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June 8, 2009

Paula Higashi, Executive Director
Commission on State Mandates
980 Ninth Street, Suite 300
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RE: CSM 05-4206-I-06
Incorrect Reduction Claim of Los Rios Community College District
Health Fee Elimination Audit #1
Fiscal Years: 1997-98 through 2001-02
Incorrect Reduction Claim

Dear Ms. Higashi:

This letter is in rebuttal to the State Controller's Office response dated March 10, 2008, to the Incorrect Reduction Claim of Los Rios Community College District (District) submitted on September 9, 2005.

Part I. Mr. Silva's Transmittal Letter

Mr. Silva's transmittal letter, dated March 10, 2008, contains factual and legal allegations regarding the District's Incorrect Reduction Claim. Also, it was not signed under the penalty of perjury. The conclusions and assertions contained in the letter should be disregarded by the Commission due to this lack of certification.

Contrary to the conclusions in Mr. Silva's letter, the Controller's reductions were not appropriate, nor were they in accordance with law. The District did not claim costs for services provided in excess of those provided in the base year, did not inaccurately claim student health fees, and did not utilize an invalid indirect cost rate.

A. CONTROLLER'S AUDIT AUTHORITY

The District does not dispute the Controller's authority to audit claims for mandated costs and to reduce those costs that are excessive or unreasonable. This authority is

expressly contained in Government Code Section 17561. Government Code Section 17564 identifies the minimum amount of costs required to file a claim and the manner of claiming costs to be reimbursed. Thus, it is unclear to the District why Mr. Silva's letter cites Section 17564 in support of the Controller's authority to audit mandated costs. Similarly, the Statement of Decision in the Incorrect Reduction Claim of San Diego Unified School District that is cited is superfluous because it simply restates the statutory authority without elaboration. The District is unable to respond to these two citations without further elaboration from the Controller as to their intended relevance, since none is readily apparent.

B. BURDEN OF PROOF

Mr. Silva's letter erroneously asserts that the burden of proof is upon the District to establish that the Controller's adjustments were incorrect. The letter's reliance on Evidence Code Section 500 is completely misplaced because that Section is not applicable to administrative hearings, such as those conducted by the Commission.

California Code of Regulations Section 1187.5 (a) states expressly that Commission "hearings will not be conducted according to technical rules relating to evidence and witnesses." The evidentiary standard for matters before the Commission, stated in that Section, is "[a]ny relevant non-repetitive evidence . . . [that] is the sort of evidence on which responsible persons are accustomed to rely in the conduct of serious affairs." Further, Evidence Code Section 300 specifies that the Evidence Code is applicable only to actions before the California courts. There is no statute or regulation that makes the Evidence Code applicable to proceedings before the Commission, and therefore the Controller cannot rely on Section 500 to shift his burden of proof onto the District.

The Statement of Decision in the Incorrect Reduction Claim of San Diego Unified School District that is cited in Mr. Silva's letter relied on *Honeywell, Inc. v. State Board of Equalization* ((1982) 128 Cal.App.3d 739, 744) for the proposition that the claimant had the burden of proof in showing that it did not experience offsetting savings. The decision was supported by "common sense" in that the burden of proof should rest with the party having the power to create, maintain, and provide evidence.

In this incorrect reduction claim, the issue is not the District's original reimbursement claims, but the Controller's methods for determining adjustments. The Controller is the party with the power to create, maintain, and provide evidence regarding its auditing methods and procedures, as well as the specific facts relied upon for its audit findings. Thus, by Mr. Silva's own reasoning, the burden is upon the Controller to demonstrate that its methods were in compliance with applicable law.

Finally, the Controller must meet the burden of going forward. "Until the agency has met its burden of going forward with the evidence necessary to sustain a finding, the [party requesting review] has no duty to rebut the allegations or otherwise respond." *(Daniels v. Department of Motor Vehicles* (1983) 33 Cal.3d 532, 536). Therefore, the Controller

must first provide evidence as to the propriety of its audit findings because it bears the burden of going forward and because it is the party with the power to create, maintain, and provide this evidence.

C. SERVICES PROVIDED

Mr. Silva's letter makes several misstatements of the facts and the law regarding the specific audit findings. First, it asserts that the Parameters and Guidelines require that claimed costs are allowable only for services that were provided in the base year. The proper standard is that claimants must ensure that the same services that were *available* in the base year continue to be *available* for students. There is no requirement that particular services actually be utilized in subsequent years.

Thus, the fact that the District was given an "opportunity" to demonstrate that the services in question were actually provided in the base year is irrelevant because the District is not required to provide this information. There is no requirement that the college districts maintain records for over two decades to prove the specific health services that were provided because the mandate requires only a maintenance of effort.

D. INDIRECT COST RATE

Mr. Silva's letter asserts that the Controller's Office substituted its own indirect cost rate because the District used an "unapproved" rate. There is no requirement that the indirect cost rate be "approved" by any agency. The District calculated its indirect cost rate using the same source document (CCFS-311) as the Controller. It also used the FAM-29C method, but corrected for instances where the Controller did not follow the CCFS-311 determination of direct and indirect costs. The characterization of the indirect cost rate used by the District in Mr. Silva's letter is misleading and misstates the requirements of the Parameters and Guidelines.

E. AUTHORIZED HEALTH SERVICES FEES

The District did not "confuse" health services fees that were authorized and those that were collected, as claimed in Mr. Silva's letter. Further, his statement of the Parameters and Guidelines is out of context and misleading. The authorized health services fees are to be included in "reimbursement for this mandate received from any source" as stated in the parameters and guidelines. The District complied with Generally Accepted Accounting Principles (GAAP) and the Parameters and Guidelines when it properly reported, as offsetting revenue, health service fees that were actually received.

Although the Parameters and Guidelines clearly state that claimants must report revenue that is received, Mr. Silva's letter asserts that the amount authorized is relevant due to "mandate law in general" and the Court's decision in *Connell v. Santa Margarita Water District.* The District cannot respond to the rubric of "mandate law in general"

because it references no particular statute, regulation, or court decision as its basis. The reliance on *Connell* is misplaced because the Court in that case determined only that approval of the test claim in question was in violation of Government Code Section 17556 (d), which prohibits approval of a test claim when there are offsetting savings sufficient to fully fund it. The Court makes absolutely no finding regarding offsetting revenue in the parameters and guidelines or the reimbursement process.

F. AUDIT INITIATION

The assertions in Mr. Silva's letter regarding the facts surrounding the initiation of the audit and the relevant law are erroneous. Further, the gratuitous arguendo assumption that Ms. Bray's declaration is accurate is both insulting and unnecessary. Ms. Bray signed her declaration under the penalty of perjury and attached contemporaneously recorded documents to support her statements. Thus, there should be no implication that her declaration is anything but accurate.

Mr. Silva's letter states that it is the Controller's position that a field audit is initiated no later than the date of the audit letter. Although the letter claims this position is "consistent with other statutes of limitations provisions," absolutely no supporting law is cited. The District is unaware of any relevant statute, regulation, or case law that indicates that the date of the audit letter is the initiation date. Further, this position is contrary to the statements of the audit letter itself, which was included in Exhibit G of the District's Incorrect Reduction Claim. That letter clearly states:

> As discussed during a telephone conversation on December 19, 2002, SCO auditor Mary Khoshmashrab *will commence the audit* of the subject programs *on Thursday, January 16, 2003*, beginning with an entrance conference at 9:30 a.m. (Emphasis supplied)

Thus, the very letter relied upon in Mr. Silva's letter contradicts the position the Controller is now taking.

The position in Mr. Silva's letter is also in direct contradiction with Mr. Spano's response, which was attached as Tab 2 to Mr. Silva's letter and is discussed more thoroughly below. Mr. Spano's response (Tab 2; pg. 20) states: "The SCO initiates an audit by conducting the audit entrance conference."[1] Therefore, it appears that the

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[1] Audit Initiation: The Controller has taken various positions on the date the audit is initiated in different audit reports. For example, the following audits state that the initial telephone contact initiates the audit:

> -Los Rios Community College District, Health Fee Elimination, issued June 24, 2004.
> -Los Rios Community College District, Mandate Reimbursement Process, issued June 24, 2004.

Controller does not have a consistent "position" on the initiation of an audit, since two contradictory positions are stated.

Finally, Mr. Silva's letter cites "analogous procedures" and "established practice" for the proposition that an audit does not need to be completed within the statute of limitations. However, these assertions are completely unsupported by law or fact. As more thoroughly discussed below in Part II, the statute of limitations for audit would be meaningless if the Controller were permitted to merely initiate an audit and then complete it by issuing the final audit report at some unspecified future date.

The final audit report is the only logical document that concludes an audit, since adjustments can and are changed up until the time that it is issued, and there is no logical reason for allowing the Controller to complete an audit at any time after the statute of limitations has expired. Further evidence of this is provided by the Legislature's amendment of Government Code Section 17558.5, effective January 1, 2005, which states that in no circumstance may an audit be completed more than two years after it has been initiated.

Part II. State Controller's Office Analysis and Response to the Incorrect Reduction Claim by Los Rios Community College District (Spano Response)

RE: I. SCO REBUTTAL TO STATEMENT OF DISPUTE - CLARIFICATION OF REIMBURSABLE ACTIVITIES, CLAIM CRITERIA, AND DOCUMENTATION REQUIREMENTS

Mr. Spano's response (Tab 2; pg. 4) asserts the September 2002 Controller's claiming instructions in its "clarification" of applicable law and standards, specifically the section

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The following audits state that the audit entrance conference initiates the audit:

-Newport-Mesa Unified School District, School District of Choice, issued August 31, 2004.

-State Center Community College District, Health Fee Elimination, issued September 17, 2004.

-Clovis Unified School District, Graduation Requirements, issued October 22, 2004.

-San Bernardino Community College District, Health Fee Elimination, issued November 10, 2004.

-West Valley-Mission Community College District, Health Fee Elimination, issued April 8, 2005.

-Long Beach Community College District, Health Fee Elimination, issued April 27, 2005.

-North Orange County Community College District, Health Fee Elimination, issued July 22, 2005.

-Poway Unified School District, Emergency Procedures, Earthquakes and Disasters, issued August 31, 2005.

discussing indirect costs. However, this version of the claiming instructions was issued *after* all of the fiscal years that are the subject of this Incorrect Reduction Claim. The District originally asserted the September 1997 version of the claiming instructions, which was in effect during the first fiscal year of this claim. It is unclear to the District why the Controller did not include a copy of the claiming instructions that were actually in effect during at least one of the fiscal years in question in its response. But, since the claiming instructions are only guidelines and not a statement of the applicable law, they should have no effect on the determination of this Incorrect Reduction Claim, regardless of the version cited.

RE: II. DISTRICT CLAIMED UNALLOWABLE SALARY AND RELATED INDIRECT COSTS

The Controller asserts that the District claimed unallowable employee salaries and benefits totaling $128,593 for the audit period, with related indirect costs of $39,529.

Services Provided vs. Available

Mr. Spano's response (Tab 2; pg. 5) states that the auditors used health service logs to determine the services provided at each college. However, there is no provision in the Parameters and Guidelines that requires the District to maintain such records. The District is only required to maintain the availability of the same services as those offered in the 1986-87 fiscal year. Therefore, the only relevant documentation for the Controller's audit is that which supports the costs associated with maintaining the availability of these services, and not the actual services provided.

Furthermore, the health service logs are not necessarily indicative of all of the services that were provided. The logs are simply a sign-in sheet on which the student states their symptoms or services they believe they might need, if that student wishes to disclose the information on the log. There is no evidence that students are able to accurately diagnose themselves or predict the services they will need in every case. Therefore, even if the Controller's audit of services rendered were appropriate, the health services logs chosen by the Controller are inadequate for that purpose.

The Controller incorrectly audited services *rendered*, rather than services *available*. Mr. Spano's response (Tab 2; pg. 6) concedes this when it states that it compared services rendered during the audit year with those available during the base year. There is no basis in law or fact that requires the entire variety of health care services *available* each year to actually have been utilized, which is to say *rendered*, each year. The costs of maintaining supplies and retaining trained personnel to make these services available are incurred regardless of whether students actually require a particular service each year. The District is certifying that the same level of services continue to be available, not that each and every service was rendered each year. For example, hearing tests may be available every year but there may be a year in which no hearing tests were required by students.

Incidences of diseases and courses of treatment change over time. This dynamic perhaps was not anticipated when the Parameters and Guidelines were adopted in 1987. If so, this matter cannot be charged to the claimants, as it is a Commission adopted document. The Controller, as the audit agency imposing the adjustment, has the burden of proving the factual and legal basis for its adjustments. Instead, the Controller incorrectly audited the services rendered rather than services available to the students.

The alleged "second-chance opportunity" to present documentation of services rendered in the base year was not appropriate because the District is not required to maintain such documentation. Section VII of the Parameters and Guidelines require only that the District maintain documentation "to substantiate a maintenance of effort," and not documentation that supports the services actually rendered in the base year. To require otherwise would create a statute of limitations for audit for the base year that never ends, so long as the health fee elimination mandate was in place.

Audit by Sampling

The Controller cites *Government Auditing Standards, 2003 Revision* (the Yellow Book) issued by the federal government in support of its choice to use sampling methods. (Selections discussed attached as Exhibit "B") However, it is unclear how these federal standards, of and by themselves, are applicable to state mandate reimbursement, or how they permit the Controller to circumvent the California Administrative Procedure Act (APA).

Generally Approved Government Auditing Standards (GAGAS) derived from *Government Auditing Standards* are required to be used for state or local program auditing only when the audit concerns the receipt of federal funds or when a state or local statute requires their use.[2] The Health Fee Elimination mandate program does not concern the receipt of federal funds. As reimbursement for a state mandate, by definition, it concerns only the receipt of state funding. There is also no state statute that makes GAGAS applicable to state mandate reimbursement. Therefore, the Controller must comply with the APA if it wishes to impose these federal government auditing standards on the state mandate reimbursement claim audits.

Further, the Controller did not comply with Government Auditing Standards as stated in Mr. Spano's response (Tab 2; pg. 7). Section 3.34 of Government Auditing Standards, 2003 Revision (GAS), states that professional judgment "requires auditors to exercise reasonable care and diligence and to observe the principles of serving the public

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[2] *Government Auditing Standards*, 2003 Revision, Section 1.05 (c) requires that "GAGAS be followed in audits of state and local governments and nonprofit entities that receive federal awards." Section 1.06 states that "state and local laws and regulations *may* require auditors at the state and local levels of government to follow GAGAS." (Emphasis supplied)

interest and maintaining the highest degree of integrity, objectivity, and independence. . . ." The Controller simply asserts that professional judgment was used without even addressing whether the method chosen was reasonable or objective. Professional judgment does not allow auditors to simply choose any method they want without supporting that decision. The Controller cannot support the decision to use sampling simply by asserting professional judgment without stating why it was appropriate in this mandate audit.

Section 8.11 of GAS provides that "when sampling significantly supports auditors' findings, describe the sample design and state why it was chosen, including whether the results can be projected to the intended population." The Controller did not do this. Specifically, the audit report contains no discussion of why or how the sample design was chosen, or of its applicability to the entire costs claimed. The ultimate risk from extrapolating findings from a sample is that the conclusions obtained from the sample may not be representative of the universe. That is, the errors perceived from the sample do not occur at the same rate in the universe. This is what has occurred in this audit. There is no evidence that a survey of services provided has any relationship to the services that are made available to students, and no evidence that the data from a single month has any relationship to other months throughout the school year or during the summer.

Further, Section 8.13 of GAS provides:

> Auditors should report findings by providing credible evidence that relates to the audit objectives. These findings should be supported by sufficient, competent, and relevant evidence. They also should be presented in a manner to promote adequate understanding of the matters reported and to provide convincing but fair presentations in proper perspective. The audit report should provide selective background information to provide the context for the overall message and to help the reader understand the findings and significance of the issues discussed.

The audit report contains only peremptory statements regarding the results of the Controller's sampling extrapolation. It does not report any "sufficient, competent, and relevant evidence" in support of these conclusions or the methods used, as is required. The Controller has not stated the selection criteria for the sample, the confidence interval, error range, or any of the other crucial elements of determining and applying a sample. Therefore, the audit report is not in compliance with *Government Auditing Standards*, notwithstanding the Controller's assertion.

In a subsequent audit of this mandate program for this District, the Controller admitted that sampling was not a valid method of auditing this mandate program, and should not be used as the basis of an adjustment. The final audit report for fiscal years 2002-03, 2003-04, and 2004-05 (Exhibit "C"), which was released on May 21, 2008, states: "We revised our audit finding to eliminate previously reported unallowable costs that resulted from extrapolating sample results to the full fiscal year for each college." The Controller

removed the adjustment because it agreed that the extrapolation was improper. The Controller's epiphany that sampling in the second audit was improper applies to the first audit as well.

The Controller determined a "percentage" that it asserts represented allowable services and then applied this to all salary and benefit costs. This method has no relation to the actual costs incurred for the services being disallowed. It also does not take into account that the District must maintain a staffed health services center in order to make sure that the base year services are available, even if the students do not require any such services at all. Additionally, this method assumes that the only mandate activities staff performs are student clinic visits. This ignores the fact that a wide variety of duties are required to maintain health services, other than the actual time spent with each student.

Claimants are required to report actual costs in their mandate reimbursement claims. The purpose of an audit is to determine if these actual costs are supported. Therefore, a method that relies on averages and percentages from a non-statistical sample cannot be used to show the validity of actual costs claimed. In its Incorrect Reduction Claim, the District raised the possibility that the sampling could improperly penalize it by excluding allowable services, particularly since the Controller determined that, when a student declines to state the reason for the visit, any services rendered are unallowable per se. Mr. Spano's response (Tab 2; pg. 8) states "[t]he district ignores the opposite possibility that the sample selection may have excluded additional unallowable services and thus, the unallowable costs are actually understated." The District does not ignore this possibility - Mr. Spano's response makes the District's point precisely. The sampling method is an unreliable means of "estimating" allowable costs. It should not be relied upon instead of auditing the actual costs reported.

Mr. Spano's response (Tab 2; pg. 8) attempts to shift the burden to the District in proving that the sampling method was improper by citing Title 2, CCR, Section 1185 (e)(3). However, that Section specifies that if the incorrect reduction claim "utilizes assertions or representations of fact, such assertions or representations shall be supported by testimonial or documentary evidence and shall be submitted with the claim." The District's opposition to the sampling method concerns the legality and propriety of that method. It does not concern any assertions of fact, and therefore the Controller cannot shift the burden to the District to prove that the method was improper.

Similarly, Mr. Spano's response (Tab 2; pg. 9) asserts that the District is somehow responsible for showing the actual costs of non-mandated activities. There is absolutely no requirement that the District maintain records or cost information regarding non-mandated activities. The District did not claim any costs related to non-mandated activities, and documentation is required only to support costs that are claimed. The Controller's conclusion that the only alternative to the District providing this information is to disallow all claimed costs is absurd. The alternative is not to disallow all costs - it is to properly audit those costs that were claimed.

Audit Standard

Mr. Spano's response (Tab 2; pg.10) asserts that:

> *Government Code* Section 17561(d)(2) allows the SCO to audit the district's records to verify actual mandate-related costs and reduce any claim that the SCO determines is excessive or unreasonable. In addition, *Government Code* Section 12410 states, "The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment." (Emphasis in original)

Section 12410 is found in the part of the Government Code that provides a general description of the duties of the Controller. It is not specific to the audit of mandate reimbursement claims. The only applicable audit standard is found in Government Code Section 17561(d)(2), which specifically pertains to the audit standards for mandate reimbursement claims. The fact that Section 17561(d)(2) specifies its own audit standard (excessive or unreasonable) implies that the general SCO audit standard (correctness, legality, and sufficient provisions of law) is not generally intended to apply. Therefore, the Controller may only reduce a mandate reimbursement claim if it specifically finds that the amounts claimed are unreasonable or excessive under Section 17561(d)(2).

Further, the Controller has not asserted or demonstrated that, if Section 12410 was the applicable standard, the audit adjustments were made in accordance with this standard. The District's claim was correct, in that it reported the actual costs incurred. There is also no allegation in the audit report that the claim was in any way illegal. Finally, the phrase "sufficient provisions of law for payment" refers to the requirement that there be adequate appropriations prior to the disbursement of any funds. There is no indication that any funds were disbursed without sufficient appropriations. Thus, even if standards of Section 12410 were applicable to mandate reimbursement audits, the Controller has failed to put forth any evidence that these standards are not met.

Additionally, there is no indication that the Controller is actually relying on the audit standards set forth in Section 12410 for the adjustments to the District's reimbursement claims. Mr. Spano's response (Tab 2; pg.10) claims that it did indeed determine that the District's costs were excessive, as required by Section 17561(d)(2), because the claimed costs were not "proper" since they were for services that exceeded those provided in the FY 1986-87 base year. This statement has no basis in the Parameters and Guidelines, which require a maintenance of effort of those services available and make no requirement that the same services are actually provided in subsequent years. The audit report and Mr. Spano's response simply state a conclusion that the unallowable costs are excessive, without demonstrating that they are. The Parameters and Guidelines and the mandate legislation determine what services are "proper' for reimbursement, and the Controller has failed to show how the services in question contradicted these requirements. Specifically, the audit report and the Controller's

response fail to identify which services are being disallowed and exceeding those available in the base year.

RE: III. DISTRICT CLAIMED UNALLOWABLE SERVICES AND SUPPLIES AND RELATED INDIRECT COSTS

The Controller asserts that the District claimed unallowable services and supplies costs totaling $28,782, with $8,887 in related indirect costs.

Athletic Services

Of the unallowable costs, $26,100 was attributed to physical exams for intercollegiate athletics and the salaries of health professionals present at athletic events. The Controller ignores the express provision of the Parameters and Guidelines that physicals for athletes are included as reimbursable costs, so long as the service was available in Fiscal Year 1986-87. There is also no condition on other services, such as medications or tests being available to student athletes. The Controller relies on Education Code Section 76355(e), which states in part, "[i]f the cost to maintain that level of service exceeds the limits specified in subdivision (a), the excess cost shall be borne by the district." Mr. Spano's response (Tab 2; pg. 11) then makes the conclusion that the "'maintenance of effort' requirement applies to those health services for which the district may levy a fee." This conclusion ignores the history of the Health Fee Elimination mandate program, which at one time prohibited any fees from being collected.

Education Code Section 76355, subdivision (a), permits the collection of student fees for health services. Subdivision (d)(1) requires that these fees, if collected, be deposited in a designated fund and be expended only as authorized. Subdivision (d)(2) prohibits expenditures *from the fund* for physical examinations for intercollegiate athletics or the salaries of health professionals for athletic events. The prohibition only applies to the expenditure of funds from the special account into which the student fees are deposited. Since this District does not collect a student health services fee, there is no such restricted fund and the expenditures are not subject to the requirements of Section 76355, subdivision (d)(2).

The Parameters and Guidelines control the scope of reimbursement under the Health Fee Elimination mandate, and they expressly include physicals for athletes and the type of services that are provided by health professionals at athletic events, so long as these services were available in the base year. Therefore, a restriction on the use of fees collected cannot be used to support an adjustment that is in direct contradiction with the Parameters and Guidelines.

Mr. Spano's response (Tab 2; pg. 11) asserts that since athletic related costs are not permitted expenditures from the fund authorized by Section 76355, that the District is not required to provide these services. This link is not found in the law, and is in direct

contradiction with the Health Fee Elimination mandate legislation, which requires that health services that were available in the base year be maintained. As previously stated, the Parameters and Guidelines expressly include athletic related health services. Thus, the District is required by law to maintain athletic related health services that were available during the base year, and the costs associated with those services are reimbursable under this mandate.

RE: IV. DISTRICT OVERSTATED ITS INDIRECT COST RATES CLAIMED

The Controller determined that the District overstated indirect costs by $361,689 for the audit period because the District's indirect cost rate was not federally approved. The Controller continues to insist that any indirect cost rate not derived from one of the three methods described in its claiming instructions must be excessive, regardless of the reasonableness of the rate used. However, the Controller's claiming instructions are not laws or regulations, and therefore are not enforceable.

No particular indirect cost rate calculation is required by law. The Controller insists that the rate be calculated according to the claiming instructions. The Parameters and Guidelines state that "[i]ndirect costs *may be claimed* in the manner described by the State Controller in his claiming instructions." The district claimed these indirect costs "in the manner" described by the Controller. The correct forms were used and the claimed amounts were entered at the correct locations. Further, "may" is not "shall"; the Parameters and Guidelines do not *require* that indirect costs be claimed in the manner described by the Controller.

The District utilized the CCFS-311 classification of accounts which is more rational and consistent than the Controller's evolving formula. Further, it should be noted that the Controller did not determine that the District's rate was excessive or unreasonable. In the audit report, the Controller asserts that because the Parameters and Guidelines specifically references the claiming instructions, the claiming instructions thereby become authoritative criteria. Since the Controller's claiming instructions were never adopted as law, or regulations pursuant to the Administrative Procedure Act, the claiming instructions are a statement of the Controller's interpretation and not law. The Controller's interpretation of Section VI of the Parameters and Guidelines would, in essence, subject claimants to underground rulemaking at the direction of the Commission. The Controller's claiming instructions are unilaterally created and modified without public notice or comment. The Commission would violate the Administrative Procedure Act if it held that the Controller's claiming instructions are enforceable as standards or regulations. In fact, until 2005, the Controller regularly included a "forward" in the Mandated Cost Manual for Community Colleges (September 30, 2003 version attached as Exhibit "D") that explicitly stated the claiming instructions were "issued for the sole purpose of assisting claimants" and "should not be construed in any manner to be statutes, regulations, or standards."

Neither State law nor the Parameters and Guidelines make compliance with the Controller's claiming instructions a condition of reimbursement. The District has followed the Parameters and Guidelines. The burden of proof is on the Controller to prove that the product of the District's calculation is unreasonable, not to recalculate the rate according to its unenforceable ministerial preferences.

Indeed, federally "approved" rates that the Controller will accept without further action, are "negotiated" rates calculated by a district and submitted for approval, indicating that the process is not an exact science, but a determination of the relevance and reasonableness of the cost allocation assumptions made for the method used. The indirect cost rates claimed by the District ranged from 30.4% to 31.45%, which is less then 2 percentage points from the 30% federally approved rate obtained by the District for FY 2005-06. This is convincing evidence that the District's indirect cost rates were in fact reasonable.

Further evidence of the arbitrary nature of the Controller's determination of the "allowable" indirect cost rate is found in its sudden and unsupported determination that federally approved rates are no longer permissible. The audit report for Yosemite Community College District, issued April 30, 2009 (attached as Exhibit "E"), states on page 7: "For FY 2004-05, FY 2005-06, and FY 2006-07, the parameters and guidelines and the SCO's claiming instructions do not provide districts the option of using a federally-approved rate." It then concludes, on page 9, that "[b]ecause the Health Fee Elimination Program's parameters and guidelines do not specifically allow for a federally-approved rate, the district's federally-approved rates are irrelevant for FY 2004-05, FY 2005-06, and FY 2006-07."

There is absolutely no basis in law for the Controller to make this change in policy. There was no amendment to the Parameters and Guidelines - the language regarding indirect cost rates remains exactly the same as it was prior to FY 2004-05. The Controller simply decided to stop accepting federally approved rates, after years of accepting them, with absolutely no justification or opportunity for public comment. This is in direct violation of the Administrative Procedures Act, and illustrates the unilateral and arbitrary method the Controller uses in determining "allowable" cost rates for this mandate program.

In an attempt to defend the arbitrariness of the choice to apply only the FAM-29C method, Mr. Spano's letter points out that the method is one of three that a *claimant may choose* to use under the parameters and guidelines for nine other mandate programs. However, there is no mention of the Controller's FAM-29C method in the Parameters and Guidelines adopted for *this* mandate program. Further, the fact that the claimants in those other mandate programs may choose one of three methods, with potentially widely divergent results, demonstrates that the Controller's choice to simply pick his own method and substitute it for the one used by the District was an arbitrary preference.

Finally, Mr. Spano's response (Tab 2; pg.14) notes that no district requested a review of the claiming instructions pursuant to Title 2, California Code of Regulations Section 1186. The claiming instructions are not properly adopted regulations or standards. There is no requirement that a claimant request such review, even if they are inconsistent with the Parameters and Guidelines, because the claiming instructions are not enforceable regulations. Thus, the fact that no review was requested by any of the claimants is not determinative of the validity or force of the claiming instructions.

RE: V. DISTRICT UNDERSTATED AUTHORIZED HEALTH SERVICE FEES

The Controller determined that revenue offsets were understated by $6,101,947 for the audit period. This adjustment is due to the fact that the District did not collect any fees as "authorized" by Education Code Section 76355(a). Further, the Controller calculated the "authorized" health service fee amount without making any distinction between full-time and part-time students. Education Code Section 76355 gives the governing board the discretion to determine if any fee should be charged, and subsection (b) specifically permits the governing board to make a separate determination regarding part-time students. The District is not required to charge a health fee, and must only claim offsetting revenue it actually experiences.

The Controller continues to rely on Government Code Section 17556(d), as amended by Statues of 1989, Chapter 589, while neglecting its context and omitting a crucial clause. Section 17556(d) does specify that the Commission on State Mandates shall not find costs mandated by the state if the local agency has the authority to levy fees, but only if those fees are "*sufficient to pay for the mandated program*" (emphasis added). Section 17556 pertains specifically to the Commission's determination on a test claim, and does not concern the development of parameters and guidelines or the claiming process. The Commission has already found state-mandated costs for this program, and the Controller cannot substitute its judgment for that of the Commission through the audit process.

The two court cases Mr. Spano's response (Tab 2; pg. 17) relies upon (*County of Fresno v. California* (1991) 53 Cal.3d 482 and *Connell v. Santa Margarita* (1997) 59 Cal.App.4th 382) are similarly misplaced. Both cases concern the approval of a test claim by the Commission. They do not address the issue of offsetting revenue in the reimbursement stages, only whether there is fee authority *sufficient to fully fund* the mandate that would prevent the Commission from approving the test claim.

In *County of Fresno*, the Commission had specifically found that the fee authority was sufficient to fully fund the test claim activities and denied the test claim. The court simply agreed to uphold this determination because Government Code Section 17556 (d) was consistent with the California Constitution. The Commission has approved the Health Fee Elimination mandate, and therefore found that the fee authority is not sufficient to fully fund the mandate. Thus, *County of Fresno* is not applicable because it concerns the activity of approving or denying a test claim and has no bearing on the

annual claim reimbursement process.

Similarly, although a test claim had been approved and parameters and guidelines were adopted, the court in *Connell* focused its determination on whether the initial approval of the test claim had been proper. It did not evaluate the parameters and guidelines or the reimbursement process because it found that the initial approval of the test claim had been in violation of Section 17556(d).

Next, the Controller notes that health service fees were included in the Parameters and Guidelines as a possible source of offsetting savings, and then concludes that fees authorized by Education Code Section 76355 *must* be deducted because "[t]o the extent districts have the authority to charge a fee, they are not required to incur a cost." The Parameters and Guidelines actually state:

> Any offsetting savings that the claimant experiences as a direct result of this statute must be deducted from the costs claimed. In addition, reimbursement for this mandate received from any source, e.g., federal, state, etc., shall be identified and deducted from this claim. This shall include the amount of [student fees] as authorized by Education Code Section 72246(a)[3].

In order for a district to "experience" these "offsetting savings" the district must actually have collected these fees. Note that the student health fees are named as a potential source of the reimbursement *received* in the previous sentence. The use of the term "any offsetting savings" further illustrates the permissive nature of the fees. Student fees actually collected must be used to offset costs, but not student fees that could have been collected and were not. Thus, the Controller's conclusion is based on an illogical interpretation of the Parameters and Guidelines by the Controller.

Mr. Spano's response (Tab 2; pg. 17) claims that it is "clear" that the Commission's intent was for claimed costs to be reduced by fees authorized, rather than fees received as stated in the Parameters and Guidelines. It is true that the Department of Finance proposed, as part of the amendments that were adopted on May 25, 1989, that a sentence be added to the offsetting savings section expressly stating that if no health service fee was charged, the claimant would be required to deduct the amount authorized.

However, the Commission declined to add this requirement and adopted the parameters and guidelines without this language. The fact that the Commission staff and the California Community College Chancellors Office agreed with DOF's interpretation does not negate the fact that the Commission adopted parameters and guidelines that *did not* include the additional language. It would be ridiculous if the

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[3] Former Education Code Section 72246 was repealed by Chapter 8, Statutes of 1993, Section 29, and was replaced by Education Code Section 76355.

Commission held that every proposal that is discussed was somehow implied into the adopted document, because the proposals of the various parties are often contradictory. Therefore, it is evident that the Commission intends the language of the parameters and guidelines to be construed as written, and only those savings that are *experienced* are to be deducted.

Finally, Mr. Spano's response (Tab 2; pg. 17) states that the auditor used the District's enrollment and BOGG grant records to calculate authorized health service fees, and then claims that the District is "responsible" for providing this information. This is not a requirement of the Parameters and Guidelines, and there is no other statutory requirement that the District provide this information to the Controller.

The District complied with the Parameters and Guidelines when it did not report health service fee revenue it never received. As discussed, there is no basis in law for the Controller's finding that the District was required to reduce its claimed costs by "authorized" health service fees. Therefore, the adjustments that result from this finding should be reversed.

RE: VI. STATUTE OF LIMITATIONS FOR AUDIT

The District asserts that the FY 1997-98, FY 1998-99 and FY 1999-00 claims were beyond the statute of limitations for audit when the Controller initiated its audit on June 24, 2004.

Scheduling of Audit Conference

Mr. Spano's response (Tab 2; pg. 20) claims that the District's inability to schedule an entrance conference with less than two weeks notice, and at the end of December when many employees schedule vacation time, constitutes a "willful act" to intentionally "delay the completion of an audit" under Government Code Section 17558.5(c). Yet, the District was not delaying the *completion* of the audit because the audit had not even begun. The Controller contends that "[b]ecause the district delayed the audit start date, the district equally delayed the audit completion." However, there is no support for this contention in the statute. Section 17558.5(c) specifically concerns only the completion of an audit and makes no mention of scheduling its initiation. Timely initiation of the audit is the responsibility of the Controller, and not the District.

As indicated by Carrie Bray's declaration, which is attached to the District's Incorrect Reduction Claim, she was first contacted by the Controller's Office regarding this audit on Thursday, December 12, 2002. Throughout the course of the next week there were a series of telephone calls and messages between Ms. Bray and the auditor, all with the stated intention of scheduling the entrance conference in January 2003, not December 2002 as stated in Mr. Spano's response (Tab 2; pg. 20).

Further, the District scheduled the entrance conference in January 2003 because a key employee was unavailable due to a previously scheduled vacation. Additionally, the same District staff that was essential to the mandate audit process were involved in the District's financial audit during December 2002. Mr. Spano's response (Tab 2; pg. 20) asserts that a telephone message was left for Ms. Bray on December 10, 2002, although Ms. Bray has no record of this message, which requested that a meeting be scheduled the week of December 16, 2002.

It is unreasonable to expect that District staff members could drop everything and schedule a meeting with all relevant personnel on only a few days notice. The inability of the District to comply with this demand is *not* a willful act designed for the purpose of delaying an audit. The purpose of scheduling the entrance conference in January was to ensure that the District's interests were adequately represented by having all necessary personnel present. The Controller routinely grants claimants several weeks to arrange for relevant staff to be present at an entrance conference. Yet, no such allowance was made for this district and no justification is provided for the immediate need to initiate the audit in this case.

This scheduling process is not unique, and the Controller should have planned for it. There is no reason that the SCO could not have contacted the District in October or November of 2002 if it desired to conduct an entrance conference in December 2002. The District should not be penalized for the Controller's delay in requesting an entrance conference. Further, it appears that the Controller was aware of this impending audit deadline due to the numerous phone calls to the District. The District's response and requests were not unreasonable, and the SCO's attempts to rush the District into an entrance conference at the eleventh hour do not have the effect of actually initiating the audit prior to the entrance conference.

Finally, Mr. Spano's response (Tab 2; pg. 20) asserts that the Controller *initiates* an audit by conducting the entrance conference. (As discussed above, there is no indication that the Controller actually has a firm position on the initiation of an audit due to the various standards set forth.) It then concludes that the audit was somehow "effectively initiated in December 2002," even though the entrance conference was not conducted until January 16, 2003, and that this result is dictated by Government Code Section 17558.5(c). As discussed above, the District's actions do not constitute a "willful act" to intentionally "delay the completion of an audit" under Government Code Section 17558.5(c). The Controller cannot move up the initiation date simply because the District was unable to comply with the Controller's unreasonable demands.

"Subject to Audit"

Even if the Commission finds that the "audit was effectively initiated in December 2002" as contended by the Controller, it was completed long after the time limitation for audit expired. As the Controller correctly points out, the phrase "subject to" in Government Code Section 17558.5 places a claimant "under the power or authority of" the Controller

in respect to audits. Therefore, once the FY 1997-98, FY 1998-99, and FY 1999-00 claims were no longer subject to audit on December 31, 2002, the Controller's authority to audit came to an end, along with the authority to make adjustments based on this audit. If the Controller had failed to make any adjustments by issuing a final audit report, then the time limitation is not extended simply because the audit process had begun.

A key tenet of statutory interpretation is that "statutes must be given a reasonable and common sense construction . . . that will lead to a wise policy rather than to mischief or absurdity." *(Bush v. Bright* (1968) 264 Cal.App.2d 788, 792) If the Controller's interpretation was correct, (i.e., so long as an audit was begun before the time limitation ran out then it could be completed at any later time) then there would be the absurd result that the Controller could issue a final audit report years or decades later and be entitled to the adjustments it contained.

The claimant would be in a state of limbo, not knowing whether the audit had been abandoned or the Controller's Office was simply taking its time. As the process currently stands, several months can pass between the exit conference, issuance of the draft audit report, and issuance of the final audit report. The Controller is free to abandon an audit at any point in the process, and there is no requirement that the claimant be notified of this. Thus, there is a very real possibility for this type of uncertainty to arise if the Controller's interpretation were correct.

Among the important purposes of statutes of limitations are protecting settled expectations, giving stability to transactions, and encouraging the prompt enforcement of substantive law. (*Marin Healthcare Dist. v. Sutter Health* (2002) 103 Cal.App.4th 861, 872). The Controller's interpretation of Section 17558.5 frustrates these important purposes by creating uncertainty and giving the Controller the ability to indefinitely delay the completion of an audit.

Finally, Mr. Spano's response (Tab 2; pg. 20) concludes that "clearly" the Legislature amended Government Code Section 17558.5 with Chapter 890, Statutes of 2004 to state that a reimbursement claim was "subject to the initiation of an audit" as a clarification of its intent for the previous language that stated only "subject to audit." However, the Controller provides absolutely no evidence that this is true.

"Courts are not to infer that legislation merely clarifies existing law unless (1) the nature of the amendment clearly demonstrates such an intent or (2) the legislature has itself stated that the particular amendment is merely declaratory of existing law." *(Goldman v. Standard Ins. Co.* (2003) 341 F.3d 1023, 1029). There is no evidence that either of these conditions exist for the 2004 amendment of Section 17558.5.

Therefore, the reasonable interpretation is that the reimbursement claim is only subject to any adjustments that are the result of an audit if the audit is completed before the time limitation for audit has run out. In this case, that would mean that the FY 1997-98,

FY 1998-99, and FY 1999-00 claims were beyond the time limitation when the Controller completed the audit by issuing the final audit report on June 24, 2004, and any resulting adjustments are void.

IV. Certification

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

Executed on June 8, 2009 at Sacramento, California, by

Keith B. Petersen, President
SixTen & Associates

Attachments:

Exhibit "A"	*Daniels v. Department of Motor Vehicles* (1983) 33 Cal.3d 532
Exhibit "B"	Selections from *Government Auditing Standards*, 2003 Edition
Exhibit "C"	Los Rios CCD Health Fee Elimination Audit # 2 issued May 21, 2008
Exhibit "D"	SCO Mandated Cost Manual for Community Colleges, September 30, 2003 update
Exhibit "E"	Yosemite CCD Health Fee Elimination Draft Audit Report issued April 30, 2009
Exhibit "F"	*Bush v. Bright* (1968) 264 Cal.App.2d 788
Exhibit "G"	*Marin Healthcare Dist. v. Sutter Health* (2002) 103 Cal.App.4th 861
Exhibit "H"	*Goldman v. Standard Ins. Co.* (2003) 341 F.3d 1023

C: Jon Sharpe, Deputy Chancellor
Los Rios Community College District
1919 Spanos Court
Sacramento, CA 95825-3981

Jim L. Spano, Chief, Mandated Costs Audits Bureau
Division of Audits, Office of the State Controller
P.O. Box 942850, Sacramento, CA 94250-5874

DECLARATION OF SERVICE

Re: Incorrect Reduction Claim 05-4206-I-06
Los Rios Community College District
Health Fee Elimination

I declare:

I am employed in the office of SixTen and Associates, which is the appointed representative of the above named claimant. I am 18 years of age or older and not a party to the entitled matter. My business address is 3841 North Freeway Blvd., Suite 170, Sacramento, CA 95834.

On the date indicated below, I served the attached letter dated June 8, 2009, to Paula Higashi, Executive Director, Commission on State Mandates, to:

Paula Higashi, Executive Director
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814

Jim L. Spano, Division of Audits
Office of the State Controller
P.O. Box 942850
Sacramento, CA 94250-5874

Jon Sharpe, Deputy Chancellor
Los Rios Community College District
1919 Spanos Court
Sacramento, CA 95825-3981

☒ **U.S. MAIL:** I am familiar with the business practice at SixTen and Associates for the collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at SixTen and Associates is deposited with the United States Postal Service that same day in the ordinary course of business.

☐ **OTHER SERVICE:** I caused such envelope(s) to be delivered to the office of the addressee(s) listed above by:

(Describe)

☐ **FACSIMILE TRANSMISSION:** On the date below from facsimile machine number (858) 514-8645, I personally transmitted to the above-named person(s) to the facsimile number(s) shown above, pursuant to California Rules of Court 2003-2008. A true copy of the above-described document(s) was(were) transmitted by facsimile transmission and the transmission was reported as complete and without error.

☐ A copy of the transmission report issued by the transmitting machine is attached to this proof of service.

☐ **PERSONAL SERVICE:** By causing a true copy of the above-described document(s) to be hand delivered to the office(s) of the addressee(s).

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 June 8, 2009, at Sacramento, California.

Kyle M. Peters

Exhibit A

Daniels v. Department of Motor Vehicles (1983) 33 Cal.3d 532 , 189 Cal.Rptr. 512; 658 P.2d 1313

[L.A. No. 31586. Supreme Court of California. March 10, 1983.]

WILFRED ANTHONY DANIELS, Plaintiff and Appellant, v. DEPARTMENT OF MOTOR VEHICLES, Defendant and Respondent

(Opinion by Broussard, J., expressing the unanimous views of the court.) **[33 Cal.3d 533]**

COUNSEL

James Gaus for Plaintiff and Appellant.

George Deukmejian, Attorney General, and Thomas Scheerer, Deputy Attorney General, for Defendant and Respondent.

OPINION

BROUSSARD, J.

In this appeal we consider whether an accident report filed pursuant to Vehicle Code section 16000 fn. 1 is sufficient without additional evidence to support the suspension of a driver's license in a formal Department of Motor Vehicles (D.M.V.) hearing.

In May 1979, the D.M.V. received what is known as an SR 1 report fn. 2 completed and signed by Carlita Lynn Dorham. The report described an accident **[33 Cal.3d 535]** that allegedly occurred April 25, 1979, involving a vehicle owned and operated by Dorham and another vehicle owned and operated by licensee Daniels.

On October 10, 1979, the D.M.V. issued an order of suspension of Daniels' driver's license for his failure to file an accident report and proof of financial responsibility. Daniels requested a formal hearing pursuant to section 16075. At the hearing, the referee produced and received into evidence the SR 1 report. The attorney for Daniels objected to the report on the grounds that it contained hearsay and that it had not been authenticated. The objection was overruled on the theory that the report was admissible under section 14108, which provides that at formal hearings "... the department shall consider its official records and may receive sworn testimony ...."

Daniels was called as a witness by the referee, but on advice of counsel, refused to respond when asked whether he was involved in the accident. He asserted that testifying would tend to incriminate him in the commission of a crime.

The referee found that Daniels had been in an accident involving property damage in excess of $350, and that he did not have insurance or other type of financial responsibility covering the accident in effect at the time that it occurred.

Following the recommendation of the referee, the D.M.V. issued its order of suspension January 28, 1980. Daniels' petition for writ of mandate was denied by the superior court. The Court of Appeal reversed.

The events underlying the companion case of Himelspach v. Department of Motor Vehicles (1983) post, at page 542 [189 Cal.Rptr. 518, 658 P.2d 1319], are procedurally similar except that Himelspach did not personally attend the formal hearing. However, she was represented by counsel who, coincidentally, is the same attorney who represents Daniels. The Court of Appeal affirmed the superior court's denial of a petition for writ of mandate. We granted a hearing to resolve the conflicting decisions of the Courts of Appeal.

The California Financial Responsibility Law (Veh. Code, § 16000 et seq.) requires drivers of motor vehicles to be self-insured, to have insurance, or to be otherwise financially responsible for damages caused by accidents. A driver involved in an accident causing property damage over $500 (formerly $350) or death or personal injury must report such accident to the D.M.V. on an approved SR 1 report form. Failure to report an accident covered by section 16000 results in a notice of intent to suspend. The notice advises the driver or owner of his or her right to a formal or an informal hearing on the matter. (See §§ 14100 et seq. and 16075.) Those sections provide the procedural parameters **[33 Cal.3d 536]** for the hearing. Those procedural matters not covered by the Vehicle Code are governed by the Administrative Procedure Act (Gov. Code, § 11500 et seq.; see Veh. Code, § 14112). The question in issue here is whether the procedure whereby the D.M.V. bases its order suspending a license solely on the SR 1 report is authorized by statute and complies with the dictates of due process. For the reasons that follow, we conclude that, when the licensee requests a hearing, the use of the SR 1 report as the sole basis for suspension of a license under the Financial Responsibility Law is not authorized by statute. Because we so conclude, we do not decide whether the procedure of basing suspensions solely on the SR 1 report violates due process.

[1] When an administrative agency initiates an action to suspend or revoke a license, the burden of proving the facts necessary to support the action rests with the agency making the allegation. Until the agency has met its burden of going forward with the evidence necessary to sustain a finding, the licensee has no duty to rebut the allegations or otherwise respond. La Prade v. Dept. of Water & Power (1945) 27 Cal.2d 47, 51 [162 P.2d 13]; Parker v. City of Fountain Valley (1981) 127 Cal.App.3d 99, 113 [179 Cal.Rptr. 351]; Martin v. State Personnel Bd. (1972) 26 Cal.App.3d 573 [103 Cal.Rptr. 306]. [2] The mere fact that the licensee has the right to subpoena witnesses (§ 14104.5) does not relieve the D.M.V. of meeting its burden of producing competent evidence supporting a suspension. Thus, in this case, the licensee had no duty to testify or otherwise rebut the allegations at the hearing until the D.M.V. made a prima facie showing by competent evidence that the licensee was involved in an accident that required the filing of an SR 1 report.

[3] It is well recognized that the private interest at stake in this case -- the right to retain a driver's license absent competent proof of a violation of the law -- is a substantial one. (Burkhart v. Department of Motor Vehicles (1981) 124 Cal.App.3d 99, 108 [177 Cal.Rptr. 175]; see Dixon v. Love (1977) 431 U.S. 105 [52 L.Ed.2d 172, 97 S.Ct. 1723].) Nevertheless, the D.M.V. contends that the societal interest in having an expeditious and inexpensive hearing outweighs the interest of the licensee. Whatever the weight given to the interest in an expeditious hearing, it is not so great as to allow the deprivation of a property interest absent a showing by substantial competent evidence of facts supporting a suspension.

On this point, the United States Supreme Court has noted that the "assurance of a desirable flexibility in administrative procedure does not go so far as to justify orders without a basis in evidence having rational probative force. Mere uncorroborated hearsay or rumor does not constitute substantial evidence." (Edison Co. v. Labor Board (1938) 305 U.S. 197, 230 [83 L.Ed. 126, 140, 59 S.Ct. 206].) This court has also taken the position that "[t]here must be substantial evidence to support such a board's ruling, and hearsay, unless **[33 Cal.3d 537]** specially permitted by statute, is not competent evidence to that end. [Citations.]" (Walker v. City of San Gabriel (1942) 20 Cal.2d 879, 881 [129 P.2d 349, 142 A.L.R. 1383].) Thus, the suspension in this case is invalid unless it can be said that the evidence produced at the hearing was legally sufficient to support the findings.

[4] In this regard, two theories are advanced by the D.M.V. to support the use of the SR 1 report as the sole basis for findings justifying a suspension. First, it is argued that the evidence falls within a statutory exception to the hearsay rule. Second, even if the report is hearsay that would be inadmissible over objection in a civil action, it is specially permitted by statute in suspension hearings.

"'Hearsay evidence' is evidence of a statement that was made other than by a witness while testifying at the hearing and that is offered to prove the truth of the matter stated." (Evid. Code, § 1200, subd. (a).) Unless otherwise provided by law, hearsay evidence is inadmissible. (Evid. Code, § 1200, subd. (b).) There is no dispute that the SR 1 report constitutes hearsay and that it would be inadmissible in a civil action unless it meets the requirements of a recognized exception to the hearsay rule. The D.M.V. asserts that the report falls within the business record exception provided by Evidence Code section 1271. That statute makes admissible evidence of a writing made as a record of an event when (a) the writing was made in the regular course of business; (b) the writing was made at or near the time of the act, condition or event, (c) the custodian or other qualified witness testifies to its identity and the mode of its preparation; and (d) the source of information and method and time of preparation were such as to indicate its trustworthiness.

Two of the four requirements of Evidence Code section 1271 are met in this case. The report was made shortly after the accident, and the fact that the report is made under penalty of perjury and pursuant to a legal duty tends to indicate its trustworthiness. However, the D.M.V. as custodian, upon receipt of the form, is in no position to testify to its identity and the mode of its preparation. Most significant, though, is the fact that the report is not made in the regular course of business.

The D.M.V. argues that the report is made in the regular course of business because it is required by law (§ 16000) and "it is the regular course of business for the Department of Motor Vehicles to receive such reports." This argument, however, misconstrues the nature of the first requirement of the business records exception. Although it may be the regular course of business for the D.M.V. to receive the report, it undoubtedly is not in the regular course of business for the citizen author to make to make such a report. And, it is this aspect of the report that bears on the trustworthiness factor contemplated by this **[33 Cal.3d 538]** exception to the hearsay rule. Thus, we conclude that the SR 1 report does not meet the requirements of the business record exception to the hearsay rule.

The D.M.V. argues, however, that even if the report is hearsay that would be inadmissible in a civil proceeding, the SR 1 is an official record of the D.M.V. and that its admission in the suspension hearing is specially provided by statute.

The D.M.V. contends that the specific authority for use of the SR 1 report in a suspension hearing is found in the sections of the Vehicle Code dealing with the procedure to be followed in formal and informal hearings. In particular, the D.M.V. contends that the matter of admission of the SR 1 report is "covered" by section 14108, which provides in pertinent part that at formal hearings "... the department shall consider its official records and may receive sworn testimony ...." Section 14112, provides that "[a]ll matters in a formal hearing not covered by this chapter shall be governed, as far as applicable, by the provisions of the Government Code relating to administrative hearings ...."

If the matter is not "covered" by the Vehicle Code, the D.M.V. appears to concede that the issue is governed by Government Code section 11513, which provides in relevant part that "[h]earsay evidence may be used for the purpose of supplementing or explaining other evidence but shall not be sufficient in itself to support a finding unless it would be admissible over objection in civil actions."

The question thus becomes whether the language "shall consider its official records" is a clear legislative authorization to allow use of the report as the sole basis to support a license suspension. We conclude that section 14108, while allowing consideration of the official records of the D.M.V., does not provide authority for allowing the SR 1 to form the sole basis for a license suspension. fn. 3

The legislative mandate of Government Code section 11513 against sole reliance on hearsay evidence is emphatic; the language of section 14108 fails to express a clear legislative intent to supersede section 11513. fn. 4 Unlike statutes **[33 Cal.3d 539]** that clearly authorize exceptions to the hearsay rule, fn. 5 section 14108 does not reflect any factors providing the necessary competency, reliability, and trustworthiness that would transform the SR 1 report into legally sufficient evidence. That the report is made an "official record" of the D.M.V. does not suffice to create a greater degree of competency, reliability or trustworthiness in the preparation of the report. Particularly in this case, the form, as filed, lacks the requisite assurance of reliability that must be demanded before it will support a finding. In this case, for example, there is no claim of bodily injury. The section of the form providing for a "Cost Estimate by a Garageman" is incomplete. The estimate by the author is of $400 damage, but there is no mention of any expert opinion or other basis for concluding that there was in fact that amount of damage. The amount of property damage is crucial because no duty arises to prepare the report or otherwise rebut the claim of facts authorizing suspension unless, in the absence of bodily injury, the amount of damages exceeds the statutory trigger point.

The D.M.V. contends that the rationale of Burkhart v. Department of Motor Vehicles, supra, 124 Cal.App.3d 99, supports reliance solely on the SR 1 report. In Burkhart the court held that the police officer's written statement admitted in a license suspension hearing under the implied consent law (§ 13353) **[33 Cal.3d 540]** was sufficient in itself to support a finding of failure to complete a chemical test, and that the procedure did not violate due process. Burkhart was arrested for driving under the influence of alcohol. (§ 23102, subd. (a).) On the same date the arresting officer executed a sworn statement under section 13353 to the effect that Burkhart had refused to take any chemical test as required by that section. Upon notice of intent to suspend his license, Burkhart requested a hearing pursuant to section 14107. The hearing was postponed twice because of the failure of the arresting officer to appear, and finally an informal hearing was held without the presence of the officer. At the hearing, the referee introduced the officer's sworn statement over objection of Burkhart's counsel. Burkhart and his wife contested several portions of the officer's statement; nevertheless, the referee found against Burkhart. The superior court held that the officer's statement was not sufficient prima facie evidence of any matter as to which there is conflicting evidence. In holding to the contrary, the Court of Appeal recognized that due process required a balancing test of the various interests involved, but concluded that the presence of the officer would not substantially enhance the reliability

of the hearing process, and the governmental interest and fiscal and administrative burdens involved outweighed requiring the state to produce the officer at the hearing.

In reaching that conclusion, Burkhart relied on Fankhauser v. Orr (1968) 268 Cal.App.2d 418 [74 Cal.Rptr. 61]. The Fankhauser court held that the report of the officer in an implied consent hearing was hearsay but that it was made admissible by section 14108. However, Fankhauser was a case where the licensee testified at the hearing, and his testimony supported the officer's written statement regarding probable cause to stop him and did not controvert the other averments of the officer's sworn statement. (268 Cal.App.2d at p. 423.) In addition, Burkhart specifically recognized but refused to follow contrary authority that declined to elevate the officer's written statement to the status of prima facie evidence if objected to or in conflict with other evidence. (See August v. Department of Motor Vehicles (1968) 264 Cal.App.2d 52 [70 Cal.Rptr. 172]; Fallis v. Department of Motor Vehicles (1968) 264 Cal.App.2d 373 [70 Cal.Rptr. 595].)

The court in August found that there was no dispute as to the existence of the facts upon which the D.M.V. suspended August's license under section 13353, and that August had failed to object to the introduction of the officer's report or request cross-examination of the officer at the informal hearing. Nevertheless, the court suggested that due process required providing the right to cross-examination when the licensee requests a hearing and contests the evidence presented by the agency. (264 Cal.App.2d at p. 60.) A stronger case for the right to cross-examine exists where, as here, the suspension is based on the uncorroborated report of a citizen who by chance happens to be involved in an accident. **[33 Cal.3d 541]**

Assuming, arguendo, the viability of the conclusion of Burkhart in the implied consent context, that case does not necessarily dispose of the question in this case. The result in Burkhart could be justified under the theory that the report filed by an officer under section 13353 would qualify under Evidence Code section 1271 as a business record or under Evidence Code section 1280 as an official record. Unlike the driver involved in an automobile accident, the statement under section 13353 is made by the officer in the regular course of his or her "business." In addition, the officer's report is a writing "made by and within the scope of duty of a public employee," and meets the other criteria of Evidence Code section 1280, and would thus qualify under that statutory exception to the hearsay rule as well. Whether these distinctions justify sole reliance on the officer's report in an implied consent hearing we need not now decide.

The SR 1 report filed in this case does not in itself reflect the competency, reliability, and trustworthiness necessary to permit use of the report as the sole basis for a finding supporting a license suspension. In view of the importance of the right affected and the lack of legislative authorization allowing sole reliance on the SR 1 report, we hold that, when the licensee requests a hearing, the SR 1 report is in itself insufficient to establish a prima facie showing of the facts supporting the suspension of a driver's license.

The judgment of the trial court is reversed and the cause is remanded to the trail court with directions to grant Daniels' petition and issue a peremptory writ commanding the D.M.V. to set aside its order of suspension and proceed in accordance with the views expressed herein.

Bird, C. J., Mosk, J., Richardson, J., Kaus, J., Reynoso, J., and Dalsimer, J., concurred.

FN 1. All statutory references are to the Vehicle Code unless otherwise noted. At the time of the accident, section 16000 provided: "The driver of a motor vehicle which is in any manner involved in an accident originating from the operation of a motor vehicle on any street or highway which accident has resulted in damage to the property of any one person in excess of three hundred fifty dollars ($350) or in bodily injury or in the death of any person shall within 15 days after the accident, report the accident on a form approved by the department to the office of the department of Sacramento, subject to the provisions of this chapter. A report shall not be required in the event that the motor vehicle involved in the accident was owned or leased by or under the direction of the United States, this state, or any political subdivision of this state or municipality thereof." Since the accident, the minimum monetary amount has been increased to $500.

FN 2. The report required to be filed by section 16000 is designated by the D.M.V. as an SR 1 report, and for convenience shall be referred to as such in this opinion.

FN 3. The mere admissibility of evidence does not necessarily confer the status of "sufficiency" to support a finding absent other competent evidence. "Admissibility is not the equivalent of evaluation; the former makes certain concessions in the interest of full and complete discovery while the latter, in the interest of fairness, withholds legal sanction to evidence found not to be trustworthy. Unlike the common practice in judicial proceedings, the fact that evidence may be admissible does not therefore guarantee the sufficiency of such evidence to sustain a finding." (Collins, Hearsay and the Administrative Process: A Review and Reconsideration of the State of the Law of Certain Evidentiary Procedures Applicable in California Administrative Proceedings (1976) 8 Sw.U.L.Rev. 577, 591 (hereafter cited as Hearsay and the Administrative Process).)

FN 4. Other statutory schemes authorizing admission of hearsay evidence in administrative hearings do so unequivocally. For example, the statutes governing procedure in a workers' compensation hearing quite specifically authorize the admission and sufficiency of certain evidence. Labor Code section 5703 provides: "The appeals board may receive evidence either at or subsequent to a hearing, and use as proof of any fact in dispute, the following matters, in addition to sworn testimony presented in open hearing:

"(a) Reports of attending or examining physicians.

"(b) Reports of special investigators appointed by the appeals board or a referee to investigate and report upon any scientific or medical question.

"(c) Reports of employers, containing copies of timesheets, book accounts, reports, and other records properly authenticated.

"(d) Properly authenticated copies of hospital records of the case of the injured employee.

"(e) All publications of the Division of Industrial Accidents.

"(f) All official publications of state and United States governments.

"(g) Excerpts from expert testimony received by the appeals board upon similar issues of scientific fact in other cases and the prior decisions of the appeals board upon such issues." (Italics added.)

Labor Code section 5708 provides: "All hearings and investigations before the appeals board or a referee are governed by this division and by the rules of practice and procedures adopted by the appeals board. In the conduct thereof they shall not be bound by the common law or statutory rules of evidence and procedure, but may make inquiry in the manner, through oral testimony and records, which is best calculated to ascertain the substantial rights of the parties and carry out justly the spirit and provisions of this division. All oral testimony, objections, and rulings shall be taken down in shorthand by a competent phonographic reporter." (Italics added.)

Labor Code section 5709 provides: "No informality in any proceeding or in the manner of taking testimony shall invalidate any order, decision, award, or rule made and filed as specified in this division. No order, decision, award, or rule shall be invalidated because of the admission into the record, and use as proof of any fact in dispute, of any evidence not admissible under the common law or statutory rules of evidence and procedure." (Italics added.) Even in this context, however, the "use" of hearsay evidence does not necessarily sanction sole reliance on uncorroborated hearsay. (See Hearsay and the Administrative Process, supra, fn. 132 at p. 603.)

FN 5. See, for example, Evidence Code section 1271 (business records); Evidence Code section 1280 (official records); Evidence Code section 1220 (admissions of a party); Evidence Code section 1240 (spontaneous statements).

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Exhibit B

GAO
U.S. Government Accountability Office

Professional Judgment

3.33 The general standard related to professional judgment is:

Professional judgment should be used in planning and performing audits and attestation engagements and in reporting the results.

3.34 This standard requires auditors to exercise reasonable care and diligence and to observe the principles of serving the public interest and maintaining the highest degree of integrity, objectivity, and independence in applying professional judgment to all aspects of their work. This standard also imposes a responsibility upon each auditor performing work under GAGAS to observe GAGAS. If auditors state they are performing their work in accordance with GAGAS, they should justify any departures from GAGAS.

3.35 Auditors should use professional judgment in determining the type of assignment to be performed and the standards that apply to the work; defining the scope of work; selecting the methodology; determining the type and amount of evidence to be gathered; and choosing the tests and procedures for their work. Professional judgment also should be applied in performing the tests and procedures and in evaluating and reporting the results of the work.

3.36 Professional judgment requires auditors to exercise professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of evidence. Auditors use the knowledge, skills, and experience called for by their profession to diligently perform, in good faith and with integrity, the gathering of evidence and the objective evaluation of the sufficiency, competency, and relevancy of evidence. Since evidence is gathered and evaluated throughout the assignment, professional skepticism should be exercised throughout the assignment.

3.37 Auditors neither assume that management is dishonest nor assume unquestioned honesty. In exercising professional skepticism, auditors should not be satisfied with less than persuasive evidence because of a belief that management is honest.

3.38 The exercise of professional judgment allows auditors to obtain reasonable assurance that material misstatements or significant inaccuracies in data will likely be detected if they exist. Absolute assurance is not attainable because of the nature of evidence and the characteristics of fraud. Therefore, an audit or attestation engagement conducted in accordance with GAGAS may not detect a material misstatement or significant inaccuracy, whether from error or fraud, illegal acts, or violations of provisions of contracts or grant agreements. Accordingly, while this standard places responsibility on each auditor and audit organization to exercise professional judgment in planning and performing an assignment, it does not imply unlimited responsibility, nor does it imply infallibility on the part of either the individual auditor or the audit organization.

GAO-03-673G Government Auditing Standards

GAO
U.S. Government Accountability Office

Report Contents

8.07 The reporting standard related to the contents of the report for performance audits conducted in accordance with GAGAS is:

The audit report should include the objectives, scope, and methodology; the audit results, including findings, conclusions, and recommendations, as appropriate; a reference to compliance with generally accepted government auditing standards; the views of responsible officials; and, if applicable, the nature of any privileged and confidential information omitted.

Objectives, Scope, and Methodology

8.08 Auditors should include in the report the audit objectives and the scope and methodology used for achieving the audit objectives. This information is needed by report users to understand the purpose of the audit and the nature of the audit work performed, to provide perspective as to what is reported, and to understand any significant limitations in audit objectives, scope, or methodology.

8.09 Audit objectives should be communicated in the audit report in a clear, specific, and neutral manner that avoids unstated assumptions. Auditors should explain why the audit organization undertook the assignment and state what the report is to accomplish and why the subject matter is important. Articulating what the report is to accomplish normally involves identifying the audit subject and the aspect of performance examined. The reported audit objectives provide more meaningful information to report users if they are measurable and feasible and avoid being presented in a broad or general manner. To reduce misunderstanding in cases where the objectives are particularly limited and broader objectives can be inferred, it may be necessary to state objectives that were not pursued.

8.10 In reporting the scope of the audit, auditors should describe the depth and coverage of work conducted to accomplish the audit's objectives. Auditors should, as applicable, explain the relationship between the population of items sampled and what was audited; identify organizations, geographic locations, and the period covered; report the kinds and sources of evidence; and explain any problems with the evidence. Auditors should also report significant constraints imposed on the audit approach by data limitations or scope impairments, including demands of access to certain records or individuals.

8.11 To report the methodology used, auditors should clearly explain how the audit objectives were accomplished, including the evidence gathering and analysis techniques used, in sufficient detail to allow knowledgeable users of their reports to understand the work. This explanation should identify any significant assumptions made in conducting the audit; describe any comparative techniques applied; describe the criteria used; and,

when sampling significantly supports auditors' findings, describe the sample design and state why it was chosen, including whether the results can be projected to the intended population.

8.12 Auditors should attempt to avoid misunderstanding by the report user concerning the work that was and was not done to achieve the audit objectives, particularly when the work was limited because of constraints on time or resources. The auditors' report should clearly describe the scope of the work performed and any limitations; any applicable standards that were not followed, and the reasons therefor; and how not following the applicable standards affected or could affect the results of the work. For example, if the auditors are unable to determine the reliability of information from an agency's database, and information from this database is critical to achieving the audit objectives, the report should clearly state the limitations associated with the information and refrain from making unwarranted conclusions or recommendations. In these situations, the audit report should also include the reasons the auditors were unable to perform this work and the potential impact on the findings if the information is not reliable. [1]

Findings

8.13 Auditors should report findings by providing credible evidence that relates to the audit objectives. These findings should be supported by sufficient, competent, and relevant evidence. They also should be presented in a manner to promote adequate understanding of the matters reported and to provide convincing but fair presentations in proper perspective. The audit report should provide selective background information to provide the context for the overall message and to help the reader understand the findings and significance of the issues discussed. [2]

8.14 As discussed in chapter 7, audit findings have often been regarded as containing the elements of criteria, condition, cause, and effect. However, the elements needed for a finding depend on the audit objectives. For example, an audit objective may be limited to determining the current status or condition of implementing legislative requirements, and not the related cause or effect. Thus, a finding or set of findings is complete to the extent that the audit objectives are satisfied and the report clearly relates those objectives to the elements of the finding.

8.15 To the extent possible, in presenting findings, auditors should develop the elements of criteria, condition, cause, and effect to assist officials of the audited entity or oversight officials of the audited entity in understanding the need for taking corrective action. In addition, if auditors are able to sufficiently develop the findings, auditors should provide recommendations for corrective action. Following is guidance for reporting on elements of findings:

a. Criteria provides information so that the report user will be able to determine what is the required or desired state or what is expected from the program or operation. The criteria are easier to understand when stated fairly, explicitly, and completely and when the source of the criteria is identified in the audit report. [3]

b. Condition provides evidence on what the auditors found regarding the actual situation. Reporting the scope or extent of the condition allows the report user to gain an accurate perspective.

c. Cause provides persuasive evidence on the factor or factors responsible for the difference between condition and criteria. In reporting the cause, auditors may consider whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference as opposed to other possible causes, such as poorly designed criteria or factors uncontrollable by program management. The auditors also may consider whether the identified cause

could serve as a basis for the recommendations.

d. Effect provides a clear, logical link to establish the impact of the difference between what the auditors found (condition) and what should be (criteria). Effect is easier to understand when it is stated clearly, concisely, and, if possible, in quantifiable terms. The significance of the reported effect can be demonstrated through credible evidence.

8.16 The audit report should also include any significant deficiencies [4] in internal control, all instances of fraud and illegal acts unless they are clearly inconsequential,5 significant violations of provisions of contracts or grant agreements, and significant abuse.

Internal Control Deficiencies

8.17 Auditors should include in the audit report the scope of their work on internal control and any significant deficiencies found during the audit. When auditors detect deficiencies in internal control that are not significant, they should communicate those deficiencies in a separate letter to officials of the audited entity unless the deficiencies are clearly inconsequential considering both qualitative and quantitative factors. If the auditors have communicated deficiencies in a separate letter to officials of the audited entity, they should refer to that letter in the audit report. Auditors should use professional judgment in determining whether or how to communicate deficiencies that are clearly inconsequential to officials of the audited entity. Auditors should include in their audit documentation evidence of all communications about internal control deficiencies found during the audit.

8.18 In a performance audit, auditors may identify significant deficiencies in internal control as the cause of deficient performance. In reporting this type of finding, the internal control weakness would be described as the cause.

Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, and Abuse

8.19 When auditors conclude, based on evidence obtained, that fraud, illegal acts, significant violations of provisions of contracts or grant agreements, or significant abuse either has occurred or is likely to have occurred, they should include in their audit report relevant information. [6] Abuse occurs when the conduct of a government program or entity falls far short of behavior that is expected to be reasonable and necessary business practices by a prudent person.

8.20 When reporting instances of fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse, auditors should place their findings in proper perspective by providing a description of the work conducted that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of these findings, the instances identified should be related to the population or the number of cases examined and be quantified in terms of dollar value, if appropriate. If the results cannot be projected, auditors should limit their conclusion to the items tested.

8.21 When auditors detect violations of provisions of contracts or grant agreements; or abuse that is not significant, they should communicate those findings in a separate letter to officials of the audited entity unless the findings are clearly inconsequential, considering both qualitative and quantitative factors. If the auditors have communicated instances of fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse in a separate letter to officials of the audited entity, auditors should refer to that letter in the audit report. Auditors should use their professional judgment in determining whether and how to communicate to officials of the audited entity fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse that are clearly inconsequential. Auditors should include in their

audit documentation evidence of all communications to officials of the audited entity about instances of fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse.

Direct Reporting of Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, and Abuse

8.22 GAGAS require auditors to report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to parties outside the audited entity in certain circumstances, as discussed below. [7] These requirements are in addition to any legal requirements for direct reporting of fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse. Auditors should meet these requirements even if they have resigned or been dismissed from the audit.

8.23 The audited entity may be required by law or regulation to report certain fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to specified external parties, such as a federal inspector general or a state attorney general. If auditors have communicated such fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to the audited entity and it fails to report them, then the auditors should communicate their awareness of that failure to the governing body of the audited entity. If the audited entity does not make the required report as soon as possible after the auditors' communication with the entity's governing body, then the auditors should report such fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to the external party specified in the law or regulation.

8.24 Officials of the audited entity are responsible for taking timely and appropriate steps to remedy fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that auditors report to them. When fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse involves assistance received directly or indirectly from a government agency, auditors may have a duty to report such fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to that government agency if officials of the audited entity fail to take remedial steps. If auditors conclude that such failure is likely to cause them to report such findings or resign from the audit, they should communicate that conclusion to the governing body of the audited entity. Then, if the audited entity does not report the fraud, illegal act, violation of provisions of contracts or grant agreements, or abuse as soon as possible to the entity that provided the government assistance, the auditors should report the fraud, illegal act, violation of provisions of contracts or grant agreements, or abuse directly to that entity.

8.25 In these situations, auditors should obtain sufficient, competent, and relevant evidence, such as confirmation with outside parties, to corroborate assertions by officials of the audited entity that the officials have reported fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse. If the officials are unable to do so, then the auditors should report such fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly as discussed above.

8.26 Laws, regulations, or other authority may require auditors to report promptly indications of certain types of fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to law enforcement or investigatory authorities. In such circumstances, when auditors conclude that these types of fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse either have occurred or are likely to have occurred, they should ask those authorities or legal counsel if publicly reporting certain information about the potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse would compromise investigative or legal proceedings. Auditors should limit the extent of their public reporting to matters that would not compromise those proceedings, such as information that is

already a part of the public record.

Conclusions

8.27 Auditors should report conclusions when called for by the audit objectives and the results of the audit. Conclusions are logical inferences about the program based on the auditors' findings and should represent more than just a summary of the findings. Conclusions should be clearly stated, not implied. The strength of the auditors' conclusions depends on the persuasiveness of the evidence supporting the findings and the soundness of the logic used to formulate the conclusions. Conclusions are stronger if they set up the report's recommendations and convince the knowledgeable user of the report that action is necessary.

Recommendations

8.28 If warranted, auditors should make recommendations for actions to correct problems identified during the audit and to improve programs and operations. Auditors should make recommendations when the potential for improvement in programs, operations, and performance is substantiated by the reported findings and conclusions. Recommendations should logically flow from the findings and conclusions and need to state clearly the actions to be taken. Recommendations to effect compliance with laws and regulations and improve internal control also should be made when significant instances of possible fraud, illegal acts, or violations of provisions of contracts or grant agreements are noted, or when abuse or deficiencies in internal control are found.

8.29 Constructive recommendations can encourage improvements in the conduct of government programs and operations. For recommendations to be most constructive, they should be directed at resolving the cause of identified problems, action oriented and specific, addressed to parties that have the authority to act, practical and, to the extent feasible, cost effective and measurable.

Statement on Compliance with GAGAS

8.30 Auditors should report that the audit was made in accordance with GAGAS. The statement of compliance with GAGAS refers to all the applicable standards that the auditors should have followed during the audit. The statement referencing compliance with GAGAS should be qualified in situations in which the auditors did not follow an applicable standard. In these situations, auditors should disclose in the scope section of the report the applicable standard that was not followed, the reasons therefor, and how not following the standard affected, or could have affected, the results of the audit. In assessing the impact of not following an applicable standard on the results of the audit, auditors may need to qualify any assurances, disclaim from providing any assurances, or withdraw from the audit.

Reporting Views of Responsible Officials

8.31 Auditors should report the views of responsible officials of the audited program concerning auditors' findings, conclusions, and recommendations; as well as planned corrective actions. One of the most effective ways to ensure that a report is fair, complete, and objective is to obtain advance review and comments by responsible officials of the audited entity and others, as may be appropriate. Including the views of responsible officials results in a report that presents not only the auditors' findings, conclusions, and recommendations, but also what the responsible officials of the audited entity think about the audit results and what corrective actions officials of the audited entity plan to take. Auditors should include in their report a copy of the officials' written comments or a summary of the comments received.

8.32 Auditors should normally request that the responsible officials submit in writing their views on reported findings, conclusions, and recommendations, as well as management's planned corrective actions. Oral comments are acceptable as well and,

in some cases, may be the only or most expeditious way to obtain comments. Cases in which obtaining oral comments can be effective include when there is a time-critical requirement to meet a user's needs; the auditors have worked closely with the responsible officials throughout the conduct of the work and the parties are very familiar with the findings and issues addressed in the draft report; or the auditors do not expect major disagreements with the draft report's findings, conclusions, and recommendations, or perceive any major controversies with regard to the issues discussed in the draft report. Auditors should prepare a summary of the officials' oral comments and provide a copy of the summary to officials of the audited entity to verify that the comments are accurately stated prior to finalizing the report.

8.33 Comments should be fairly and objectively evaluated and recognized, as appropriate, in the final report. Comments, such as a promise or plan for corrective action, should be noted but should not be accepted as justification for dropping a finding or a related recommendation.

8.34 When the audited entity's comments oppose the report's findings, conclusions, or recommendations and are not, in the auditors' opinion, valid, or when planned corrective actions do not adequately address the auditors' recommendations, the auditors should state their reasons for disagreeing with the comments or planned corrective actions. The auditors' disagreement should be stated in a fair and objective manner. Conversely, the auditors should modify their report as necessary if they find the comments valid.

Reporting Privileged and Confidential Information

8.35 If certain pertinent information is prohibited from general disclosure, the audit report should state the nature of the information omitted and the requirement that makes the omission necessary.

8.36 Certain information may be prohibited from general disclosure by federal, state, or local laws or regulations. In such circumstances, auditors may issue a separate limited-official-use report containing such information and distribute the report only to persons authorized by law or regulation to receive it. Additional circumstances associated with public safety and security concerns could also justify the exclusion of certain information in the report. For example, detailed information related to computer security for a particular program may be excluded from publicly available reports because of the potential damage that could be caused by the misuse of this information. In such circumstances, auditors may issue a limited-official-use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. The auditors should, when appropriate, consult with legal counsel regarding any requirements or other circumstances that may necessitate the omission of certain information.

8.37 Auditors' judgments that certain information should be excluded from publicly available reports should be made in a manner consistent with consideration of the broader public interest in the program or activity under review. When circumstances call for omission of certain information, auditors should consider whether this omission could distort the engagement results or conceal improper or unlawful practices. If auditors make the judgment that certain information should be excluded from a publicly available report, they should state the general nature of the information omitted and the reasons that make the omission necessary in the report.

1When computer-processed data are included in the report for background or informational purposes and are not significant to the auditors' findings, citing the source of the data and stating that they were not verified will satisfy the reporting standards.

2Appropriate background information may include information on how programs and

operations work; the significance of programs and operations (e.g., dollars, impact, purposes, and past audit work if relevant); a description of the audited entity's responsibilities; and explanation of terms, organizational structure, and the statutory basis for the program and operations.

3Common sources for criteria include laws, regulations, policies, procedures, and best or standard practices. The *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: Nov. 1999) and *Internal Control--Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) are two sources of established criteria auditors can use to support their judgments and conclusions about internal control. The related *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: Aug. 2001), based on the federal internal control standards, provides a systematic, organized, and structured approach to assessing internal control.

4Significant deficiencies are those matters coming to the auditor's attention that, in the auditor's judgment, affect the results of the auditors' work and the auditors' conclusions and recommendations about those results.

5Whether a particular act is, in fact, illegal may have to await final determination by a court of law. Thus, when auditors disclose matters that have led them to conclude that an illegal act is likely to have occurred, they should take care not to unintentionally imply that a final determination of illegality has been made.

6See paragraphs 8.22 through 8.26 for additional reporting considerations.

7Internal audit organizations do not have a duty to report outside the entity unless required by law, rule, regulation, or policy. See paragraph 3.28 for reporting requirements for internal audit organizations when reporting externally.

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Exhibit C

LOS RIOS COMMUNITY COLLEGE DISTRICT

Audit Report

HEALTH FEE ELIMINATION PROGRAM

Chapter 1, Statutes of 1984, 2nd Extraordinary Session, and Chapter 1118, Statutes of 1987

July 1, 2002, through June 30, 2005

JOHN CHIANG
California State Controller

May 2008

JOHN CHIANG
California State Controller

May 21, 2008

Anne Blackwood, President
Board of Trustees
Los Rios Community College District
1919 Spanos Court
Sacramento, CA 95825-3981

Dear Ms. Blackwood:

The State Controller's Office audited the costs claimed by the Los Rios Community College District for the legislatively mandated Health Fee Elimination Program (Chapter 1, Statutes of 1984, 2nd Extraordinary Session, and Chapter 1118, Statutes of 1987) for the period of July 1, 2002, through June 30, 2005.

The district claimed $2,554,615 ($2,555,615 less a $1,000 penalty for filing a late claim) for the mandated program. Our audit disclosed that the entire amount is unallowable, primarily because the district did not report authorized health service fees. The State paid the district $814,928, which the State will offset from other mandated program payments due the district. Alternatively, the district may remit this amount to the State.

If you disagree with the audit findings, you may file an Incorrect Reduction Claim (IRC) with the Commission on State Mandates (CSM). The IRC must be filed within three years following the date that we notify you of a claim reduction. You may obtain IRC information at CSM's Web site, at www.csm.ca.gov (Guidebook link); you may obtain IRC forms by telephone, at (916) 323-3562, or by e-mail, at csminfo@csm.ca.gov.

If you have any questions, please contact Jim L. Spano, Chief, Mandated Cost Audits Bureau, at (916) 323-5849.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/vb

cc: Jon Sharpe, Deputy Chancellor
Los Rios Community College District
Carrie Bray, Director, Accounting Services
Los Rios Community College District
Marty Rubio, Specialist, Fiscal Accountability Section
California Community Colleges Chancellor's Office
Jeannie Oropeza, Program Budget Manager
Education Systems Unit
Department of Finance

Contents

Audit Report

Summary

The State Controller's Office (SCO) audited the costs claimed by the Los Rios Community College District for the legislatively mandated Health Fee Elimination Program (Chapter 1, Statutes of 1984, 2nd Extraordinary Session, and Chapter 1118, Statutes of 1987) for the period of July 1, 2002, through June 30, 2005.

The district claimed $2,554,615 ($2,555,615 less a $1,000 penalty for filing a late claim) for the mandated program. Our audit disclosed that the entire amount is unallowable, primarily because the district did not report authorized health service fees. The State paid the district $814,928, which the State will offset from other mandated program payments due the district. Alternatively, the district may remit this amount to the State.

Background

Chapter 1, Statutes of 1984, 2nd Extraordinary Session (E.S.) repealed Education Code section 72246 which authorized community college districts to charge a health fee for providing health supervision and services, providing medical and hospitalization services, and operating student health centers. This statute also required that health services for which a community college district charged a fee during fiscal year (FY) 1983-84 had to be maintained at that level in FY 1984-85 and every year thereafter. The provisions of this statute would automatically sunset on December 31, 1987, reinstating the community college districts' authority to charge a health service fee as specified.

Chapter 1118, Statutes of 1987, amended Education Code section 72246 (subsequently renumbered as section 76355 by Chapter 8, Statutes of 1993). The law requires any community college district that provided health services in FY 1986-87 to maintain health services at the level provided during that year in FY 1987-88 and each fiscal year thereafter.

On November 20, 1986, the Commission on State Mandates (CSM) determined that Chapter 1, Statutes of 1984, 2nd Extraordinary Session imposed a "new program" upon community college districts by requiring specified community college districts that provided health services in FY 1983-84 to maintain health services at the level provided during that year in FY 1984-85 and each fiscal year thereafter. This maintenance-of-effort requirement applied to all community college districts that levied a health service fee in FY 1983-84.

On April 27, 1989, the CSM determined that Chapter 1118, Statutes of 1987, amended this maintenance-of-effort requirement to apply to all community college districts that provided health services in FY 1986-87, requiring them to maintain that level in FY 1987-88 and each fiscal year thereafter.

The program's parameters and guidelines establish the state mandate and define reimbursement criteria. CSM adopted parameters and guidelines on August 27, 1987, and amended them on May 25, 1989. In compliance with Government Code section 17558, the SCO issues claiming instructions to assist school districts in claiming mandated program reimbursable costs.

Objective, Scope, and Methodology

We conducted the audit to determine whether costs claimed represent increased costs resulting from the Health Fee Elimination Program for the period of July 1, 2002, through June 30, 2005.

Our audit scope included, but was not limited to, determining whether costs claimed were supported by appropriate source documents, were not funded by another source, and were not unreasonable and/or excessive.

We conducted the audit according to *Government Auditing Standards*, issued by the Comptroller General of the United States, and under the authority of Government Code sections 12410, 17558.5, and 17561. We did not audit the district's financial statements. We limited our audit scope to planning and performing audit procedures necessary to obtain reasonable assurance that costs claimed were allowable for reimbursement. Accordingly, we examined transactions, on a test basis, to determine whether the costs claimed were supported.

We limited our review of the district's internal controls to gaining an understanding of the transaction flow and claim preparation process as necessary to develop appropriate auditing procedures.

We asked the district's representative to submit a written representation letter regarding the district's accounting procedures, financial records, and mandated cost claiming procedures as recommended by *Government Auditing Standards*. However, the district declined our request.

Conclusion

Our audit disclosed instances of noncompliance with the requirements outlined above. These instances are described in the accompanying Summary of Program Costs (Schedule 1) and in the Findings and Recommendations section of this report.

For the audit period, the Los Rios Community College District claimed $2,554,615 ($2,555,615 less a $1,000 penalty for filing a late claim) for costs of the Health Fee Elimination Program. Our audit disclosed that the entire amount is unallowable.

The State paid the district $814,928, which it will offset from other mandated program payments due the district. Alternatively, the district may remit this amount to the State.

Views of Responsible Official

We issued a draft audit report on February 20, 2008. Jon Sharpe, Deputy Chancellor, responded by letter dated March 11, 2008 (Attachment), disagreeing with the audit results. This final audit report includes the district's response.

After further review, we revised Finding 1 to eliminate previously reported unallowable costs that resulted from extrapolating non-statistical sample results to the population sampled. Finding 1 now shows unallowable salaries and benefits totaling $16,019 and unallowable indirect costs totaling $4,889. We previously reported unallowable salaries and benefits totaling $148,851 and unallowable indirect costs totaling $45,484.

Restricted Use

This report is solely for the information and use of the Los Rios Community College District, the California Community Colleges Chancellor's Office, the California Department of Finance, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

May 21, 2008

Schedule 1—
Summary of Program Costs
July 1, 2002, through June 30, 2005

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference [1]
July 1, 2002, through June 30, 2003				
Direct costs:				
Salaries	$ 501,152	$ 498,087	$ (3,065)	Finding 1
Benefits	115,242	114,542	(700)	Finding 1
Services and supplies	12,117	6,287	(5,830)	Finding 2
Total direct costs	628,511	618,916	(9,595)	
Indirect costs	186,417	107,398	(79,019)	Findings 1, 2, 3
Total direct and indirect costs	814,928	726,314	(88,614)	
Less authorized health service fees	—	(1,293,681)	(1,293,681)	Finding 4
Subtotal	814,928	(567,367)	(1,382,295)	
Audit adjustments that exceed costs claimed	—	567,367	567,367	
Total program costs	$ 814,928	—	$ (814,928)	
Less amount paid by the State		(814,928)		
Allowable costs claimed in excess of (less than) amount paid		$ (814,928)		
July 1, 2003, through June 30, 2004				
Direct costs:				
Salaries	$ 516,187	$ 508,796	$ (7,391)	Finding 1
Benefits	128,945	127,151	(1,794)	Finding 1
Services and supplies	19,506	13,031	(6,475)	Finding 2
Total direct costs	664,638	648,978	(15,660)	
Indirect costs	201,983	113,671	(88,312)	Findings 1, 2, 3
Total direct and indirect costs	866,621	762,649	(103,972)	
Less authorized health service fees	—	(1,137,243)	(1,137,243)	Finding 4
Less late filing penalty	(1,000)	(1,000)	—	
Subtotal	865,621	(375,594)	(1,241,215)	
Audit adjustments that exceed costs claimed	—	375,594	375,594	
Total program costs	$ 865,621	—	$ (865,621)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ —		

Schedule 1 (continued)

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference [1]
July 1, 2004, through June 30, 2005				
Direct costs:				
Salaries	$ 516,410	$ 513,946	$ (2,464)	Finding 1
Benefits	128,609	128,004	(605)	Finding 1
Services and supplies	17,352	8,590	(8,762)	Finding 2
Total direct costs	662,371	650,540	(11,831)	
Indirect costs	211,695	231,352	19,657	Findings 1, 2, 3
Total direct and indirect costs	874,066	881,892	7,826	
Less authorized health service fees	—	(1,123,546)	(1,123,546)	Finding 4
Subtotal	874,066	(241,654)	(1,115,720)	
Audit adjustments that exceed costs claimed	—	241,654	241,654	
Total program costs	$ 874,066	—	$ (874,066)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ —		
Summary: July 1, 2002, through June 30, 2005				
Direct costs:				
Salaries	$ 1,533,749	$ 1,520,829	$ (12,920)	
Benefits	372,796	369,697	(3,099)	
Services and supplies	48,975	27,908	(21,067)	
Total direct costs	1,955,520	1,918,434	(37,086)	
Indirect costs	600,095	452,421	(147,674)	
Total direct and indirect costs	2,555,615	2,370,855	(184,760)	
Less authorized health service fees	—	(3,554,470)	(3,554,470)	
Less late filing penalty	(1,000)	(1,000)	—	
Subtotal	2,554,615	(1,184,615)	(3,739,230)	
Audit adjustments that exceed costs claimed	—	1,184,615	1,184,615	
Total program costs	$ 2,554,615	—	$(2,554,615)	
Less amount paid by the State		(814,928)		
Allowable costs claimed in excess of (less than) amount paid		$ (814,928)		

[1] See the Findings and Recommendations section.

Findings and Recommendations

**FINDING 1—
Unallowable salaries and benefits**

The district claimed unallowable salaries and benefits totaling $16,019. The related indirect costs total $4,889. The unallowable salaries and benefits are attributable to (1) the increased level of health services that American River College (ARC) provided and (2) the insufficient supporting documentation that Consumnes River College (CRC) and Sacramento City College (SCC) provided.

The district's claims identified the health services that the district provided during fiscal year (FY) 1986-87, the mandated program's base year. For each college, we examined health service logs that covered a one-month period in each fiscal year. For CRC, we expanded our sample to include a second one-month period in FY 2003-04. The health service logs identify actual health services provided. ARC's health service logs showed that it provided health services exceeding the services that the district provided during FY 1986-87. In addition, CRC's and SCC's health service logs included entries that did not identify the service provided. As a result, we were unable to verify that those services were mandate-related.

The following table shows the percentage of unallowable or unsupported health services provided and the resulting unallowable salaries and benefits for each college and fiscal year:

	ARC	CRC	SCC	Total
Fiscal Year 2002-03:				
Salaries and benefits claimed	$ 241,188	$ 145,430	$ 229,776	
Number of months per year	÷ 12	÷ 12	÷ 12	
Average monthly salaries and benefits claimed	20,099	12,119	19,148	
Percentage of unallowable services provided	× (5.65)%	× (12.50)%	× (5.82)%	
Audit adjustment	(1,136)	(1,515)	(1,114)	$ (3,765)
Fiscal Year 2003-04:				
Salaries and benefits claimed	240,486	179,984	224,662	
Number of months per year	÷ 12	÷ 12	÷ 12	
Average monthly salaries and benefits claimed	20,041	14,999	18,722	
Number of months audited	× 1	× 2	× 1	
Total salaries and benefits for months audited	20,041	29,998	18,722	
Percentage of unallowable services provided	× (4.20)%	× (24.09)%	× (5.96)%	
Audit adjustment	(842)	(7,227)	(1,116)	(9,185)
Fiscal Year 2004-05:				
Salaries and benefits claimed	253,007	178,176	213,836	
Number of months per year	÷ 12	÷ 12	÷ 12	
Average monthly salaries and benefits claimed	21,084	14,848	17,820	
Percentage of unallowable services provided	× (5.04)%	× (13.51)%	× —	
Audit adjustment	(1,063)	(2,006)	—	(3,069)
Total audit adjustment	$ (3,041)	$ (10,748)	$ (2,230)	$ (16,019)

The following table summarizes the unallowable salaries and benefits and the related indirect costs:

	Fiscal Year			Total
	2002-03	2003-04	2004-05	
Salaries and benefits	$ (3,765)	$ (9,185)	$ (3,069)	$ (16,019)
Related indirect costs	(1,117)	(2,791)	(981)	(4,889)
Audit adjustment	$ (4,882)	$ (11,976)	$ (4,050)	$ (20,908)

The program's parameters and guidelines state that a community college district may claim costs only for those health services that it provided in FY 1986-87. In addition, the parameters and guidelines state that "all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs."

Recommendation

We recommend that the district maintain logs that consistently identify the health services actually provided. In addition, we recommend that the district adopt uniform health service logs by implementing ARC's health service log system for all colleges. We also recommend that the district claim only those costs related to health services that the district provided in FY 1986-87.

District's Response

> The audit work which generated these findings was a review of "service logs" . . . These logs are actually sign-in sheets in which persons obtaining service, with or without appointments, write their name and provide a four or five word description of their ailment. Some patients declined to state the reason for their visit, which is their right under state and federal laws, specifically HIPPA privacy laws.
>
> The service logs were not prepared for mandate or financial cost accounting purposes nor are they required by the parameters and guidelines. Neither the parameters and guidelines nor the Controller's claiming instructions require the claimants to report the number or type of service actually provided, but only require the claimant to provide an inventory of services available to students.
>
> There is no evidence that the service logs record all of the services provided each month. The extrapolation [finding] assumes that all staff labor is applied only to patient visits.
>
> There is no indication that the number of services provided in each of these months is a statistically valid sample of the scope of services provided. That is, patient visits may not be representative of all types of services provided.
>
> The time spent by staff to provide service varies by the type of service provided. The extrapolation assumes every patient visit requires the same amount of staff time to provide service.
>
> The audit disallows those visits for which no reason is stated by the patient. This essentially disallows services which are probably allowable. This penalizes the District for complying with privacy requirements.

> The audit report recommends that in the future the district maintain logs "that consistently identify the health services actually provided." This of course indicates that the auditor does not believe the current logs are representative of the services actually provided, yet the auditor used the logs for sampling and extrapolation. Therefore, the audit report concedes that findings are based on an incompetent source.
>
> The audit report quotes the parameters and guidelines as the legal basis for the adjustment, specifically, that " ... all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs." It is ironic and entirely unacceptable for the Controller to adjust claimed costs for insufficient documentation when the auditor chose documents never intended nor designed for cost accounting as the basis for these findings and then criticized the District's source documentation.

The district also objected to the SCO extrapolating sample results to total salaries and benefits claimed for each college and fiscal year.

SCO's Comment

We revised our audit finding to eliminate previously reported unallowable costs that resulted from extrapolating sample results to the full fiscal year for each college. For those colleges and fiscal years for which we sampled one month of services provided, we calculated unallowable costs by applying the percentage of unallowable services to the average monthly salaries and benefits claimed. Because we sampled two months for Consumnes River College's FY 2003-04 services provided, we doubled that amount. We also made non-substantive edits to our recommendation.

During our audit field work, we asked the district to provide documentation showing the actual services that the district provided. In response, the district provided the health service logs. We gave the district an opportunity to provide any other documentation that supports actual services provided. The district did not provide any other documentation during our audit fieldwork or in response to our draft audit report.

The district incorrectly states that the parameters and guidelines and the SCO's claiming instructions "only require the claimant to provide an inventory of services available to students." The parameters and guidelines actually state, "Only services provided in 1986-87 fiscal year may be claimed." They require the district to claim salaries and benefits by describing the mandated functions performed and specifying the actual number of hours devoted to each function. In addition, they state, "All costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs."

The district states that the service logs do not record all of the health services that it provided each month. However, the district provided no other documentation related to patient visits or the actual amount of time spent on reimbursable activities.

The district states, "The time spent by staff to provide service varies by the type of service provided. The extrapolation [finding] assumes every patient visit requires the same amount of staff time to provide service." However, the district did not provide any documentation that shows the actual time spent on unallowable activities. The district did not provide any documentation that specifies the actual number of hours devoted to each mandated function as required by the parameters and guidelines. In addition, the district failed to provide any reasonable alternative methodology to calculate costs claimed that are attributable to unallowable activities. The district's failure to provide any evidence of the individual costs allegedly incurred puts its entire claim in question. We conclude that the audit methodology is reasonable in light of the district's lack of supporting documentation.

The district also states, "The audit disallows those visits for which no reason is stated by the patient. This essentially disallows services which are probably allowable. This penalizes the District for complying with privacy requirements." The parameters and guidelines require the district to describe the mandated functions performed and specify the actual number of hours devoted to each function. The district provided no documentation showing that the referenced patient visits were "probably allowable." The district's compliance with Health Insurance Portability and Accountability Act (HIPAA) requirements is not relevant. It is the district's responsibility to maintain documentation that complies with the parameters and guidelines' requirements. The district may document actual services provided without violating HIPAA requirements simply by providing the same health service logs without disclosing patient names. District staff may contemporaneously identify the service(s) provided if the patient does not.

The district cites the audit report recommendation that states, "We recommend that the district maintain logs that consistently identify the health services actually provided." The district then incorrectly concludes that the SCO does not believe that the current logs are representative of the services actually provided and hypothesizes falsely that the audit report concedes to reporting a finding based on an incompetent source. Our recommendation only addresses the issue of documented patient visits that do not identify the actual service provided.

The district states, "It is ironic and entirely unacceptable for the Controller to adjust claimed costs for insufficient documentation when the auditor chose documents never intended nor designed for cost accounting as the basis for these findings and then criticized the District's source documentation." The SCO did not "choose" the documents. The SCO requested that the district provide documentation supporting actual services provided, in accordance with the parameters and guidelines' requirements. In response, the district provided copies of the health service logs. The district provided no other documentation to support actual services provided. The SCO did not "criticize" the source documentation, but instead noted instances in which the source documentation either did not identify the actual health services provided or identified unallowable services.

FINDING 2— Unallowable services and supplies

The district claimed unallowable services and supplies totaling $21,067. The related indirect costs total $6,497.

The district claimed $12,305 to provide medical services at sporting events and physical examinations for intercollegiate athletes. Education Code section 76355, subdivision (d)(2), states that authorized expenditures shall not include physical examinations for intercollegiate athletics and the salaries of health professionals for athletic events.

In addition, the district claimed $3,568 for laboratory service costs and $5,194 for immunization costs. The district's claims show that it did not provide these services during FY 1986-87. The parameters and guidelines state that a community college district may claim costs only for those health services that it provided in FY 1986-87.

The following table summarizes the audit adjustment:

	Fiscal Year			
	2002-03	2003-04	2004-05	Total
Services and supplies	$ (5,830)	$ (6,475)	$ (8,762)	$ (21,067)
Indirect costs	(1,729)	(1,968)	(2,800)	(6,497)
Audit adjustment	$ (7,559)	$ (8,443)	$ (11,562)	$ (27,564)

Recommendation

We recommend that the district claim costs only for those health services that it provided in FY 1986-87.

District's Response

> The audit findings do not state which tests and immunizations are disallowed, so it cannot be determined if the finding is accurate.

SCO's Comment

Our finding and recommendation are unchanged. During our exit conference conducted January 10, 2008, we provided the district a detailed schedule showing each individual unallowable item, identified by both the district's reference number and voucher number. The district did not provide any documentation to refute the audit finding.

FINDING 3— Overstated and understated indirect cost rates claimed

The district overstated its indirect cost rates for FY 2002-03 and FY 2003-04. The district understated its indirect cost rate for FY 2004-05. The overstated and understated indirect cost rates resulted in unallowable indirect costs totaling $136,288.

The district prepared its FY 2002-03 and FY 2003-04 indirect cost rate proposals (ICRPs) using Office of Management and Budget (OMB) Circular A-21 methodology. However, the district did not obtain federal approval for these ICRPs.

The district prepared its FY 2004-05 ICRP using the SCO's FAM-29C methodology. However, the district did not prepare the ICRP according to the SCO's claiming instructions. The district prepared the FY 2004-05 ICRP using FY 2003-04 actual cost data and did not properly allocate costs as indirect costs or direct costs.

We calculated allowable indirect cost rates using the FAM-29C methodology that the SCO's claiming instructions allow. The following table summarizes the claimed and allowable indirect cost rates and the resulting audit adjustment.

	Fiscal Year			
	2002-03	2003-04	2004-05	Total
Allowable indirect cost rate	16.47%	16.26%	35.76%	
Claimed indirect cost rate	(29.66)%	(30.39)%	(31.96)%	
(Overstated)/understated indirect cost rate	(13.19)%	(14.13)%	3.80%	
Allowable direct costs claimed	$ 577,502	$ 591,315	$ 616,785	
Audit adjustment	$ (76,173)	$ (83,553)	$ 23,438	$(136,288)

The parameters and guidelines state that "indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." The SCO's claiming instructions state that districts must obtain federal approval for an ICRP prepared in accordance with OMB Circular A-21. Alternatively, the district may compute an indirect cost rate using Form FAM-29C, which is based on total fiscal year expenditures that the district reports in the California Community Colleges Annual Financial and Budget Report, Expenditures by Activity (CCFS-311).

Recommendation

We recommend that the district claim indirect costs based on indirect cost rates computed in accordance with the SCO's claiming instructions. The district must obtain federal approval for ICRPs prepared in accordance with OMB Circular A-21. Alternatively, the district should prepare its ICRPs using SCO's Form FAM-29C.

District's Response

> This finding results from the District calculating the indirect cost rated based upon how the CCSF-311 report characterizes the various accounts as direct or indirect costs. The Controller's method arbitrarily assigns certain costs to different categories. For example, for the first two fiscal years in this audit, the Controller does not include depreciation as an indirect cost, but does for the third fiscal year. The Controller insists that the rate be calculated according to the claiming instructions. The parameters and guidelines for Health Fee Elimination (as last amended on 5/25/89) state that "Indirect costs maybe claimed in the manner described by the State Controller in his claiming instructions." It does not require that indirect costs be claimed in the manner described by the State Controller. The District utilized the CCSF-311 classification of accounts which is more rational and consistent than the Controller's evolving formula.

SCO's Comment

Our finding and recommendation are unchanged. The district erroneously states that it calculated its indirect cost rates "based upon how the CCFS-311 report characterizes the various accounts as direct or indirect costs." The California Community Colleges Chancellor's Office's (CCCCO's) CCFS-311 report does not identify individual accounts as direct or indirect.

The SCO did not "arbitrarily" assign costs to direct or indirect cost categories. The SCO calculated indirect cost rates based on its claiming instructions applicable to each fiscal year. The SCO's Form FAM-29C methodology provides equitable rates that districts may use to allocate district administrative support costs to personnel that perform mandated program activities.

The district incorrectly concludes that the parameters and guidelines do not require that the district claim indirect costs according to the SCO's claiming instructions. The parameters and guidelines state, "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." The district misinterprets "may be claimed" by concluding that compliance with the claiming instructions is voluntary. Instead, "may be claimed" simply permits the district to claim indirect costs. However, if the district chooses to claim indirect costs, then it must comply with the SCO's claiming instructions.

FINDING 4—
Unreported authorized health service fees

The district did not report authorized health service fees totaling $3,554,470.

Mandated costs do not include costs that are reimbursable from authorized fees. Government Code section 17514 states that "costs mandated by the state" means any increased costs that a school district is required to incur. To the extent community college districts can charge a fee, they are not required to incur a cost. In addition, Government Code section 17556 states that the Commission on State Mandates (CSM) shall not find costs mandated by the State if the school district has the authority to levy fees to pay for the mandated program or increased level of service.

For the audit period, Education Code section 76355, subdivision (c), states that health fees are authorized for all students except those who: (1) depend exclusively on prayer for healing; (2) are attending a community college under an approved apprenticeship training program; or (3) demonstrate financial need. The CCCCO identified the fees authorized by Education Code section 76355, subdivision (a). For FY 2002-03 and FY 2003-04, the authorized fees are $12 per semester and $9 per summer session. For FY 2004-05, the authorized fees are $13 per semester and $10 per summer session.

We obtained student enrollment, Board of Governors Grant (BOGG) recipient, and apprenticeship program enrollment data from the CCCCO. The CCCCO data is based on student data that the district reported. We calculated total authorized health service fees using the authorized health service fee rates that the CCCCO identified.

The following table shows the authorized health service fee calculation and audit adjustment:

	Semester			
	Summer	Fall	Spring	Total
Fiscal Year 2002-03:				
Student enrollment	28,310	72,031	68,248	
BOGG recipients	(7,847)	(20,059)	(19,597)	
Apprenticeship program enrollees	(790)	(5,236)	(2,335)	
Students subject to health fee	19,673	46,736	46,316	
Authorized health fee rate	× $ (9)	× $ (12)	× $ (12)	
Audit adjustment, FY 2002-03	$ (177,057)	$ (560,832)	$ (555,792)	$ (1,293,681)
Fiscal Year 2003-04:				
Student enrollment	25,500	67,881	67,013	
BOGG recipients	(9,579)	(23,472)	(23,344)	
Apprenticeship program enrollees	(674)	(2,244)	(2,499)	
Students subject to health fee	15,247	42,165	41,170	
Authorized health fee rate	× $ (9)	× $ (12)	× $ (12)	
Audit adjustment, FY 2003-04	$ (137,223)	$ (505,980)	$ (494,040)	(1,137,243)
Fiscal Year 2004-05:				
Student enrollment	25,290	67,316	67,936	
BOGG recipients	(11,302)	(27,138)	(27,250)	
Apprenticeship program enrollees	(1,385)	(2,461)	(1,671)	
Students subject to health fee	12,603	37,717	39,015	
Authorized health fee rate	× $ (10)	× $ (13)	× $ (13)	
Audit adjustment, FY 2004-05	$ (126,030)	$ (490,321)	$ (507,195)	(1,123,546)
Total audit adjustment				$ (3,554,470)

Recommendation

We recommend that the district deduct authorized health service fees from mandate-related costs claimed. The district should maintain records that support its calculation of authorized health service fees. These records should identify the actual non-duplicated student enrollment and students who are exempt from health service fees under Education Code section 76355, subdivision (c).

District's Response

> This finding reduces the claimed program costs by a calculated amount of student health services fees never collected. The District does not collect a student health services fee.
>
> Education Code Section 76355, subdivision (a), in relevant part, provides: "The governing board of a district maintaining a community college *may require* community college students to pay a fee . . . for health supervision and services. . . ." There is no requirement that community colleges levy these fees. The permissive nature of the provision is further illustrated in subdivision (b) which states "*If*, pursuant to this section, a fee is required, the governing board of the district shall decide the amount of the fee, if any, that a part-time

student is required to pay. *The governing board may decide whether the fee shall be mandatory or optional.*" (Emphasis supplied in both instances)

The Parameters and Guidelines, as last amended on 5/25/89, state, in relevant part, "Any offsetting savings . . . must be deducted from the costs claimed . . . This shall include the amount of (student fees) as authorized by Education Code Section 72246 (a)[1]." The use of the term "offsetting savings" further illustrates the permissive nature of the fees. Student fees actually collected must be used to offset costs, but not student fees that could have been collected and were not.

The audit report also cites Government Code Section 17556 which only prohibits the Commission on State Mandates from finding costs in certain instances. Here, the Commission has already made a finding of a new program or increased costs.

[1] Former Education Code Section 72246 was repealed by Chapter 8, Statutes of 1993, Section 29, and was replaced by Education Code Section 76355.

SCO's Comment

Our finding and recommendation are unchanged. We agree that community college districts may choose not to levy a health service fee. However, Education Code section 76355, subdivision (a), provides districts the authority to levy a health service fee. The CCCCO notifies districts of the fee amount authorized pursuant to Education Code section 76355, subdivision (a).

Regardless of the district's decision to levy or not levy a health service fee, the district does have the *authority* to levy the fee. Government Code section 17514 states, "'Costs mandated by the state' means any increased costs which a local agency or school district is *required* to incur . . ." [Emphasis added]." To the extent the district is authorized to collect health service fees attributable to health service expenses, it is not *required* to incur a cost. Therefore, those health service expenses do not meet the statutory definition of mandated costs.

In addition, Government Code section 17556, subdivision (d), state that the CSM shall not find costs mandated by the State if the district has the authority to levy fees to pay for the mandated program or increased level of service. For the Health Fee Elimination Program, the CSM did recognize that another funding source was available by including health service fees as offsetting savings in the parameters and guidelines. The result is the same: To the extent districts have the authority to charge a fee, they are not required to incur a cost.

ADDITIONAL ISSUE—Claim Payment

The district's response included comments regarding the amounts paid by the State, as shown in Schedule 1, Summary of Program Costs. The district's response and SCO's comment are as follows:

District's Response

> The audit report asserts in several locations that the District was paid $814,928 and this amount should be remitted to the state. The money was never "paid" to the District. The Controller offset the amount payable by reductions to payments for other mandate claims and fiscal years.

SCO's Comment

The claim payment amount is unchanged. The term "paid" is simply the past tense of "pay," which is defined as "discharging indebtedness" [1]. The State discharged its FY 2002-03 indebtedness to the district by equally discharging the district's indebtedness to the State for other mandated program claims.

[1] Merriam-Webster's Collegiate Dictionary, Tenth Edition

Attachment—
District's Response to
Draft Audit Report

LOS RIOS
COMMUNITY COLLEGE DISTRICT

American River College
Cosumnes River College
Folsom Lake College
Sacramento City College

1919 Spanos Court
Sacramento, CA 95825
Phone: 916 568-3111
Fax: 916 568-3061
www.losrios.edu

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

March 11, 2008

Jim L. Spano, Chief,
Mandated Costs Audits Bureau
Division of Audits
Office of the State Controller
P.O. Box 942850
Sacramento, CA 94250-5874

Re: Chapter 1, Statutes of 1984
Health Fee Elimination
State Controller's Audit
Fiscal Years: 2002-03, 2003-04, and 2004-05

Dear Mr. Spano:

This letter is the response of the Los Rios Community College District to the letter from Jeffrey V. Brownfield, Chief, Division of Audits, dated February 20, 2008, and received by the District on February 28, 2008, which transmitted the draft audit report for the above referenced mandate program and fiscal years.

Finding 1 - Unallowable salaries and benefits

The draft audit report eliminates $194,335 of salary and benefits for the three fiscal years. The stated reasons are that some of the services sampled exceeded those of the FY 1986-87 base year and that there was insufficient supporting documentation for other services. The audit work which generated these findings was a review of "service logs" for one month at each college for each fiscal year, with an additional month reviewed at Consumnes River College for one fiscal year. These logs are actually sign-in sheets in which persons obtaining service, with or without appointments, write their name and provide a four or five word description of their ailment. Some patients declined to state the reason for their visit, which is their right under state and federal laws, specifically HIPPA privacy laws.

Based on a review of these logs, the audit concluded that some visits were for services not provided in the base year, and where the patient declined to state the reason for the visit, the audit determined that this was insufficient documentation and thus disallowed the visit. These excess and unidentified services were determined to be "unallowable" and generated exception rates (ranging from about 4% to 24%) which were extrapolated to the entire cost of the salary and benefits for the student health services program.

These "service logs" are inappropriate as the basis for "findings" and extrapolation for the audit adjustments for several reasons:

-The service logs were not prepared for mandate or financial cost accounting purposes nor are they required by the parameters and guidelines. Neither the parameters and guidelines nor the Controller's claiming instructions require the claimants to report the number or type of service actually provided, but only require the claimant to provide an inventory of services available to students.

-There is no evidence that the one month of service logs reviewed for each of the three years (36 months of service) at each of the three colleges are representative of the entire year (total number of visits). There is definitely seasonal workload (fewer students in the summer) and seasonal staffing. The extrapolation assumes the workload and labor costs are the same each month.

-There is no evidence that the service logs record all of the services provided each month. The extrapolation is adjusting total salaries and benefits and therefore assumes that *all* staff labor is applied only to patient visits.

-There is no indication that the number of services provided in each of these months is a statistically valid sample of the scope of services provided. That is, patient visits may not be representative of all types of services provided.

-The time spent by staff to provide service varies by the type of service provided. The extrapolation assumes every patient visit requires the same amount of staff time to provide service.

-The audit disallows those visits for which no reason is stated by the patient. This essentially disallows services which are probably allowable. This penalizes the District for complying with privacy requirements.

-Extrapolation of sample findings requires a statistically valid sample. The service logs are not factually or statistically relevant to the cost of services so they cannot be used as a sample of services provided. The extrapolation of the exceptions to the total salary and benefits costs is not a relevant universe of cost for extrapolation of the service log. The audit report recommends that in the future the district maintain logs "that consistently identify the health services actually provided." This of course indicates that the auditor does not believe the current logs are representative of the services actually provided, yet the auditor used the logs for sampling and extrapolation. Therefore, the audit report concedes that findings are based on an incompetent source.

The audit report quotes the parameters and guidelines as the legal basis for the adjustment, specifically, that " . . . all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs." It is ironic and entirely unacceptable for the Controller to adjust claimed costs for insufficient

documentation when the auditor chose documents never intended nor designed for cost accounting as the basis for these findings and then criticized the District's source documentation.

Finding 2 - Unallowable services and supplies

Lab and Immunization Services

The finding disallows $3,568 for laboratory services and $5,194 for immunizations which the audit concludes were not provided in the base-year. The source of this conclusion was the health services inventory which is part of the claim. The audit findings do not state which tests and immunizations are disallowed, so it cannot be determined if the finding is accurate.

Finding 3 - Overstated and understated indirect cost rates claimed

This finding results from the District calculating the indirect cost rated based upon how the CCSF-311 report characterizes the various accounts as direct or indirect costs. The Controller's method arbitrarily assigns certain costs to different categories. For example, for the first two fiscal years in this audit, the Controller does not include depreciation as an indirect cost, but does for the third fiscal year.

The Controller insists that the rate be calculated according to the claiming instructions. The parameters and guidelines for Health Fee Elimination (as last amended on 5/25/89) state that "Indirect costs *may be claimed* in the manner described by the State Controller in his claiming instructions." It does not require that indirect costs be claimed in the manner described by the State Controller. The District utilized the CCSF-311 classification of accounts which is more rational and consistent than the Controller's evolving formula.

Finding 4 - Understated authorized health service fees

This finding reduces the claimed program costs by a calculated amount of student health services fees never collected. The District does not collect a student health services fee.

Education Code Section 76355, subdivision (a), in relevant part, provides: "The governing board of a district maintaining a community college *may require* community college students to pay a fee . . . for health supervision and services . . . " There is no requirement that community colleges levy these fees. The permissive nature of the provision is further illustrated in subdivision (b) which states "*If*, pursuant to this section, a fee is required, the governing board of the district shall decide the amount of the fee, if any, that a part-time student is required to pay. *The governing board may decide whether the fee shall be mandatory or optional*." (Emphasis supplied in both instances)

The Parameters and Guidelines, as last amended on 5/25/89, state, in relevant part, "*Any* offsetting savings . . . must be deducted from the costs claimed . . . This shall include the amount of (student fees) as authorized by Education Code Section 72246(a)[1]." The use of the term "*any* offsetting savings" further illustrates the permissive nature of the fees. Student fees actually collected must be used to offset costs, but not student fees that could have been collected and were not.

The audit report also cites Government Code Section 17556 which only prohibits the Commission on State Mandates from finding costs in certain instances. Here, the Commission has already made a finding of a new program or increased costs.

The audit manager indicated at the entrance conference that this adjustment would be made and then stated at the exit conference that future claims would be audited to continue this adjustment. It would seem unnecessary to continue to burden the District and expend state staff resources for field audits when the Controller has decided that no costs will be allowed.

Claim Payment

The audit report asserts in several locations that the District was paid $814,928 and this amount should be remitted to the state. The money was never "paid" to the District. The Controller offset the amount payable by reductions to payments for other mandate claims and fiscal years.

o o o

Therefore, for the reasons stated above, Los Rios Community College District requests that the audit report be changed to comply with the law.

Sincerely,

Jon Sharpe, Deputy Chancellor
Los Rios Community College District

C: Jeffrey V. Brownfield, Chief, Division of Audits
Keith Petersen, SixTen and Associates
Carrie Bray, Director, Accounting Services
Raymond Andres, General Accounting Supervisor

[1] Former Education Code Section 72246 was repealed by Chapter 8, Statutes of 1993, Section 29, and was replaced by Education Code Section 76355.

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

http://www.sco.ca.gov

Exhibit D

MANDATED COST MANUAL FOR COMMUNITY COLLEGES

STATE OF CALIFORNIA

STEVE WESTLY
STATE CONTROLLER

FOREWORD

The claiming instructions contained in this manual are issued for the sole purpose of assisting claimants with the preparation of claims for submission to the State Controller's Office. These instructions have been prepared based upon interpretation of the State of California statutes, regulations, and parameters and guidelines adopted by the Commission on State Mandates. Therefore, unless otherwise specified, these instructions should not be construed in any manner to be statutes, regulations, or standards.

If you have any questions concerning the enclosed material, write to the address below or call the Local Reimbursements Section at (916) 324-5729, or email to lrsdar@sco.ca.gov.

State Controller's Office
Attn: Local Reimbursements Section
Division of Accounting and Reporting
P.O. Box 942850
Sacramento, CA 94250

Prepared by the State Controller's Office
Updated September 30, 2003

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REIMBURSABLE STATE MANDATED COST PROGRAMS

Claims for the following State mandated cost programs may be filed with the SCO. For your convenience, the programs are listed in alphabetical order by program name. An "X" indicates the fiscal year for which a claim may be filed.

2002-03 Reimbursement Claims	2003-04 Estimated Claims	Community College Districts		
x	x	Chapter	77/78	Absentee Ballots
x	x	Chapter	961/75	Collective Bargaining
x	x	Chapter	1120/96	Health Benefits for Survivors of Peace Officers & Firefighters
x	x	Chapter	1/84	Health Fee Elimination
x	x	Chapter	783/95	Investment Reports
x	x	Chapter	284/98	Law Enforcement College Jurisdiction Agreements
x	x	Chapter	126/93	Law Enforcement Sexual Harassment Training
x	x	Chapter	486/75	Mandate Reimbursement Process
x	x	Chapter	641/86	Open Meetings Act/Brown Act Reform
x	x	Chapter	465/76	Peace Officers Procedural Bill of Rights
x	x	Chapter	875/85	Photographic Record of Evidence
x	x	Chapter	908/96	Sex Offenders: Disclosure by Law Enforcement Officers
x	x	Chapter	1249/92	Threats Against Peace Officers

APPROPRIATIONS FOR THE 2003-04 FISCAL YEAR

Source of State Mandated Cost Appropriations

Schedule			Program	Amount Appropriated
Chapter 379/02, Item 6110-295-0001[1]				
(1)	Chapter	77/78	Absentee Ballots	$ 0
(2)	Chapter	961/75	Collective Bargaining	0
(3)	Chapter	1120/96	Health Benefits for Survivors of Peace Officers and Firefighters	0
(4)	Chapter	783/95	Investment Reports	0
(5)	Chapter	284/98	Law Enforcement College Jurisdiction Agreements	0
(6)	Chapter	126/93	Law Enforcement Sexual Harassment Training	0
(7)	Chapter	486/75	Mandate Reimbursement Process	0
(8)	Chapter	641/86	Open Meetings Act/Brown Act Reform	0
(9)	Chapter	465/76	Peace Officers Procedural Bill of Rights	0
(10)	Chapter	875/85	Photographic Record of Evidence	0
(11)	Chapter	908/96	Sex Offenders: Disclosure by Law Enforcement Officers	0
(12)	Chapter	1249/92	Threats Against Peace Officers	0
Total Appropriations, Item 6110-295-001				**$ 0**
Chapter 379/02, Item 6870-295-0001				
(13)	Chapter	1/84	Health Fee Elimination	1,000
TOTAL - Funding for the 2003-04 Fiscal Year				**$1,000**

[1] Pursuant to provision 5, "The Controller shall not make any payment from this item to reimburse community college districts for claimed costs of state-mandated education programs. Reimbursements to community college districts for education mandates shall be paid from the appropriate item within the community colleges budget."

FILING A CLAIM

1. Introduction

The law in the State of California, (Government Code Sections 17500 through 17616), provides for the reimbursement of costs incurred by school districts for costs mandated by the State. Costs mandated by the State means any increased costs which a school district is required to incur after July 1, 1980, as a result of any statute enacted after January 1, 1975, or any executive order implementing such statute which mandates a new program or higher level of service of an existing program.

Estimated claims that show costs to be incurred in the current fiscal year and reimbursement claims that detail the costs actually incurred for the prior fiscal year may be filed with the State Controller's Office (SCO). Claims for on-going programs are filed annually by January 15. Claims for new programs are filed within 120 days from the date claiming instructions are issued for the program. A 10 percent penalty, (up to $1,000 for continuing claims, no limit for initial claims), is assessed for late claims. The SCO may audit the records of any school district to verify the actual amount of mandated costs and may reduce any claim that is excessive or unreasonable.

When a program has been reimbursed for three or more years, the COSM may approve the program for inclusion in the State Mandates Apportionment System (SMAS). For programs included in SMAS, the SCO determines the amount of each claimant's entitlement based on an average of three consecutive fiscal years of actual costs adjusted by any changes in the Implicit Price Deflator (IPD). Claimants with an established entitlement receive an annual apportionment adjusted by any changes in the IPD and, under certain circumstances, by any changes in workload. Claimants with an established entitlement do not file further claims for the program.

The SCO is authorized to make payments for costs of mandated programs from amounts appropriated by the State Budget Act, by the State Mandates Claims Fund, or by specific legislation. In the event the appropriation is insufficient to pay claims in full, claimants will receive prorated payments in proportion to the dollar amount of approved claims for the program. Balances of prorated payments will be made when supplementary funds are made available.

The instructions contained in this manual are intended to provide general guidance for filing a mandated cost claim. Since each mandate is administered separately, it is important to refer to the specific program for information relating to established policies on eligible reimbursable costs.

2. Types of Claims

There are three types of claims: Reimbursement, Estimated, and Entitlement. A claimant may file a reimbursement claim for actual mandated costs incurred in the prior fiscal year or may file an estimated claim for mandated costs to be incurred during the current fiscal year. An entitlement claim may be filed for the purpose of establishing a base year entitlement amount for mandated programs included in SMAS. A claimant who has established a base year entitlement for a program would receive an automatic annual payment which is reflective of the current costs for the program.

All claims received by the SCO will be reviewed to verify actual costs. An adjustment of the claim will be made if the amount claimed is determined to be excessive, improper, or unreasonable. The claim must be filed with sufficient documentation to support the costs claimed. The types of documentation required to substantiate a claim are identified in the instructions for the program. The certification of claim, form FAM-27, must be signed and dated by the entity's authorized officer in order for the SCO to make payment on the claim.

A. Reimbursement Claim

A reimbursement claim is defined in GC Section 17522 as any claim filed with the SCO by a local agency for reimbursement of costs incurred for which an appropriation is made for the purpose of paying the claim. The claim must include supporting documentation to substantiate the costs claimed.

Initial reimbursement claims are first-time claims for reimbursement of costs for one or more prior fiscal years of a program that was previously unfunded. Claims are due 120 days from the date of issuance of the claiming instructions for the program by the SCO. The first statute that appropriates funds for the mandated program will specify the fiscal years for which costs are eligible for reimbursement.

Annual reimbursement claims must be filed by January 15 following the fiscal year in which costs were incurred for the program. A reimbursement claim must detail the costs actually incurred in the prior fiscal year.

An actual claim for the 2002-03 fiscal year may be filed by January 15, 2004, without a late penalty. Claims filed after the deadline will be reduced by a late penalty of 10%, not to exceed $1,000. However, initial reimbursement claims will be reduced by a late penalty of 10% with no limitation. In order for a claim to be considered properly filed, it must include any specific supporting documentation requested in the instructions. Claims filed more than one year after the deadline or without the requested supporting documentation will not be accepted.

B. Estimated Claim

An estimated claim is defined in GC Section 17522 as any claim filed with the SCO, during the fiscal year in which the mandated costs are to be incurred by the local agency, against an appropriation made to the SCO for the purpose of paying those costs.

An estimated claim may be filed in conjunction with an initial reimbursement claim, annual reimbursement claim, or at other times for estimated costs to be incurred during the current fiscal year. Annual estimated claims are due January 15 of the fiscal year in which the costs are to be incurred. Initial estimated claims are due on the date specified in the claiming instructions. Timely filed estimated claims are paid before those filed after the deadline.

After receiving payment for an estimated claim, the claimant must file a reimbursement claim by January 15 following the fiscal year in which costs were incurred. If the claimant fails to file a reimbursement claim, monies received for the estimated claims must be returned to the State.

C. Entitlement Claim

An entitlement claim is defined in GC Section 17522 as any claim filed by a local agency with the SCO for the sole purpose of establishing or adjusting a base year entitlement for a mandated program that has been included in SMAS. An entitlement claim should not contain nonrecurring or initial start-up costs. There is no statutory deadline for the filing of entitlement claims. However, entitlement claims and supporting documents should be filed by January 15 to permit an orderly processing of claims. When the claims are approved and a base year entitlement amount is determined, the claimant will receive an apportionment reflective of the program's current year costs. School mandates included in SMAS are listed in Section 2, number 6.

Once a mandate has been included in SMAS and the claimant has established a base year entitlement, the claimant will receive automatic payments from the SCO for the mandate. The automatic apportionment is determined by adjusting the claimant's base year entitlement for changes in the implicit price deflator of costs of goods and services to governmental agencies, as determined by the State Department of Finance. For programs approved by the COSM for inclusion in SMAS on or after January 1, 1988, the payment for each year succeeding the three year base period is adjusted according to any changes by both the deflator and average daily attendance. Annual apportionments for programs included in the system are paid on or before November 30 of each year.

A base year entitlement is determined by computing an average of the claimant's costs for any three consecutive years after the program has been approved for the SMAS process. The amount is first adjusted according to any changes in the deflator. The deflator is applied separately to each year's costs for the three years, which comprise the base year. The SCO will perform this computation for each claimant who has filed claims for three consecutive years. If a claimant has incurred costs for three consecutive years but has not filed a claim in each of those years, the claimant may file an entitlement claim, form FAM-43, to establish a base year entitlement. An entitlement claim does not result in the claimant being reimbursed for the costs incurred, but rather entitles the claimant to receive automatic payments from SMAS.

3. Minimum Claim Amount

For initial claims and annual claims filed on or after September 30, 2002, if the total costs for a given year do not exceed $1,000, no reimbursement shall be allowed except as otherwise allowed by GC Section 17564. The county shall determine if the submission of a combined claim is economically feasible and shall be responsible for disbursing the funds to each special district. Combined claims may be filed only when the county is the fiscal agent for the special districts. A combined claim must show the individual claim costs for each eligible school district. All subsequent claims based upon the same mandate shall only be filed in the combined form unless a special district, provides to the county and to the Controller, at least 180 days prior to the deadline for filing the claim, a written notice of its intent to file a separate claim.

GC Section 17564(a) provides that no claim shall be filed pursuant to Sections 17551 and 17561, unless such a claim exceeds one thousand dollars ($1,000), provided that a county superintendent of schools may submit a combined claim on behalf of school districts within their county if the combined claim exceeds $1,000, even if the individual school district's claim does not each exceed $1,000. The county superintendent of schools shall determine if the submission of the combined claim is economically feasible and shall be responsible for disbursing the funds to each school district. These combined claims may be filed only when the county superintendent of schools is the fiscal agent for the districts. A combined claim must show the individual claim costs for each eligible district. All subsequent claims based upon the same mandate shall only be filed in the combined form unless a school district provides a written notice of its intent to file a separate claim to the county superintendent of schools and to the SCO at least 180 days prior to the deadline for filing the claim.

4. Filing Deadline for Claims

Initial reimbursement claims (first-time claims) for reimbursement of costs of a previously unfunded mandated program must be filed within 120 days from the date of issuance of the program's claiming instructions by the SCO. If the initial reimbursement claim is filed after the deadline, but within one year of the deadline, the approved claim must be reduced by a 10% penalty. A claim filed more than one year after the deadline cannot be accepted for reimbursement.

Annual reimbursement claims for costs incurred during the previous fiscal year and estimated claims for costs to be incurred during the current fiscal year must be filed with the SCO and postmarked on or before January 15. If the annual or estimated reimbursement claim is filed after the deadline, but within one year of the deadline, the approved claim must be reduced by a 10% late penalty, not to exceed $1,000. Claims must include supporting data to show how the amount claimed was derived. Without this information, the claim cannot be accepted.

Entitlement claims do not have a filing deadline. However, entitlement claims and supporting documents should be filed by January 15 to permit an orderly processing of claims. Entitlement claims are used to establish a base year entitlement amount for calculating automatic annual payments. Entitlement does not result in the claimant being reimbursed for costs incurred, but rather entitles the claimant to receive automatic payments from SMAS.

5. Payment of Claims

In order for the SCO to authorize payment of a claim, the Certification of Claim, form FAM-27, must be properly filled out, signed, and dated by the entity's authorized officer.

Reimbursement and estimated claims are paid within 60 days of the filing deadline for the claim. A claimant is entitled to receive accrued interest at the pooled money investment account rate if the payment was made more than 60 days after the claim filing deadline or the actual date of claim receipt, whichever is later. For an initial claim, interest begins to accrue when the payment is made more than 365 days after the adoption of the program's statewide cost estimate. The SCO may withhold up to 20 percent of the amount of an initial claim until the claim is audited to verify the actual amount of the mandated costs. The 20 percent withheld is not subject to accrued interest.

In the event the amount appropriated by the Legislature is insufficient to pay the approved amount in full for a program, claimants will receive a prorated payment in proportion to the amount of approved claims timely filed and on hand at the time of proration.

The SCO reports the amounts of insufficient appropriations to the State Department of Finance, the Chairperson of the Joint Legislative Budget Committee, and the Chairperson of the respective committee in each house of the Legislature which considers appropriations in order to assure appropriation of these funds in the Budget Act. If these funds cannot be appropriated on a timely basis in the Budget Act, this information is transmitted to the COSM which will include these amounts in its report to assure that an appropriation sufficient to pay the claims is included in the next local government claims bill or other appropriation bills. When the supplementary funds are made available, the balance of the claims will be paid.

Unless specified in the statutes, regulations, or parameters and guidelines, the determination of allowable and unallowable costs for mandates is based on the Parameters and Guidelines adopted by the COSM. The determination of allowable reimbursable mandated costs for unfunded mandates is made by the COSM. The SCO determines allowable reimbursable costs, subject to amendment by the COSM, for mandates funded by special legislation. Unless specified, allowable costs are those direct and indirect costs, less applicable credits, considered to be eligible for reimbursement. In order for costs to be allowable and thus eligible for reimbursement, the costs must meet the following general criteria:

1. The cost is necessary and reasonable for proper and efficient administration of the mandate and not a general expense required to carry out the overall responsibilities of government.
2. The cost is allocable to a particular cost objective identified in the Parameters and Guidelines.
3. The cost is net of any applicable credits that offset or reduce expenses of items allocable to the mandate.

The SCO has identified certain costs that, for the purpose of claiming mandated costs, are unallowable and should not be claimed on the claim forms unless specified as reimbursable under the program. These expenses include, but are not limited to, subscriptions, depreciation, memberships, conferences, workshops general education, and travel costs.

6. State Mandates Apportionment System (SMAS)

Chapter 1534, Statutes of 1985, established SMAS, a method of paying certain mandated programs as apportionments. This method is utilized whenever a program has been approved for inclusion in SMAS by the COSM.

When a mandated program has been included in SMAS, the SCO will determine a base year entitlement amount for each school district that has submitted reimbursement claims, (or entitlement claims), for three consecutive fiscal years. A base year entitlement amount is determined by averaging the approved reimbursement claims, (or entitlement claims), for 1982-83, 1983-84, and 1984-85 years or any three consecutive fiscal years thereafter. The amounts are first adjusted by any change in IPD, which is applied separately to each year's costs for the three years

that comprise the base period. The base period means the three fiscal years immediately succeeding the COSM's approval.

Each school district with an established base year entitlement for the program will receive automatic annual payments from the SCO reflective of the program's current year costs. The amount of apportionment is adjusted annually for any change in the IPD. If the mandated program was included in SMAS after January 1, 1988, the annual apportionment is adjusted for any change in both the IPD and workload.

In the event a school district has incurred costs for three consecutive fiscal years but did not file a reimbursement claim in one or more of those fiscal years, the school district may file an entitlement claim for each of those missed years to establish a base year entitlement. An "entitlement claim" means any claim filed by a county with the SCO for the sole purpose of establishing a base year entitlement. A base year entitlement shall not include any nonrecurring or initial start-up costs.

Initial apportionments are made on an individual program basis. After the initial year, all apportionments are made by November 30. The amount to be apportioned is the base year entitlement adjusted by annual changes in the IPD for the cost of goods and services to governmental agencies as determined by the State Department of Finance.

In the event the county determines that the amount of apportionment does not accurately reflect costs incurred to comply with a mandate, the process of adjusting an established base year entitlement upon which the apportionment is based, is set forth in GC Section 17615.8 and requires the approval of the COSM.

School Mandates Included In SMAS

Program Name	Chapter/Statute	Program Number
Immunization Records	Ch. 1176/77	32

Pupil Expulsion Transcripts, program #91, Chapter 1253/75 was removed from SMAS for the 2002-03 fiscal year. This program was consolidated with other mandate programs that are included in Pupil Suspension, Expulsions, and Expulsion Appeals, program #176.

7. Direct Costs

A direct cost is a cost that can be identified specifically with a particular program or activity. Each claimed reimbursable cost must be supported by documentation as described in Section 12. Costs that are typically classified as direct costs are:

(1) Employee Wages, Salaries, and Fringe Benefits

For each of the mandated activities performed, the claimant must list the names of the employees who worked on the mandate, their job classification, hours worked on the mandate, and rate of pay. The claimant may, in-lieu of reporting actual compensation and fringe benefits, use a productive hourly rate:

(a) Productive Hourly Rate Options

A local agency may use one of the following methods to compute productive hourly rates:

- Actual annual productive hours for each employee
- The weighted-average annual productive hours for each job title, or
- 1,800* annual productive hours for all employees

If actual annual productive hours or weighted-average annual productive hours for each job title is chosen, the claim must include a computation of how these hours were computed.

* 1,800 annual productive hours excludes the following employee time:
  - o Paid holidays
  - o Vacation earned
  - o Sick leave taken
  - o Informal time off
  - o Jury duty
  - o Military leave taken.

(b) Compute a Productive Hourly Rate

1. Compute a productive hourly rate for salaried employees to include actual fringe benefit costs. The methodology for converting a salary to a productive hourly rate is to compute the employee's annual salary and fringe benefits and divide by the annual productive hours.

Table 1 Productive Hourly Rate, Annual Salary + Benefits Method

Formula:	**Description:**
[(EAS + Benefits) ÷ APH] = PHR	EAS = Employee's Annual Salary
	APH = Annual Productive Hours
[($26,000 + $8,099)] ÷ 1,800 hrs = 18.94	PHR = Productive Hourly Rate

- As illustrated in Table 1, if you assume an employee's compensation was $26,000 and $8,099 for annual salary and fringe benefits, respectively, using the "Salary + Benefits Method," the productive hourly rate would be $18.94. To convert a biweekly salary to EAS, multiply the biweekly salary by 26. To convert a monthly salary to EAS, multiply the monthly salary by 12. Use the same methodology to convert other salary periods.

2. A claimant may also compute the productive hourly rate by using the "Percent of Salary Method."

Table 2 Productive Hourly Rate, Percent of Salary Method

Example:		
Step 1: *Fringe Benefits as a Percent of Salary*		**Step 2:** *Productive Hourly Rate*
Retirement	15.00 %	**Formula:**
Social Security & Medicare	7.65	[(EAS x (1 + FBR)) ÷ APH] = PHR
Health & Dental Insurance	5.25	
Workers Compensation	3.25	[($26,000 x (1.3115)) ÷ 1,800] = $18.94
Total	**31.15 %**	
Description:		
EAS = Employee's Annual Salary		APH = Annual Productive Hours
FBR = Fringe Benefit Rate		PHR = Productive Hourly Rate

- As illustrated in Table 3, both methods produce the same productive hourly rate.

Reimbursement for personnel services includes, but is not limited to, compensation paid for salaries, wages and employee fringe benefits. Employee fringe benefits include employer's contributions for social security, pension plans, insurance, workmen's compensation insurance and similar payments. These benefits are eligible for reimbursement as long as they are distributed equitably to all activities. Whether these costs are allowable is based on the following presumptions:

- The amount of compensation is reasonable for the service rendered.
- The compensation paid and benefits received are appropriately authorized by the governing board.
- Amounts charged for personnel services are based on payroll documents that are supported by time and attendance or equivalent records for individual employees.
- The methods used to distribute personnel services should produce an equitable distribution of direct and indirect allowable costs.

For each of the employees included in the claim, the claimant must use reasonable rates and hours in computing the wage cost. If a person of a higher-level job position performs an activity which normally would be performed by a lower-level position, reimbursement for time spent is allowable at the average salary range for the lower-level position. The salary rate of the person at the higher level position may be claimed if it can be shown that it was more cost effective in comparison to the performance by a person at the lower-level position under normal circumstances and conditions. The number of hours charged to an activity should reflect the time expected to complete the activity under normal circumstances and conditions. The numbers of hours in excess of normal expected hours are not reimbursable.

(c) Calculating an Average Productive Hourly Rate

In those instances where the claiming instructions allow a unit as a basis of claiming costs, the direct labor component of the unit cost should be expressed as an average productive hourly rate and can be determined as follows:

Table 4 Calculating an Average Productive Hourly Rate

	Time Spent	Productive Hourly Rate	Total Cost by Employee
Employee A	1.25 hrs	$6.00	$7.50
Employee B	0.75 hrs	4.50	3.38
Employee C	3.50 hrs	10.00	35.00
Total	5.50 hrs		$45.88
Average Productive Hourly Rate is $45.88/5.50 hrs. = $8.34			

(d) Employer's Fringe Benefits Contribution

A local agency has the option of claiming actual employer's fringe benefit contributions or may compute an average fringe benefit cost for the employee's job classification and claim it as a percentage of direct labor. The same time base should be used for both salary and fringe benefits when computing a percentage. For example, if health and dental insurance payments are made annually, use an annual salary. After the percentage of salary for each fringe benefit is computed, total them.

For example:

Employer's Contribution	% of Salary
Retirement	15.00%
Social Security	7.65%
Health and Dental Insurance	5.25%
Worker's Compensation	0.75%
Total	28.65%

(e) Materials and Supplies

Only actual expenses can be claimed for materials and supplies, which were acquired and consumed specifically for the purpose of a mandated program. The claimant must list the materials and supplies that were used to perform the mandated activity, the number of units consumed, the cost per unit, and the total dollar amount claimed. Materials and supplies purchased to perform a particular mandated activity are expected to be reasonable in quality, quantity and cost. Purchases in excess of reasonable quality, quantity and cost are not reimbursable. Materials and supplies withdrawn from inventory and charged to the mandated activity must be based on a recognized method of pricing, consistently applied. Purchases shall be claimed at the actual price after deducting discounts, rebates and allowances received by local agencies.

(f) Calculating a Unit Cost for Materials and Supplies

In those instances where the claiming instructions suggest that a unit cost be developed for use as a basis of claiming costs mandated by the State, the materials and supplies component of the unit cost should be expressed as a unit cost of materials and supplies as shown in Table 1 or Table 2:

Table 1 Calculating A Unit Cost for Materials and Supplies

Supplies	Cost Per Unit	Amount of Supplies Used Per Activity	Unit Cost of Supplies Per Activity
Paper	0.02	4	$0.08
Files	0.10	1	0.10
Envelopes	0.03	2	0.06
Photocopies	0.10	4	0.40
			$0.64

Table 2 Calculating a Unit Cost for Materials and Supplies

Supplies	Supplies Used	Unit Cost of Supplies Per Activity
Paper ($10.00 for 500 sheet ream)	250 Sheets	$5.00
Files ($2.50 for box of 25)	10 Folders	1.00
Envelopes ($3.00 for box of 100)	50 Envelopes	1.50
Photocopies ($0.05 per copy)	40 Copies	2.00
		$9.50

If the number of reimbursable instances, is 25, then the unit cost of supplies is $0.38 per reimbursable instance ($9.50 / 25).

(g) Contract Services

The cost of contract services is allowable if the local agency lacks the staff resources or necessary expertise, or it is economically feasible to hire a contractor to perform the mandated activity. The claimant must give the name of the contractor; explain the reason for having to hire a contractor; describe the mandated activities performed; give the dates when the activities were performed, the number of hours spent performing the mandate, the hourly billing rate, and the total cost. The hourly billing rate shall not exceed the rate specified in the claiming instructions for the mandated program. The contractor's invoice, or statement, which includes an itemized list of costs for activities performed, must accompany the claim.

(h) Equipment Rental Costs

Equipment purchases and leases (with an option to purchase) are not reimbursable as a direct cost unless specifically allowed by the claiming instructions for the particular mandate. Equipment rentals used solely for the mandate are reimbursable to the extent such costs do not exceed the retail purchase price of the equipment plus a finance charge. The claimant must explain the purpose and use for the equipment, the time period for which the equipment was rented and the total cost of the rental. If the equipment is used for purposes other than reimbursable activities, only the prorata portion of the rental costs can be claimed.

(i) Capital Outlay

Capital outlays for land, buildings, equipment, furniture and fixtures may be claimed if the claiming instructions specify them as allowable. If they are allowable, the claiming instructions for the program will specify a basis for the reimbursement. If the fixed asset or equipment is also used for purposes other than reimbursable activities for a specific mandate, only the prorata portion of the purchase price used to implement the reimbursable activities can be claimed.

(j) Travel Expenses

Travel expenses are normally reimbursable in accordance with travel rules and regulations of the local jurisdiction. For some programs, however, the claiming instructions may specify certain limitations on expenses, or that expenses can only be reimbursed in accordance with the State Board of Control travel standards. When claiming travel expenses, the claimant must explain the purpose of the trip, identify the name and address of the persons incurring the expense, the date and time of departure and return for the trip, description of each expense claimed, the cost of transportation,

number of private auto mileage traveled, and the cost of tolls and parking with receipts required for charges over $10.00.

(k) Documentation

It is the responsibility of the claimant to make available to the SCO, upon request, documentation in the form of general and subsidiary ledgers, purchase orders, invoices, contracts, canceled warrants, equipment usage records, land deeds, receipts, employee time sheets, agency travel guidelines, inventory records, and other relevant documents to support claimed costs. The type of documentation necessary for each claim may differ with the type of mandate.

8. Indirect Costs

Indirect costs are: (a) Incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved. Indirect costs can originate in the department performing the mandate or in departments that supply the department performing the mandate with goods, services and facilities. As noted previously, in order for a cost to be allowable, it must be allocable to a particular cost objective. With respect to indirect costs, this requires that the cost be distributed to benefiting cost objectives on bases, which produce an equitable result in relation to the benefits derived by the mandate.

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. Completion of this form consists of three main steps:

1. The elimination of unallowable costs from the expenses reported on the financial statements.
2. The segregation of the adjusted expenses between those incurred for direct and indirect activities.
3. The development of a ratio between the total indirect expenses and the total direct expenses incurred by the community college.

The computation is based on total expenditures as reported in "California Community Colleges Annual Financial and Budget Report, Expenditures by Activity (CCFS-311)." Expenditures classified by activity are segregated by the function they serve. Each function may include expenses for salaries, fringe benefits, supplies, and capital outlay. OMB Circular A-21 requires expenditures for capital outlays to be excluded from the indirect cost rate computation.

Generally, a direct cost is one incurred specifically for one activity, while indirect costs are of a more general nature and are incurred for the benefit of several activities. As previously noted, the objective of this computation is to equitably allocate administrative support costs to personnel that perform mandated cost activities claimed by the college. For the purpose of this computation we have defined indirect costs to be those costs which provide administrative support to personnel who perform mandated cost activities. We have defined direct costs to be those costs that do not provide administrative support to personnel who perform mandated cost activities and those costs that are directly related to instructional activities of the college. Accounts that should be classified

as indirect costs are: Planning, Policy Making and Coordination, Fiscal Operations, Human Resources Management, Management Information Systems, Other General Institutional Support Services, and Logistical Services. If any costs included in these accounts are claimed as a mandated cost, i.e., salaries of employees performing mandated cost activities, the cost should be reclassified as a direct cost. Accounts in the following groups of accounts should be classified as direct costs: Instruction, Instructional Administration, Instructional Support Services, Admissions and Records, Counseling and Guidance, Other Student Services, Operation and Maintenance of Plant, Community Relations, Staff Development, Staff Diversity, Non-instructional Staff-Retirees' Benefits and Retirement Incentives, Community Services, Ancillary Services and Auxiliary Operations. A college may classify a portion of the expenses reported in the account Operation and Maintenance of Plant as indirect. The claimant has the option of using a 7% or a higher indirect cost percentage if the college can support its allocation basis.

The indirect cost rate, derived by determining the ratio of total indirect expenses to total direct expenses when applied to the direct costs claimed, will result in an equitable distribution of the college's mandate related indirect costs. An example of the methodology used to compute an indirect cost rate is presented in Table 4.

Table 4 Indirect Cost Rate for Community Colleges

MANDATED COST INDIRECT COST RATE FOR COMMUNITY COLLEGES				FORM FAM-29C		
(01) Claimant				(02) Period of Claim		
(03) Expenditures by Activity				(04) Allowable Costs		
Activity	EDP	Total	Adjustments	Total	Indirect	Direct
Subtotal Instruction	599	$19,590,357	$1,339,059	$18,251,298	$0	$18,251,298
Instructional Administration and Instructional Governance	6000					
Academic Administration	6010	2,941,386	105,348	2,836,038	0	2,836,038
Course and Curriculum Develop.	6020	21,595	0	21,595	0	21,595
Academic/Faculty Senate	6030					
Other Instructional Administration & Instructional Governance	6090					
Instructional Support Services	6100					
Learning Center	6110	22,737	863	21,874	0	21,874
Library	6120	518,220	2,591	515,629	0	515,629
Media	6130	522,530	115,710	406,820	0	406,820
Museums and Galleries	6140	0	0	0	0	0
Academic Information Systems and Tech.	6150					
Other Instructional Support Services	6190					
Admissions and Records	6200	584,939	12,952	571,987	0	571,987
Counseling and Guidance	6300					
Counseling and Guidance	6310					
Matriculation and Student Assessment	6320					
Transfer Programs	6330					
Career Guidance	6340					
Other Student Counseling and Guidance	6390					
Other Student Services	6400					
Disabled Students Programs & Services	6420					
Subtotal		$24,201,764	$1,576,523	$22,625,241	$0	$22,625,241

Table 4 Indirect Cost Rate for Community Colleges (continued)

MANDATED COST INDIRECT COST RATE FOR COMMUNITY COLLEGES				FORM FAM-29C		
(01) Claimant				(02) Period of Claim		
(03) Expenditures by Activity				(04) Allowable Costs		
Activity	EDP	Total	Adjustments	Total	Indirect	Direct
Extended Opportunity Programs & Services	6430					
Health Services	6440	0	0	0	0	0
Student Personnel Admin.	6450	289,926	12,953	276,973	0	276,973
Financial Aid Administration	6460	391,459	20,724	370,735	0	370,735
Job Placement Services	6470	83,663	0	83,663	0	83,663
Veterans Services	6480	25,427	0	25,427	0	25,427
Miscellaneous Student Services	6490	0	0	0	0	0
Operation & Maintenance of Plant	6500					
Building Maintenance and Repairs	6510	1,079,260	44,039	1,035,221	0	1,035,221
Custodial Services	6530	1,227,668	33,677	1,193,991	0	1,193,991
Grounds Maintenance and Repairs	6550	596,257	70,807	525,450	0	525,450
Utilities	6570	1,236,305	0	1,236,305	0	1,236,305
Other	6590	3,454	3,454	0	0	0
Planning, Policy Making, and Coordination	6600	587,817	22,451	565,366	565,366	0
General Inst. Support Services	6700					
Community Relations	6710	0	0	0	0	0
Fiscal Operations	6720	634,605	17,270	617,335	553,184	(a) 64,151
Human Resources Management	6730					
Noninstructional Staff Benefits & Incentives	6740					
Staff Development	6750					
Staff Diversity	6760					
Logistical Services	6770					
Management Information Systems	6780					
Subtotal		$30,357,605	$1,801,898	$28,555,707	$1,118,550	$27,437,157

Table 4 Indirect Cost Rate for Community Colleges (continued)

MANDATED COST INDIRECT COST RATE FOR COMMUNITY COLLEGES						FORM FAM-29C
(01) Claimant				(02) Period of Claim		
(03) Expenditures by Activity				(04) Allowable Costs		
Activity	EDP	Total	Adjustments	Total	Indirect	Direct
General Inst. Sup. Serv. (cont.)	6700					
Other General Institutional Support Services	6790					
Community Services	6800					
Community Recreation	6810	703,858	20,509	683,349	0	683,349
Community Service Classes	6820	423,188	24,826	398,362	0	398,362
Community Use of Facilities	6830	89,877	10,096	79,781	0	79,781
Economic Development	6840					
Other Community Svcs. & Economic Development	6890					
Ancillary Services	6900					
Bookstores	6910	0	0	0	0	0
Child Development Center	6920	89,051	1,206	87,845	0	87,845
Farm Operations	6930	0	0	0	0	0
Food Services	6940	0	0	0	0	0
Parking	6950	420,274	6,857	413,417	0	413,417
Student Activities	6960	0	0	0	0	0
Student Housing	6970	0	0	0	0	0
Other	6990	0	0	0	0	0
Auxiliary Operations	7000					
Auxiliary Classes	7010	1,124,557	12,401	1,112,156	0	1,112,156
Other Auxiliary Operations	7090	0	0	0	0	0
Physical Property Acquisitions	7100	814,318	814,318	0	0	0
(05) Total		$34,022,728	$2,692,111	$31,330,617	$1,118,550	$30,212,067
(06) Indirect Cost Rate: (Total Indirect Cost/Total Direct Cost)				3,70233%		
(07) Notes (a) Mandated Cost activities designated as direct costs per claim instructions.						

9. Offset Against Mandated Claims

As noted previously, allowable costs are defined as those direct and indirect costs, less applicable credits, considered to be eligible for reimbursement. When all or part of the costs of a mandated program are specifically reimbursable from local assistance revenue sources (e.g., state, federal, foundation, etc.), only that portion of any increased costs payable from school district funds is eligible for reimbursement under the provisions of GC Section 17561.

Example 1:

As illustrated in Table 5, this example shows how the "Offset against State Mandated Claims" is determined for school districts receiving block grant revenues not based on a formula allocation. Program costs for each of the situations equals $100,000.

Table 5 Offset Against State Mandates, Example 1

	Program Costs	Actual Local Assistance Revenues	State Mandated Costs	Offset Against State Mandated Claims	Claimable Mandated Costs
1.	$100,000	$95,000	$2,500	$-0-	$2,500
2.	100,000	97,000	2,500	-0-	2,500
3.	100,000	98,000	2,500	500	2,000
4.	100,000	100,000	2,500	2,500	-0-
5.	100,000 *	50,000	2,500	1,250	1,250
6.	100,000 *	49,000	2,500	250	2,250

* School district share is $50,000 of the program cost.

Numbers (1) through (4), in Table 5, show intended funding at 100% from local assistance revenue sources. Numbers (5) and (6) show cost sharing on a 50/50 basis with the district. In numbers (1) through (6), included in the program costs of $100,000 are state mandated costs of $2,500. The offset against state mandated claims is the amount of actual local assistance revenues which exceeds the difference between program costs and state mandated costs. This offset cannot exceed the amount of state mandated costs.

In (1), local assistance revenues were less than expected. Local assistance funding was not in excess of the difference between program costs and state mandated costs. As a result, the offset against state mandated claims is zero and $2,500 is claimable as mandated costs.

In (4), local assistance revenues were fully realized to cover the entire cost of the program, including the state mandate activity; therefore, the offset against state mandated claims is $2,500, and claimable costs are $0..

In (5), the district is sharing 50% of the project cost. Since local assistance revenues of $50,000 were fully realized, the offset against state mandated claims is $1,250.

In (6), local assistance revenues were less than the amount expended and the offset against state mandated claims is $250. Therefore, the claimable mandated costs are $2,250.

Example 2:

As illustrated in Table 6, this example shows how the offset against state mandated claims is determined for school districts receiving special project funds based on approved actual costs. Local assistance revenues for special projects must be applied proportionately to approved costs.

Table 6 Offset Against State Mandates, Example 2

	Program Costs	Actual Local Assistance Revenues	State Mandated Costs	Offset Against State Mandated Claims	Claimable Mandated Costs
1.	$100,000	$100,000	$2,500	$2,500	$-0-
2.	100,000 **	75,000	2,500	1,875	625
3.	100,000 **	45,000	1,500	1,125	375

** School district share is $25,000 of the program cost.

In (2), the entire program cost was approved. Since the local assistance revenue source covers 75% of the program cost, it also proportionately covered 75% of the $2,500 state mandated costs, or $1,875.

If in (3) local assistance revenues are less than the amount expected because only $60,000 of the $100,000 program costs were determined to be valid by the contracting agency, then a proportionate share of state mandated costs is likewise reduced to $1,500. The offset against state mandated claims is $1,125. Therefore, the claimable mandated costs are $375.

Federal and State Funding Sources

The listing in Appendix C is not inclusive of all funding sources that should be offset against mandated claims but contains some of the more common ones. State school fund apportionments and federal aid for education, which are based on average daily attendance and are part of the general system of financing public schools as well as block grants which do not provide for specific reimbursement of costs (i.e., allocation formulas not tied to expenditures), should not be included as reimbursements from local assistance revenue sources.

Governing Authority

The costs of salaries and expenses of the governing authority, such as the school superintendent and governing board, are not reimbursable. These are costs of general government as described in the Office of Management and Budget Circular A-87, "Cost Principles for State, Local and Indian Tribal Governments ".

10. Notice of Claim Adjustment

All claims submitted to the SCO are reviewed to determine if the claim was prepared in accordance with the claiming instructions. If any adjustments are made to a claim, the claimant will receive a "Notice of Claim Adjustments" detailing adjustments made by the SCO.

11. Audit of Costs

All claims submitted to the State Controller's Office (SCO) are reviewed to determine if costs are related to the mandate, are reasonable and not excessive, and the claim was prepared in accordance with the SCO's claiming instrucitons and the Parameters and Guidelines (P's & G's) adopted by the Commission on State Mandates (COSM). If any adjustments are made to a claim, a "Notice of Claim Adjustment" specifying the claim component adjusted, the amount adjusted, and the reason for the adjustment, will be mailed within 30 days after payment of the claim.

Pursuant to Government Code (GC) Section 17558.5, subdivision (a), a reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than three years after the date that the actual reimbursement claim is filed or last amended, whichever is later. However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the claim is filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim. All documents used to support the reimbursable activities, must be

retained during the period subject to audit. If an audit has been initiated by the Controller during the period subject to audit, the retention period is extended until the ultimate resolution of any audit findings.

On-site audits will be conducted by the SCO as deemed necessary. Accordingly, all documentation to support actual costs claimed must be retained for a period of three years after the end of the calendar year in which the reimbursement claim was filed or amended regardless of the year of costs incurred. When no funds are appropriated for initial claims at the time the claim is filed, supporting documents must be retained for three years from the date of initial payment of the claim. Claim documentation shall be made available to the SCO on request.

12. Source Documents

To be eligible for mandated cost reimbursement for any fiscal year, only actual costs may be claimed. Actual costs are those costs actually incurred to implement the mandated activities. Actual costs must be traceable and supported by source documents that show the validity of such costs, when they were incurred, and their relationship to the reimbursable activities. A source document is a document created at or near the same time the actual cost was incurred for the event or activity in question. Source documents may include, but are not limited to, employee time records or time logs, sign-in sheets, invoices, and receipts.

Evidence corroborating the source documents may include, but is not limited to, worksheets, cost allocation reports (system generated), purchase orders, contracts, agendas, training packets, and declarations. Declarations must include a certification or declaration stating, "I certify under penalty of perjury under the laws of the State of California that the foregoing is true and correct based upon personal knowledge." Evidence corroborating the source documents may include data relevant to the reimbursable activities otherwise in compliance with local, state, and federal government requirements. However, corroborating documents cannot be substituted for source documents.

13. Claim Forms and Instructions

A claimant may submit a computer generated report in substitution for Form-1 and Form-2, provided the format of the report and data fields contained within the report are identical to the claim forms included with these instructions. The claim forms provided with these instructions should be duplicated and used by the claimant to file an estimated or reimbursement claim. The SCO will revise the manual and claim forms as necessary.

A. Form-2, Component/Activity Cost Detail

This form is used to segregate the detail costs by claim component. In some mandates, specific reimbursable activities have been identified for each component. The expenses reported on this form must be supported by the official financial records of the claimant and copies of supporting documentation, as specified in the claiming instructions, must be submitted with the claims. All supporting documents must be retained for a period of not less than three years after the reimbursement claim was filed or last amended.

B. Form-1, Claim Summary

This form is used to summarize direct costs by component and compute allowable indirect costs for the mandate. The direct costs summarized on this form are derived from Form-2 and are carried forward to form FAM-27.

Community colleges 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 form FAM-29C.

C. Form FAM-27, Claim for Payment

This form contains a certification that must be signed by an authorized officer of the county. All applicable information from Form-1 must be carried forward onto this form in order for the SCO to process the claim for payment. An original and one copy of the FAM-27 is required.

Claims should be rounded to the nearest dollar. Submit a signed original and one copy of form FAM-27, Claim for Payment, and all other forms and supporting documents **(To expedite the payment process, please sign the form FAM-27 with blue ink, and attach a copy of the form FAM-27 to the top of the claim package.)** Use the following mailing addresses:

If delivered by U.S. Postal Service:	If delivered by Other delivery services:
Office of the State Controller Attn: Local Reimbursements Section Division of Accounting and Reporting P.O. Box 942850 Sacramento, CA 94250	Office of the State Controller Attn: Local Reimbursements Section Division of Accounting and Reporting 3301 C Street, Suite 500 Sacramento, CA 95816

14. RETENTION OF CLAIMING INSTRUCTIONS

For your convenience, the revised claiming instructions in this package have been arranged in alphabetical order by program name. These revisions should be inserted in the School Mandated Cost Manual and the old forms they replace should be removed. The instructions should then be retained permanently for future reference, and the forms should be duplicated to meet your filing requirements. Annually, updated forms and any other information or instructions claimants may need to file claims, as well as instructions and forms for all new programs released throughout the year will be placed on the SCO's web site at **www.sco.ca.gov/ard/local/locreim/index/shtml**.

If you have any questions concerning mandated cost reimbursements, please write to us at the address listed for filing claims, send e-mail to lrsdar@sco.ca.gov, or call the Local Reimbursements Section at (916) 324-5729.

All claims submitted to the SCO are reviewed to determine if costs are related to the mandate, are reasonable and not excessive, and the claim was prepared in accordance with the SCO's claiming instructions and the COSM's P's and G's. If any adjustments are made to a claim, a "Notice of Claim Adjustment" specifying the claim component adjusted, the amount adjusted, and the reason for the adjustment, will be mailed within 30 days after payment of the claim.

On-site audits will be conducted by the SCO as deemed necessary. Pursuant to GC Section 17558.5, subdivision (a), a reimbursement claim for actual costs filed by a school district is subject to audit by the State Controller no later than three years after the date the actual reimbursement claim was filed or last amended, whichever is later. However, if no funds were appropriated or no payment was made to a claimant for the program for the fiscal year for which the claim was filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim. Therefore, all documentation to support actual costs claimed must be retained for the same period, and shall be made available to the SCO on request.

Exhibit E

YOSEMITE COMMUNITY COLLEGE DISTRICT

Audit Report

HEALTH FEE ELIMINATION PROGRAM

Chapter 1, Statutes of 1984, 2nd Extraordinary Session,
and Chapter 1118, Statutes of 1987

July 1, 2002, through June 30, 2007

JOHN CHIANG
California State Controller

April 2009

JOHN CHIANG
California State Controller

April 30, 2009

Anne DeMartini, Board Chair
Board of Trustees
Yosemite Community College District
2201 Blue Gum Avenue
Modesto, CA 95358

Dear Ms. DeMartini:

The State Controller's Office audited the costs claimed by Yosemite Community College District for the legislatively mandated Health Fee Elimination Program (Chapter 1, Statutes of 1984, 2nd Extraordinary Session, and Chapter 1118, Statutes of 1987) for the period of July 1, 2002, through June 30, 2007.

The district claimed $1,203,995 ($1,213,995 less a $10,000 penalty for filing a late claim) for the mandated program. Our audit disclosed that $752,122 is allowable and $451,873 is unallowable. The costs are unallowable because the district claimed understated services and supplies costs, overstated indirect costs, understated authorized health service fees, and understated offsetting savings/reimbursements. The State paid the district $273,783. Allowable costs claimed exceed the amount paid by $478,339.

If you disagree with the audit findings, you may file an Incorrect Reduction Claim (IRC) with the Commission on State Mandates (CSM). The IRC must be filed within three years following the date that we notify you of a claim reduction. You may obtain IRC information at CSM's Web site link at www.csm.ca.gov/docs/IRCForm.pdf.

If you have any questions, please contact Jim L. Spano, Chief, Mandated Cost Audits Bureau, at (916) 323-5849.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/sk

cc: Teresa Scott, Executive Vice Chancellor
Yosemite Community College District
Kuldeep Kaur, Specialist
Fiscal Planning and Administration
California Community Colleges Chancellor's Office
Jeannie Oropeza, Program Budget Manager
Education Systems Unit
Department of Finance

Contents

Audit Report

Summary

The State Controller's Office (SCO) audited the costs claimed by Yosemite Community College District for the legislatively mandated Health Fee Elimination Program (Chapter 1, Statutes of 1984, 2nd Extraordinary Session, and Chapter 1118, Statutes of 1987) for the period of July 1, 2002, through June 30, 2007.

The district claimed $1,203,995 ($1,213,995 less a $10,000 penalty for filing a late claim) for the mandated program. Our audit disclosed that $752,122 is allowable and $451,873 is unallowable. The costs are unallowable because the district claimed understated services and supplies costs, overstated indirect costs, understated authorized health service fees, and understated offsetting savings/reimbursements. The State paid the district $273,783. Allowable costs claimed exceed the amount paid by $478,339.

Background

Chapter 1, Statutes of 1984, 2nd Extraordinary Session (E.S.) repealed Education Code section 72246, which authorized community college districts to charge a health fee for providing health supervision and services, providing medical and hospitalization services, and operating student health centers. This statute also required that health services for which a community college district charged a fee during fiscal year (FY) 1983-84 had to be maintained at that level in FY 1984-85 and every year thereafter. The provisions of this statute would automatically sunset on December 31, 1987, reinstating the community college districts' authority to charge a health service fee as specified.

Chapter 1118, Statutes of 1987, amended Education Code section 72246 (subsequently renumbered as section 76355 by Chapter 8, Statutes of 1993). The law requires any community college district that provided health services in FY 1986-87 to maintain health services at the level provided during that year for FY 1987-88 and for each fiscal year thereafter.

On November 20, 1986, the Commission on State Mandates (CSM) determined that Chapter 1, Statutes of 1984, 2nd Extraordinary Session imposed a "new program" upon community college districts by requiring specified community college districts that provided health services in FY 1983-84 to maintain health services at the level provided during that year for FY 1984-85 and for each fiscal year thereafter. This maintenance-of-effort requirement applied to all community college districts that levied a health service fee in FY 1983-84.

On April 27, 1989, the CSM determined that Chapter 1118, Statutes of 1987, amended this maintenance-of-effort requirement to apply to all community college districts that provided health services in FY 1986-87, requiring them to maintain that level in FY 1987-88 and for each fiscal year thereafter.

The program's parameters and guidelines establish the state mandate and define reimbursement criteria. CSM adopted parameters and guidelines on August 27, 1987, and amended them on May 25, 1989. In compliance with Government Code section 17558, the SCO issues claiming instructions to assist school districts in claiming mandated program reimbursable costs.

Objective, Scope, and Methodology

We conducted the audit to determine whether costs claimed represent increased costs resulting from the Health Fee Elimination Program for the period of July 1, 2002, through June 30, 2007.

Our audit scope included, but was not limited to, determining whether costs claimed were supported by appropriate source documents, were not funded by another source, and were not unreasonable and/or excessive.

We conducted this performance audit under the authority of Government Code sections 12410, 17558.5, and 17561. We did not audit the district's financial statements. We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We limited our review of the district's internal controls to gaining an understanding of the transaction flow and claim preparation process as necessary to develop appropriate auditing procedures.

We asked the district's representative to submit a written representation letter regarding the district's accounting procedures, financial records, and mandated cost claiming procedures as recommended by generally accepted government auditing standards. However, the district declined our request.

Conclusion

Our audit disclosed instances of noncompliance with the requirements outlined above. These instances are described in the accompanying Summary of Program Costs (Schedule 1) and in the Findings and Recommendations section of this report.

For the audit period, Yosemite Community College District claimed $1,203,995 ($1,213,995 less a $10,000 penalty for filing a late claim) for costs of the Health Fee Elimination Program. Our audit disclosed that $752,122 is allowable and $451,873 is unallowable.

For the FY 2002-03 claim, the State paid the district $39,067. Our audit disclosed that the claimed costs are unallowable. The State will offset $39,067 from other mandated program payments due the district. Alternatively, the district may remit this amount to the State.

For the FY 2003-04 claim, the State made no payment to the district. Our audit disclosed that $70,158 is allowable. The State will pay that amount, contingent upon available appropriations.

For the FY 2004-05 claim, the State made no payment to the district. Our audit disclosed that $268,128 is allowable. The State will that amount, contingent upon available appropriations.

For the FY 2005-06 claim, the State made no payment to the district. Our audit disclosed that $230,962 is allowable. The State will that amount, contingent upon available appropriations.

For the FY 2006-07 claim, the State paid the district $234,716. Our audit disclosed that $182,874 is allowable. The State will offset $51,842 from other mandated program payments due the district. Alternatively, the district may remit this amount to the State.

Views of Responsible Official

We issued a draft audit report on March 12, 2009. Teresa Scott, Executive Vice Chancellor, responded by letter dated March 24, 2009 (Attachment), disagreeing with the audit results except for Findings 1 and 3. This final audit report includes the district's response.

Restricted Use

This report is solely for the information and use of Yosemite Community College District, the California Community Colleges Chancellor's Office, the California Department of Finance, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

April 30, 2009

Schedule 1—
Summary of Program Costs
July 1, 2002, through June 30, 2007

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference[1]
July 1, 2002, through June 30, 2003				
Direct costs:				
Salaries	$ 248,395	$ 248,395	$ —	
Benefits	77,779	77,779	—	
Services and supplies	70,613	70,613	—	
Total direct costs	396,787	396,787	—	
Indirect costs	95,030	84,206	(10,824)	Finding 2
Total direct and indirect costs	491,817	480,993	(10,824)	
Less authorized health service fees	(446,250)	(490,194)	(43,944)	Finding 4
Less offsetting savings/reimbursements	(6,500)	(21,458)	(14,958)	Finding 5
Subtotal	39,067	(30,659)	(69,726)	
Audit adjustments that exceed costs claimed	—	30,659	30,659	
Total program costs	$ 39,067	—	$ (39,067)	
Less amount paid by the State		(39,067)		
Allowable costs claimed in excess of (less than) amount paid		$ (39,067)		
July 1, 2003, through June 30, 2004				
Direct costs:				
Salaries	$ 264,370	$ 264,370	$ —	
Benefits	116,417	116,417	—	
Services and supplies	89,423	90,508	1,085	Finding 1
Total direct costs	470,210	471,295	1,085	
Indirect costs	118,916	89,621	(29,295)	Finding 2
Total direct and indirect costs	589,126	560,916	(28,210)	
Less authorized health service fees	(431,580)	(442,899)	(11,319)	Findings 3, 4
Less offsetting savings/reimbursements	(6,500)	(47,859)	(41,359)	Finding 5
Total program costs	$ 151,046	70,158	$ (80,888)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ 70,158		

Schedule 1 (continued)

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference [1]
July 1, 2004, through June 30, 2005				
Direct costs:				
Salaries	$ 303,647	$ 303,647	$ —	
Benefits	141,296	141,296	—	
Services and supplies	73,063	73,237	174	Finding 1
Total direct costs	518,006	518,180	174	
Indirect costs	180,680	187,633	6,953	Finding 2
Total direct and indirect costs	698,686	705,813	7,127	
Less authorized health service fees	(411,492)	(416,184)	(4,692)	Finding 4
Less offsetting savings/reimbursements	(6,500)	(21,501)	(15,001)	Finding 5
Total program costs	$ 280,694	268,128	$ (12,566)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ 268,128		
July 1, 2005, through June 30, 2006				
Direct costs:				
Salaries	$ 344,990	$ 344,990	$ —	
Benefits	159,108	159,108	—	
Services and supplies	99,407	107,911	8,504	Finding 1
Total direct costs	603,505	612,009	8,504	
Indirect costs	219,555	203,371	(16,184)	Finding 2
Total direct and indirect costs	823,060	815,380	(7,680)	
Less authorized health service fees	(402,179)	(554,058)	(151,879)	Finding 4
Less offsetting savings/reimbursements	(7,557)	(30,360)	(22,803)	Finding 5
Total program costs	$ 413,324	230,962	$ (182,362)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ 230,962		
July 1, 2006, through June 30, 2007				
Direct costs:				
Salaries	$ 453,320	$ 453,320	$ —	
Benefits	187,474	187,474	—	
Services and supplies	105,929	105,929	—	
Total direct costs	746,723	746,723	—	
Indirect costs	306,679	259,188	(47,491)	Finding 2
Total direct and indirect costs	1,053,402	1,005,911	(47,491)	
Less authorized health service fees	(709,335)	(774,633)	(65,298)	Finding 4
Less offsetting savings/reimbursements	(14,203)	(38,889)	(24,686)	Finding 5
Less late filing penalty [2]	(10,000)	(9,515)	485	
Total program costs	$ 319,864	182,874	$ (136,990)	
Less amount paid by the State		(234,716)		
Allowable costs claimed in excess of (less than) amount paid		$ (51,842)		

Schedule 1 (continued)

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference [1]
Summary: July 1, 2002, through June 30, 2007				
Direct costs:				
Salaries	$ 1,614,722	$ 1,614,722	$ —	
Benefits	682,074	682,074	—	
Services and supplies	438,435	448,198	9,763	
Total direct costs	2,735,231	2,744,994	9,763	
Indirect costs	920,860	824,019	(96,841)	
Total direct and indirect costs	3,656,091	3,569,013	(87,078)	
Less authorized health service fees	(2,400,836)	(2,677,968)	(277,132)	
Less offsetting savings/reimbursements	(41,260)	(160,067)	(118,807)	
Less late filing penalty [2]	(10,000)	(9,515)	485	
Subtotal	1,203,995	721,463	(482,532)	
Audit adjustments that exceed costs claimed	—	30,659	30,659	
Total program costs	$ 1,203,995	752,122	$ (451,873)	
Less amount paid by the State		(273,783)		
Allowable costs claimed in excess of (less than) amount paid		$ 478,339		

[1] See the Findings and Recommendations section.

[2] The district incorrectly self-assessed a $10,000 late claim penalty. The correct penalty amount is $9,515.

Findings and Recommendations

FINDING 1—
Understated services and supplies

The district understated services and supplies by $9,763 for the audit period. The district accounted for most health services-related revenues and expenses in its Fund 14 accounts. The district claimed costs based on its Fund 14 accounts. However, the district separately accounted for some student fee revenue and related materials and supplies expenses in separate Fund 12 accounts that the district did not include in claimed costs. This finding reports an audit adjustment for the understated services and supplies. We reported an audit adjustment for the associated understated revenue in Finding 5 of our report.

The following table summarizes the audit adjustment.

	Fiscal Year			
	2003-04	2004-05	2005-06	Total
Audit adjustment	$ 1,085	$ 174	$ 8,504	$ 9,763

The parameters and guidelines state that all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs.

Recommendation

We recommend that the district claim health services costs that its accounting records support.

District's Response

The District does not dispute this finding.

SCO's Comment

Our finding and recommendation are unchanged.

FINDING 2— Overstated indirect costs

The district overstated indirect costs by $96,841 for the audit period. The district overstated or understated indirect costs for each fiscal year.

For fiscal year (FY) 2002-03 and FY 2003-04, the district claimed indirect costs based on indirect cost rates prepared using the principles of Title 2, *Code of Federal Regulations*, Part 220 (Office of Management and Budget Circular A-21). The district also had separate federally-approved rates. The district claimed indirect costs using indirect cost rates that did not agree with its federally-approved rate. We calculated allowable indirect costs based on the district's federally-approved rate. We applied the district's federally-approved rate to allowable salaries and wages, which is the direct cost base identified in the federal approval letter.

For FY 2004-05, FY 2005-06, and FY 2006-07, the parameters and guidelines and the SCO's claiming instructions do not provide districts the option of using a federally-approved rate. The district claimed indirect costs based on indirect cost rates it prepared using the FAM-29C methodology allowed by the parameters and guidelines and the SCO's claiming instructions. However, the district did not allocate direct and indirect costs as specified in the claiming instructions. We recalculated the rates and applied the allowable indirect cost rates to allowable direct costs.

The following table summarizes the audit adjustment:

	Fiscal Year					
	2002-03	2003-04	2004-05	2005-06	2006-07	Total
Allowable salaries and wages	$ 248,395	$ 264,370	$ —	$ —	$ —	
Allowable direct costs	—	—	518,180	612,009	746,723	
Allowable indirect cost rate	× 33.90%	× 33.90%	× 36.21%	× 33.23%	× 34.71%	
Allowable indirect costs	84,206	89,621	187,633	203,371	259,188	
Less indirect costs claimed	(95,030)	(118,916)	(180,680)	(219,555)	(306,679)	
Audit adjustment	$ (10,824)	$ (29,295)	$ 6,953	$ (16,184)	$ (47,491)	$ (96,841)

The parameters and guidelines state, "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions."

For FY 2002-03 and FY 2003-04, the SCO's claiming instructions state:

> 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 [FAM-29C] methodology . . . .

For FY 2004-05 forward, the SCO's claiming instructions state:

> A CCD [community college district] may claim indirect costs using the Controller's methodology (FAM-29C) . . . If specifically allowed by a mandated program's [parameters and guidelines], a district may alternately choose to claim indirect costs using either (1) a federally approved rate prepared in accordance with Office of Management and Budget (OMB) Circular A-21, *Cost Principles for Educational Institutions*; or (2) a flat 7% rate.

Because the Health Fee Elimination Program's parameters and guidelines do not specifically allow for a federally-approved rate, the district's federally-approved rates are irrelevant for FY 2004-05, FY 2005-06, and FY 2006-07.

Recommendation

We recommend that the district claim indirect costs based on indirect cost rates computed in accordance with the SCO's claiming instructions. For the Health Fee Elimination Program, the district should prepare its indirect cost rate proposals using SCO's FAM-29C methodology.

District's Response

FY 2002-03 and FY 2003-04

Since federally approved rates are an acceptable alternative method, the District does not dispute this audit finding as to FY 2002-03 and FY 2003-04.

FY 2004-05 and FY 2005-06

The draft audit report is factually in error when it states that the District prepared indirect cost rate proposals for FY 2004-05 and FY 2005-06 in accordance with OMB A-21. No proposal was made to any state or federal agency for an "approved" indirect cost rate. The District used the same FAM-29C method based on the CCFS-311 as the auditor, but made different allocations of indirect costs. The principal difference is that the District used the capital costs stated in the CCFS-311, whereas the Controller deleted these capital costs and substituted depreciation expense as stated on the District's annual financial statements.

FY 2006-07

The District used the same FAM-29C method based on the CCFS-311 as did the auditor. . . . The remaining difference in the rate claimed by the District in the amended FY 2006-07 claim and the audited rate is a result of differences in how some of the indirect costs were treated.

Parameters and Guidelines

The parameters and guidelines for the Health Fee Elimination program (as last amended on May 25, 1989), which are the legally enforceable standards for claiming costs, state that: "Indirect costs *may be claimed* in the manner described by the Controller in his claiming instructions." (Emphasis added) Therefore, the parameters and guidelines *do not require* that indirect costs be claimed in the manner described by the Controller.

Since the Controller's claiming instructions were never adopted as rules or regulations, they have no force of law. The burden is on the Controller to show that the indirect cost rate used by the District is excessive or unreasonable, which is the only mandated cost audit standard in statute (Government Code Section 17651(d)(2)). If the Controller wishes to enforce different audit standards for mandated cost reimbursement, the Controller should comply with the Administrative Procedure Act.

Prior Year CCFS-311

The draft audit report did not disclose that for FY 2004-05, FY 2005-06, and FY 2006-07, the audit used the most recent CCFS-311 information available for the calculation of the indirect cost rate. The District used the prior year CCFS-311. The CCFS-311 is prepared based on annual costs from the prior fiscal year for use in the current budget year. When the audit utilizes a different CCFS-311 than the District, this constitutes an undisclosed audit adjustment. The audit report does not state an enforceable requirement to use the most current CCFS-311.

As a practical example of how unjustifiable the Controller's position is on prior year CCFS-311 reports, note that the federally approved indirect cost rates (such as the federal rate the audit used for FY 2002-03 and FY 2003-04) are approved for periods of two to four years. This means the data from which the rates were calculated can be from three to five years prior to the last year in which the federal rate is used.

SCO's Comment

We modified our audit finding slightly for clarification. Our audit adjustment and recommendation are unchanged. Our comments to the district's response are as follows:

FY 2004-05 and FY 2005-06

The district inaccurately states "No proposal was made to any state or federal agency for an 'approved' indirect cost rate." On March 25, 2004, the U.S. Department of Health and Human Services approved the district's indirect cost rate for FY 2004-05 through FY 2007-08. However, the district did not use these federally approved rates to claim mandate-related indirect costs. We modified our audit finding to state that the district submitted indirect cost rate proposals using FAM-29C methodology for FY 2004-05 and FY 2005-06. In its response, the district states that it did not adhere to the SCO's claiming instructions because it "made different allocations of indirect costs." The parameters and guidelines state, "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions."

FY 2006-07

The district did not provide its FY 2006-07 ICRP in time for inclusion in the draft report. Therefore, our draft audit report stated that the district did not provide its FY 2006-07 ICRP. We modified our audit finding to state that the district prepared its FY 2006-07 ICRP using FAM-29C methodology.

The district did not allocate direct and indirect costs as specified in the SCO's claiming instructions.

Parameters and Guidelines

The parameters and guidelines state, "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." The district misinterprets the phrase "may be claimed" by concluding that compliance with the claiming instructions is voluntary. The district's assertion is invalid, as it would allow districts to claim indirect costs in whatever manner they choose. Instead, "may be claimed" simply permits the district to claim indirect costs. However, if the district claims indirect costs, then the district must comply with the SCO's claiming instructions.

Neither this district nor any other district requested that the Commission on State Mandates (CSM) review the SCO's claiming instructions pursuant to Title 2, *California Code of Regulations* (CCR), Section 1186. Furthermore, the district may not now request a review of the claiming instructions applicable to the audit period. Title 2 CCR 1186(j)(2) states, "A request for review filed after the initial claiming deadline must be submitted on or before January 15 following a fiscal year in order to establish eligibility for reimbursement for that fiscal year."

The district contends that "The burden is on the Controller to show that the indirect cost rate used by the District is excessive or unreasonable, which is the only mandated cost audit standard in statute. . . ." Government Code section 17558.5 requires the district to file a reimbursement claim for actual mandate-related costs. Government Code section 17561, subdivision (d)(2), allows the SCO to audit the district's records to verify actual mandate-related costs and reduce any claim that the SCO determines is excessive or unreasonable. In addition, Government Code section 12410 states, "The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment." Therefore, the district's contention is without merit.

Nevertheless, the SCO did conclude that the district's FY 2005-06 and FY 2006-07 indirect cost rates were excessive. (The SCO concluded that the district understated its FY 2004-05 indirect cost rate. The district did not explain why it is contesting an audit adjustment in its favor.) "Excessive" is defined as "exceeding what is usual, *proper*, necessary, or normal. . . . Excessive implies an amount or degree too great to be reasonable or acceptable. . . [emphasis added]."[1] The SCO calculated indirect cost rates using the alternative methodology identified in the SCO's claiming instructions. The alternative methodology indirect cost rates did not support the rates that the district claimed; thus, the claimed rates were excessive.

[1] Merriam-Webster's Collegiate Dictionary, Tenth Edition, © 2001.

Prior Year CCFS-311

The district states, "The CCFS-311 is prepared based on annual costs from the prior fiscal year for use in the current budget year." Although this is how the district used its data, there are no mandate-related authoritative criteria supporting this methodology. Government Code section 17558.5 requires the district to file a reimbursement claim for actual mandate-related costs. In addition, the parameters and guidelines require the district to report actual costs. For each fiscal year, "actual costs" are costs of the current fiscal year, not costs from a prior fiscal year.

The parameters and guidelines and the SCO's claiming instructions do not allow districts to claim indirect costs based on federally approved rates in FY 2004-05, FY 2005-06, and FY 2006-07. Therefore, the district's comments regarding federally approved rates are irrelevant.

FINDING 3— Offsetting savings/ reimbursements incorrectly reported as authorized health service fees

The district incorrectly reported offsetting savings/reimbursements totaling $39,090 as authorized health service fees in FY 2003-04. This amount included interest revenue, duplicate staff charges that the district also claimed as offsetting savings/reimbursements, and miscellaneous student fees that the district recognized when it converted from cash to accrual-basis accounting.

The following table summarizes the audit adjustment and the adjusted authorized health service fees claimed:

	Fiscal Year 2003-04
Interest	$ 12,625
Staff charges	6,500
Miscellaneous student fees	19,965
Audit adjustment	39,090
Authorized health service fees claimed	(431,580)
Adjusted authorized health service fees claimed	$(392,490)

The parameters and guidelines state, "Reimbursement for this mandate received from any source, e.g., federal, state, etc., shall be identified and deducted from this claim." The SCO's claiming instructions direct claimants to separately report authorized health service fees and other reimbursements. Except for the duplicate staff charges, we recognized these revenues in our audit adjustment for understated offsetting savings/reimbursements in Finding 5.

Recommendation

We recommend that the district properly claim revenue as offsetting savings/reimbursements when the revenue is unrelated to the authorized student health fee.

District's Response

The District does not dispute this finding.

SCO's Comment

Our finding and recommendation are unchanged.

FINDING 4— Understated authorized health service fees

The district understated authorized health service fees by $316,222 for the audit period. The district understated these fees because it reported actual receipts rather than authorized fees and because it did not charge students the full authorized fee amount in FY 2005-06 and FY 2006-07.

Mandated costs do not include costs that are reimbursable from authorized fees. Government Code section 17514 states that "costs mandated by the state" means any increased costs that a school district is required to incur. To the extent community college districts can charge a fee, they are not required to incur a cost. In addition, Government Code section 17556 states that the Commission on State Mandates shall not find costs mandated by the State if the school district has the authority to levy fees to pay for the mandated program or increased level of service.

For the audit period, Education Code section 76355, subdivision (c), states that health fees are authorized for all students except those who: (1) depend exclusively on prayer for healing; (2) are attending a community college under an approved apprenticeship training program; or (3) demonstrate financial need. The California Community Colleges Chancellor's Office (CCCCO) identified the fees authorized by Education Code section 76355, subdivision (a). For FY 2002-03 and FY 2003-04, the authorized fees were $12 per semester and $9 per summer session. For FY 2004-05, the authorized fees were $13 per semester and $10 per summer session. For FY 2005-06, the authorized fees were $14 per semester and $11 per summer session. For FY 2006-07, the authorized fees were $15 per semester and $12 per summer session.

We obtained student enrollment and Board of Governors Grant (BOGG) recipient data from the CCCCO. The CCCCO identified enrollment and BOGG recipient data from its management information system (MIS) based on student data that the district reported. CCCCO identified the district's enrollment based on CCCCO's MIS data element STD7, codes A through G. CCCCO eliminated any duplicate students based on their social security numbers. From the district enrollment, CCCCO identified the number of BOGG recipients based on MIS data element SF21, all codes with first letter of B or F. The district does not have an apprenticeship program and it did not identify any students that it excluded from the health service fee pursuant to Education Code section 76355, subdivision (c)(1).

The following table shows the authorized health service fee calculation and audit adjustment:

	Semester			
	Summer	Fall	Spring	Total
Fiscal Year 2002-03				
Number of enrolled students	10,568	24,587	22,472	
Less number of BOGG recipients	(2,694)	(6,214)	(5,901)	
Subtotal	7,874	18,373	16,571	
Authorized health fee rate	× $ (9)	× $(12)	× $(12)	
Authorized health service fees	$ (70,866)	$(220,476)	$(198,852)	$(490,194)
Less authorized health service fees claimed				446,250
Audit adjustment				(43,944)
Fiscal Year 2003-04				
Number of enrolled students	9,580	22,631	22,031	
Less number of BOGG recipients	(2,569)	(6,486)	(6,526)	
Subtotal	7,011	16,145	15,505	
Authorized health fee rate	× $ (9)	× $(12)	× $(12)	
Authorized health service fees	$ (63,099)	$(193,740)	$(186,060)	(442,899)
Less adjusted authorized health service fees claimed (Finding 3)				392,490
Audit adjustment				(50,409)
Fiscal Year 2004-05				
Number of enrolled students	9,865	21,620	20,839	
Less number of BOGG recipients	(3,734)	(7,672)	(7,489)	
Subtotal	6,131	13,948	13,350	
Authorized health fee rate	× $(10)	× $(13)	× $(13)	
Authorized health service fees	$ (61,310)	$(181,324)	$(173,550)	(416,184)
Less authorized health service fees claimed				411,492
Audit adjustment				(4,692)
Fiscal Year 2005-06				
Number of enrolled students	10,127	21,763	21,020	
Less number of BOGG recipients	(4,007)	(8,016)	—	
Subtotal	6,120	13,747	21,020	
Authorized health fee rate	× $(11)	× $(14)	× $(14)	
Authorized health service fees	$ (67,320)	$(192,458)	$(294,280)	(554,058)
Less authorized health service fees claimed				402,179
Audit adjustment				(151,879)
Fiscal Year 2006-07				
Number of enrolled students	10,579	22,214	20,965	
Authorized health fee rate	× $(12)	× $(15)	× $(15)	
Authorized health service fees	$(126,948)	$(333,210)	$(314,475)	(774,633)
Less authorized health service fees claimed				709,335
Audit adjustment				(65,298)
Total audit adjustment				$(316,222)

Recommendation

We recommend that the district deduct authorized health service fees from mandate-related costs claimed. To properly calculate authorized health service fees, we recommend that the district identify the number of enrolled students based on CCCCO data element STD7, codes A through G. The district should eliminate duplicate entries for students who attend more than one of the district's colleges. In addition, we recommend that the district maintain documentation that identifies the number of students excluded from the health service fee based on Education Code section 76355, subdivision (c)(1). If the district denies health services to any portion of its student population, it should maintain contemporaneous documentation of a district policy that excludes those students and documentation identifying the number of students excluded.

District's Response

The audit utilizes student enrollment information from the State Community College Chancellor's data base. These statistics are not available to districts at the time the claims are prepared nor does the audit report substantiate this source as either uniquely accurate or superior to enrollment data maintained by the District and independently audited each year. However, since the District did not calculate the fees based on student enrollment, this is not a District annual claim issue, but a Controller's audit adjustment rationale.

COLLECTIBLE STUDENT HEALTH SERVICE FEES

The District asserts that the "collectible method" of determining the student health service fee revenue offset is not supported by law or fact.

"Authorized" Fee Amount

There is no "authorized" rate other than the amounts stated in Education Code Section 76355. The draft audit report alleges that claimants must compute the total student health fees collectible based on the highest authorized rate. The draft audit report does not provide the statutory basis for the calculation of the "authorized" rate, nor the source of the legal right of any state entity to "authorize" student health services rates absent rulemaking or compliance with the Administrative Procedure Act by the "authorizing" state agency.

Optional Fee

Education Code Section 76355, subdivision (a), states that "[t]he governing board of a district maintaining a community college *may require* community college students to pay a fee... for health supervision and services...." There is no requirement that community colleges levy these fees. The permissive nature of the provision is further illustrated in subdivision (b) which states: "*If*, pursuant to this section, a fee is required, the governing board of the district shall decide the amount of the fee, if any, that a part-time student is required to pay. *The governing board may decide whether the fee shall be mandatory or optional*" (Emphasis supplied in both instances). Therefore, districts have the option of charging a fee to some or all of its students.

Government Code Section 17514

The draft audit report relies upon Government Code Section 17514 for the conclusion that "[t]o the extent that community college districts can charge a fee, they are not required to incur a cost." First, charging a fee has no relationship to whether costs are incurred to provide the student health services program. Second, Government Code Section 17514, as added by Chapter 1459, Statutes of 1984, actually states:

> "Costs mandated by the state" means any increased costs which a local agency or school district is required to incur after July 1, 1980, as a result of any statute enacted on or after January 1, 1975, or any executive order implementing any statute enacted on or after January 1, 1975, which mandates a new program or higher level of service of an existing program within the meaning of Section 6 of Article XIII B of the California Constitution.

The operating cost of the student health service program is not determined by the fees collected. There is nothing in the language of the statute regarding the authority to charge a fee, or any nexus of fee revenue to increased cost, or any language that describes the legal effect of fees collected.

Government Code Section 17556

The draft audit report relies upon Government Code Section 17556 for the conclusion that "the Commission on State Mandates (CSM) shall not find costs mandated by the State if the school district has the authority to levy fees to pay for the mandated program or increased level of service."

The draft audit report misrepresents the law. Government Code Section 17556 prohibits the Commission on State Mandates from finding costs subject to reimbursement, that is, approving a test claim activity for reimbursement, where the authority exists to levy fees in an amount sufficient to offset the entire mandated costs. Here, the Commission has already approved the test claim and made a finding of a new program or higher level of service for which the claimants do not have the ability to levy a fee in an amount sufficient to offset the entire mandated costs.

Parameters and Guidelines

The parameters and guidelines, as last amended on May 25, 1989, state, in relevant part: "*Any* offsetting savings that the claimant experiences as a direct result of this statute must be deducted from the costs claimed. . . This shall include the amount of [student fees] as authorized by Education Code Section 72246(a)." The use of the term "*any* offsetting savings" further illustrates the permissive nature of the fees. Student fees actually collected must be used to offset costs, but not student fees that could have been collected and were not, because uncollected fees are "offsetting savings" that were not "experienced." The parameters and guidelines do not allow the Controller to reduce claimed costs by revenue never received by the claimants and such an offset is contrary to the generally accepted accounting principle that requires revenues and costs to be properly matched.

SCO's Comment

Our finding and recommendation are unchanged. The district states, "The audit utilizes student enrollment information from the State Community College Chancellor's data base. These statistics are not available to districts at the time the claims are prepared nor does the audit report substantiate this source as either uniquely accurate or superior to enrollment data maintained by the District. . . ." This is the district's own data. In addition, the district implies that the SCO used data that is somehow different from "enrollment data maintained by the District." Our audit used data retrieved from the California Community Colleges Chancellor's Office (CCCCO). The CCCCO data is extracted directly from enrollment information that the district submitted. Districts are required to submit this data to the CCCCO within one month after each term ends; thus, the district has its fiscal year enrollment data available approximately seven months before its mandated program claims are due to the state.

The district also states, "Since the District did not calculate the fees based on student enrollment, this is not a District annual claim issue, but a Controller's audit adjustment rationale." We disagree; this is a district annual claim issue. For its FY 2002-03 claim, the district reported inaccurate student enrollment. For its FY 2003-04 through FY 2006-07 claims, the district failed to follow specific SCO claiming instructions. The district did not report student enrollment and did not calculate the total health fees that could have been collected.

"Authorized" Fee Amount

We agree that Education Code section 76355 (specifically, subdivision (a)) authorizes the health service fee rate. The statutory section also provides the basis for calculating the authorized rate applicable to each fiscal year. The statutory section states:

> (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.
>
> (2) The governing board of each community college district may increase this 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).

The CCCCO *notifies* districts when the authorized rate increases pursuant to Education Code section 76355, subdivision (a)(2). Therefore, the Administrative Procedures Act is irrelevant.

Optional Fee

We agree that community college districts may choose not to levy a health service fee or to levy a fee less than the authorized amount. Regardless of the district's decision to levy or not levy the authorized health service fee, Education Code section 76355, subdivision (a), provides districts the *authority* to levy the fee.

Government Code Section 17514

Government Code section 17514 states, "'Costs mandated by the state' means any increased costs which a local agency or school district is *required* [emphasis added] to incur. . . . " The district ignores the direct correlation that if the district has authority to collect fees attributable to health service expenses, then it is not *required* to incur a cost. Therefore, those health service expenses do not meet the statutory definition of mandated costs.

Government Code Section 17556

The district presents an invalid argument that the statutory language applies only when the fee authority is sufficient to offset the "entire" mandated costs. The CSM recognized that the Health Fee Elimination Program's costs are not uniform between districts. Districts provided different levels of service in FY 1986-87 (the "base year"). Furthermore, districts provided these services at varying costs. As a result, the fee authority may be sufficient to pay for some districts' mandated program costs, while it is insufficient to pay the "entire" cost of other districts. Meanwhile, Education Code section 76355 (formerly section 72246) established a uniform health service fee assessment for students statewide. Therefore, the CSM adopted parameters and guidelines that clearly recognize an available funding source by identifying the health service fees as offsetting reimbursements. To the extent that districts have authority to charge a fee, they are not required to incur a cost.

Two court cases addressed the issue of fee authority.[2] Both cases concluded that "costs" as used in the constitutional provision, exclude "expenses that are recoverable from sources other than taxes." In both cases, the source other than taxes was fee authority.

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[2] *County of Fresno v. California* (1991) 53 Cal. 3d 482; *Connell v. Santa Margarita* (1997) 59 Cal. App. 4th 382.

Parameters and Guidelines

The district incorrectly interprets the parameters and guidelines' requirement regarding authorized health service fees. The CSM clearly recognized the *availability* of another funding source by including the fees as offsetting savings in the parameters and guidelines. The CSM's staff analysis of May 25, 1989, states the following regarding the proposed parameters and guidelines amendments that the CSM adopted that day:

> Staff amended Item "VIII. Offsetting Savings and Other Reimbursements" to reflect the reinstatement of [the] fee authority.
>
> In response to that amendment, the [Department of Finance (DOF)] has proposed the addition of the following language to Item VIII. to clarify the impact of the fee authority on claimants' reimbursable costs:
>
> "If a claimant does not levy the fee authorized by Education Code Section 72246(a), it shall deduct an amount equal to what it would have received had the fee been levied."
>
> Staff concurs with the DOF proposed language which does not substantively change the scope of Item VIII.

Thus, the CSM concluded that claimants must deduct authorized health service fees from mandate-reimbursable costs claimed. Furthermore, the staff analysis included an attached letter from the CCCCO dated April 3, 1989. In that letter, the CCCCO concurred with the DOF and the CSM regarding authorized health service fees.

The CSM did not revise the proposed parameters and guidelines amendments further, as the CSM's staff concluded that DOF's proposed language did not substantively change the scope of its proposed language. The CSM's meeting minutes of May 25, 1989, show that the CSM adopted the proposed parameters and guidelines on consent, with no additional discussion. Therefore, no community college districts objected and there was no change to the CSM's conclusion regarding authorized health service fees.

The district states that "such an offset is contrary to the generally accepted accounting principle that requires revenues and costs to be properly matched." This statement is presented out of context; generally accepted accounting principles are not controlling criteria in identifying authorized health fee revenues attributable to the Health Fee Elimination mandated program. If a district voluntarily assesses less than the authorized health service fees, or fails to collect fees assessed, it is the district's responsibility to "match" health service expenditures with other district revenue sources.

FINDING 5— Understated offsetting savings/reimbursements

The district understated offsetting savings/reimbursements by $118,807 for the audit period.

The district did not report offsetting savings/reimbursements for interest, student fees, and other miscellaneous revenue documented in its accounting records. The district charged students a separate fee for various health services that it provided. In FY 2003-04, the district also recognized miscellaneous revenue as it converted from a cash to accrual basis accounting system.

The following table summarizes the audit adjustment:

	Fiscal Year					
	2002-03	2003-04	2004-05	2005-06	2006-07	Total
Interest	$ (16,890)	$ (12,625)	$ (13,216)	$ (17,014)	$ (24,686)	$ (84,431)
Student fees and other miscellaneous revenue	1,932	(28,734)	(1,785)	(5,789)	—	(34,376)
Audit adjustment	$ (14,958)	$ (41,359)	$ (15,001)	$ (22,803)	$ (24,686)	$(118,807)

The parameters and guidelines state:

> Any offsetting savings the claimant experiences as a direct result of this statute must be deducted from the costs claimed. In addition, reimbursement for this mandate received from any source, e.g., federal, state, etc., shall be identified and deducted from this claim.

Recommendation

We recommend that the district report all offsetting savings/ reimbursements on its mandated cost claims.

District's Response

> Finding 5 offsets $84,431 of interest income against the claimed cost of the student health services program. . . . The interest income is paid by the Stanislaus County Treasurer where the District deposits its cash in a pooled investment fund. The District allocates the total investment income reported by the County to its various funds.
>
> The draft audit report characterizes the interest income offset as an "offsetting savings/reimbursement". . . .
>
> The parameters and guidelines criteria for offsetting savings and reimbursements do not apply to interest income. First, the interest income is not generated "as a direct result of" Education Code 76355, the statutory basis for the student health services program. Indeed, since the student health service program operates at a loss (the reason for the annual mandate claim for excess costs), the student health service program cannot generate investment principal. Second, the interest income is neither state nor federal reimbursement for providing the student health service program. Third, the interest income is not fees paid by others for services not included in the student health service program.

SCO's Comment

The parameters and guidelines state, "Any offsetting savings the claimant experiences as a direct result of this statute must be deducted from the costs claimed." In its response, the district confirms that it received pooled investment fund income attributable to its health services fund. The health services fund and its associated revenues exist specifically because of Chapter 1118, Statutes of 1987, which authorized districts to assess a health service fee.

The district states, "Indeed, since the student health service program operates at a loss . . . the student health service program cannot generate investment principal." The district's response fails to consider basic cash flow principles. Each term, districts collect health fee revenue at the beginning of the term. This revenue is available for deposit in the county pooled investment fund and is depleted during the term as the district incurs health service program expenses. The revenue earns interest until such time that it is depleted.

During our exit conference conducted January 23, 2009, the district's consultant stated to district personnel that the district's mistake was that it posted interest revenue to the health services fund. We strongly recommend that the district continue to allocate interest earned on pooled investment funds according to generally accepted accounting principles.

OTHER ISSUE— FY 2006-07 amounts paid

The district's response included comments regarding FY 2006-07 amounts paid. The district's response and SCO's comment are as follows:

District's Response

> The draft audit report states that the District was paid $234,716 on the FY 2006-07 annual claim. The last remittance advice (March 12, 2007) received by the District for this fiscal year indicates that the amount paid was $263,110.

SCO's Comment

The Summary of Program Costs (Schedule 1) is unchanged. The district is contesting a reported amount that is in its favor. The district's response fails to disclose that the district re-paid the SCO $28,394, as documented by the SCO's remittance advice dated April 23, 2008. Thus, the net amount that the State paid to the district is $234,716.

OTHER ISSUE— FY 2006-07 late claim filing penalty

The district's response included comments regarding the FY 2006-07 late claim penalty. The district's response and SCO's comment are as follows:

District's Response

> On February 6, 2009, the District submitted an amended FY 2006-07 claim in the amount of $329,864 that incorporates some of the audit adjustments. presented at the January 23, 2009, exit conference. Since this amended claim is a late claim, it is subject to a late filing penalty of 10% of the amount claimed up to $10,000. The draft audit report adjusts the late filing penalty to $9,515 for the audited allowed "total program costs" of $192,389. Ten percent of $192,389-is not $9,515. It appears the late filing penalty should be $10,000.

SCO's Comment

The Summary of Program Costs (Schedule 1) is unchanged. Again, the district is contesting an adjustment in its favor. Nevertheless, the district is in error. The district erroneously equates an "amended claim" with a "late claim." When a district amends its claim after the claim filing date established by Government Code section 17560, only the additional claimed costs are subject to the late claim penalty assessment (i.e., the original amount claimed is not late; only the new, additional costs are filed late). The district's amended claim increased total claimed costs by $95,148, from $234,716 to $329,864. The SCO correctly applied a 10% late penalty assessment to the $95,148 increase pursuant to Government Code section 17568. Allowable costs are irrelevant to the late claim penalty assessment.

OTHER ISSUE— Statute of limitations

The district's response included comments related to the statute of limitations applicable to the district's FY 2002-03 and FY 2003-04 mandated cost claims. The district's response and SCO's comment are as follows:

District's Response

> Government Code Section 17558.5, as amended effective January 1, 2003, requires the Controller to initiate an audit within three years after a claim is filed. The District's FY 2002-03 claim was filed on January 12, 2004. The District's FY 2003-04 claim was filed on January 10, 2005. The entrance conference date for the audit was March 24, 2008, which is after the three-year period to commence the audit for those two fiscal years had expired.

SCO's Comment

Our findings and recommendations are unchanged. The district cited only a portion of Government Code section 17558.5, subdivision (a), which actually states:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than three years after the date that the actual reimbursement claim is filed or last amended, whichever is later.

> *However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the claim is filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim* [emphasis added].

For its FY 2002-03 claim, the district received its initial payment on October 25, 2006. Pursuant to Government Code section 17558.5, subdivision (a), the SCO had until October 24, 2009, to initiate an audit of this claim. For its FY 2003-04 claim, the district received no payment. Pursuant to the same statutory language, the time for the SCO to initiate an audit has not yet commenced. Therefore, the SCO properly initiated an audit of these claims within the statutory time allowed.

OTHER ISSUE— Public records request

The district's response included a public records request. The district's response and SCO's comment are as follows:

District's Response

> The District requests that the Controller provide the District any and all written instructions, memorandums, or other writings in effect and applicable during the claiming period to Finding 1 (indirect cost rate calculation standards) and Finding 2 (calculation of the student health services fees offset).

SCO's Comment

The SCO provided the district the requested records by separate letter dated April 7, 2009.

Attachment—
District's Response to
Draft Audit Report

Office of the Executive Vice Chancellor

Yosemite Community College District
P.O. Box 4065 / Modesto, CA 95352 / 2201 Blue Gum Avenue
Phone (209) 575-6530 / FAX (209) 575-6562

March 24, 2009

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

Jim L. Spano, Chief
Mandated Costs Audits Bureau
Division of Audits, California State Controller
P.O. Box 942850
Sacramento, CA 94250-5874

Re: Chapter 1, Statutes of 1984
Health Fee Elimination
Yosemite Community College District
Fiscal Years: 2002-03, 2003-04, 2004-05, 2005-06, and 2006-07 (amended)

Dear Mr. Spano:

This letter is the response of the Yosemite Community College District to the draft audit report for the above referenced program and fiscal years transmitted by the letter from Jeffrey Brownfield, Chief, Division of Audits, State Controller's Office, dated March 12, 2009, and received by the District on March 13, 2009.

Finding 1: Understated services and supplies

This District does not dispute this finding. See Finding 5.

Finding 2: Overstated indirect costs

Indirect Cost Rates Claimed and Audited

Fiscal Year	As Claimed	Claimed Source	As Audited	Audit Report Source
2002-03	23.95%	CCFS-311	33.90%	"Federally approved rate"
2003-04	25.29%	CCFS-311	33.90%	"Federally approved rate"
2004-05	34.88%	CCFS-311	36.21%	CCFS-311 and depreciation
2005-06	36.38%	CCFS-311	33.23%	CCFS-311 and depreciation
2006-07 (amended)	41.07%	CCFS-311 and depreciation	34.71%	CCFS-311 and depreciation

The Controller asserts that the indirect cost method used by the District was inappropriate since it was not a cost study specifically approved by the federal government.

CHOICE OF METHODS

The draft audit report states that the District prepared its indirect cost rates for the fiscal years 2002-03 through 2005-06 as "proposals" in accordance with OMB A-21 that were not federally approved.

FY 2002-03 and FY 2003-04

The District had an "approved" federal rate for FY 2002-03 and FY 2003-04 that was used for the audit adjustment. Since federally approved rates are an acceptable alternative method, the District does not dispute this audit finding as to FY 2002-03 and FY 2003-04.

FY 2004-05 and FY 2005-06

The draft audit report is factually in error when it states that the District prepared indirect cost rate proposals for FY 2004-05 and FY 2005-06 in accordance with OMB A-21. No proposal was made to any state or federal agency for an "approved" indirect cost rate. The District used the same FAM-29C method based on the CCFS-311 as the auditor, but made different allocations of indirect costs. The principal difference is that the District used the capital costs stated in the CCFS-311, whereas the Controller deleted these capital costs and substituted depreciation expense as stated on the District's annual financial statements.

FY 2006-07

On February 6, 2009, the District submitted an amended FY 2006-07 claim. The District used the same FAM-29C method based on the CCFS-311 as did the auditor. The District deleted the capital costs stated in the CCFS-311 and substituted the depreciation expense as reported in the District's annual financial statements. The District was not on notice of this method of treating depreciation costs at the time the FY 2004-05 and FY 2005-06 annual claims were timely filed. The audit report uses this method retroactively to FY 2004-05. The remaining difference in the rate claimed by the District in the amended FY 2006-07 claim and the audited rate is a result of differences in how some of the indirect costs were treated.

Parameters and Guidelines

The parameters and guidelines for the Health Fee Elimination program (as last amended on May 25, 1989), which are the legally enforceable standards for claiming costs, state that: "Indirect costs *may be claimed* in the manner described by the Controller in his claiming instructions." (Emphasis added) Therefore, the parameters and guidelines *do not require* that indirect costs be claimed in the manner described by the Controller.

Since the Controller's claiming instructions were never adopted as rules or regulations, they have no force of law. The burden is on the Controller to show that the indirect cost rate used by the District is excessive or unreasonable, which is the only mandated cost audit standard in statute (Government Code Section 17651(d)(2)). If the Controller wishes to enforce different audit standards for mandated cost reimbursement, the Controller should comply with the Administrative Procedure Act.

PRIOR YEAR CCFS-311

The draft audit report did not disclose that for FY 2004-05, FY 2005-06, and FY 2006-07, the audit used the most recent CCFS-311 information available for the calculation of the indirect cost rate. The District used the prior year CCFS-311. The CCFS-311 is prepared based on annual costs from the prior fiscal year for use in the current budget year. When the audit utilizes a different CCFS-311 than the District, this constitutes an undisclosed audit adjustment. The audit report does not state an enforceable requirement to use the most current CCFS-311.

As a practical example of how unjustifiable the Controller's position is on prior year CCFS-311 reports, note that the federally approved indirect cost rates (such as the federal rate the audit used for FY 2002-03 and FY 2003-04) are approved for periods of two to four years. This means the data from which the rates were calculated can be from three to five years prior to the last year in which the federal rate is used.

Since the draft audit report has stated no legal basis to disallow the indirect cost rate calculation method used by the District, and has not shown a factual basis to reject the rates as unreasonable or excessive, the adjustments should be withdrawn.

Finding 3: Offsetting savings/reimbursements incorrectly reported as authorized health service fees

This District does not dispute this finding. See Finding 5.

Finding 4: Understated authorized health service fees

The draft audit report concludes that the student health service fee revenue offsets were understated for the five-year audit period. The difference between the claimed amount and the audited amount is that the District utilized actual revenues received rather than a calculation of the student health service fees potentially collectible. The auditor calculated "authorized health fee revenues," that is, the student fees collectible based on the highest student health service fee chargeable to all eligible students, rather than the full-time or part-time student health service fee actually charged by the District to the students not exempted by state law or District policy (e.g., BOGG waiver students).

The audit utilizes student enrollment information from the State Community College Chancellor's data base. These statistics are not available to districts at the time the claims are prepared nor does the audit report substantiate this source as either uniquely accurate

or superior to enrollment data maintained by the District and independently audited each year. However, since the District did not calculate the fees based on student enrollment, this is not a District annual claim issue, but a Controller's audit adjustment rationale.

COLLECTIBLE STUDENT HEALTH SERVICE FEES

The District asserts that the "collectible method" of determining the student health service fee revenue offset is not supported by law or fact.

"Authorized" Fee Amount

There is no "authorized" rate other than the amounts stated in Education Code Section 76355. The draft audit report alleges that claimants must compute the total student health fees collectible based on the highest authorized rate. The draft audit report does not provide the statutory basis for the calculation of the "authorized" rate, nor the source of the legal right of any state entity to "authorize" student health services rates absent rulemaking or compliance with the Administrative Procedure Act by the "authorizing" state agency.

Optional Fee

Education Code Section 76355, subdivision (a), states that "[t]he governing board of a district maintaining a community college *may require* community college students to pay a fee . . . for health supervision and services . . . " There is no requirement that community colleges levy these fees. The permissive nature of the provision is further illustrated in subdivision (b) which states: "*If*, pursuant to this section, a fee is required, the governing board of the district shall decide the amount of the fee, if any, that a part-time student is required to pay. *The governing board may decide whether the fee shall be mandatory or optional*." (Emphasis supplied in both instances) Therefore, districts have the option of charging a fee to some or all of its students.

Government Code Section 17514

The draft audit report relies upon Government Code Section 17514 for the conclusion that "[t]o the extent that community college districts can charge a fee, they are not required to incur a cost." First, charging a fee has no relationship to whether costs are incurred to provide the student health services program. Second, Government Code Section 17514, as added by Chapter 1459, Statutes of 1984, actually states:

> "Costs mandated by the state" means any increased costs which a local agency or school district is required to incur after July 1, 1980, as a result of any statute enacted on or after January 1, 1975, or any executive order implementing any statute enacted on or after January 1, 1975, which mandates a new program or higher level of service of an existing program within the meaning of Section 6 of Article XIII B of the California Constitution.

The operating cost of the student health service program is not determined by the fees collected. There is nothing in the language of the statute regarding the authority to charge a fee, or any nexus of fee revenue to increased cost, or any language that describes the legal effect of fees collected.

Government Code Section 17556

The draft audit report relies upon Government Code Section 17556 for the conclusion that "the Commission on State Mandates (CSM) shall not find costs mandated by the State if the school district has the authority to levy fees to pay for the mandated program or increased level of service." Government Code Section 17556, as amended by Statutes of 2004, Chapter 895, actually states:

> The commission shall not find costs mandated by the state, as defined in Section 17514, in any claim submitted by a local agency or school district, if after a hearing, the commission finds that: . . .
>
> (d) The local agency or school district has the authority to levy service charges, fees, or assessments sufficient to pay for the mandated program or increased level of service.

The draft audit report misrepresents the law. Government Code Section 17556 prohibits the Commission on State Mandates from finding costs subject to reimbursement, that is, approving a test claim activity for reimbursement, where the authority exists to levy fees in an amount sufficient to offset the entire mandated costs. Here, the Commission has already approved the test claim and made a finding of a new program or higher level of service for which the claimants do not have the ability to levy a fee in an amount sufficient to offset the entire mandated costs.

Parameters and Guidelines

The parameters and guidelines, as last amended on May 25, 1989, state, in relevant part: "*Any* offsetting savings that the claimant experiences as a direct result of this statute must be deducted from the costs claimed . . . This shall include the amount of [student fees] as authorized by Education Code Section 72246(a)." The use of the term "*any* offsetting savings" further illustrates the permissive nature of the fees. Student fees actually collected must be used to offset costs, but not student fees that could have been collected and were not, because uncollected fees are "offsetting savings" that were not "experienced." The parameters and guidelines do not allow the Controller to reduce claimed costs by revenue never received by the claimants and such an offset is contrary to the generally accepted accounting principle that requires revenues and costs to be properly matched.

Since the draft audit report has stated no legal basis to disallow actual revenues as the amount of the offsetting revenue, the adjustments should be withdrawn.

Finding 5: Understated offsetting savings/reimbursements

Findings 1, 3, and 5 are connected by their content.

"FUND 12"

In accordance with governmental accounting practices, the District separately accounted for some costs and revenues (e.g., clinical services) in a fund (Fund 12) separate from the student health service center fund (Fund 14). Finding 1 merges those costs ($9,763) and revenue ($34,376 located in Finding 5) with Fund 14 which is consistent with the cost accounting practice of matching costs and revenues. The District does not dispute Finding 1.

FY 2003-04 CORRECTIONS

Finding 3 properly reverses $39,090 in revenue reductions to the FY 2003-04 claimed costs that were either duplicated from Fund 12 or the result of changes in accruals. The District does not dispute Finding 3.

INTEREST INCOME

Finding 5 offsets $84,431 of interest income against the claimed cost of the student health services program. Of this amount, $12,625 was properly added back to the program costs in Finding 3 for FY 2003-04. The interest income is paid by the Stanislaus County Treasurer where the District deposits its cash in a pooled investment fund. The District allocates the total investment income reported by the County to its various funds.

The draft audit report characterizes the interest income offset as an "offsetting savings/reimbursement." The draft audit report cites only a portion of the parameters and guidelines for this proposition. The entire relevant citation is:

> VIII. OFFSETTING SAVINGS AND OTHER REIMBURSEMENTS
>
> Any offsetting savings the claimant experiences as a direct result of this statute must be deducted from the costs claimed. In addition, reimbursement for this mandate received from any source, e.g., federal, state, etc., shall be identified and deducted from this claim. This shall include the amount of $7.50 per full-time student per semester, $5.00 per full-time student for summer school, or $5.00 per full-time student per quarter, as authorized by Education Code Section 72246(a). This shall also include payments (fees) received from individuals other than students who are not covered by Education Code Section 72246 for health services.

The parameters and guidelines criteria for offsetting savings and reimbursements do not apply to interest income. First, the interest income is not generated "as a direct result of"

Education Code 76355, the statutory basis for the student health services program. Indeed, since the student health service program operates at a loss (the reason for the annual mandate claim for excess costs), the student health service program cannot generate investment principal. Second, the interest income is neither state nor federal reimbursement for providing the student health service program. Third, the interest income is not fees paid by others for services not included in the student health service program.

Since interest income does not meet the parameters and guidelines criteria for offsetting savings and reimbursements and the draft audit report has stated no other basis for this finding, the adjustments should be withdrawn.

Other Issues

FY 2006-07 Amounts Paid

The draft audit report states that the District was paid $234,716 on the FY 2006-07 annual claim. The last remittance advice (March 12, 2007) received by the District for this fiscal year indicates that the amount paid was $263,110.

FY 2006-07 Late Claim Filing Penalty

On February 6, 2009, the District submitted an amended FY 2006-07 claim in the amount of $329,864 that incorporates some of the audit adjustments presented at the January 23, 2009, exit conference. Since this amended claim is a late claim, it is subject to a late filing penalty of 10% of the amount claimed up to $10,000. The draft audit report adjusts the late filing penalty to $9,515 for the audited allowed "total program costs" of $192,389. Ten percent of $192,389 is not $9,515. It appears the late filing penalty should be $10,000.

Statute of Limitations

Fiscal Year	Date Submitted to SCO	SOL to audit expires
FY 2002-03	January 12, 2004	Audit must start by January 12, 2007
FY 2003-04	January 10, 2005	Audit must start by January 10, 2008

Government Code Section 17558.5, as amended effective January 1, 2003, requires the Controller to initiate an audit within three years after a claim is filed. The District's FY 2002-03 claim was filed on January 12, 2004. The District's FY 2003-04 claim was filed on January 10, 2005. The entrance conference date for the audit was March 24, 2008, which is after the three-year period to commence the audit for those two fiscal years had expired.

The audit report should be changed to exclude findings for the FY 2002-03 and FY 2003-04 annual claims.

Public Records Request

The District requests that the Controller provide the District any and all written instructions, memorandums, or other writings in effect and applicable during the claiming period to Finding 1 (indirect cost rate calculation standards) and Finding 2 (calculation of the student health services fees offset).

Government Code section 6253, subdivision (c), requires the state agency that is the subject of the request, within 10 days from receipt of a request for a copy of records, to determine whether the request, in whole or in part, seeks copies of disclosable public records in its possession and to promptly notify the requesting party of that determination and the reasons therefore. Also, as required, when so notifying the District, please state the estimated date and time when the records will be made available.

O O O

The District requests that the audit report be changed to comply with the appropriate application of the parameters and guidelines regarding allowable activity costs and the Government Code sections concerning audits of mandate claims.

Sincerely,

Teresa Scott
Executive Vice Chancellor

TMS/KP/cs

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

http://www.sco.ca.gov

Exhibit F

Bush v. Bright , 264 Cal.App.2d 788

[Civ. No. 24819. First Dist., Div. One. Aug. 8, 1968.]

ARTHUR CURTIS ANTRIM BUSH, Plaintiff and Respondent, v. TOM BRIGHT, as Director of the Department of Motor Vehicles, etc., et al., Defendants and Appellants.

COUNSEL

Thomas C. Lynch, Attorney General, and Victor D. Sonenberg, Deputy Attorney General, for Defendants and Appellants.

Berwyn A. Rice for Plaintiff and Respondent. **[264 Cal.App.2d 790]**

OPINION

ELKINGTON, J.

This appeal concerns the interpretation of Vehicle Code section 13353, enacted in 1966, relating to chemical tests of intoxicated automobile drivers.

The section applies to any lawfully arrested person whom a peace officer has reasonable cause to believe was driving a motor vehicle upon a highway while under the influence of intoxicating liquor. It provides that such person shall be deemed to have given his consent to a chemical test of his blood, breath or urine. He may choose the type of test to be given. It also provides that if such a person refuses the officer's request to submit to such a test it need not be given, but his driver's license shall be suspended for six months.provision is made that the person be told of the penalty which will result from his refusal.

[1] The purpose of section 13353 is to reduce the toll of death and injury resulting from the operation of motor vehicles on California highways by intoxicated persons. As said in People v. Sudduth, 65 Cal.2d 543, 546 [55 Cal.Rptr. 393, 421 P.2d 401], "In a day when excessive loss of life and property is caused by inebriated drivers, an imperative need exists for a fair, efficient, and accurate system of detection, enforcement and, hence, prevention."

The obvious reason for acquiescence in the refusal of such a test by a person who as a matter of law is "deemed to have given his consent" is to avoid the violence which would often attend forcible tests upon recalcitrant inebriates. With this exception, the chemical tests may be given to any person covered by the statute, even if he be "dead, unconscious, or otherwise in a condition rendering him incapable of refusal."

[2] Such tests do not violate one's right against self- incrimination (Schmerber v. California, 384 U.S. 757, 760-765 [16 L.Ed.2d 908, 913-916, 86 S.Ct. 1826]; People v. Sudduth, supra, 65 Cal.2d 543, 546-547; United States v. Wade, 388 U.S. 218, 221 [18 L.Ed.2d 1149, 1153, 87 S.Ct. 1926]), nor one's right to be free from unreasonable searches and seizures (Schmerber v. California, supra, pp. 766-772 [16 L.Ed.2d pp. 917-920]), nor one's right to counsel (United States v. Wade, supra; People v. Sudduth, supra, p. 546; see also Gilbert v. California, 388 U.S. 263 [18 L.Ed.2d 1178, 87 S.Ct. 1951]).

The record before us discloses facts which are essentially uncontradicted. Respondent Arthur Curtis Antrim Bush was seen by a police officer driving an automobile in an erratic manner. He was lawfully arrested for the offense of driving a motor

vehicle while under the influence of intoxicating liquor. **[264 Cal.App.2d 791]** Bush had been at a party earlier that evening where he admittedly had at least 12 drinks of Scotch over ice. The drinks were larger than one would get in a bar, "certainly" more than an ounce in each drink. He then went to another party where he was sure he did not decrease the amount of his drinking. It is clear that when he was arrested he was grossly intoxicated. However, on three occasions when requested to submit to a chemical test he responded by answering "No," or by shaking his head negatively. Accordingly, a test was not given him. He had been properly advised as to the consequences of such a refusal.

After a Motor Vehicle Department administrative hearing Bush's license was ordered revoked for six months. He then sought a writ of mandate (Code Civ. Proc., § 1094.5) in the superior court for the purpose of annulling the order. The superior court exercised its independent judgment on the administrative record. fn. 1

[3] The court's findings recite that at the time Bush "was requested to submit to said test [he] was incapable of refusing to so submit because of his extreme intoxication." It was concluded as a matter of law "The petitioner did not violate the provisions of Vehicle Code section 13353." From the ensuing judgment setting aside Bush's license suspension this appeal was taken.

Bush based his argument below, as he does here, on the following language of section 13353: "Any person who is dead, unconscious, or otherwise in a condition rendering him incapable of refusal shall be deemed not to have withdrawn his consent." He contends that this provision "is intended to provide the person arrested with certain inalienable rights" affording "a fundamental protection to the person whose reasoning power or intelligence has been so greatly impaired as to prevent him from making an intelligent choice or waiving the right afforded him." The Legislature, he says, "intended that a person be aware of his rights and be given an opportunity to make a reasonable choice or a waiver." Finally, he says, since he was too drunk to make an intelligent waiver of his rights, he was completely unaffected by the portion of the statute under which he could refuse the test, and by the penalty provision for its refusal. **[264 Cal.App.2d 792]**

The statute's provision that "Any person who is dead, unconscious, or otherwise in a condition rendering him incapable of refusal shall be deemed not to have withdrawn his consent" does not confer any "rights" upon an intoxicated driver. It simply allows the chemical test of a person who is dead, unconscious or otherwise unable to refuse--making it clear that even in such cases the earlier provision that the person shall be deemed to have given his consent shall nevertheless apply.

Bush otherwise miscontrues the purpose and meaning of the statute. It is firmly established that a drunken driver has no right to resist or refuse such a test (See Schmerber v. California, supra, 384 U.S. 757, 760-765 [16 L.Ed.2d 908, 913-916]; People v. Sudduth, supra, 65 Cal.2d 543, 546-547). It is simply because such a person has the physical power to make the test impractical, and dangerous to himself and those charged with administering it, that it is excused upon an indication of his unwillingness. Since Bush's claimed rights are nonexistent there can be no issue as to their waiver.

The construction placed upon the statute by the lower court and by Bush would lead to absurd consequences--the greater the degree of intoxication of an automobile driver, the lesser the degree of his accountability under the statute. It would invalidate section 13353 as to grossly intoxicated drivers and frustrate the purpose of the Legislature.

[4] "Statutes must be given a reasonable and common sense construction in accordance with the apparent purpose and intention of the lawmakers--one that is practical rather than technical, and that will lead to a wise policy rather than to mischief or absurdity." (45 Cal.Jur.2d 625-626.) [5] "[I]n construing a statute the courts may consider the consequences that might flow from a particular interpretation. They will construe the statute with a view to promoting rather than to defeating its general purpose and the policy behind it." (Id., p. 631.) [6] Remedial statutes such as section 13353 "must be liberally construed to effect their objects and suppress the mischief at which they are directed. They should not be given a strained construction that might impair their remedial effect." (Id., pp. 681-682.)

Bush seems to argue that it is unreasonable and unfair to hold a person, deprived of understanding by his voluntary intoxication, accountable under Vehicle Code section 13353. An accountability for the results of one's voluntary intoxication is by no means novel in our law. For example, it has long **[264 Cal.App.2d 793]** been the rule, as to crimes not involving specific intent or diminished capacity, that "No act committed by a person while in a state of voluntary intoxication is less criminal by reason of his having been in such condition." (Pen. Code, § 22.) Even if one be unconscious as a result of his voluntary intoxication he may nevertheless be held criminally responsible for an act committed while in that state. "The union or joint operation of act and intent or criminal negligence must exist in every crime, ... and is deemed to exist irrespective of unconsciousness arising from voluntary intoxication." (People v. Conley, 64 Cal.2d 310, 324 [49 Cal.Rptr. 815, 411 P.2d 911]; see also People v. Alexander, 182 Cal.App.2d 281, 291-292 [6 Cal.Rptr. 153]; Witkin, Cal. Crimes (1963) § 143, p. 136.)

It seems reasonable to us that an automobile driver should be held accountable for his act of refusing a test under section 13353 while in a state of voluntary intoxication. [7] We therefore hold that, if the requirements of section 13353 are otherwise met, regardless of the degree of his voluntary intoxication or lack of understanding resulting therefrom, when a driver of an automobile refuses or otherwise manifests an unwillingness to take the required test he is subject to the license suspension provisions of that section.

The judgment is reversed. The superior court, on appropriate findings, will enter judgment in favor of appellants.

Molinari, P. J., and Sims, J., concurred.

FN 1. The case was tried on the theory that the court was required to exercise its "independent judgment" on the record and that the "substantial evidence" rule did not apply. It is unnecessary in our resolution of this appeal to determine which was the applicable rule.

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Exhibit G

Marin Healthcare Dist. v. Sutter Health (2002) 103 Cal.App.4th 861 , 127 Cal.Rptr.2d 113

[No. C034127. Third Dist. Nov. 14, 2002.]

MARIN HEALTHCARE DISTRICT, Plaintiff and Appellant, v. SUTTER HEALTH et al., Defendants and Respondents.

(Superior Court of Sacramento County, No. 97AS05803, John R. Lewis, Judge.)

(Opinion by Kolkey, J., with Blease, Acting P. J., and Raye, J., concurring.)

COUNSEL

Steefel, Levitt & Weiss, Stephen S. Mayne and David T. Vanalek for Plaintiff and Appellant.

McDonough, Holland & Allen and Richard E. Brandt for Defendant and Respondent Sutter Health.

Keegin, Harrison, Schoppert & Smith, Jeffrey S. Schoppert and Wendy L. Wyse for Defendants and Respondents Marin General Hospital and Marin Community Health. **[103 Cal.App.4th 866]**

OPINION

KOLKEY, J.—

In this action, we must determine whether the judicially created doctrine enunciated in *Hoadley v. San Francisco* (1875) 50 Cal. 265 (*Hoadley*)-that the statute of limitations does not apply to actions by the state to recover property dedicated for public use against an adverse possessor-should be extended to bar the application of the statute of limitations to the state's action to void a *lease* of public-use property. Because the purpose of the *Hoadley* doctrine is to prevent public-use property that the state cannot directly alienate from being indirectly alienated through the passage of time-that is, through the statute of limitations-we conclude that the doctrine has no application to a lease of property which the state is authorized to make.

In this case, the plaintiff, Marin Healthcare District (the District), a political subdivision of the state, brought suit to recover possession of a publicly owned hospital and related assets that it had leased and transferred **[103 Cal.App.4th 867]** in 1985 to defendant Marin General Hospital (Marin General) fn. 1 pursuant to the terms of the Local Health Care District Law (Health & Saf. Code, § 32000 et seq.). The District's complaint alleges that the 1985 agreements are void because its chief executive and legal counsel had a financial interest in the agreements at the time of their execution, in violation of Government Code section 1090, which prohibits state employees from having any financial interest in any contract made by them or by any body of which they are members. fn. 2 But because the action was filed 12 years after the agreements were signed, the trial court concluded that the suit was time-barred.

The District contends here-as it did in the trial court-that under the California Supreme Court's decision in *Hoadley*, "a suit by a governmental entity to recover public-use property from a private party to whom it was illegally or invalidly transferred is *never* barred by *any* statute of limitations."

We conclude, to the contrary, that *Hoadley* stands for the more narrow rule that "property held by the state in trust for the people cannot be lost through adverse possession." (*People v. Shirokow* (1980) 26 Cal.3d 301, 311 [162 Cal.Rptr. 30, 605 P.2d 859].) Other cases have only extended the doctrine to prevent the statute of limitations from barring the recovery of public-use property that the state had no authority to alienate. (E.g., *Sixth District etc. Assoc. v. Wright* (1908) 154 Cal. 119, 129-130 [97 P. 144].) The doctrine has no application to the lease of property into which the state is authorized by law to enter (and which property the state will recover at the end of the lease term).

Extension of the *Hoadley* doctrine here would conflict with the Legislature's determination to apply statutes of limitations to actions brought by the state, including the type pleaded here. Specifically, ever since the first session of the California Legislature, " '[t]he general legislative policy of California [has been] that the state shall be bound by its statute of limitations with respect to the bringing of actions for the enforcement of any and all such rights as may accrue to the state.' " (*People v. Osgood* (1930) 104 **[103 Cal.App.4th 868]** Cal.App. 133, 135 [285 P. 753].) While there are good policy reasons both for and against subjecting void leases of public property to the statute of limitations, we must defer to the Legislature's determination that the state, like other parties, is bound by the statute of limitations. We shall therefore affirm the judgment barring this 12-year-delayed suit from unsettling the balance of Marin General's lease term.

Factual and Procedural Background

The facts underlying this action are undisputed.

The District, a political subdivision of the State of California, is a local health care district organized and operating under the provisions of the Local Health Care District Law (Health & Saf. Code, § 32000 et seq.). The District owns an acute care hospital facility located in Marin County.

The statutory scheme governing local health care districts permits such districts to delegate pursuant to a lease of up to 30 years the responsibility of operating and maintaining a district-owned hospital (Health & Saf. Code, § 32126), and authorizes them to transfer the assets to a nonprofit corporation "to operate and maintain the assets" (Health & Saf. Code, § 32121, subd. (p)(1)). fn. 3 "The Legislature's stated reason for allowing such transfers [was] to permit local hospital districts 'to remain competitive in the ever changing health care environment ....' (Stats. 1985, ch. 382, § 5, p. 1556.)" (*Yoffie v. Marin Hospital Dist.* (1987) 193 Cal.App.3d 743, 746 [238 Cal.Rptr. 502].)

In or about November 1985, pursuant to those statutory provisions, the District leased the hospital's facilities and transferred certain of the District's assets used in the operation of the hospital, including cash, accounts receivable, and inventory, to defendant Marin General, a nonprofit public benefit corporation. The relevant agreements included a 30-year lease agreement and an agreement for transfer of assets (collectively, the 1985 contracts). Marin General has continuously operated the hospital facility since 1985.

At the time the 1985 contracts were entered, the District's chief executive officer was Henry J. Buhrmann. However, while Buhrmann was still employed as the District's chief executive officer, he became president and chief executive officer of Marin General and signed the 1985 contracts on **[103 Cal.App.4th 869]** behalf of *Marin General*. Two of the District's directors executed the contracts on the District's behalf. Moreover, the District's legal counsel, Quentin L. Cook, became legal counsel to Marin General before the 1985 contracts were executed. And when Marin General later combined to form another health care entity, Cook became chief executive officer of that entity.

In November 1997, nearly 12 years after the 1985 contracts were signed, the District filed the instant action against Marin General and the affiliated defendants, Marin Community Health and Sutter Health. (See fn. 1, *ante*.) The operative (first amended) complaint alleges that at the time the 1985 contracts were entered, Buhrmann's and Cook's simultaneous employment by Marin General and the District created a prohibited financial interest in those contracts within the meaning of Government Code section 1090. That statute prohibits state, county, district, and city officers or employees from being "financially interested in any contract made by them in their official capacity, or by any body or board of which they are members." (*Ibid.*) fn. 4 And because the 1985 contracts were purportedly made in violation of Government Code section 1090, the complaint alleges that the contracts are void under Government Code section 1092. fn. 5

The first and second causes of action of the complaint seek a declaration that the 1985 contracts are void by virtue of Buhrmann's or Cook's alleged financial interest in the contracts and that therefore the District is entitled to recover the assets transferred by the 1985 contracts. The District also seeks to impose a constructive trust on all hospital assets (the fifth cause of action), to conduct an accounting of the assets transferred under the 1985 contracts and their proceeds (the sixth cause of action), and to direct defendants to deliver the assets to the District (the seventh cause of action). fn. 6

Defendants admitted the existence of a controversy concerning the District's claim that the 1985 contracts are void, denied

any wrongdoing, and alleged that the causes of action based on the purported invalidity of the 1985 contracts (the first, second, fifth, sixth, and seventh causes of action) were barred by the applicable statutes of limitations. **[103 Cal.App.4th 870]**

Defendants then brought a motion for summary adjudication with respect to the first, second, fifth, sixth, and seventh causes of action on the grounds that they were barred by all applicable statutes of limitations. fn. 7 In support of their motion, defendants argued that the gravamen of the District's complaint was a claim that the 1985 contracts were void in violation of Government Code section 1092. As such, they claimed that the suit was an action "other than for the recovery of real property" within the meaning of Code of Civil Procedure section 335 et seq. and was barred by the applicable statutes of limitations.

The District, in turn, moved for summary adjudication of, among other things, "defendants' affirmative defense of the statute of limitations." Relying on the common law principle adopted by the California Supreme Court in *Hoadley, supra,* 50 Cal. 265, the District argued, both in support of its motion and in opposition to defendants' motion, that under settled case law, "a suit by a governmental entity to recover public-use property from a private party to whom it was illegally or invalidly transferred is *never* barred by *any* statute of limitations."

The trial court rejected the District's purported application of *Hoadley* and granted defendants' motions. In its tentative decision, which was subsequently incorporated into the judgment, the trial court opined in part that the "contracts here are fundamentally different from those in the *Hoadley* line of cases. The 1985 lease and sale of assets were legitimate contracts. Violation of [Government Code] Section 1090 can result in them being declared void. This is not like the *Hoadley* line of cases where the orig[i]nal transactions had no legitimacy. Statutes of limitations do attach to claims seeking to have contracts declared void based on the nature of the claim asserted.... The issue here then is what limitations period applies to actions brought under [Government Code] Section 1090. *Schaef*[]*er v. Berinstein* [(1960) 180 Cal.App.2d 107 [4 Cal.Rptr. 236], disapproved on another point in *Jefferson v. J. E. French Co.* (1960) 54 Cal.2d 717, 719-720 [7 Cal.Rptr. 899, 355 P.2d 643]] is on point and stands for the proposition that the nature of the underlying right sued on will determine the applicable statute." (Italics added.)

The trial court then concluded that the appropriate statute of limitations for the District's claims concerning the validity of the 1985 contracts under Government Code section 1092 was the four-year catchall provision of **[103 Cal.App.4th 871]** Code of Civil Procedure section 343, and applying that statute, ruled that the District's claims were time-barred.

The parties thereafter settled the remaining claims in the complaint and stipulated to entry of judgment incorporating the trial court's ruling on the statute of limitations.

Discussion

I. *Standard of Review*

[1] "[F]rom commencement to conclusion, the party moving for summary judgment bears the burden of persuasion that there is no triable issue of material fact and that he is entitled to judgment as a matter of law. [Fn. omitted.]" (*Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 850 [107 Cal.Rptr.2d 841, 24 P.3d 493].) We review independently an order granting summary judgment or summary adjudication of issues. (*Id.* at p. 860; *Hernandez v. Modesto Portuguese Pentecost Assn.* (1995) 40 Cal.App.4th 1274, 1279 [48 Cal.Rptr.2d 229].)

[2] Although resolution of a statute of limitations defense normally poses a factual question reserved to the trier of fact, summary adjudication will nonetheless be proper "if the court can draw only one legitimate inference from uncontradicted evidence regarding the limitations question." (*City of San Diego v. U.S. Gypsum Co.* (1994) 30 Cal.App.4th 575, 582 [35 Cal.Rptr.2d 876]; *FNB Mortgage Corp. v. Pacific General Group* (1999) 76 Cal.App.4th 1116, 1126 [90 Cal.Rptr.2d 841].) This is such a case.

II. *The Causes of Action are Subject to the Statute of Limitations*

The gravamen of the District's claims is that the 1985 contracts are void as a matter of law because its chief executive officer and counsel each had a financial interest in the contracts in violation of Government Code section 1090. It is settled that "a contract in which a public officer is interested is *void,* not merely voidable. [Citations.]" (*Thomson v. Call* (1985) 38 Cal.3d 633, 646, fn. 15 [214 Cal.Rptr. 139, 699 P.2d 316].)

But the District refrained from filing suit for the first 12 years of its 30-year lease. It argues that "under the rule confirmed in [*Hoadley*], a conveyance of public-use property that was not valid and effective when it was made can be attacked, and the

property reclaimed by the public, regardless of how much time has passed."

[3] There are certainly good policy arguments both for and against applying a limitations period to an action to void a lease of public property. **[103 Cal.App.4th 872]** On the one hand, "[t]he purpose of statutes of limitations is to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared." (*Cutujian v. Benedict Hills Estates Assn.* (1996) 41 Cal.App.4th 1379, 1387 [49 Cal.Rptr.2d 166], citing *Telegraphers v. Ry. Express Agency* (1944) 321 U.S. 342, 348-349 [64 S.Ct. 582, 586, 88 L.Ed. 788, 792]; accord, *Wood v. Elling Corp.* (1977) 20 Cal.3d 353, 362 [142 Cal.Rptr. 696, 572 P.2d 755].) Statutes of limitations also serve many other salutary purposes-some of which are relevant to this case-including protecting settled expectations; giving stability to transactions; promoting the value of diligence; encouraging the prompt enforcement of substantive law; avoiding the retrospective application of contemporary standards; and reducing the volume of litigation. (*Board of Regents v. Tomanio* (1980) 446 U.S. 478, 487 [100 S.Ct. 1790, 1796-1797, 64 L.Ed.2d 440, 449]; *Norgart v. Upjohn Co.* (1999) 21 Cal.4th 383, 395-396 [87 Cal.Rptr.2d 453, 981 P.2d 79]; *Gutierrez v. Mofid* (1985) 39 Cal.3d 892, 899 [218 Cal.Rptr. 313, 705 P.2d 886]; Ochoa & Wistrich, *The Puzzling Purposes of Statutes of Limitation* (1997) 28 Pacific L.J. 453.)

On the other hand, courts have noted that cases should be decided on their merits (see *Norgart v. Upjohn Co., supra,* 21 Cal.4th at p. 396) and that "[t]he public is not to lose its rights through the negligence of its agents" in failing to bring suit promptly. (*Board of Education v. Martin* (1891) 92 Cal. 209, 218 [28 P. 799].)

However, as a court, we must defer to the Legislature's judgment on which of these two policies to adopt. As our Supreme Court stated in a somewhat similar circumstance, "[t]o establish any particular limitations period under any particular statute of limitations entails the striking of a balance between the two [policies]. To establish any such period under any such statute belongs to the Legislature alone [citation], subject only to constitutional constraints [citation]." (*Norgart v. Upjohn Co., supra,* 21 Cal.4th at p. 396.)

As shown below, the Legislature has expressly addressed the application of statutes of limitations to actions brought by the state or its agencies.

A. *The Application of Statutes of Limitations to a Public Entity*

The parties agree that the District is a political subdivision of the state. We thus first turn to whether the Legislature intended to apply a statute of limitations to a suit by a state entity to void a contract in violation of Government Code section 1092. **[103 Cal.App.4th 873]**

"The rule quod nullum tempus occurrit regi-that the sovereign is exempt from the consequences of its laches, and from the operation of statutes of limitations-appears to be a vestigial survival of the prerogative of the Crown," but is nowadays premised on considerations of public policy. (*Guaranty Trust Co. v. U.S.* (1938) 304 U.S. 126, 132 [58 S.Ct. 785, 788, 82 L.Ed. 1224, 1227-1228].) " 'The true reason ... is to be found in the great public policy of preserving the public rights, revenues, and property from injury and loss, by the negligence of public officers.' " (*Ibid.*)

[4] Accordingly, "the implied immunity of the domestic 'sovereign,' state or national, has been universally deemed to be an exception to local statutes of limitations where the government, state or national, is not expressly included ...." (*Guaranty Trust Co. v. U.S., supra,* 304 U.S. at p. 133 [58 S.Ct. at p. 789, 82 L.Ed. at p. 1228].)

This is the rule in California: The rights of the sovereign "are not barred by lapse of time unless by legislation the immunity is expressly waived." (*City of L. A. v. County of L. A.* (1937) 9 Cal.2d 624, 627 [72 P.2d 138, 113 A.L.R. 370].) fn. 8

But sections 315 and 345 of the Code of Civil Procedure fn. 9 expressly waive the state's legislative immunity by applying statutes of limitations to various types of actions by the state and its agencies. "That it is not the policy of this commonwealth not to be bound by any statute of limitations is made clear by certain enactments which date back to the first session of the state legislature. (Code Civ. Proc., [§§] 315, 317, 345.) ... 'The general legislative policy of California is that the state shall be bound by its statute of limitations with respect to the bringing of actions for the enforcement of any and all such rights as may accrue to the state.' " (*People v. Osgood, supra,* 104 Cal.App. at p. 135.)

Title 2 of part 2 (commencing with § 312) addresses general statutes of limitations. Section 312, which is part of chapter 1 of title 2, reflects the Legislature's historical preference for limiting the time within which civil actions may be initiated: "Civil actions, *without exception*, can only be commenced within the periods prescribed in this title, after the cause of action shall have accrued, unless where, in special cases, a different limitation is prescribed by statute." (Italics added.) Chapter 2 of title 2 addresses **[103 Cal.App.4th 874]** the time for commencing actions for the recovery of real property (§ 315 et seq.),

while chapter 3 (§ 335 et seq.) addresses the time for commencing actions other than for the recovery of real property. In both cases, the Legislature has expressly subjected the state to the limitations periods.

With respect to actions for the recovery of real property, section 315 provides that "[t]he people of this State will not sue any person for or in respect to any real property, or the issues or profits thereof, by reason of the right or title of the people to the same, unless: [¶] 1. Such right or title shall have accrued within ten years before any action or other proceeding for the same is commenced ...." "The words 'right or title' in this passage are to be construed to mean 'cause of action.' " (*People v. Kings Co. Development Co.* (1918) 177 Cal. 529, 534 [171 P. 102]; accord, *People v. Chambers* (1951) 37 Cal.2d 552, 556 [233 P.2d 557] (*Chambers*).)

[5a] Thus, if the present action is deemed to seek the recovery of real property under chapter 2 of title 2 "by reason of the right or title of the people to the same," this 12-year-delayed action, brought by a state entity, would be subject to (and as we shall show, barred by) the 10-year limitations period specified in section 315.

On the other hand, if this action is deemed other than for the recovery of real property, it comes under chapter 3 of title 2 (commencing with section 335). fn. 10 But section 345 expressly waives the state's immunity from *any* of the relevant statutes of limitations in that chapter: "The limitations prescribed in this chapter apply to actions brought in the name of the state or county or for the benefit of the state or county, in the same manner as to actions by private parties ...." (§ 345.)

Accordingly, we next address whether one of the statutes of limitations that the Legislature has expressly made applicable to the state applies to the claim here.

B. *Determination of the Applicable Statute of Limitations*

[6] "To determine the statute of limitations which applies to a cause of action it is necessary to identify the nature of the cause of action, i.e., the 'gravamen' of the cause of action. [Citations.] '[T]he nature of the right sued upon and not the form of action nor the relief demanded determines the **[103 Cal.App.4th 875]** applicability of the statute of limitations under our code.' [Citation.]" (*Hensler v. City of Glendale* (1994) 8 Cal.4th 1, 22-23 [32 Cal.Rptr.2d 244, 876 P.2d 1043], citing *Leeper v. Beltrami* (1959) 53 Cal.2d 195, 214 [1 Cal.Rptr. 12, 347 P.2d 12, 77 A.L.R.2d 803], and *Maguire v. Hibernia S. & L. Soc.* (1944) 23 Cal.2d 719, 733 [146 P.2d 673, 151 A.L.R. 1062]; see also Note, *Developments in the Law-Statutes of Limitations* (1950) 63 Harv. L.Rev. 1177, 1192, 1195-1198.)

Put another way, "[w]hat is significant for statute of limitations purposes is the primary interest invaded by defendant's wrongful conduct. [Citation.]" (*Barton v. New United Motor Manufacturing, Inc.* (1996) 43 Cal.App.4th 1200, 1207 [51 Cal.Rptr.2d 328]; see *Day v. Greene* (1963) 59 Cal.2d 404, 410-411 [29 Cal.Rptr. 785, 380 P.2d 385, 94 A.L.R.2d 802] [although a complaint may be styled as a breach of contract action, if the gravamen of the claim is fraud, the three-year period prescribed in § 338 governs, rather than the period applicable to contracts]; 3 Witkin, Cal. Procedure (4th ed. 1996) Actions, § 474, p. 599 ["If the 'gravamen' of the action is held to be tort, the action, though in form one for breach of contract, is subject to the tort limitation period"].)

Thus, for example, in *Leeper v. Beltrami, supra,* 53 Cal.2d 195, the California Supreme Court held that an action to set aside a deed and to quiet title to real property was barred by the three-year limitation period for fraud actions under section 338, rather than the five-year period under section 318 fn. 11 applicable to the recovery of real property, because the plaintiffs' recovery depended upon their right to avoid a contractual obligation, which, in turn, depended upon a finding of duress, a type of fraud. (*Leeper,* at pp. 213-214.) Based on its conclusion that "the modern tendency is to look beyond the relief sought, and to view the matter from the basic cause of action giving rise to the plaintiff's right to relief" (*id.* at p. 214), the state Supreme Court analyzed the case as follows: "Quieting title is the relief granted once a court determines that title belongs in plaintiff. In determining that question, where a contract exists between the parties, the court must first find something wrong with that contract. In other words, in such a case, the plaintiff must show he has a substantive right to relief before he can be granted any relief at all. Plaintiff must show a right to rescind before he can be granted the right to quiet his title." (*Id.* at p. 216.) Accordingly, the court applied the three-year limitation period for fraud actions to the quiet title action. **[103 Cal.App.4th 876]**

[5b] Here, the gravamen of the District's first and second causes of action, seeking to declare the 1985 contracts void, is its claim that these agreements are unlawful under Government Code section 1090, and therefore void under Government Code section 1092. Indeed, the operative complaint styles both the first and second causes of action "[f]or a Declaration Against All Defendants that the 1985 Contracts Were Made in Violation of Government Code § 1090." While the form of the pleading is not determinative of the issue (*Quintilliani v. Mannerino* (1998) 62 Cal.App.4th 54, 65-66 [72 Cal.Rptr.2d 359]), none of the allegations in either cause of action hint at another basis for the District's claim for relief. And the other causes of action subject to defendants' summary adjudication motion-imposition of a constructive trust over the transferred assets,

an accounting of the transferred assets, and an injunction to return the transferred assets-are fairly described as ancillary to the first two.

Thus, the nature of the right sued on here is the public's right to be free of a government contract made under the influence of a financial conflict of interest. Accordingly, the applicable statute of limitations is the statute applicable to a claim under Government Code sections 1090 and 1092, not a claim for the recovery of real property-although that is the ultimate relief the declaration seeks.

C. *Claims Under Government Code Section 1092 Are Subject to the Limitations Periods Under Chapter 3*

Neither Government Code sections 1090 and 1092, nor the statutory scheme of which they are a part, specifies a limitations period for actions brought to void a contract entered in violation of Government Code section 1092.

Accordingly, the limitations periods under title 2 of part 2 apply (commencing with § 312) because section 312 provides that "[c]ivil actions, *without exception,* can only be commenced within the periods prescribed in this title ... unless where, in special cases, a different limitation is prescribed by statute." (Italics added.)

And since the nature of the right sued on here is the public's right to be free of a government contract made under the influence of a financial conflict of interest, this is an action "other than for the recovery of real property," and is thus covered by chapter 3 of title 2 of part 2 (commencing with § 335). And "[t]he limitations prescribed in [that] chapter apply to actions brought in the name of the State ... or for the benefit of the State ...." (§ 345.) **[103 Cal.App.4th 877]**

However, no case has squarely addressed the applicable statute of limitations for suits to void a contract in violation of Government Code section 1092, although various decisions have applied statutes of limitations to cases raising a financial conflict of interest under Government Code section 1090 or its predecessor statute. (See, e.g., *People v. Honig* (1996) 48 Cal.App.4th 289, 304, fn. 1 [55 Cal.Rptr.2d 555] [applying the three-year limitations period to penal actions under Gov. Code, § 1097 for violations of Gov. Code, § 1090]; *County of Marin v. Messner* (1941) 44 Cal.App.2d 577, 591 [112 P.2d 731] [action to recover money paid without authority under predecessor statute to Gov. Code, § 1090 is subject to three-year limitations period for liability created by statute]; *Schaefer v. Berinstein* (1956) 140 Cal.App.2d 278, 294, 297 [295 P.2d 113] [when gravamen of taxpayer's action is fraud against the city based, in part, on violation of Gov. Code, § 1090, three-year statute applies].)

Accordingly, as we noted, to determine the applicable statute of limitations, we must look to the " 'nature of the right sued upon and not ... the relief demanded.' " (*Hensler v. City of Glendale, supra,* 8 Cal.4th at p. 23.) Government Code section 1090 prohibits state, county, district, and city officers or employees from being "financially interested in any contract made by them in their official capacity, or by any body or board of which they are members." And under Government Code section 1092, "[e]very contract made in violation of any of the provisions of Section 1090 may be avoided at the instance of any party except the officer interested therein." [7] "California courts have generally held that a contract in which a public officer is interested is *void,* not merely voidable." (*Thomson v. Call, supra,* 38 Cal.3d at p. 646, fn. 15.) Moreover, a governmental agency "is entitled to recover any consideration which it has paid, without restoring the benefits received under the contract." (*Id.* at p. 647.) The California Supreme Court has ruled that this remedy results "in a substantial forfeiture" and provides "public officials with a strong incentive to avoid conflict-of-interest situations scrupulously." (*Id.* at p. 650.)

In this light, the one-year limitations period under section 340, subdivision (1), could be argued to apply to the District's claims to declare the 1985 contracts void and to repossess the transferred assets because it applies to "[a]n action upon a statute for a penalty or forfeiture, when the action is given to an individual, or to an individual and the state, except when the statute imposing it prescribes a different limitation." [8] A forfeiture is "[t]he divestiture of property without compensation" or "[t]he loss of a right, privilege, or property because of a crime, breach of obligation, or neglect of duty." (Black's Law Dict. (7th ed. 1999) p. 661, col. 1.) Government Code section 1092, which voids contracts in which a state employee has a financial conflict of interest without regard to the restoration of benefits, certainly would appear to effect a forfeiture. **[103 Cal.App.4th 878]**

[5c] However, we need not decide whether section 340, subdivision (1), applies in this case. Even if an action under Government Code section 1092 is not deemed a claim based on a statute for a forfeiture, the District's causes of action-brought 12 years after it entered the purportedly void agreements-would be time-barred under the four-year limitations period under the catchall provision of section 343. Section 343, which is also part of chapter 3 (which applies to all actions brought by the state [§ 345]), provides: "An action for relief not hereinbefore provided for must be commenced within four years after the cause of action shall have accrued."

[9] As the California Supreme Court long ago explained, " '[t]he legislature has ... specified the limitations applicable to a wide variety of actions, and then to rebut the possible inference that actions not therein specifically described are to be regarded as exempt from limitations, it has specified a four-year limitation upon "an action for relief not hereinbefore provided for" (§ 343); and where it has intended that an action shall be exempt from limitations it has said so in clear and unmistakable language. [Citations.]' " (*Moss v. Moss* (1942) 20 Cal.2d 640, 645 [128 P.2d 526, 141 A.L.R. 1422], quoting *Bogart v. George K. Porter Co.* (1924) 193 Cal. 197, 201 [223 P. 959, 31 A.L.R. 1045].)

[5d] Applying section 343 to this action to void the 1985 contracts on the ground of illegality would certainly be consistent with existing case authority. (E.g., *Moss v. Moss, supra,* "20 Cal.2d at pp. 644-645 [holding that cause of action for cancellation of an agreement is governed by § 343, in part because there is "no section of the code that expressly limits the time within which an action must be brought for cancellation of an instrument because of its illegality"]; *Zakaessian v. Zakaessian* (1945) 70 Cal.App.2d 721, 725 [161 P.2d 677] ["[o]rdinarily a suit to set aside and cancel a void instrument is governed by section 343 of the Code of Civil Procedure" unless, for example "the gravamen of the cause of action stated involves fraud or a mistake"]; see also *Piller v. Southern Pac. R.R. Co.* (1877) 52 Cal. 42, 44 ["the four years' limitation of [section] 343 applies to all suits in equity not strictly of concurrent cognizance in law and equity"]; *Dunn v. County of Los Angeles* (1957) 155 Cal.App.2d 789, 805 [318 P.2d 795] [action to set aside deed on the ground of coercion is governed by § 343].)

[10] In any event, we reject the District's contention that the gravamen of its causes of action is possession of real property or ejectment. First, possession of real property is the ultimate relief sought (following a declaration to that effect), not the nature of the right sued upon, which controls the selection of the statute of limitations. (See *Leeper v. Beltrami, supra,* 53 **[103 Cal.App.4th 879]** Cal.2d at pp. 213-214.) fn. 12 Instead, the District's right to recover the hospital facility from defendants depends wholly upon its establishing that Buhrmann and Cook were "financially interested" in the 1985 contracts so as to render those agreements void under Government Code section 1092. Second, only one of the two 1985 contracts that the District seeks to void pertains to real property. The agreement for transfer of assets cannot be founded on a claim to recover real property; therefore, this portion of the claim must surely be premised on chapter 3 of title 2 of part 2 of the Code of Civil Procedure addressing actions other than for the recovery of real property.

Nor does the fact that the contracts are claimed void avoid the statute of limitations. Actions to void contracts are nonetheless subject to the statute of limitations. (E.g., *Smith v. Bach* (1921) 53 Cal.App. 63 [199 P. 1106]; 3 Witkin, Cal. Procedure, *supra,* Actions § 507, p. 640.)

[5e] Finally, even if the gravamen of the District's causes of action was deemed to be for the recovery of real property under chapter 2 of title 2 (commencing with § 315), the District's 12-year delayed action would be barred because it would be subject to the 10-year limitations period under section 315 for actions by the people of this state "in respect to any real property" by reason of "the right or title of the people to the same."

D. *Accrual of the District's Causes of Action*

[11] As a general rule, a statute of limitations accrues when the act occurs which gives rise to the claim (*Myers v. Eastwood Care Center, Inc.* (1982) 31 Cal.3d 628, 634 [183 Cal.Rptr. 386, 645 P.2d 1218]), that is, when "the plaintiff sustains actual and appreciable harm. [Citation.] Any 'manifest and palpable' injury will commence the statutory period. [Citation.]" (*Garver v. Brace* (1996) 47 Cal.App.4th 995, 1000 [55 Cal.Rptr.2d 220].)

[5f] Assuming for the sake of argument that the 1985 agreements were made in violation of Government Code section 1090, the District sustained a "manifest and palpable" injury no later than November 1985. That is when it entered a contract influenced by a financial conflict of interest-the harm the statute seeks to avoid.

[12] After all, "Government Code section 1090 codified the common law prohibition of public officials having a financial interest in contracts **[103 Cal.App.4th 880]** they make in their official capacities." (*BreakZone Billiards v. City of Torrance* (2000) 81 Cal.App.4th 1205, 1230 [97 Cal.Rptr.2d 467].) Because "it is recognized ' "that an impairment of impartial judgment can occur in even the most well-meaning men when their personal economic interests are affected by the business they transact on behalf of the Government" ' [citations]," the objective of the conflict of interest statutes " 'is to remove or limit the *possibility* of any personal influence, either directly or indirectly which might bear on an official's decision ....' [Citations.]" (*People v. Honig, supra,* 48 Cal.App.4th at p. 314.) Accordingly, Government Code section 1090 has been interpreted to prohibit a financially interested employee from participating in the "planning, preliminary discussion, compromises, drawing of plans and specifications and solicitation of bids that [lead] up to the formal making of the contract." (*People v. Honig, supra,* 48 Cal.App.4th at pp. 314-315, citing *Stigall v. City of Taft* (1962) 58 Cal.2d 565, 571 [25 Cal.Rptr. 441, 375 P.2d 289]; see also *Thomson v. Call, supra,* 38 Cal.3d at pp. 647-648.)

[5g] Based on the limited record before us, it is undisputed that Buhrmann and Cook worked simultaneously for the District and Marin General before the 1985 contracts were executed in November 1985. Hence, the harm that Government Code section 1090 seeks to avoid arose no later than November 1985 when the contracts were executed. Accordingly, the District's causes of action to declare the 1985 contracts void under Government Code section 1092 accrued no later than November 1985. And the District makes no allegation that the commencement of the running of the statute of limitations should be tolled, only that its action is exempt from the otherwise applicable statute of limitations. Thus, unless the *Hoadley* doctrine exempts this action from the statute of limitations, defendants have successfully established that this action, filed in 1997-12 years later-is untimely under either section 315, section 340, subdivision (1), or section 343.

III. *The District Has Not Established That Its ActionIs Exempt from the Statute of Limitations*

[13] The District's opposition to defendants' motion for summary adjudication rests wholly upon its insistence that "under the rule confirmed in [*Hoadley*] a conveyance of public-use property that was not valid and effective when it was made can be attacked, and the property reclaimed by the public, regardless of how much time has passed."

As we shall explain, *Hoadley* does not stand for such a broad proposition. No published case has applied the holding of *Hoadley*, or its reasoning, to an action to set aside contracts allegedly made in violation of Government Code section 1090. **[103 Cal.App.4th 881]**

In *Hoadley*, the plaintiff sued the City of San Francisco to quiet title to two parcels of land, located in an area dedicated for use as city squares. He claimed that he had acquired title (1) by virtue of an ordinance and a confirmatory act, and (2) by adverse possession. (*Hoadley, supra*, 50 Cal. at pp. 271-272.)

After holding that the plaintiff did not acquire title to the public squares pursuant to the ordinance or the confirmatory act (*Hoadley, supra*, 50 Cal. at p. 273), the court in *Hoadley* considered whether the city was barred by the applicable statute of limitations from opposing the plaintiff's claim of adverse possession. First, the court ruled that adverse possession could not extinguish a public use to which the land had been dedicated: "The Statute of Limitations was not intended as a bar to the assertion by the public of rights of that character." (*Id.* at p. 275.) Next, it ruled that the city's legal title could not be extinguished by adverse possession: "That is to say, the title was granted to the city in trust, for public use; and the city had no authority ... to alienate or in any manner dispose of it, but only to hold it for the purposes expressed in the statute. It was granted to the city for public use, and is held for that purpose only. It cannot be conveyed to private persons, and is effectually withdrawn from commerce; and the city having no authority to convey the title, private persons are virtually precluded from acquiring it. The land itself, and not the use only, was dedicated to the public. Land held for that purpose, whether held by the State or a municipality, in our opinion, is not subject to the operation of the Statute of Limitations." (*Id.* at pp. 275-276.)

Thus, *Hoadley*'s holding was premised on the governmental entity's lack of "authority ... to alienate" property held for public use (*Hoadley, supra*, 50 Cal. at p. 275) and the presumably concomitant inability of a private person to acquire it indirectly through the failure of the government to timely bring suit within the statute of limitations-quite unlike the instant case where the District had statutory authority to enter into a lease.

This is made more clear by *Hoadley*'s reliance on the reasoning in *Commonwealth v. Alberger* (1836) 1 Whart. 469 (*Commonwealth*), among other cases, in coming to its conclusion. (*Hoadley, supra,* 50 Cal. at p. 275.) In *Commonwealth*, the Supreme Court of Pennsylvania held that William Penn's son had no authority to sell a portion of a public square in Philadelphia dedicated to public use by his father. In holding that the defendants were not "protected by the lapse of time" (*Commonwealth,* at p. 486), the Supreme Court of Pennsylvania opined: "It is well settled that lapse of time furnishes no defense for an encroachment on a public right; such as the erecting of an obstruction on a street or public square.... [¶] These **[103 Cal.App.4th 882]** principles are of universal application, and control the present case as well as others. There is no room for presumption since the grant itself is shown and proves defective; and if there were no grant shown, presumption will not be made to support a nuisance, by encroachment on a public right; and no statute of limitations bars the proceeding by indictment to abate it. These principles, indeed, pervade the laws of the most enlightened nations as well as our own code, and are essential to the protection of public rights, which would be gradually frittered away, if the want of complaint or prosecution gave the party a right. Individuals may reasonably be held to a limited period to enforce their right against adverse occupants, because they have interest sufficient to make them vigilant. But in public rights of property, each individual feels but a slight interest, and rather tolerates even a manifest encroachment, than seeks a dispute to set it right ... [citation]." (*Id.* at pp. 486, 488.)

Accordingly, based on this analysis, it is clear that *Hoadley* held that public-use property that cannot be alienated directly should not be alienated indirectly to an adverse possessor through the passage of time.

Indeed, *Hoadley*'s holding that the statute of limitations does not bar the state's recovery of public-use property against a claim of adverse possession is simply the mirror image of the rule that a private party cannot acquire prescriptive title to public-use property through adverse possession: "[S]o far as the title to real property is concerned,-prescription and limitation are convertible terms; and a plea of the proper statute of limitations is a good plea of a prescriptive right." (*Water Co. v. Richardson* (1887) 72 Cal. 598, 601 [14 P. 379]; see *People v. Shirokow, supra,* 26 Cal.3d at p. 311.) Thus, *Hoadley*'s holding that property held by the state in trust cannot be lost through adverse possession is not so much a rule concerning the application of the statute of limitations as it is a substantive doctrine that a private party cannot acquire prescriptive title to public rights founded on adverse possession. Indeed, Civil Code section 1007 was amended in 1935 to codify this by prohibiting the acquisition of title by adverse possession of any public-use property, no matter how long the property is occupied. (Stats. 1935, ch. 519, § 1, p. 1592.) fn. 13 Hence, a statute now defines in more direct terms the common law exception that *Hoadley* established.

We thus face the question whether *Hoadley* should be *extended* beyond its codification to exempt any conveyance of public-use property from the **[103 Cal.App.4th 883]** statute of limitations, in the face of other statutory enactments that expressly apply limitations to actions brought by the state.

A. *The Adverse Possession Cases*

Hoadley has most commonly been cited as authority to bar an adverse possessor of public-use property from asserting the statute of limitations against the government's action to recover the property. (E.g., *Board of Education v. Martin, supra,* 92 Cal. 209 [the California Supreme Court relied upon *Hoadley* to hold that no statute of limitations bars an educational district from recovering lands taken by adverse possession]; *People v. Kerber* (1908) 152 Cal. 731, 733 [93 P. 878] [the statute of limitations does not apply to an action by the state to recover a portion of San Diego Bay tidelands purportedly acquired by adverse possession because tidelands "belong to the state by virtue of its sovereignty" and "constitute property devoted to public use, of which private persons cannot obtain title by prescription, founded upon adverse occupancy for the period prescribed by the statute of limitations"]; *County of Yolo v. Barney* (1889) 79 Cal. 375, 378-381 [21 P. 833] [no statute of limitations restricted ability of hospital district to quiet title to property claimed by adverse possession]; *San Leandro v. Le Breton* (1887) 72 Cal. 170, 177 [13 P. 405] [no statute of limitations bars city from recovering land marked for public use against a claim of adverse possession], disapproved on another ground in *People v. Reed* (1889) 81 Cal. 70, 79 [22 P. 474]; *Visalia v. Jacobs* (1884) 65 Cal. 434, 435-436 [4 P. 433] [no statute of limitations bars city from recovering a portion of a city street taken by adverse possession]; *Proctor v. City & County of San Francisco* (9th Cir. 1900) 100 Fed. 348, 350-351 ["It is ... settled by a series of decisions by the supreme court that the rights of municipal corporations in such property are not affected by adverse possession, however long continued"]; see 3 Witkin, Cal. Procedure, *supra*, Actions, § 456, p. 578 ["There can be no adverse possession of property devoted to a public use"].)

More recently, in *People v. Shirokow*, *supra*, 26 Cal.3d 301, the California Supreme Court characterized *Hoadley* in conformity with these cases as holding that property held in public trust cannot be lost through adverse possession: "More than a century ago, in *Hoadley*[, *supra*,] 50 Cal. [at pages] 274-276, we articulated the rule that property held by the state in trust for the people cannot be lost through adverse possession. The statute of limitations is of no effect in an action by the state to recover such property from an adverse possessor whose use of the property for private purposes is not **[103 Cal.App.4th 884]** consistent with the public use. [Citation.]" (*People v. Shirokow, supra,* 26 Cal.3d at p. 311.)

Accordingly, *Hoadley* has no application to the circumstances presented here for several reasons.

First, the instant case does not involve the application of the statute of limitations to a claim of adverse possession of public property.

Second, *Hoadley*'s premise is that the passage of time cannot grant title to that which the government has no authority to alienate. Here, the District had authority to enter into a lease of the hospital. The issue in this case is not whether the public property could be leased, but whether it was leased in conformity with the law. For this reason, too, *Hoadley* does not apply.

Indeed, the California Supreme Court in *Ames v. City of San Diego* (1894) 101 Cal. 390 [35 P. 1005], distinguished *Hoadley* on precisely this ground: "[I]n case of lands, the legal title to which is vested in the city, and which may be alienated by it, the rule just stated [in *Hoadley*] in relation to land dedicated to the public use does not apply." (*Id.* at p. 394.)

Finally, *Hoadley* surely does not apply to that part of the District's claim that concerns property that could never be the subject of adverse possession, namely, the assets (including the cash, inventory, and accounts receivable) which were transferred under the 1985 contracts.

B. *The Unauthorized Transfer Cases*

The District observes, however, that "the Supreme Court ... disposed of any notion that the *Hoadley* no-limitations rule was restricted to situations where public-use property had merely been seized and held by a private individual on a claim of adverse possession," since it has also been cited to defeat the application of the statute of limitations in actions for the recovery of public-use property that has been voluntarily transferred.

But a careful reading of the cases upon which the District relies demonstrates that they do not support its assertion that the "*Hoadley* rule" bars the application of the statute of limitations to *any* invalid, illegal, or "ineffective" transfer of a public-use asset, "*regardless* of the particular legal defect that rendered the original transfer invalid." Instead, these cases only extend *Hoadley* to bar the assertion of the statute of limitations with respect to the recovery of public-use property that the government had no authority to alienate. **[103 Cal.App.4th 885]**

In *Sixth District etc. Assoc. v. Wright, supra,* 154 Cal. 119 (*Sixth District*), for instance, the California Supreme Court cited *People v. Kerber, supra,* 152 Cal. 731 (an adverse possession case, which in turn relied upon *Hoadley*) to reject a statute of limitations defense to an action to recover a gift made in violation of the state Constitution's ban on gifts of public property. (*Sixth District, supra,* at p. 130.) In *Sixth District*, the governing board of an agricultural district conveyed to a private corporation all of the district's property in purported accordance with a statute expressly authorizing such transactions. (*Id.* at pp. 122-126.) However, the California Supreme Court held that the act purporting to authorize the transaction conflicted with a provision of the state Constitution barring gifts of public property (*id.* at pp. 128-129) and rejected the defendants' assertion of the statute of limitations: "[T]he property was held in trust by a state institution or public agency for a public use, which public use has not been discontinued or abandoned *by any lawful act of public authority.* As to such property it is well settled that the statute of limitations has no application." (*Id.* at p. 130, italics added.)

Thus, *Sixth District,* like *Hoadley,* was premised on public property held in trust that the government had no authority to alienate; thus, no limitation period could operate to alienate indirectly what could not be alienated directly.

The District also relies on *Chambers, supra,* 37 Cal.2d 552, for the proposition that no limitations period can bar a suit to retrieve public-trust property invalidly conveyed to a private party. But in *Chambers*, the state sought to quiet title on park land, which was mistakenly conveyed by a tax deed to a private party, Chambers. (*Id.* at p. 555.) Opposing the state's argument that the tax deed was void, Chambers defended on the basis of various statutes of limitations (*id.* at pp. 555-556), which the court rejected. First, the court found that the action was commenced *within* the 10-year period of section 315 for actions by the people of the state " 'in respect to any real property.' " (*Id.* at p. 556, quoting § 315.) And citing *Hoadley,* it noted that in any event, "neither section 315 of the Code of Civil Procedure nor the provisions on adverse possession ... apply to property owned by the state and devoted to a public use." (*Chambers,* at pp. 556-557.) Next, the court rejected Chambers's assertion that the action was barred by the one-year limitations periods contained in the Revenue and Taxation Code, observing the general rule that "statutes of limitation do not apply against the state unless expressly made applicable" and ruling that "tax statutes do not apply against the state as to its property." (*Chambers, supra,* at p. 559.) It further reasoned that "it seems that if the statutes on adverse possession do not run against the property of the state which is dedicated to a public purpose (see authorities cited [including *Hoadley*]) the opposite result should not be reached, depriving the state of its property, by application to it of the **[103 Cal.App.4th 886]** provisions ... of the Revenue and Taxation Code. We hold therefore that they do not apply to the state." (*Id.* at p. 560, bracketed text added.)

Chambers, supra, 37 Cal.2d 552, does not assist the District. First and foremost, relying on the rule that statutes of limitations do not apply against the state unless made expressly applicable, *Chambers* merely construed the limitations periods in the tax statutes not to "apply against the state as to its property." (*Id.* at p. 559.) Second, although it suggested in dictum that section 315 does not apply to public-use property owned by the state, we do not rely on section 315 for the applicable limitations period in this case; thus, we have no need to rely on a construction of that section. Moreover, the cases that the Supreme Court cited for its dictum that section 315 does not apply to public-use property owned by the state (many of which we have cited here) do not so broadly hold. Third, regardless of the characterization of *Hoadley* in *Chambers,* the California Supreme Court's more recent characterization of *Hoadley* in *People v. Shirokow, supra,* 26 Cal.3d at page 311, more narrowly defines the doctrine to hold that the rule is "that property held by the state in trust for the people cannot be lost through adverse possession." The Supreme Court's holding in *Hoadley* and its most recent characterization of *Hoadley* would appear to be the most reliable expositions of the decision's scope. Fourth and finally, *Chambers* acknowledged that the limitations periods under *chapter 3* of title 2 of part 2 (which we have found applies here) are, in fact, applicable to actions brought by the state. (*Chambers, supra,* "37 Cal.2d at p. 559.)

The remainder of the cases relied upon by the District simply hold that the passage of time does not prevent the state from recovering public-use property that the state has no right to alienate. (*People v. California Fish Co.* (1913) 166 Cal. 576, 598-600, 611-612 [138 P. 79] [the state did not have the legal power to transfer certain coastal tidelands because, in part, "[a] patent for state land, issued by the officers in a case where there has been no valid application or survey approved nor any valid payment of the price, is, of course, void as against the state"]; *California Trout, Inc. v. State Water Resources*

Control Bd. (1989) 207 Cal.App.3d 585, 631 [255 Cal.Rptr. 184] [licenses to validate diversion of water exceeded amount permitted under state law and thus action seeking rescission of licenses was not untimely because "[a]n encroachment on the public trust interest shielded by [statute] cannot ripen into a contrary right due to lapse of any statute of limitations"]; *Allen v. Hussey* (1950) 101 Cal.App.2d 457, 467-468, 473-475 [225 P.2d 674] [lucrative long-term lease of airport facilities, for which irrigation district received $1 annual fee, was unauthorized breach of public trust and an unconstitutional gift of public funds].)

In contrast, the District here makes no allegation that it had "no authority" to effect a lease and transfer hospital assets on the terms provided. To the **[103 Cal.App.4th 887]** contrary, the provisions of the Local Health Care District Law then in effect expressly authorized such a lease and the other transfers involved. Nor does the District contend that the then-statutory framework permitting the transactions was unconstitutional or otherwise unlawful. The prohibition on conflicts of interest contained in Government Code section 1090 in no way prohibits the transfers authorized by the Local Health Care District Law (Health & Saf. Code, § 32000 et seq.), but instead directs individual government employees not to "hav[e] a financial interest in contracts they make in their official capacities." (*BreakZone Billiards v. City of Torrance, supra,* 81 Cal.App.4th at p. 1230.)

Accordingly, Government Code section 1090 does not deprive the government of authority to contract over, and thus the District had authority to lease, the public-use property. In contrast, all of the aforementioned cases that bar application of the statute of limitations are based on the premise that the passage of time cannot be permitted to indirectly alienate public-use property that the government is not authorized to alienate directly. Here, the District is entitled to lease the property, and just as importantly, the passage of time will not cause the District to lose the property. To the contrary, the lease will ultimately expire by its own terms, and the District will regain possession of the property. We thus decline to expand the holding of *Hoadley* to apply to a lease of public-use property and to the transfer of assets that the law authorizes the District to make.

IV. *Conclusion*

An action to void a contract under Government Code section 1092 comes within the limitations periods specified in chapter 3 of title 2 of part 2 of the Code of Civil Procedure. (§ 335 et seq.) And the Legislature has expressly applied all of the limitations periods in that chapter to actions brought in the name of the state. (§ 345.)

The public policy underlying *Hoadley, supra,* 50 Cal. 265-that "property held by the state in trust for the people cannot be lost through adverse possession" (*People v. Shirokow, supra,* 26 Cal.3d at p. 311)-is not furthered by extending it to allow an untimely suit to void a lease of public-use property, which will expire by its own terms and which the state is otherwise authorized to enter. Instead, *Hoadley* is meant to prevent public-use property that the state cannot directly alienate from being indirectly alienated by the passage of time. That is not the case with property that the state is authorized to lease and which the state will recover at the end of the lease term.

Moreover, even if the public policy under *Hoadley* was furthered by allowing an untimely suit to void a lease of public-use property, it is for the **[103 Cal.App.4th 888]** Legislature to weigh the competing public policies and so determine. Thus far, the Legislature has not created any exceptions to its subjection of the state to the limitation periods in chapter 3, and it has expressly codified *Hoadley* with respect to adverse possession claims.

Accordingly, we conclude that this action is time-barred. Defendants' uninterrupted operation of the hospital facility for nearly half of its 30-year lease before suit was brought certainly gave rise to a legitimate expectation that the 1985 contracts would not be challenged and that defendants could rely on those contracts in making investment decisions. Such expectations are precisely what the Legislature chose to protect when it expressly subjected the state to the same limitation periods that bind private parties' contract, tort, and statutory claims.

Disposition

The judgment is affirmed. Defendants are awarded their costs on appeal. (Cal. Rules of Court, rule 26(a).)

Blease, Acting P. J., and Raye, J., concurred.

Appellant's petition for review by the Supreme Court was denied February 25, 2003.

FN 1. Codefendant Marin Community Health is the sole member of defendant Marin General. After the agreements in issue were signed, another codefendant, Sutter Health, became the sole member of Marin Community Health.

FN 2. Government Code section 1090 provides: "Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. Nor shall state, county, district, judicial district, and city officers or employees be purchasers at any sale or vendors at any purchase made by them in their official capacity. [¶] As used in this article, 'district' means any agency of the state formed pursuant to general law or special act, for the local performance of governmental or proprietary functions within limited boundaries."

FN 3. The applicable code provisions have been amended several times since 1985 when the lease here was entered. Health and Safety Code section 32121 was amended in 1986, 1988, 1989, 1990, 1992, 1993, 1994, 1995, 1996, and 1998; Health and Safety Code section 32126 was amended in 1992, 1993, 1994, and 1998. (See 41 West's Ann. Health & Saf. Code (1999 ed.) foll. §§ 32121, 32126, pp. 242, 257.)

FN 4. See footnote 2, *ante*, for the full text of Government Code section 1090.

FN 5. Government Code section 1092 states: "Every contract made in violation of any of the provisions of Section 1090 may be avoided at the instance of any party except the officer interested therein. No such contract may be avoided because of the interest of an officer therein unless such contract is made in the official capacity of such officer, or by a board or body of which he is a member."

FN 6. The District's other causes of action have been dismissed.

FN 7. Marin General and Marin Community Health filed a joint motion for summary adjudication; Sutter Health filed a separate motion. However, as the two motions raise essentially the same issues, we shall refer to the defendants' motions for summary adjudication in the singular.

FN 8. Some courts have somewhat broadened this standard and ruled that statutes of limitations do not bind the state and its agencies "unless they do so expressly *or by necessary implication.*" (E.g., *Philbrick v. State Personnel Board* (1942) 53 Cal.App.2d 222, 228 [127 P.2d 634], italics added.)

FN 9. Unless otherwise designated, all further statutory references (including statutory references to chapters and title) are to the Code of Civil Procedure.

FN 10. Section 335 provides: "The periods prescribed for the commencement of actions other than for the recovery of real property, are as follows:"

The sections that follow section 335 then prescribe the limitations periods for various types of actions.

FN 11. Section 318 provides in pertinent part: "No action for the recovery of real property, or for the recovery of the possession thereof, can be maintained, unless it appear that the plaintiff ... was seized or possessed of the property in question, within five years before the commencement of the action."

FN 12. A contrary result was suggested in *People v. Kings Co. Development Co., supra,* 177 Cal. at page 535, where the court found that an action by the state to cancel a land patent, issued by officers acting under the influence of fraud, was an action in respect to land and was governed by section 315 for actions to recover real property. But that case preceded *Leeper v. Beltrami, supra,* 53 Cal.2d 195, and *Hensler v. City of Glendale, supra,* 8 Cal.4th at pages 22-23, which so clearly held that the nature of the right sued upon controlled the determination of the applicable statute of limitations.

FN 13. Civil Code section 1007, following a further amendment in 1968, presently provides: "Occupancy for the period prescribed by the Code of Civil Procedure as sufficient to bar any action for the recovery of the property confers a title thereto, denominated a title by prescription, which is sufficient against all, *but no possession by any person, firm or corporation no matter how long continued* of any land, water, water right, easement, or other property whatsoever dedicated to a public use by a public utility, or dedicated to or owned by the state or any public entity, shall ever ripen into any title, interest or right against the owner thereof." (Civ. Code, § 1007, italics added, as further amended by Stats. 1968, ch. 1112, § 1, pp. 2125-2126.)

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Exhibit H

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PATRICE L. GOLDMAN, individually and on behalf of others similarly situated, *Plaintiff-Appellant,* v. STANDARD INSURANCE COMPANY, *Defendant-Appellee.*	No. 00-16691 D.C. No. CV-98-01013-VRW OPINION

Appeal from the United States District Court
for the Northern District of California
Vaughn R. Walker, District Judge, Presiding

Argued and Submitted September 12, 2001
Submission Withdrawn November 21, 2001
Resubmitted March 17, 2003
San Francisco, California

Filed August 29, 2003

Before: William A. Fletcher, Raymond C. Fisher and Richard C. Tallman,* Circuit Judges.

Opinion by Judge Fisher

*Judge Tallman was drawn to replace Judge Henry Politz. Judge Tallman has read the briefs, reviewed the record, and listened to the tape of oral argument held on September 12, 2001.

COUNSEL

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OPINION

FISHER, Circuit Judge:

In 1996, appellant Patrice Goldman, an attorney, applied for a disability income insurance policy with appellee Standard Insurance Company ("Standard") through a program approved by the State Bar of California and available only to its members. Standard declined to issue Goldman a policy, because she had been diagnosed as having an "Adjustment Disorder with mixed anxiety and depressed mood, DSM IV (Diagnostic and Statistical Manual of Mental Disorders) 309.28," and was participating in weekly therapy sessions with a licensed clinical social worker.[1] Standard's underwrit-

[1]Adjustment disorder is a short-term condition that occurs when a person is unable to cope with a particular source of stress. American Psychi-

ing policy is to deny coverage for applicants with adjustment disorder until at least one year after the cessation of treatment.

Goldman initially filed suit in federal district court seeking damages and declaratory and injunctive relief for violation of the Americans With Disabilities Act ("ADA"), 42 U.S.C. § 12101 *et seq.*; California's Unruh Civil Rights Act, California Civil Code section 51 ("Unruh Act"); and California Business and Professions Code section 17200 *et seq.*, but shortly thereafter she dismissed her federal complaint and filed the same claims in California state court. Standard, however, removed the case to federal court on March 13, 1998. The district court exercised its jurisdiction under 28 U.S.C. § 1331 based on the ADA claim, and its supplemental jurisdiction over the state law claims.

In December 1999, the district court granted summary judgment against Goldman. The court found that Goldman could not qualify as a disabled person under the ADA, because Standard did not regard her as *presently* substantially limited by her adjustment disorder but only as a person who *may* be substantially limited in the future. In so holding, the court relied upon the United States Supreme Court's interpretation of the ADA in *Sutton v. United Air Lines*, 527 U.S. 471, 482 (1999), requiring a plaintiff to show she is "presently — not potentially or hypothetically — substantially limited." *Id.* The district court concluded that the Unruh Act incorporated the ADA definition of disability and thus Goldman also was not covered by the Unruh Act. Finally, the court rejected Goldman's claim under section 17200. Goldman appeals the entry of summary judgment on her claims under the Unruh

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atric Association, Diagnostic and Statistical Manual of Mental Disorders 679-80 (4th ed. 2000). The distress is in excess of that which would be expected to result from the stressor and causes a significant impairment in social or occupational functioning. *Id.* The type of adjustment disorder from which Goldman suffers manifests itself in a combination of depressed and anxious feelings.

Act and section 17200, but does not pursue her ADA claim.[2] We conclude that unlike the ADA as interpreted by *Sutton*, the definition of disability under the Unruh Act does not require a plaintiff to show that she is regarded as having a *present* limitation of a major life activity.[3] As the California Legislature recently clarified, this was the state of California law in 1997, when Standard refused to issue Goldman a policy, and it remains the law today. We thus reverse the summary judgment on Goldman's claim under the Unruh Act and under section 17200.

Discussion

I.

Standard of Review

We "review de novo a grant of summary judgment and must determine whether, viewing the evidence in the light most favorable to the nonmoving party, there are any genuine issues of material fact and whether the district court correctly applied the relevant substantive law." *Roach v. Mail Handlers Benefits Plan*, 298 F.3d 847, 849 (9th Cir. 2002) (internal quotations and citation omitted). A district court's interpretation of state law is reviewed de novo. *Paulson v. City of San Diego*, 294 F.3d 1124, 1128 (9th Cir. 2002) (en banc). We must determine what meaning the state's highest court would give the statute in question. *Id.*

[2]Because Goldman does not appeal her ADA claim, we do not address the propriety of the district court's ruling that Goldman failed to satisfy the definition of disability under the ADA's "regarded as" prong, 42 U.S.C. § 12102(2)(C).

[3]We are not concerned with whether or not the Unruh Act requires the limitation to be substantial. Standard regards Goldman as having a condition that may completely prohibit her from performing her job and thus as having a condition that may substantially limit her ability to work, which we assume, absent argument to the contrary, is a major life activity under pre-2000 California law.

II.

Goldman's Unruh Civil Rights Act claim

[1] The Unruh Act provides:

> All persons within the jurisdiction of this state are free and equal, and no matter what their sex, race, color, religion, ancestry, national origin, *disability*, or medical condition are entitled to the full and equal accommodations, advantages, facilities, privileges, or services in all business establishments of every kind whatsoever.

Cal. Civ. Code § 51(b) (West 2003) (emphasis added). "The Unruh Civil Rights Act works to ensure that all persons receive the full accommodations of any business within California, regardless of the person's disabilities." *Chabner v. United of Omaha Life Ins. Co.*, 225 F.3d 1042, 1050 (9th Cir. 2000) (holding that the Unruh Act prohibits an insurance company from imposing unreasonable pricing differentials based on an applicant's disability).

[2] Goldman alleges that Standard refused to issue her insurance coverage solely on the basis of her diagnosis of adjustment disorder. The Unruh Act applies to insurance companies, *see* Cal. Ins. Code § 1861.03(a) (West 2003), and an insurance company's refusal to provide coverage on the basis of disability may constitute a denial of "full and equal . . . services" if the discrimination is not reasonable. *See Chabner*, 225 F.3d at 1050 ("disparities in treatment and pricing that are reasonable do not violate the Unruh Act") (citing *Koire v. Metro Car Wash*, 40 Cal. 3d 24 (1985)). Thus, if Goldman's adjustment disorder constitutes a disability within the meaning of the Unruh Act, then the Act may provide relief against Standard's refusal to issue a policy.

A. Goldman is disabled for the purposes of the Unruh Act.

[3] To survive summary judgment, Goldman must first demonstrate a triable issue of fact as to whether she has a "disability" within the meaning of the Unruh Act. Thus we must determine what constitutes a disability for purposes of that Act. In 1997, when Standard refused to issue a policy to Goldman, the Act did not define the term "disability."[4] In 2000, however, the California Legislature enacted the Pop-pink Act, which amended the Unruh Act to define the term as any mental or physical disability covered by the Fair Employment and Housing Act ("FEHA"), California Government Code section 12920 *et seq.*. Cal. Civ. Code § 51(e)(1) (West 2003); *see* 2000 Cal. Stat. Ch. 1049 (Assembly Bill 2222,

[4]We are aware that the pre-2000 version of California Civil Code § 54 contained a definition of "disability," which incorporated the language used in the ADA definition of the term, and that courts and commentators have sometimes referred to § 54 of the Civil Code as part of the Unruh Act. *See, e.g., Molski v. Gleich*, 318 F.3d 937, 944-45 (9th Cir. 2003); *Botosan v. Paul McNally Realty*, 216 F.3d 827, 835 n.3 (9th Cir. 2000); *Colmenares v. Braemar Country Club, Inc.*, 29 Cal. 4th 1019, 1025-26, 1027-28 (2003); *Donald v. Sacramento Valley Bank*, 209 Cal. App. 3d 1183, 1185-86 (1989). However, the California Court of Appeal has explained that only § 51 truly comprises the Unruh Act and that courts should not permit the inclusion of other Civil Code sections as nominally part of the Unruh Act to obscure legally significant differences between the statutes. *Gatto v. County of Sonoma*, 98 Cal. App. 4th 744, 757-58 (2002) (discussing different statutes of limitations applicable to various Civil Code sections sometimes termed as part of the Unruh Act); *cf. Hankins v. El Torito Rests., Inc.*, 63 Cal. App. 4th 510, 517, 520 n.4 (1988) (noting that unlike a § 51 claim, § 54 does not require intent); *see also* Cal. Dep't of Fair Employment & Hous., General Information about the Unruh Civil Rights Act, *at* http://www.dfeh.ca.gov/Publications/DFEH%20250.pdf (last visited July 29, 2003) (explaining the Unruh Act is codified at Civil Code §§ 51 through 51.3). This comports with the fact that the definition of "disability" in § 54 is applicable to statutes in Part 2.5 of the Civil Code, Cal. Civ. Code § 54(b) (West 1997), whereas § 51 is in Part 2. To avoid any confusion, all references to the Unruh Act in this opinion mean California Civil Code § 51.

Sec. 2). FEHA includes within the definition of "mental disability" two subsections that are relevant here:

> (1) Having any mental or psychological disorder or condition, such as mental retardation, organic brain syndrome, emotional or mental illness, or specific learning disabilities, that limits a major life activity.
>
> . . .
>
> (5) Being regarded or treated by the employer or other entity covered by this part as having, or having had, a mental or psychological disorder or condition that *has no present disabling effect, but that may become a mental disability* as described in paragraph (1) or (2).

Cal. Gov't Code § 12926(i)(1), (5) (West 2003) (emphasis added).

Through the help of therapy, Goldman functions effectively in her daily life and occupation as an attorney. She is not presently limited in any major life activity and — given subsection (5) of California Government Code § 12926(i), which directly addresses a future disability — does not appear to be covered by subsection (1). Standard, however, believes that Goldman may someday be entirely prohibited from working given her diagnosis of adjustment disorder. This belief was the basis of Standard's refusal to issue Goldman a disability insurance policy. Thus, assuming the definition of disability in the 2000 amendment is applicable to Goldman, either because the amendments were intended to apply retroactively or because they merely clarified existing law, Goldman would be regarded as disabled under subsection (5) of the definition. *Id.* § 12926(i)(5).[5]

[5]Goldman alternatively argues that the pre-2000 Unruh Act shares the definition of "mental disability" in the pre-2000 version of FEHA, which,

Standard contends that the 2000 amendments were not intended to apply retrospectively and that the amendments constituted a change rather than a clarification of existing law under the Unruh Act. According to Standard, the 1997 version of the Unruh Act incorporated the ADA definition of "disability," and thus the Supreme Court's interpretation of the ADA as requiring a person to be presently limited in a major life function must apply to the Unruh Act as well. *See Sutton*, 527 U.S. at 482. Because it considered Goldman to be potentially but not presently limited by her condition, Standard argues that in 1997, Goldman did not come within the disability antidiscrimination protections of the Unruh Act.

[4] The parties have argued extensively as to the retroactive application of the 2000 amendments. In the absence of an express retroactivity provision, California legislation is presumed to operate prospectively "unless it is very clear from extrinsic sources that the Legislature or the voters must have intended a retroactive application." *In re Eastport Assocs.*,

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unlike FEHA's definition of "physical disability," did not require that a mental disability have *any* limiting effect, present or future. *See Jensen v. Wells Fargo Bank,* 85 Cal. App. 4th 245, 257 (2000); *Pensinger v. Bowsmith, Inc.*, 60 Cal. App. 4th 709, 721-22 (1998). *But see Muller v. Auto. Club*, 61 Cal. App. 4th 431, 441-43 (1998) (mental disability requires substantial limitation of major life activity). Standard not only disagrees that this FEHA definition applies, but argues the question is foreclosed by the California Supreme Court's recent decision in *Colmenares*, where the court noted that certain non-FEHA statutes, including "the Unruh Act," had incorporated the ADA's definition of "disability." 29 Cal.4th at 1025-27 (citing § 54 as the "Unruh Act"). Thus, argues Standard, the pre-2000 FEHA definition cannot be the same as that under the Unruh Act.

It is neither prudent nor necessary for us to decide whether *Colmenares'* reference to the Unruh Act embraced § 51, the section under which Goldman's claim arises, or whether it meant only to refer to § 54 *et seq.* As discussed at note 4 *supra*, the term Unruh Act has commonly been used in referring to § 54. Instead, we assume *arguendo* the pre-2000 version of the Unruh Act's definition of "mental disability" required a limitation of a major life function.

935 F.2d 1071, 1079 (9th Cir. 1991) (quoting *Evangelatos v. Superior Court*, 44 Cal.3d 1188, 1209 (1988)). While Goldman's appeal was pending before us, the California Supreme Court took for review a case that raised the issue of whether the 2000 amendments were intended to apply retroactively. *Colmenares v. Braemar Country Club, Inc.*, 29 Cal.4th 1019, 1024 n.2 (2003).[6] Accordingly, we withdrew submission of Goldman's case pending a decision in *Colmenares*. Rather than reaching the retroactivity question, however, the California Supreme Court concluded that the 2000 amendments merely clarified, rather than changed, the existing law that was relevant to the specific claims involved in that case. *Id.* at 1024 n.2, 1030-31 (noting, in construing whether FEHA required a limitation be substantial, that a legislative act that merely clarifies the law has no retrospective effect because the true meaning of the statute remains the same).

[5] For similar reasons, and guided by *Colmenares*, we likewise do not need to resolve the retroactive application of the Poppink Act generally, because we are persuaded that California's disability antidiscrimination law has never required that a plaintiff be regarded as *presently* limited by her disability. The 2000 amendments, although making other changes to the existing definition of disability under California law, merely clarified that the definition does not include such a limitation nor has it ever done so.

Courts are not to infer that legislation merely clarifies existing law unless (1) the nature of the amendment clearly demonstrates such an intent or (2) the legislature has itself stated that the particular amendment is merely declaratory of exist-

[6]In addition to granting review of *Colmenares*, previously published at 89 Cal. App. 4th 778 (2001), which had held that the Poppink Act modified existing law to a standard that is broader than the ADA, the California Supreme Court granted review of *Wittkopf v. County of Los Angeles*, previously published at 90 Cal. App. 4th 1205 (2001), which had come to the opposite conclusion.

ing law. *Victoria Groves Five v. Chaffey Joint Union High Sch. Dist.*, 225 Cal. App. 3d 1548, 1555 (1990). Both indicia are present here.

1. Nature of the Amendment — The Unruh Act Before 2000

In ascertaining the intent of the California Legislature, it is instructive to look to the pre-2000 understanding of disability in the context of the Unruh Act as section 51 has evolved. The Unruh Act was enacted in 1959 to broaden the prior version of California Civil Code section 51 to provide full and equal public accommodations regardless of race, color, religion, ancestry or national origin. *Harris v. Capital Growth Investors XIV*, 52 Cal.3d 1142, 1151-52 (1991). In 1987, the Legislature added "blindness or other physical disability" to the list of protected classifications. *Id.* at 1153. This amendment brought the Unruh Act into accord with California Civil Code section 54 *et seq.*, which entitled "[b]lind persons, visually handicapped persons, deaf persons, and other physically disabled persons" to full and equal access to common carriers, places of public accommodation, telephone facilities and other enumerated services, *see* Cal. Civ. Code § 54.1 (West 1987), and with FEHA, which prohibited employment discrimination based on "physical handicap." *Colmenares*, 29 Cal.4th at 1024-25. In the version of FEHA in effect from 1980 through 1992, "physical handicap" was defined to include "impairment of sight, hearing, or speech, or impairment of physical ability." *Id.* (internal quotations omitted). Rather than defining the term "impairment" as used in FEHA, the Fair Employment and Housing Commission adopted a regulation, drawn from the federal Rehabilitation Act of 1973, which defined "physical handicap" as a condition that "substantially limits one or more major life activities." *Id.* at 1025 (quoting former Cal. Admin. Code tit. 2, § 7293.6, subd. (j)(1)).

In 1990, Congress enacted the ADA, which defined the term "disability" as "(A) a physical or mental impairment that substantially limits one or more of the major life activities of such individual; (B) a record of such an impairment; or (C) being regarded as having such an impairment." 42 U.S.C. § 12102(2). Two years later, the California Legislature amended the Unruh Act, Civil Code section 54 and FEHA to expand coverage in light of the ADA. The Unruh Act's terminology, "blindness and physical disability," was changed to simply "disability," which was not defined. The Unruh Act was, however, amended so that "[a] violation of the right of any individual under the Americans with Disabilities Act (Public Law 101-336) shall also constitute a violation of this section." Cal. Civ. Code § 51 (West 1993). The Legislature added this reference to the ADA in order "to strengthen California law in this area [i.e., disability rights] where it is weaker than the Americans with Disabilities Act of 1990 . . . and to retain California law when it provides more protection for individuals with disabilities than the [ADA]." *Gatto*, 98 Cal. App. 4th at 758-59 (quoting Assemb. Bill No. 1077, ch. 913, § 1, 1992 Cal. Stat. 4282). Section 54's definition of "physical and mental disability" and FEHA's definition of "physical disability," on the other hand, were given statutory definitions generally modeled on the language of the ADA definition. *Colmenares*, 29 Cal.4th at 1025-26. Of particular importance here, both section 54 and FEHA required that the impairment "*limits*" participation in major life activities, the same language used in the ADA and in the California regulations implementing the prior version of FEHA.[7]

[7]Although both were modeled on the ADA's definition, § 54 differed from FEHA in that the former, like the ADA itself, required the limitation to be substantial. Section 54 defined "disability" as an "impairment that *substantially limits* one or more of the major life activities of the individual." *Compare* Cal. Civ. Code § 54(b)(1) (West 1997) (defining "disability" as an "impairment that *substantially limits* one or more of the major life activities of the individual"), *with* Cal. Gov't Code § 12926(k)(1)(B) (West 1997) (defining "physical disability" as a condition that "*limits* an individual's ability to participate in major life activities").

In 1999, the United States Supreme Court held that "a person [must] be *presently* — not potentially or hypothetically — substantially limited in order to demonstrate a disability" within the meaning of the ADA. *Sutton*, 527 U.S. at 482 (emphasis added). This conclusion turned largely on the fact that "the phrase 'substantially *limits*' appears in the Act in the present indicative verb form." *Id.* (emphasis added). The definition of "physical disability" employed in FEHA and of "mental and physical disability" in California Civil Code section 54 also use the present indicative verb form, "limits." We assume *arguendo* that the definition of mental disability for purposes of the Unruh Act pre-2000 would also have been expressed using "limits" in the present indicative. We cannot, however, take the next step Standard urges: that the verb form compels reading the Unruh Act in the restrictive manner *Sutton* read the ADA. To do so would fly in the face of the California Legislature's clearly expressed intent that the Unruh Act's antidiscrimination provisions be read broadly, and that it looked to the ADA as a model for putting a floor on coverage for the disabled, not a cap on liability.

First, when it adopted the "limits" terminology of the ADA, the Legislature also specified that, for purposes of FEHA:

> It is the intent of the Legislature that the definition of "physical disability" in this subdivision shall have the *same meaning as* the term "physical handicap" formerly defined by this subsection and construed in *American National Ins. Co. v. Fair Employment & Housing Com.*, 32 Cal.3d 603.

Cal. Gov't Code § 12926(k)(4) (West 1997) (emphasis added); *see also Cassista v. Cmty. Foods, Inc.*, 5 Cal.4th 1050, 1059 (1993) (discussing the legislative intent to maintain continuity of the definition). In *American National*, the California Supreme Court interpreted the term "physical handicap" as used in the pre-1992 version of FEHA broadly and, among other things, held that the term included physical

conditions "that *may handicap in the future but have no presently disabling effect.*" *Am. Nat'l Ins. Co. v. Fair Employment and Hous. Comm'n*, 32 Cal.3d 603, 610 (1982) (emphasis added).[8]

By adopting *American National*'s interpretation, the California Legislature made clear that it did not understand the term "limits" in the 1992 version of FEHA to imply a requirement of present disability, contrary to the Supreme Court's later interpretation of the same term in the ADA in *Sutton*. The same 1992 act that incorporated the limits language into FEHA also did so for section 54, albeit further requiring that the limitation be substantial. Given the clear legislative understanding of the term "limits" in FEHA as being consistent with *American National*'s holding that a presently disabling condition was not necessary, we must assume — absent compelling evidence otherwise — that the California Legislature did not intend a different understanding of that term in other sections that were amended by the same legislation.[9] Thus,

[8]The version of FEHA in effect at the time *American National Insurance Co.* was decided in 1982 did not use the "limits" terminology. Rather, it defined "physical handicap" to include an "(1) impairment of sight, hearing or speech, or (2) impairment of physical ability because of amputation or loss of function or coordination." *Am. Nat'l Ins. Co.*, 32 Cal.3d at 608.

[9]Relying on *Harris*, 52 Cal.3d at 1173-1174, Standard contends that the California Supreme Court has expressly disapproved an analogy between FEHA and the Unruh Act. In that case, the court refused to apply FEHA's disparate impact test to the Unruh Act. In doing so, it stated that "the *general* antidiscriminatory objectives of the Unruh Act are much broader than the *specific* antidiscrimination principles underlying titles VII and VIII . . . [and] their state FEHA counterparts." *Id.* at 1174 (internal quotation marks omitted). This language does not foreclose our analysis that the two statutes use the same definition of the term "limits." While application of the disparate impact model — a new *type* of liability — to the Unruh Act would expose all businesses to "new liability and potential court regulation of their day-to-day practices," *id.*, no such consequence flows from application of FEHA's definition of the term "limits" across the California statutes amended by the same 1992 Act.

whether construing FEHA's or Civil Code section 54's use of the word "limits" or the Unruh Act's implied incorporation of that terminology as of 1997, we should assume that a plaintiff would have been considered disabled if she was regarded as having a disability that might limit a major life activity in the future.

[6] The 2000 amendments therefore did not alter, but merely clarified, that California's disability antidiscrimination statutes — although historically modeled on the ADA — are broader than federal law, as it came to be interpreted by the Supreme Court in *Sutton* in 1999. This conclusion is reinforced by the California Legislature's own declaration enacted in 2000 as part of the Poppink Act and by that Act's legislative history.

2. Legislative Statement that the 2000 Amendment was Merely Declaratory of Existing Law

In the Poppink Act the Legislature declared that:

> The law of this state in the area of disabilities provides protections independent from those in the federal Americans with Disabilities Act of 1990 (Public Law 101-336). Although the federal act provides a floor of protection, *this state's law has always, even prior to passage of the federal act, afforded additional protections*.

Cal. Gov't Code § 12926.1(a) (emphasis added). This statement appears to be at least in part a reference to the California Supreme Court's decision in *American National*, which preceded the enactment of the ADA by eight years. For instance, the Report of the Assembly Committee on the Judiciary specifically noted that the incorporation by the Poppink Act of *American National*'s interpretation of FEHA into California Government Code section 12926(k)(4) reflected that California law has always been different from the ADA as inter-

preted in *Sutton*.[10] *See* Assembly Comm. on Judiciary, Bill Analysis of Assembly Bill No. 2222, 1999-2000 Reg. Sess., at 4-5 (Apr. 11, 2000) (noting that *American National* is contrary to *Sutton* and that "the more restrictive ADA definition, as recently construed by the U.S. Supreme Court, should not . . . be allowed to preclude a finding that a person is disabled under FEHA). Moreover, this declaration echoes the intent of the California Legislature in 1992 "to strengthen California law in this area . . . where it is weaker than the Americans with Disabilities Act of 1990 . . . and *to retain California law when it provides more protection for individuals with disabilities than the [ADA].*" *Gatto*, 98 Cal. App. 4th at 759 (quoting Assemb. Bill No. 1077, ch. 913, § 1, 1992 Cal. Stat. 4282) (emphasis added).[11] "[A]lthough construction of a statute is a

[10]Standard notes that a prior version of the Poppink Act contained legislative findings that specifically stated:

> The Legislature declares that the amendments made by this act to subdivisions (h), (i), and (k) of Section 12926 of the Government Code and Sections 51, 51.5, and 54 of the Civil Code are declaratory of existing state law.

See Assembly Bill No. 2222 § 1.5, 1999-2000 Reg. Sess., at 2 (as amended on May 26, 2000). On July 6, 2000, the bill was amended to delete these findings and to replace them with those now codified at California Government Code § 12926.1. *See* Assembly Bill No. 2222, 1999-2000 Reg. Sess., at 3 (as amended on July 6, 2000). This substitution does not help Standard, however. The declaration that was enacted continues to note the historical distinction between the ADA and California law. Moreover, unlike the original draft, the enacted declaration recognizes that the amendments clarified some aspects of the law while changing others. Thus, § 12926.1 appears to be a more narrowly tailored declaration of the clarification of existing law.

[11]Our understanding of § 12926.1 as declaratory of existing law is supported by the California Supreme Court's decision in *Colmenares*. The lower court's decisions in *Colmenares*, previously published at 89 Cal. App. 4th 778, 781-84 (2001), read § 12926.1 as indicating a modification. In coming to this conclusion, it emphasized a few select words in the declaration that it believed demonstrated the statute "tells us not what the law already says but that, in a time yet to come, the statute is intended *to result in* broader coverage." *Id.* at 781-83 (relying on the words "to result in" in

judicial function, where a statute is unclear, a subsequent expression of the Legislature bearing upon the intent of the prior statute may be properly considered in determining the effect and meaning of the prior statute." *Tyler v. State*, 134 Cal. App. 3d 973, 977 (1982).

Nonetheless, Standard contends the legislative history of the Poppink Act shows that it modified existing law and was not intended merely as a clarification. It notes two press releases from the bill's author, then Assembly Member Sheila James Kuehl, which state that the Poppink Act was "designed to strengthen the rights of workers with disabilities." Standard also relies on the report of the Assembly Committee on Appropriations, which stated that the bill:

> *Modifies* and standardizes the definitions of "mental disability," "physical disability" and "medical condition" for purposes of California's Unruh Civil Rights Act and Fair Employment and Housing Act (FEHA) and *to clarify* that California's disability protections are broader than federal protections under the Americans with Disabilities Act (ADA).

Assembly Comm. on Appropriations, Bill Analysis of Assembly Bill No. 2222, 1999-2000 Reg. Sess., at 1-2 (May 17, 2000) (emphasis added). These statements do not alter our conclusion; they simply show that the legislation modified the law in part and clarified it in part.

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subsection (c) and "to require" and "to provide" in subsection (d)). On the other hand, in *Wittkopf v. County of Los Angeles*, previously published at 90 Cal. App. 4th 1205, 1215-17 (2001), Justice Boland interpreted § 12926.1 as a declaration of existing law, noting as we do that the section begins by stating that California disability antidiscrimination law has always been broader than the ADA. In reversing *Colmenares* and upholding *Wittkopf*, the California Supreme Court clearly expressed its preference for Justice Boland's analysis.

First, Standard's argument ignores statements of the intent to clarify contained in these same sources. Second, the California Supreme Court, in *Colmenares*, specifically held that parts of the Poppink Act were intended to clarify rather than to modify existing law. *Colmenares*, 29 Cal.4th at 1030-31. Finally, we find no anomaly in legislative statements that the Poppink Act was designed both to modify *and* to clarify. Clearly, the amendments did both. For instance, the Poppink Act modified the definition of "disability" in section 54 to delete the requirement that a limitation be substantial. *Compare* Cal. Civ. Code § 54(b) (West 1997), *with* Cal. Civ. Code § 54(b) (West 2003) (incorporating the definition enacted by the Poppink Act and found in Cal. Gov't Code § 12926). The Poppink Act both modified and clarified FEHA, first by adding the "limits" language to the definition of "mental disability," then by clarifying that FEHA — past or present — did not require that a limitation be substantial. *Compare* Cal. Gov't Code § 12926(i) (West 1997) (no limits language for mental disability), *with* Cal. Gov't Code § 12926(i)(1) (West 2003) (adding limits language). Thus, it is not surprising that the Legislature would have referred to both modification and clarification.

Moreover, the intent to clarify that California disability antidiscrimination law is broader than that of the ADA is evident throughout the legislative history of the Poppink Act. The Assembly Committee on the Judiciary framed the "key issue" as whether "the definition of mental and physical disability and medical condition [should] be clarified in California's civil rights laws," Assembly Comm. on Judiciary, Bill Analysis of Assembly Bill No. 2222, 1999-2000 Reg. Sess., at 1 (Apr. 11, 2000), and specifically stated that the bill would "*clarify* the definition" of disability in the Unruh Act, which had previously "had no definition at all." *Id.* at 5 (emphasis added). Additionally, the California Supreme Court in *Colmenares* emphasized that certain changes to the Unruh Act were made to "*clarify*[ ] that California's disability protections are

broader than federal protections." 29 Cal.4th at 1027 (emphasis in original).

Only one piece of legislative history counsels against our interpretation. The Report of the Senate Judiciary Committee cast the bill as one which "make[s] various definitional changes to the existing civil rights laws" and that "[t]he greatest change" is the definition of "limitation," which is to be determined without regard to mitigating measures. Senate Comm. on Judiciary, Bill Analysis of Assembly Bill No. 2222, 1999-2000 Reg. Sess., at 1 (Aug. 8, 2000).

[7] Despite this one statement, we are persuaded that existing law as relevant here was merely clarified and that California law has not required that a plaintiff be regarded as having a presently limiting condition. This intent is evident in the wealth of legislative statements, the declaration contained in California Government Code section 12926.1, the California Supreme Court's decision in *Colmenares* and our own review of California law as it existed before the 2000 amendments. Because Goldman established that Standard refused to insure her based on a mental condition that has no present disabling effect, but that may become a mental disability that will substantially limit Goldman's ability to engage in a major life function, she has established that she was "disabled" in 1997 within the meaning of the Unruh Act.

B. Goldman presents a genuine issue of material fact as to the reasonableness of Standard's decision to deny her coverage.

[8] Standard might still be entitled to summary judgment if its decision to deny Goldman insurance coverage because of her assumed disability was reasonable as a matter of law. We have held that California Insurance Code section 10144 establishes the standard for assessing the reasonableness of a nonstandard insurance premium, prohibiting any insurer from refusing insurance "solely because of a physical or mental

impairment," except where the refusal "is based on sound actuarial principles or is related to actual and reasonably anticipated experience." *Chabner*, 225 F.3d at 1050 (quoting Cal. Ins. Code § 10144).

[9] Viewing the facts most favorably to Goldman as the nonmoving party, we conclude that Standard has not established as a matter of law that its decision to refuse coverage to Goldman was "based on sound actuarial principles" or "related to actual and reasonably anticipated experience." Goldman has presented sufficient evidence to create triable issues of fact regarding both prongs of the section 10144 standard. In assessing Goldman's proffered evidence, our role is not to "weigh the evidence [or] determine the truth of the matter, but to determine whether there is a genuine issue for trial." *Suzuki Motor Corp. v. Consumers Union of U.S., Inc.*, 330 F.3d 1110, 1140 (9th Cir. 2003) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986)).

First, Goldman's actuarial expert, Charles C. DeWeese, examined Standard's underwriting policy regarding adjustment disorder and concluded in his expert witness report that Standard's policy as well as its application to Goldman was inconsistent with principles of risk classification embodied in Actuarial Standard of Practice No. 12. DeWeese's expert opinion thus creates a triable issue whether Standard's refusal of coverage was "based on sound actuarial principles," section 10144's first prong.

Second, Goldman presented evidence to refute Standard's fundamental thesis relating to section 10144's second prong — that a diagnosis of adjustment disorder may predict future disability. Goldman's experts challenged this proposition on the basis of medical data, actuarial principles and actual experience.

According to Goldman's expert, Gary S. Sachs, M.D., nothing in his clinical experience, research or the professional literature suggests that employed individuals with a current diagnosis of adjustment disorder are more likely than other

individuals to become subsequently disabled from working for any non-psychiatric or psychiatric reason. Dr. Sachs specifically contradicted the declarations of Standard's own actuarial and underwriting experts. Similarly, Goldman's actuarial expert, DeWeese, stated that no "credible publicly available actuarial data, studies, or other objective evidence," including Standard's own studies, "support the proposition that working individuals with adjustment disorder and/or receiving mental health counseling are at a higher risk than other individuals to subsequently become disabled from working."

Both of these experts' opinions directly challenged the validity of Standard's studies. They criticized Standard for grouping together all individuals with psychiatric conditions or receiving medical health services as posing a similar risk of subsequent disability from working. The experts explained that such a grouping was not supported by medical data, reported claims experience or sound actuarial principles of risk classification. Dr. Sachs claimed that "better predictors of whether an individual will or will not subsequently become disabled from working are their personal work history, response to treatment, compliance with treatment, persistence of severe symptoms, prolonged periods of remission during treatment, and an absence of alcohol and substance abuse." DeWeese echoed the sentiment, stating that actuarial literature also recognized "an individual's work history and their motivation to work" as a "critical factor."

In addition to presenting evidence contradicting Standard's claim that individuals diagnosed with adjustment disorders are more likely to become disabled, Goldman also raised questions of fact as to whether Standard could profitably offer disability income insurance to Goldman. Dr. Sachs stated that Goldman did not present greater-than-average risk of becoming disabled. DeWeese disputed the more general proposition that "an insurance company jeopardizes the financial viability of the insurance by underwriting this risk [of mental disorder claims]." DeWeese pointed out that Standard's conclusion was based on the duration of psychiatric claims, a factor

which is relevant only when considered in conjunction with the number of claims. Moreover, DeWeese posited that Standard would not have to "increase prices dramatically" if it investigated and considered applicants with current or past treatment for a nondisabling psychiatric condition.

Who is correct in this battle of experts is not for us to decide. We do conclude, however, that Goldman's expert evidence is sufficient to deny Standard summary judgment on its section 10144 defense.

III.

Goldman's Section 17200 claim

[10] California's unfair competition law, Business & Professions Code section 17200 *et seq.*, prohibits "any unlawful, unfair or fraudulent business act or practice. . . . By proscribing any unlawful business practice, § 17200 borrows violations of other laws and treats them as unlawful practices that the unfair competition law makes independently actionable." *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.*, 20 Cal. 4th 163, 180 (1999) (quotations and citations omitted). Because summary judgment is not warranted on Goldman's Unruh Act claim, her claim under section 17200 also survives.

Goldman urges that we hold Standard liable under section 17200 even if we conclude Standard has not violated the Unruh Act. Goldman relies on the principle that "a practice may be deemed unfair even if not specifically proscribed by some other law . . . . In other words, a practice is prohibited as 'unfair' or 'deceptive' even if not 'unlawful' and vice versa." *Id.* at 180. But there is a "safe harbor" exception to this principle that precludes Goldman's attempt to isolate her section 17200 claim. *Id.* at 165-66.

Under California law, if the Legislature has provided a safe harbor for certain conduct, that conduct will not create liabil-

ity under section 17200. But "[t]o forestall an action under the unfair competition law, another provision must actually 'bar' the action or clearly permit the conduct." *Id.* at 183. We view California Insurance Code section 10144 as meeting this standard. As we have seen, it specifically permits an insurance company to refuse coverage on the basis of a mental impairment, as long as that denial was "based on sound actuarial principles or [was] related to actual and reasonably anticipated experience." Section 10144 provides a safe harbor for such denials of insurance coverage, thereby defeating a section 17200 claim based upon "unfair business practices." Thus, Goldman's section 17200 claim is dependant upon her prevailing on her Unruh Act claim and overcoming Standard's reasonableness defense under section 10144.

Conclusion

We hold that, unlike the ADA as interpreted by the United States Supreme Court in *Sutton v. United Air Lines*, 527 U.S. 471 (1999), the 1997 version of the Unruh Act did not require a presently limiting disability. The 2000 Poppink Act merely clarified that this was the existing state of California law. Goldman satisfies the Unruh Act definition of disability that was effective in 1997, because Standard regarded her as having a mental disorder that has no presently disabling effect but may have that effect in the future. Further, Goldman has sufficiently disputed Standard's claim that its decision was based on sound actuarial principles or related to actual and reasonably anticipated experience. Cal. Ins. Code § 10144. Therefore, the district court's grant of summary judgment on Goldman's Unruh Act claim is reversed as is the court's grant of summary judgment on Goldman's unfair competition claim.

REVERSED AND REMANDED.