of Management and Budget (OMB) Circular A-21.[79] Or, "[a]lternatively, districts may use form FAM-29C to compute indirect costs rates."[80] The Controller asserts that a claimant "should obtain federal approval when it prepares ICRPs using OMB Circular A-21."[81] 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 ofNaval 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.[82]

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, thus, the reduction is correct as a matter of law.

In its audit of the subject reimbursement claims, 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.[83] 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*]."[84] 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."[85]

Claimant's argument is not persuasive. The Controller argues that its finding that the indirect cost rates claimed were not supported, and not calculated consistently with the parameters and guidelines is indeed a determination that the rates were excessive.[86] Moreover, the absence of a direct "mention of the Controller's FAM-29C method in the parameters and guidelines adopted

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[78] *Ibid*.

[79] *Ibid*.

[80] *Ibid*.

[81] *Ibid*.

[82] Exhibit B, Controller's Comments, at p. 14.

[83] See Exhibit B, Controller's Comments, at p. 15.

[84] Exhibit A, Incorrect Reduction Claim, at p. 14.

[85] Exhibit C, Claimant Rebuttal Comments, at p. 6.

[86] See Exhibit B, Controller's Comments, at p. 15.

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.[87]

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."[88] 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.

Based on the foregoing, the Commission finds that the Controller's reduction was based on an alternative method authorized by the claiming instructions for calculating indirect costs, and is therefore not arbitrary, capricious, or entirely lacking in evidentiary support.

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.[89] 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 disputes the reduction, 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 argues that "[i]n order for the district to 'experience' these 'offsetting savings' the district must actually have collected these fees." Claimant concludes that "[s]tudent fees actually collected must be used to offset costs, but not student fees that could have been collected and were not."[90]

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

[87] See Exhibit B, Controller's Comments, at pp. 23-26.

[88] Exhibit A, Incorrect Reduction Claim, at p. 12.

[89] Exhibit A, Incorrect Reduction Claim, at p. 15.

[90] Exhibit A, Incorrect Reduction Claim, at p. 16.

> by the amount of student health fees authorized per the Education Code [section] 76355.[91]

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 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.[92] Here, the Controller asserts that claimant should have collected an additional fee amount 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.[93] 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."[94] 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:

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[91] *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 811.

[92] 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.

[93] See Exhibit B, Controller's Comments, at p. 17; Exhibit A, Incorrect Reduction Claim, at pp. 66-67.

[94] Exhibit A, Incorrect Reduction Claim, at pp. 17-18.

> 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.[95]

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.'"[96] Additionally, in responding to the community college districts' argument that, "since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission's P&G's,"[97] 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*.[98] (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.[99] Moreover, 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.[100]

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.

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[95] *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 812.

[96] *Ibid.*

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

[98] *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 812.

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

[100] *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.

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 $385,753based on understated health fee revenues.
- 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.

Based on the foregoing, the Commission denies this IRC.

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

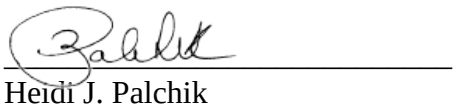
I am a resident of the County of Solano and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On September 9, 2014, I served the:

> **Draft Proposed Decision, Schedule for Comments, and Notice of Hearing**
> *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 September 9, 2014 at Sacramento, California.



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COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 8/18/14

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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