

BEFORE THE  
COMMISSION ON STATE MANDATES  
STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM  
ON:**

Civil Code Sections 1834 and 1846; Food and Agriculture Code Sections 31108, 31752, 31752.5, 31753, 32001, and 32003; As Added or Amended by Statutes 1998, Chapter 752 (SB 1785)

Fiscal Years 2001-2002, 2002-2003; 2006-2007, 2007-2008, and 2008-2009

Southeast Area Animal Control Authority,  
Claimant

Case No.: 14-9811-I-03

*Animal Adoption*

DECISION PURSUANT TO  
GOVERNMENT CODE SECTION 17500 ET  
SEQ.; CALIFORNIA CODE OF  
REGULATIONS, TITLE 2, DIVISION 2,  
CHAPTER 2.5, ARTICLE 7

*(Adopted January 27, 2017)*

*(Served February 1, 2017)*

**DECISION**

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on January 27, 2017. Annette Chinn appeared on behalf of the Southeast Area Animal Control Authority, and Lisa Kurokawa and Masha Vorobyova appeared on behalf of the State Controller’s Office.

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

The Commission adopted the Proposed Decision to partially approve this IRC by a vote of 7-0 as follows:

<b>Member</b>	<b>Vote</b>
Richard Chivaro, Representative of the State Controller, Vice Chairperson	Yes
Mark Hariri, Representative of the State Treasurer	Yes
Scott Morgan, Representative of the Director of the Office of Planning and Research	Yes
Sarah Olsen, Public Member	Yes
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	Yes
Carmen Ramirez, City Council Member	Yes
Don Saylor, County Supervisor	Yes

**Summary of the Findings**

This IRC was filed in response to an audit by the State Controller’s Office (Controller) of the Southeast Area Animal Control Authority’s (claimant’s) initial reimbursement claims under the *Animal Adoption* program for fiscal years 2001-2002, 2002-2003, 2006-2007, 2007-2008, and

2008-2009. The Controller reduced and recalculated the claims because it found that the claimant did not comply with the Parameters and Guidelines when calculating costs under the actual cost method, claimed unallowable costs and ineligible staff, misstated animal census data, overstated the number of eligible animals, understated the number of reimbursable days, did not claim allowable costs, misstated indirect costs, and overstated offsetting revenues.<sup>1</sup>

The Commission partially approves this IRC, and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission regulations, that the Controller reinstate costs that relate to the following incorrect reductions to the extent the claimant can provide documentation to support the validity of the costs incurred:<sup>2</sup>

- The reduction of costs relating to the exclusion of animals deemed treatable upon arrival at the shelter and later euthanized during the increased holding period because they became non-rehabilitatable.
- The reduction of costs relating to the Controller's recalculation of costs following the *Purifoy v. Howell* decision and its use of an average number of reimbursable days, to the extent the recalculation resulted in an exclusion of "eligible animals" correctly held under the law.

The Commission further finds that all other reductions made by the Controller are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support.

### **I. Chronology**

01/15/2003 Claimant signed and dated the reimbursement claim for fiscal year 2001-2002.<sup>3</sup>

01/15/2004 Claimant signed and dated the reimbursement claim for fiscal year 2002-2003.<sup>4</sup>

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<sup>1</sup> See Exhibit A, IRC, page 464 (Cover Letter of Final Audit Report, page 1).

<sup>2</sup> Section VI. of the Parameters and Guidelines require claimants to provide source documents that show the evidence of the validity of such costs and their relationship to the mandate. The supporting documentation must be kept on file by the agency during the audit period required by Government Code section 17558.5. In this respect, claimants are required by Food and Agriculture Code section 32003 to maintain records on animals that are taken up, euthanized, or impounded. Such records shall identify the date the animal was taken up, euthanized, or impounded; the circumstances surrounding these events; and the names of the personnel performing these activities.

The record in this case shows that the claimant started maintaining records using the Paw Trax system in fiscal years 2006-2007 and 2008-2009, and that no records were available for the earlier fiscal years of 2001-2002 and 2002-2003. See Exhibit B, Controller's Late Comments on the IRC, page 15 (State Controller's Office Analysis and Response, page 9). The Controller should, on remand and under its audit authority, re-assess fiscal years 2001-2002 and 2002-2003 in conformity with its reassessment of data for 2006-2007 and 2008-2009 for purposes of reinstating costs incorrectly reduced.

<sup>3</sup> Exhibit A, IRC, page 546 (Form FAM-27).

<sup>4</sup> Exhibit A, IRC, page 563 (Form FAM-27).

- 01/15/2008 Claimant signed and dated the reimbursement claim for fiscal year 2006-2007.<sup>5</sup>
- 01/22/2009 Claimant signed and dated the reimbursement claim for fiscal year 2007-2008.<sup>6</sup>
- 02/04/2010 Claimant signed and dated the reimbursement claim for fiscal year 2008-2009.<sup>7</sup>
- 08/12/2010 Controller dated a letter to claimant regarding the start of the audit.<sup>8</sup>
- 05/22/2012 Controller dated the Draft Audit Report.<sup>9</sup>
- 06/04/2012 Claimant signed and dated a letter in response to the Draft Audit Report.<sup>10</sup>
- 06/15/2012 Controller dated the Final Audit Report.<sup>11</sup>
- 06/08/2015 Claimant filed this IRC.<sup>12</sup>
- 11/10/2015 Controller filed late comments on the IRC.<sup>13</sup>
- 02/11/2016 Claimant filed late rebuttal comments.<sup>14</sup>
- 11/7/2016 Commission staff issued the Draft Proposed Decision.<sup>15</sup>
- 12/05/2016 Controller filed comments on the Draft Proposed Decision.<sup>16</sup>
- 12/06/2016 Claimant filed late comments on the Draft Proposed Decision.<sup>17</sup>

## **II. Background**

### The Animal Adoption Program

The *Animal Adoption* program arose from amendments to the Civil Code and Food and Agriculture Code made by Statutes 1998, chapter 752 (SB 1785<sup>18</sup>). The purpose of the test claim statute was to carry out the state policy that “no adoptable animal should be euthanized if it can

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<sup>5</sup> Exhibit A, IRC, page 593 (Form FAM-27).

<sup>6</sup> Exhibit A, IRC, page 614 (Form FAM-27).

<sup>7</sup> Exhibit A, IRC, page 641 (Form FAM-27).

<sup>8</sup> Exhibit B, Controller’s Late Comments on the IRC, page 5.

<sup>9</sup> Exhibit A, IRC, page 468.

<sup>10</sup> Exhibit A, IRC, pages 524-539 (Letter from Dan Morrison to James Spano, dated June 4, 2012, pages 1-16).

<sup>11</sup> Exhibit A, IRC, page 464 (cover letter), pages 463-540 (Final Audit Report).

<sup>12</sup> Exhibit A, IRC, pages 1, 2.

<sup>13</sup> Exhibit B, Controller’s Late Comments on the IRC, page 1.

<sup>14</sup> Exhibit C, Claimant’s Late Rebuttal Comments, page 1.

<sup>15</sup> Exhibit E, Draft Proposed Decision.

<sup>16</sup> Exhibit F, Controller’s Comments on the Draft Proposed Decision.

<sup>17</sup> Exhibit G, Claimant’s Late Comments on the Draft Proposed Decision.

<sup>18</sup> Sometimes referred to as the Hayden Bill.

be adopted into a suitable home” and “no treatable animal should be euthanized.”<sup>19</sup> Generally, the program increases the holding period to allow for the adoption and redemption of stray and abandoned dogs, cats, and other specified animals before the local agency can euthanize the animal, and requires:

- verification of the temperament of feral cats;
- posting of lost and found lists;
- maintenance of records for impounded animals; and
- that impounded animals receive “necessary and prompt veterinary care.”

On January 25, 2001, the Commission partially approved the Test Claim, for the increased costs in performing the following activities only:

1. Providing care and maintenance during the increased holding period for impounded dogs and cats that are ultimately euthanized. The increased holding period shall be measured by calculating the difference between three days from the day of capture and four business days from the day after impoundment, as specified below in 3 (a) and 3 (b), or six business days from the day after impoundment (Food & Agr. Code, §§ 31108, 31752);
2. Providing care and maintenance for four business days from the day after impoundment, as specified below in 3 (a) and 3 (b), or six business days from the day after impoundment, for impounded rabbits, guinea pigs, hamsters, pot-bellied pigs, birds, lizards, snakes, turtles, or tortoises legally allowed as personal property that are ultimately euthanized (Food & Agr. Code, § 31753);
3. For dogs, cats, and other specified animals held for four business days after the day of impoundment, either:
  - (a) Making the animal available for owner redemption on one weekday evening until at least 7:00 p.m., or one weekend day; or
  - (b) For those local agencies with fewer than three full-time employees or that are not open during all regular weekday business hours, establishing a procedure to enable owners to reclaim their animals by appointment at a mutually agreeable time when the agency would otherwise be closed (Food & Agr., Code §§ 31108, 31752, and 31753);
4. Verifying whether a cat is feral or tame by using a standardized protocol (Food & Agr. Code, § 31752.5);
5. Posting lost and found lists (Food & Agr. Code, § 32001);
6. Maintaining records on animals that are not medically treated by a veterinarian, but are either taken up, euthanized after the holding period, or impounded (Food & Agr. Code, § 32003); and

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<sup>19</sup> Civil Code section 1834.4, Penal Code section 559d, and Food and Agricultural Code section 17005 as added or amended by Statutes 1998, chapter 752.

7. Providing “necessary and prompt veterinary care” for abandoned animals, other than injured cats and dogs given emergency treatment, that are ultimately euthanized (Civ. Code, §§ 1834 and 1846).<sup>20</sup>

The Commission first addressed the Parameters and Guidelines for *Animal Adoption* at its August 23, 2001, hearing, but the matter was continued for further public comment and analysis.<sup>21</sup> The Commission adopted the first set of Parameters and Guidelines for this program on February 28, 2002.<sup>22</sup> The Parameters and Guidelines were then re-issued as corrected on March 20, 2002.<sup>23</sup> The 2002 Parameters and Guidelines, in addition to the activities identified in the Test Claim Statement of Decision, provide reimbursement for one-time activities of developing policies and procedures; training; and developing or procuring computer software for maintaining records; as well as:

- Acquiring additional space by purchase or lease and/or construction of new facilities to provide appropriate or adequate shelter necessary to comply with the mandated activities during the increased holding period for impounded stray or abandoned dogs, cats, and other animals.<sup>24</sup>
- Remodeling/renovating existing facilities to provide appropriate or adequate shelter necessary to comply with the mandated activities during the increased holding period for impounded stray or abandoned dogs, cats, and other animals.<sup>25</sup>

Section VI. of the Parameters and Guidelines also require claimants to provide source documents that show the evidence of the validity of such costs and their relationship to the mandate. The supporting documentation must be kept on file by the agency during the audit period required by Government Code section 17558.5. In this respect, claimants are required by Food and Agriculture Code section 32003 to maintain records on animals that are taken up, euthanized, or impounded. Such records shall identify the date the animal was taken up, euthanized, or impounded; the circumstances surrounding these events; and the names of the personnel performing these activities.

On March 12, 2003, the Joint Legislative Audit Committee authorized an audit of the *Animal Adoption* mandate, which was completed by the Bureau of State Audits on October 15, 2003. The audit report recommended that the Legislature direct the Commission to amend the Parameters and Guidelines of the *Animal Adoption* mandate to correct the formula for determining the reimbursable portion of acquiring additional shelter space. In 2004, AB 2224

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<sup>20</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 74-75 (Statement of Decision, *Animal Adoption*, adopted Jan. 25, 2001, pages 37-38).

<sup>21</sup> Exhibit H, Staff Analysis and Proposed Parameters and Guidelines, Item 8, August 23, 2001.

<sup>22</sup> Exhibit A, IRC, page 109 (2002 Parameters and Guidelines, page 1).

<sup>23</sup> Exhibit A, IRC, page 109 (2002 Parameters and Guidelines, page 1).

<sup>24</sup> Exhibit A, IRC, page 111 (2002 Parameters and Guidelines, page 3).

<sup>25</sup> Exhibit A, IRC, page 113 (2002 Parameters and Guidelines, page 5).

(Stats. 2004, ch. 313) was enacted to direct the Commission to amend the Parameters and Guidelines for the *Animal Adoption* program to:

1. Amend the formula for determining the reimbursable portion of acquiring or building additional shelter space that is larger than needed to comply with the increased holding period to specify that costs incurred to address preexisting shelter overcrowding or animal population growth are not reimbursable.
2. Clarify how the costs for care and maintenance shall be calculated.
3. Detail the documentation necessary to support reimbursement claims under this mandate, in consultation with the Bureau of State Audits and the Controller's office.

On January 26, 2006, the Commission adopted the Parameters and Guidelines Amendment, applicable to claims beginning July 1, 2005, in accordance with AB 2224, to require, among other things, contemporaneous source documents to show the validity of costs claimed and their relationship to the reimbursable activities.<sup>26</sup> The 2006 amendment also clarified the definition of "average daily census" of dogs and cats, for purposes of the formula used to calculate care and maintenance costs; this amendment is clarifying only, and does not affect the methodology used to calculate actual costs for this component.<sup>27</sup>

#### The Controller's Audit and Reduction of Costs

Costs of \$2,316,724 for the mandated program were claimed during the audit period (fiscal years 2001-2002, 2002-2003, 2006-2007, 2007-2008, and 2008-2009), which were reduced by \$1,556,633.<sup>28</sup>

The Controller determined that the claimant combined and claimed costs for at least four cost components of the program under the cost component of care and maintenance.<sup>29</sup> The claimant calculated costs by adding up the costs incurred in its Animal Shelter Division, Kennel Division, and Veterinary Division, adding in indirect costs, subtracting the cost of euthanasia supplies, and then dividing the total by the average daily census of animals. The claimant's methodology included costs for maintaining lost and found lists, maintaining non-medical records, feral cat review, and necessary and prompt veterinary care. The Controller concluded, however, that the reimbursable costs for the other cost components are not determined in the same manner as the costs for care and maintenance. In addition, the expenditures claimed included activities that are not reimbursable.

Although the Controller originally found that all costs claimed were unallowable because the claimant did not comply with the Parameters and Guidelines, the Controller worked with the claimant's representatives during the course of the audit in order to determine the procedures followed to perform the reimbursable activities. The Controller allowed time studies supporting four different cost components during the course of the audit and calculated allowable costs

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<sup>26</sup> Exhibit A, IRC, pages 252-271 (2006 Parameters and Guidelines, pages 1-20).

<sup>27</sup> Exhibit H, Final Staff Analysis and Proposed Parameters and Guidelines Amendment, Item 11, January 26, 2006.

<sup>28</sup> Exhibit A, IRC, page 471 (Final Audit Report, page 6) (Summary chart).

<sup>29</sup> Exhibit A, IRC, page 475 (Final Audit Report, page 10).

based on agency-provided documentation. In its Final Audit Report, the Controller made the following principal findings:

Finding 1: The claimant overstated care and maintenance costs, resulting in a reduction of \$1,760,618.<sup>30</sup>

The Controller found, as described below, that the claimant used the actual cost method for claiming care and maintenance costs, but did not claim allowable salary and benefit costs; claimed unallowable material and supply costs; estimated the yearly census of animals; incorrectly calculated the number of stray dogs, cats, and other eligible animals that died during the increased holding period or were ultimately euthanized; and understated the number of reimbursable days.

- Salary and benefit costs. During the audit, the claimant provided actual salary and benefit costs for the audit period for three positions (animal care technicians, senior animal care technicians, and lead animal care technicians) that provide care and maintenance to the animals housed at the shelter. However, only a percentage of shelter staff time is devoted to care and maintenance. The claimant estimated that 89 percent of the animal care technician's and senior animal care technician's time and 60 percent of the lead animal care technician's time was devoted to care and maintenance. The Controller determined that the estimated percentages appeared reasonable based on the job descriptions provided.<sup>31</sup> Thus, the Controller multiplied the actual salary and benefit amounts provided by the claimant by the percentage of time spent on mandated care and maintenance activities, resulting in allowable salaries and benefits of \$952,445.<sup>32</sup>
- Material and supply costs of \$7,690,644 were overstated by the claimant. The Controller, allowing \$288,726 in materials and supplies, determined that the claimant included total costs incurred to operate the shelter (such as shelter, kennel, veterinary, and administrative divisional expenses) instead of claiming costs specifically incurred to care for and maintain the animals. The Controller determined the allowable costs by reviewing the claimant's account #140 (special activities supplies for shelter operations). The claimant indicated that account #140 is used specifically for the expenses related to the care and maintenance of animals and includes costs for animal food, cat litter, light bulbs, and cleaning supplies, and does not include expenses that are not eligible for

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<sup>30</sup> Exhibit A, IRC, pages 476-500 (Final Audit Report, page 11-35).

<sup>31</sup> Exhibit B, Controller's Late Comments on the IRC, pages 15, 109-137 (Controller's Analysis and Response, page 9 and Tab 6). The Controller noted a minor transpositional error (identifying 103 eligible other animals for the Care and Maintenance Cost component in the Final Audit Report when the audit work papers support only 100 such animals in Tab 6). Exhibit F, Controller's Comments on the Draft Proposed Decision, page 13. The Commission trusts that the Controller will reinstate the costs that were incorrectly reduced as a result of this error.

<sup>32</sup> Exhibit A, IRC, page 479 (Final Audit Report, page 14).

reimbursement (such as euthanasia medication, microchip expenses, and medical supplies).<sup>33</sup>

- Yearly animal census refers to the total number of days that all animals are housed in the shelter. The claimant estimated the yearly census by assuming that the animals were held an average of five days in fiscal years 2001-2002 and 2002-2003, an average of seven days in fiscal years 2006-2007 and 2007-2008, and an average of six days in fiscal year 2008-2009. The Controller reviewed the claimant's Paw Trax software system, which detailed the actual total annual census of animals housed in the claimant's animal shelter in fiscal years 2006-2007 through 2008-2009. Since the information was not available for fiscal years 2001-2002 and 2002-2003, the Controller used an average of the information from fiscal years 2006-2007 through 2008-2009 for those earlier years. The Controller's recalculation resulted in an increase of yearly census numbers.<sup>34</sup>
- The Controller found that number of eligible dogs, cats, and other animals that died during the increased holding period or were ultimately euthanized was overstated by the claimant. To verify the eligible animal population claimed for reimbursement of care and maintenance costs, the Controller ran a query from the claimant's Paw Trax system for fiscal years 2006-2007 and 2008-2009, and then applied an average number from that data to the earlier fiscal years for which no data was maintained. The Controller allowed reimbursement for eligible dogs and cats that died during the increased holding period (on days 4, 5, and 6), or were ultimately euthanized on day 7 or later; and "eligible" other animals that died during the increased holding period (on days 2, 3, 4, 5, and 6, or were ultimately euthanized on day 7 or later). The Controller did not count as an eligible animal, animals that died on day 1 because they were most likely irremediably suffering or were too severely injured to move, and it was likely more humane to dispose of the animal than to hold it; animals that were euthanized during the holding period; and animals that died of natural causes after the required holding period.<sup>35</sup>
- Applying the court's decision in *Purifoy v. Howell* (2010) 183 Cal.App.4th 166, which held that Saturday is not a business day for purposes of calculating the number of days in the required holding period, the Controller calculated an *average* increased holding period for all dogs and cats to be three days, and the average increased holding period for all other "eligible" animals to be six days,<sup>36</sup> and found that the claimant understated the number of reimbursable days, resulting in increased reimbursement for the claimant. "We performed an alternate analysis to determine the effect on the agency's allowable costs for care and maintenance had we considered Saturday as a business day. We performed this analysis for FY 2008-2009, the final year of the audit period. The results

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<sup>33</sup> Exhibit A, IRC, page 480 (Final Audit Report, page 15); Exhibit B, Controller's Late Comments on the IRC, pages 15, 109-137.

<sup>34</sup> Exhibit A, IRC, pages 480-481 (Final Audit Report, pages 15-16); Exhibit B, Controller's Late Comments on the IRC, pages 15, 109-137.

<sup>35</sup> Exhibit A, IRC, pages 481-482 (Final Audit Report, pages 16-17); Exhibit B, Controller's Late Comments on the IRC, pages 14-16.

<sup>36</sup> Exhibit B, Controller's Late Comments on the IRC, pages 137-138.



of this analysis revealed that allowable costs would decrease by \$15,953, from \$64,506 to \$48,553. This equates to a decrease in allowable costs of 24.7% if we included Saturday as a business day.”<sup>37</sup>

Finding 2: The claimant miscalculated holding period costs by including costs that were not related to making animals available for owner redemption, resulting in a reduction of \$466,978.<sup>38</sup>

The Parameters and Guidelines provide that an agency desiring to apply the shortened holding period is eligible for reimbursement for making animals available for owner redemption on one weekday evening until at least 7:00 p.m., or one weekend day; or, as otherwise specified in the statute. The claimant requested \$654,322 costs for the audit period for this component, by adding together expenditures of the shelter division and kennel division and a portion of the expenditures of the administration division and veterinary division. The claimant then divided the total expenditures by the total number of hours the facility was open for operation to arrive at a cost per hour. The cost per hour was multiplied by the additional hours the shelter was open for owner redemption.<sup>39</sup>

The Controller determined that this calculation is not correct and included costs beyond the scope of the mandated activity. The Controller states that the mandate is limited to keeping the shelter open for purposes of owner redemption. “We believe that other animal services such as animal control officer duties, euthanasia, spay and neutering procedures, implanting microchips, licensing, processing animal adoptions, and certain other animal services do not become temporarily reimbursable activities just because the animal shelter is open for extra hours to make animals available for owner redemption. These activities are not reimbursable under any cost component of the mandated program at any time.”<sup>40</sup>

The Controller recalculated costs based on documentation provided by the claimant identifying the hours of operation for its animal shelter, and the hours the claimant made animals available for owner redemption. On Saturdays, the claimant’s shelter was open from 8:00 a.m. to 5:00 p.m. However, the shelter made the animals available for owner redemption only from 10:00 a.m. to 5:00 p.m., for a total of seven hours per week. Based on information provided by the claimant, the Controller determined the employee classifications and the number of employees on duty specifically to make animals available for owner redemption. The Controller did not include other employees on duty that performed reimbursable activities relating to the other cost components of care and maintenance, lost and found lists, maintaining non-medical records, and necessary and prompt veterinary care. The Controller applied the allowable hours by each employee’s productive hourly and benefit rates and determined that \$187,344 is allowable for salary and benefits.<sup>41</sup>

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<sup>37</sup> Exhibit A, IRC, pages 494-495 (Final Audit Report, page 29); Exhibit B, Controller’s Late Comments on the IRC, pages 137-138, showing an increase in allowable reimbursable days for all fiscal years during the audit period.

<sup>38</sup> Exhibit A, IRC, pages 501-505 (Final Audit Report, pages 36-40).

<sup>39</sup> Exhibit A, IRC, page 501 (Final Audit Report, page 36).

<sup>40</sup> Exhibit B, Controller’s Late Comments on the IRC, page 26.

<sup>41</sup> Exhibit A, IRC, pages 502-503 (Final Audit Report, pages 37-38).

Finding 3: The claimant did not individually claim costs for lost and found lists since these costs were included in the calculation for care and maintenance; the Controller determined \$7,432 is reimbursable.<sup>42</sup>

The costs allowable are based on a time study that the claimant conducted during the course of the audit for the time spent performing the activities.

Finding 4: The claimant did not individually claim costs for maintaining non-medical records since these costs were included in the calculation for care and maintenance; the Controller determined \$86,633 is reimbursable.<sup>43</sup>

The costs allowable are based on a time study that the claimant conducted during the course of the audit for the time spent performing the activities.

Finding 5: The claimant did not individually claim costs for prompt and necessary veterinary care since these costs were included in the calculation for care and maintenance; the Controller determined \$82,487 is reimbursable.<sup>44</sup>

The costs allowable are based on a time study that the claimant conducted during the course of the audit based on the time taken to perform an initial physical exam and administer a wellness vaccine to “treatable” or “adoptable” animals for each “eligible animal.” The allowable material and supply costs are based on the actual costs of wellness vaccines administered to each “eligible” animal. The Controller defined “eligible animals” for this activity consistent with its recalculation for care and maintenance and the holding in the *Purifoy* case. Thus, the Controller allowed reimbursement for the cost of prompt and necessary veterinary care for dogs and cats that died during the increased holding period (on days 4, 5, and 6), or were ultimately euthanized on day 7 or later; and “eligible” other animals that died during the increased holding period (on days 2, 3, 4, 5, and 6, or were ultimately euthanized on day 7 or later. Prompt and necessary veterinary costs were not allowed for animals that died on day 1 because they were most likely irremediably suffering or were too severely injured to move; animals that were euthanized during the holding period; and animals that died of natural causes after the required holding period.

Finding 6: The claimant misstated its indirect costs; the Controller determined that \$336,205 was allowable.<sup>45</sup>

The reimbursement claims filed by the claimant included \$2,458,387 in overhead costs incurred by its animal shelter, kennel, and veterinary divisions. This amount was then included as part of the request for reimbursement for care and maintenance and increased holding period costs. The claimant’s calculation did not include overhead costs from its animal control and licensing/canvassing divisions. The Controller determined that including a component for overhead within a cost component is not an option outlined in the Parameters and Guidelines for claiming indirect costs. Instead, the Parameters and Guidelines state that claimants have the

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<sup>42</sup> Exhibit A, IRC, pages 506-507 (Final Audit Report, pages 41-42).

<sup>43</sup> Exhibit A, IRC, pages 508-510 (Final Audit Report, pages 43-45).

<sup>44</sup> Exhibit A, IRC, pages 511-515 (Final Audit Report, pages 46-50).

<sup>45</sup> Exhibit A, IRC, pages 516-520 (Final Audit Report, pages 51-55).

option of using 10 percent of direct labor, excluding fringe benefits, or preparing an Indirect Cost Rate Proposal (ICRP) pursuant to the Office of Management and Budget (OMB) Circular A-87.

The Controller recalculated indirect costs by working with the claimant's expenditure information from all six of its divisions during the audit period to develop an indirect cost rate proposal (ICRP) of 76.38 percent based on allowable salaries and benefits from all the divisions within the claimant's organization. The Controller found that indirect costs totaling \$336,205 were allowable.<sup>46</sup>

Finding 7: The claimant overstated offsetting revenue by \$158,206.<sup>47</sup>

This resulted in increased reimbursement to the claimant.

### **III. Positions of the Parties**

#### **A. Southeast Area Animal Control Agency**

The claimant objects to reductions totaling \$1,556,633 for fiscal years 2001-2002, 2002-2003, 2006-2007, 2007-2008, and 2008-2009, and seeks reinstatement of the entire amount reduced.

The claimant takes the following principal positions, which are more fully summarized in the analysis:

1. The claimant, a joint powers authority, possesses the standing to bring this IRC as a representative of its member cities and contracting cities.<sup>48</sup>
2. The California Court of Appeal's decision in *Purifoy v. Howell* should be applied prospectively only.<sup>49</sup>
3. The claimant acted reasonably when it utilized a self-created and unauthorized formula to calculate its reimbursable costs.<sup>50</sup> Instead of following the formula contained within the Parameters and Guidelines, the claimant used the costs of its shelter operations as its base in determining care and maintenance costs; from that base, the claimant then deducted unallowable line items (such as the costs of euthanasia) and then added the claimant's administrative costs.<sup>51</sup>
4. The Controller should not have reduced the costs associated with supervisory and other personnel working evening and weekend hours.<sup>52</sup> The claimant states that the Controller allows reimbursement for a "bare bones" level of staffing which includes only the shelter

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<sup>46</sup> Exhibit B, Controller's Late Comments on the IRC, page 34.

<sup>47</sup> Exhibit A, IRC, pages 521-522 (Final Audit Report, pages 56-57). The claimant does not object to Finding 7.

<sup>48</sup> Exhibit A, IRC, pages 63-64 (Letter from Sally Hazzard to Heather Halsey, dated July 17, 2015, pages 1-2).

<sup>49</sup> Exhibit A, IRC, pages 19-20 (Written Narrative, pages 4-5).

<sup>50</sup> Exhibit A, IRC, pages 4-18 (Written Narrative, pages 1-3 plus exhibits).

<sup>51</sup> Exhibit A, IRC, pages 4 (Written Narrative, page 1).

<sup>52</sup> Exhibit A, IRC, page 26 (Written Narrative, page 11).

personnel who deal directly with the public or the animals; this policy, the claimant argues, excludes supervisors and other necessary, but not front-line, personnel.<sup>53</sup>

5. The Controller should reinstate the claimant's animal care and maintenance costs incurred for animals which are euthanized *during* the increased holding period.<sup>54</sup>
6. The Controller should reinstate the animal care and maintenance costs incurred for animals which die of natural causes *after* the close of the increased holding period.<sup>55</sup>

The claimant filed comments on the Draft Proposed Decision, reiterating some of the arguments on the IRC and also arguing that:

7. It is "impossible" to comply with the 120-day deadline to submit claims.<sup>56</sup>
8. The claimant made a "good faith effort" to comply with the law.<sup>57</sup>
9. The Commission's standard of deference to the Controller is the equivalent of a "rubber stamp" which allows the Controller to "self-regulate."<sup>58</sup>

#### **B. State Controller's Office**

The Controller contends that it acted according to the law when it made reductions totaling \$1,556,633 to the claimant's reimbursement claims for fiscal years 2001-2002, 2002-2003, 2006-2007, 2007-2008, and 2008-2009. The Controller filed comments on the Draft Proposed Decision, contending that it applied the language of the Parameters and Guidelines "without exercising subjective interpretations"; the data in the claimant's PawTrax database makes it "impossible" to determine the claimant's reimbursement under the Commission's rule; using an average increased holding period days in the computation of allowable costs was a "reasonable and practical methodology"; and clarifying that, in this case, the Controller identified various other animals (such as ducks, rabbits, and doves) as eligible animals.<sup>59</sup>

The Controller's specific arguments with respect to each finding are summarized in the analysis.

#### **IV. Discussion**

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

Government Code section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to the local agency or school district. If the

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<sup>53</sup> Exhibit A, IRC, page 26 (Written Narrative, page 11).

<sup>54</sup> Exhibit A, IRC, pages 20-24 (Written Narrative, pages 5-9).

<sup>55</sup> Exhibit A, IRC, pages 27-28 (Written Narrative, page 1 and Mandated Costs Animal Adoption Claim Summary).

<sup>56</sup> Exhibit G, Claimant's Late Comments on the Draft Proposed Decision, pages 2-3.

<sup>57</sup> Exhibit G, Claimant's Late Comments on the Draft Proposed Decision, pages 3-5.

<sup>58</sup> Exhibit G, Claimant's Late Comments on the Draft Proposed Decision, pages 5-7.

<sup>59</sup> Exhibit F, Controller's Comments on the Draft Proposed Decision, pages 7-13.

Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9 of the Commission's regulations requires the Commission to send the Decision to the Controller and request that the costs in the claim be reinstated.

The Commission must review questions of law, including interpretation of the Parameters and Guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6, of the California Constitution.<sup>60</sup> The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."<sup>61</sup>

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.<sup>62</sup> Under this standard, the courts have found:

When reviewing the exercise of discretion, "[t]he scope of review is limited out of deference to the agency's authority and presumed expertise: 'The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]' " ... "In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . ." [Citations.] When making that inquiry, the " "court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "<sup>63</sup>

The Commission must review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.<sup>64</sup> In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertions of fact by

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<sup>60</sup> *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

<sup>61</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

<sup>62</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space Dist.* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

<sup>63</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>64</sup> *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

the parties to an IRC must be supported by documentary evidence. The Commission’s ultimate findings of fact must be supported by substantial evidence in the record.<sup>65</sup>

**A. Southeast Area Animal Control Authority (SEAACA) Has Standing, as a Representative of the Cities Which Compose or Contracted with It, to Bring this IRC.**

The threshold issue before the Commission is whether SEAACA has standing to bring this IRC.<sup>66</sup> The claimant is a joint powers authority “comprised of 8 member cities and 6 contract cities in southeast Los Angeles County and north Orange County pooling their resources to provide animal control services via a joint powers authority created by eight Los Angeles County member cities for this purpose. At the time of the claim, SEAACA was comprised of 8 member cities and 3 contract cities in southeast Los Angeles County.”<sup>67</sup>

The Commission has authority to adjudicate an IRC filed “by a local agency or school district.”<sup>68</sup> A “local agency” is defined as “any city, county, special district, authority, or other political subdivision of the state.”<sup>69</sup> A “special district,” in turn, is defined as “any agency of the state that performs governmental or proprietary functions within limited boundaries,” a definition which “includes a county service zone, a maintenance district or area, an improvement district or improvement zone, or any other zone or area.”<sup>70</sup> “Joint powers authorities” however, are specifically not included within this definition and have a history with regard to state mandate claims.

In 1984, the Legislature added the definition of “special district” for purposes of establishing the mandates process and expressly included “a joint powers agency or authority” as a form of local agency which possessed the standing to bring a test claim.<sup>71</sup> The following year, the Legislature

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<sup>65</sup> Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission’s decision is not supported by substantial evidence in the record.

<sup>66</sup> In its late comments on the IRC (Exhibit B), the Controller did not raise the issue of whether the claimant has standing to file and maintain an IRC. The Commission — a quasi-judicial agency with limited jurisdiction — raises the issue sua sponte. (See, e.g., *In re: J.T.* (2011) 195 Cal. App. 4th 707, 710 [“We raised sua sponte the issue of sister’s standing to be heard on her claims and ordered supplemental briefing on that issue.”].)

<sup>67</sup> Exhibit A, IRC, page 63 [Letter from Sally Hazzard to Heather Halsey, dated July 17, 2015, page 1.].

<sup>68</sup> Government Code section 17551(d).

<sup>69</sup> Government Code section 17518.

<sup>70</sup> Government Code section 17520.

<sup>71</sup> Statutes 1984, chapter 1459, section 1 (adding Government Code section 17520, which read, “‘Special district’ means any agency of the state which performs governmental or proprietary functions within limited boundaries. ‘Special district’ includes a redevelopment agency, a joint powers agency or entity, a county service area, a maintenance district or area, an improvement

created the IRC procedure, allowing local agencies — which included special districts which, in turn, included “a joint powers agency or authority” — to bring an IRC.<sup>72</sup> Consequently, as of January 1, 1985, a joint powers authority had standing to bring an IRC.

Twenty years later, the Legislature removed the phrase “a joint powers agency or authority” from the definition of “special district.”<sup>73</sup>

Specifically, Assembly Bill 2856 deleted the text reading “a redevelopment agency, a joint powers agency or entity” from the statutory definition of “special district.”<sup>74</sup> The deletion was intentional since the deletion was mentioned at least three times in the subsequent legislative history of the bill.<sup>75</sup> Consequently, as of January 1, 2005, joint powers authorities no longer are a local government with standing to bring an IRC.

The deletion of statutory language and the legislative analyses stating that the deletion removes joint powers agencies from the definition of “special district” for purposes of Government Code section 17520 (mandates law) demonstrates that the Legislature intended to substantively alter the law and remove from the ambit of the state mandates process those classes of persons described in the deleted language. “Where the amendment of a statute consists of the deletion of an express provision, the presumption is that a substantial change in the law was intended.”<sup>76</sup> “Where the Legislature has deleted such language, apparently purposefully, the current version of the statute cannot be interpreted to include the rejected requirement. Reading in language that the Legislature chose to remove ... violates basic principles of statutory construction and impermissibly interferes with the legislative function.”<sup>77</sup>

The remaining text in the mandates statutes cannot be read to include joint powers authorities because such a reading would reduce the 2004 amendments to null surplusage. “In deference to the Legislature, we assume its acts do not produce meaningless results; therefore, we must construe the amendment as accomplishing something and not as an idle act.”<sup>78</sup>

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district or improvement zone, or any other zone or area. ‘Special district’ does not include a city, a county, a school district, or a community college district.”).

<sup>72</sup> Statutes 1985, chapter 179, section 5 (adding Government Code section 17551(c)).

<sup>73</sup> Statutes 2004, chapter 890, section 7 (amending Government Code section 17520).

<sup>74</sup> Exhibit H, AB 2856, as amended in Senate on August 5, 2004 ([http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill\\_id=200320040AB2856](http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=200320040AB2856)) as accessed on November 3, 2016.

<sup>75</sup> Exhibit H, Assembly Floor Analysis of AB 2856, as amended August 17, 2004, pages 1-2 (“The Senate amendments. . . . 5. Remove redevelopment agencies and joint powers agencies from the definition of ‘special district.’”).

<sup>76</sup> *Subsequent Injuries Fund v. Industrial Accident Commission* (1963) 59 Cal.2d 842, 844.

<sup>77</sup> *Commonwealth v. Porges* (2011) 460 Mass. 525, 530 [952 N.E.2d 917, 921].

<sup>78</sup> *R & P Capital Resources, Inc. v. California State Lottery* (1995) 31 Cal.App.4th 1033, 1038.

Consequently, as of January 1, 2005, joint powers agencies (also known as joint powers authorities) can no longer file or maintain IRCs in their own right.<sup>79</sup> However, a joint powers agency may file and maintain such an IRC in a representative capacity on behalf of its member and contracting cities. The Commission bases its conclusion on the following reasons.

The record reflects that, at the time of the relevant claim, the claimant was composed of eight member cities and also contracted with three cities for animal control services.<sup>80</sup> The purpose of a joint powers arrangement is to allow two or more public entities to jointly exercise a shared power,<sup>81</sup> and, in this case, each of the cities possesses the power to file and maintain an IRC.<sup>82</sup> In an unpublished opinion, the Second District of the California Court of Appeal held that a joint powers authority had standing to file and maintain a test claim before the Commission because the joint powers authority was acting on behalf of its constituent entities (which, in that particular case, were counties).<sup>83</sup> “Given that the joint powers agreement expressly authorized the EIA [Excess Insurance Authority] to exercise all of the powers common to counties in California, to do all acts necessary for the exercise of said powers, and to sue and be sued in its own name, we conclude that the joint powers agreement authorized the EIA to bring the test claims on behalf of its member counties, each of which qualifies as a local agency to bring a test claim under Government Code section 17518.”<sup>84</sup> While the Court of Appeal’s unpublished opinion is not

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<sup>79</sup> Although the instant IRC includes claims for costs incurred during two fiscal years which predated the 2004 amendment (specifically, fiscal years 2001-2002 and 2002-2003), a joint powers agency or authority would not have standing to maintain an IRC in its own capacity if — as is the case here — the standing law was amended before a final judgment was entered on the claims. “For a lawsuit properly to be allowed to continue, standing must exist at all times until judgment is entered and not just on the date the complaint is filed.” *Californians for Disability Rights v. Mervyn’s, LLC* (2006) 39 Cal.4th 223, 232-233. Here, SEAACA lacked standing to bring this IRC in its own capacity even on the day the IRC was filed (June 8, 2015), since the filing date was more than 10 years after the standing statute was amended.

<sup>80</sup> Exhibit A, IRC, page 63.

<sup>81</sup> “If authorized by their legislative or other governing bodies, two or more public agencies by agreement may jointly exercise any power common to the contracting parties, including, but not limited to, the authority to levy a fee, assessment, or tax, even though one or more of the contracting agencies may be located outside this state.” Government Code section 6502 (first sentence).

<sup>82</sup> Government Code section 17518 (“‘Local agency’ means any city . . . .”); Government Code section 17551(d) (“The commission . . . shall hear and decide upon a claim by a local agency . . . that the Controller has incorrectly reduced payments to the local agency . . . .”).

<sup>83</sup> Exhibit H, *CSAC Excess Insurance Authority v. Commission on State Mandates*, Case No. B188169, 2006 WL 3735551 (Cal. Court of Appeal Dec. 20, 2006) (nonpub. opn.).

<sup>84</sup> Exhibit H, *CSAC Excess Insurance Authority v. Commission on State Mandates*, Case No. B188169, 2006 WL 3735551 (Cal. Court of Appeal Dec. 20, 2006) (nonpub. opn.), page 44.



binding,<sup>85</sup> the Commission is persuaded by the Court of Appeal’s reasoning, particularly in light of the nearly identical factual and legal issues underpinning the standing analysis.

The same facts and reasoning apply to this IRC. By the Joint Powers Agreement dated July 1, 1997 (Agreement), the cities of Bell Gardens, Downey, Montebello, Norwalk, Paramount, Pico Rivera, Santa Fe Springs and South El Monte created the current version of claimant SEAACA.<sup>86</sup> The Agreement states that:

- The member cities are “empowered by law to perform animal control services” and that the agreement’s purpose is “to exercise such powers jointly.”<sup>87</sup>
- SEAACA shall possess “the powers common to the signatory cities” including “the undertaking of such activities as may be necessary in order to provide animal control services within serviced cities.”<sup>88</sup>
- SEAACA is “authorized in its own name to do all acts necessary for the exercise of said common powers for said common purpose, including, but not limited to . . . make and enter contracts, . . . and to be sued in its own name.”<sup>89</sup>

In addition, SEAACA represents that, at relevant times, additional cities contracted with SEAACA for animal control purposes.<sup>90</sup>

Thus, the claimant may *only* seek reimbursement of costs which were incurred by its member or contracting cities since joint powers authorities are not subject to the tax and spend limitation of the California Constitution and they were deliberately deleted by the Legislature from the statute’s list of eligible claimants. The claimant may *not* seek reimbursement of costs which were incurred by the claimant separately and apart from its member or contracting cities. Here, the claimant represents that its accounting records for the costs at issue in this IRC are maintained on a city-by-city basis.<sup>91</sup>

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<sup>85</sup> *Farmers Insurance Exchange v Superior Court (Wilson)* (2013) 218 Cal.App.4th 96, 109 (“nonpublished opinions have no precedential value”).

<sup>86</sup> Exhibit D, Claimant’s Response to the Request for Additional Information, Joint Exercise of Powers Agreement, dated July 1, 1997.

<sup>87</sup> Exhibit D, Claimant’s Response to the Request for Additional Information, Joint Exercise of Powers Agreement, dated July 1, 1997, Recital A and Section 1, pages 17, 19.

<sup>88</sup> Exhibit D, Claimant’s Response to the Request for Additional Information, Joint Exercise of Powers Agreement, dated July 1, 1997, Section 4, pages 21-22.

<sup>89</sup> Exhibit D, Claimant’s Response to the Request for Additional Information, Joint Exercise of Powers Agreement, dated July 1, 1997, Section 4, pages 21-22.

<sup>90</sup> Exhibit A, IRC, page 63.

<sup>91</sup> Exhibit A, IRC, page 63 (“If the Commission on State Mandates (CSM) and the State Controller’s Office (SCO) now wish to divide the costs between 11 separate cities and have us file 11 separate Incorrect Reduction Claims, we can do so as the data is tracked in detail.” [Letter from Sally Hazzard to Heather Halsey, dated July 17, 2015, page 1]).

Additionally, the IRC raises issues which, based on this record, apply to each of the member and contracting cities equally.

Consequently, the Commission finds that the claimant possesses the standing required to file and maintain this IRC — but only in its capacity as a representative of its member and contracting cities.

**B. The Controller’s Finding that the Claimant Failed to Abide by the Parameters and Guidelines when Calculating Reimbursable Costs, Is Correct As a Matter of Law and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.**

Parameters and Guidelines provide instructions for eligible claimants to prepare reimbursement claims for the direct and indirect costs incurred under a state-mandated program.<sup>92</sup> “Claims for direct and indirect costs filed pursuant to Section 17561 shall be filed in the manner prescribed in the parameters and guidelines. . . .”<sup>93</sup> The Parameters and Guidelines are regulatory, in that before their adoption, notice and an opportunity to comment on them are provided, and a full quasi-judicial hearing is held.<sup>94</sup> Once adopted, whether after judicial review or without it, the Parameters and Guidelines are final and binding on the parties. The Parameters and Guidelines may not be amended or set aside by the Commission absent a court order pursuant to Government Code section 17559, or a later request to amend the Parameters and Guidelines pursuant to section 17557, or a request for the adoption of a new test claim decision pursuant to section 17570.<sup>95</sup>

The fundamental fact of this IRC is that the claimant did not abide by the reimbursement formula in the Parameters and Guidelines. In the Final Audit Report, the Controller stated, “The agency used the Actual Cost method, although it did not follow the instruction contained in the parameters and guidelines of how to claim costs using this method.”<sup>96</sup> The Controller found that instead of categorizing costs within each of the various claim components recognized by the Parameters and Guidelines, the claimant lumped all costs into the care and maintenance cost component. “The agency used ALL costs incurred in its Animal Shelter Division (Division 2350), Kennel Division (Division 2541), and Veterinary Division (Division 2540), less euthanasia supplies plus indirect costs, under the assumption that all costs incurred in these divisions were totally related to the care and maintenance of animals.”<sup>97</sup>

The claimant admitted that it lumped the bulk of its claimed costs into the care and maintenance cost component and did not break out the costs into the various claim components required by the Parameters and Guidelines. “SEAACA’s accounting system separates their costs by functional units: Shelter Operations, Field Operations, Licensing, Veterinary Services and Administration. Since the purpose of the Shelter division is to care and maintain the animals, the

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<sup>92</sup> Government Code section 17557; California Code of Regulations, title 2, section 1183.7(e).

<sup>93</sup> Government Code section 17564, as amended by Statutes 1999, chapter 643.

<sup>94</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 799, 805, 808.

<sup>95</sup> *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

<sup>96</sup> Exhibit A, IRC, page 491 (Final Audit Report, page 26).

<sup>97</sup> Exhibit A, IRC, page 491 (Final Audit Report, page 26).

costs of the Shelter Operations division were taken as the base for calculating total care and maintenance costs. From the total expenditures of that division, unallowable items, such as euthanasia supplies, were deleted and additional agency wide overhead costs from the Administrative division were added.”<sup>98</sup>

The claimant argues that this self-created formula is reasonable and that it yields a cost per animal per day which is comparable to that of other animal services agencies.<sup>99</sup> The claimant further asserts, in comments on the Draft Proposed Decision, that the method used was the “actual cost method” because it uses actual salary and benefits, and actual expenditures of the Shelter Operations division.<sup>100</sup>

On this record, the Commission finds that the Controller’s conclusion that the claimant failed to abide by the Parameters and Guidelines is correct as a matter of law and is supported by evidence in the record. The Parameters and Guidelines provide for reimbursement of care and maintenance costs for impounded stray or abandoned animals that die during the increased holding period or are ultimately euthanized either by claiming actual costs or by performing a time study.<sup>101</sup> The actual cost method is a formula designed to reimburse a proportion of total care and maintenance costs based on the incremental increase in service (the increased holding period) and the animals for which no fees can be collected (animals that are not adopted, redeemed, or released to a nonprofit animal rescue organization). The Parameters and Guidelines provide that actual costs for dogs and cats shall be calculated as follows:

Actual Cost Method – Under the actual cost method, actual reimbursable care and maintenance costs per animal per day are computed for an annual claim period.

a) Determine the total annual cost of care and maintenance for all dogs and cats impounded at a facility. Total cost of care and maintenance includes labor, materials, supplies, indirect costs, and contract services.

b) Determine the average daily census of dogs and cats.<sup>102</sup>

c) Multiply the average daily census of dogs and cats by 365 = yearly census of dogs and cats.

d) Divide the total annual cost of care by the yearly census of dogs and cats = cost per animal per day.

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<sup>98</sup> Exhibit A, IRC, page 4. See also Exhibit B, Controller’s Late Comments on the IRC, page 14.

<sup>99</sup> Exhibit A, IRC, pages 4-5.

<sup>100</sup> Exhibit G, Claimant’s Late Comments on the Draft Proposed Decision, page 1-2.

<sup>101</sup> Exhibit A, IRC, pages 115-118 (2002 Parameters and Guidelines, pages 7-10); Exhibit A, IRC, pages 260-264 (2006 Parameters and Guidelines, pages 9-13).

<sup>102</sup> The quoted language is taken from the 2002 Parameters and Guidelines. (Exhibit A, IRC, page 115.) The 2006 Parameters and Guidelines are substantially the same and clarify that: “For purposes of claiming reimbursement under IV.B.3, average daily census is defined as the average number of all dogs and cats at a facility housed on any given day, in a 365-day period.” This amendment is clarifying only, and has no substantive effect on the methodology used to calculate actual costs. (Exhibit A, IRC, page 261 [2006 Parameters and Guidelines, page 10.]

e) Multiply the cost per animal per day, by the number of impounded stray or abandoned dogs and cats that die during the increased holding period or are ultimately euthanized, by each reimbursable day (the difference between three days from the day of capture, and four or six business days from the day after impoundment).<sup>103</sup>

For “other animals,” the actual cost formula is essentially the same, except that the number of reimbursable days is not counted as “the difference between three days ... and four or six business days.” Because there was no 72-hour holding period required under prior law for “other animals,” the “reimbursable days” multiplier is simply “four or six business days.”<sup>104</sup>

Thus, the actual cost formula requires the eligible annual cost of care for all animals to be divided by the yearly census of animals to arrive at an average cost per animal per day. The cost per animal per day is then multiplied by the eligible number of animals and the number of increased holding period days. By its own admission, the claimant did not abide by the Parameters and Guidelines. Instead of using the cost to care for animals as the base of the calculation, the claimant used all costs incurred by the shelter operations division, which includes costs that go beyond the scope of the mandate to care and maintain each eligible animal during the increased holding period. In addition, the claimant’s formula includes costs for other reimbursable components, which are not reimbursed based on this formula.

If the claimant wishes to be reimbursed under the *Animal Adoption* state mandate reimbursement program, the claimant is required to submit calculations using the formula specified in the Parameters and Guidelines, which are regulatory documents.<sup>105</sup>

Moreover, the cost per animal per day achieved by other animal service agencies is irrelevant and, pursuant to section 1187.5(a) of the Commission’s regulations, non-relevant evidence must be excluded as a basis for the Commission’s findings.<sup>106</sup> This IRC is about the costs which were claimed and substantiated by this claimant on this record. The Controller states that the actual cost method applied to the claimant was applied no differently than for other local agencies and was based on the actual cost information provided in the expenditure ledgers of the claimant.<sup>107</sup>

The Controller’s finding — that the claimant failed to abide by the Parameters and Guidelines — is therefore correct as a matter of law and supported by evidence in the record.<sup>108</sup>

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<sup>103</sup> Exhibit A, IRC, page 115 (2002 Parameters and Guidelines, page 7).

<sup>104</sup> Exhibit A, IRC, pages 116-118 (2002 Parameters and Guidelines, pages 8-10).

<sup>105</sup> *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, 799.

<sup>106</sup> California Code of Regulations, title 2, sections 1185.1 and 1187.5.

<sup>107</sup> Exhibit A, IRC, page 492 (Final Audit Report, page 27).

<sup>108</sup> In comments on the Draft Proposed Decision, the claimant argues that it is “impossible” for a claimant to comply with the 120-day reimbursement timeframe. (Exhibit G, Claimant’s Late Comments on the Draft Proposed Decision, page 2.) The 120-day timeframe is imposed by statute, specifically, Government Code section 17561(d). The Commission, which is an administrative agency, is prohibited from declaring a statute unenforceable or refusing to enforce it. (See Cal. Const. article III, section 3.5.) Moreover, the parties have not requested that the Parameters and Guidelines be amended to change the formula or to adopt some other reasonable

### C. The Controller's Recalculation of Costs Is Partially Correct.

#### 1. The Controller's Exclusions of What It Deems "Ineligible Animals" Are Partially Incorrect as a Matter of Law, and Are Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support, Resulting in Some Incorrect Reductions in Findings 1 and 5 of the Audit Report.

The Parameters and Guidelines for the *Animal Adoption* program authorize local agencies to claim reimbursement for the costs of care and maintenance during the increased holding period for impounded stray or abandoned animals that "die during the increased holding period or are ultimately euthanized," based on a formula for determining actual costs. The Parameters and Guidelines also authorize reimbursement for providing necessary and prompt veterinary care as specified in the Parameters and Guidelines during the holding period for stray and abandoned animals that "die during the increased holding period or are ultimately euthanized." Claimants are to calculate and claim their costs for these activities in part by determining the number of "stray or abandoned animals that die during the increased holding period or are ultimately euthanized," multiplied by the costs per animal per day. The Controller determined that the claimant overstated costs for care and maintenance (Finding 1) and necessary and prompt veterinary care (Finding 5) by overstating the number of eligible animals.<sup>109</sup>

"Eligible animals" under the test claim statutes means any stray or abandoned cat, dog, "rabbit, guinea pig, hamster, potbellied pig, bird, lizard, snake, turtle, or tortoise that is legally allowed as personal property."<sup>110</sup> The following animals are excluded from "eligible animals" by statute or because the Commission found there were no increased costs under Government Code section 17556(d) due to fee authority sufficient to cover the costs of the program:

- "Animals that are irremediably suffering from a serious illness or severe injury."<sup>111</sup>
- Animals too severely injured to move or where a veterinarian is not available, in the field, and it would be more humane to dispose of the animal.<sup>112</sup>
- "Newborn animals that need maternal care and have been impounded without their mother."<sup>113</sup>
- Animals for which fees sufficient to cover the costs of the program may be collected including:
  - Owner relinquished animals, and

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reimbursement methodology pursuant to Government Code sections 17518.5 and 17557. The Parameters and Guidelines, as adopted, are final and binding. (*California School Boards Association*, 171 Cal.App.4th 1183, 1201.)

<sup>109</sup> Exhibit B, Controller's Late Comments on the IRC, pages 7, 15.

<sup>110</sup> Food and Agriculture Code sections 31108, 31752 and 31753.

<sup>111</sup> Food and Agriculture Code section 17006.

<sup>112</sup> Penal Code sections 597.1(e) and 597f(d).

<sup>113</sup> Food and Agriculture Code section 17006.

- Animals that are ultimately redeemed, adopted, or released to a nonprofit animal rescue or adoption organization.<sup>114</sup>

The Controller, in its audit and recalculation of allowable costs for care and maintenance and necessary and prompt veterinary care, states that the following animals were excluded from the population of “eligible animals:”

- Dogs, cats, and other animals that were euthanized *during* the holding period. Local agencies are eligible to receive reimbursement for dogs, cats, and other animals that were euthanized after the holding period (day 7 of the holding period and beyond). This includes animals originally determined to be treatable and adoptable, but were euthanized during the increased holding period after becoming non-rehabilitable, and animals that were euthanized too early because the claimant counted Saturday as a business day.
- Dogs, cats, and other animals that died of natural causes *after* the increased holding period. The Parameters and Guidelines authorize reimbursement for care and maintenance and veterinary services only for animals that die during the increased holding period.<sup>115</sup>
  - a) *The exclusion of animals deemed treatable upon arrival at the shelter and later euthanized during the increased holding period because they became non-rehabilitable, is incorrect as a matter of law.*

The Controller excludes from reimbursement all costs incurred for the care and maintenance and prompt and necessary veterinary care of dogs, cats, and other animals that were euthanized *during* the increased holding period. The Controller contends that agencies are eligible to receive reimbursement to care for dogs and cats and other animals that were *euthanized after the holding period*. The Controller bases its finding to exclude these animals on the plain language of the Parameters and Guidelines, which provides that local agencies are eligible to receive reimbursement for care and maintenance costs and for necessary and prompt veterinary costs only for those animals “that die during the increased holding period or are ultimately euthanized.” The Controller maintains that these costs are only eligible for reimbursement for those animals that die of natural causes during the increased holding period or are euthanized

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<sup>114</sup> Exhibit A, IRC, page 116 (2002 Parameters and Guidelines, page 8) and pages 257-266 (2006 Parameters and Guidelines, pages 6-15).

<sup>115</sup> In the Draft Proposed Decision, Commission staff also concluded that the Controller may have incorrectly excluded “other animals” on the ground that the animal was wild. This finding was based on Exhibit B, Controller’s Late Comments on the IRC, page 136, which contains a chart prepared by the auditor, titled “Raw Data — Eligible Other Animals,” showing the raw data of eligible other animals held by the claimant for fiscal year 2008-2009, with an auditor note of “wild?” next to the lines for a rabbit, a dove, and ducks. In comments to the Draft Proposed Decision, the Controller confirmed that these animals, including all rabbits and birds legally allowed as personal property, were determined to be eligible by the Controller and were not excluded from the population of “eligible animals.” (Exhibit F, Controller’s Comments on the Draft Proposed Decision, page 13). The claimant has not disputed this assertion. Therefore, there is no issue regarding the exclusion of “wild” animals in this IRC.

after the increased holding period. Thus, the Controller argues, if an animal is euthanized during the increased holding period, then no costs for that animal are eligible for reimbursement.

The Commission finds, as described below, that the Controller's interpretation of the Parameters and Guidelines is not correct.

The Commission's Parameters and Guidelines are regulatory in nature, and must therefore be construed in accordance with the rules of regulatory interpretation.<sup>116</sup> The Commission's mission when construing a regulation is to determine the intended meaning of the regulation:

The fundamental rule of interpretation is to ascertain the intent of the agency issuing the regulation so as to effectuate the purpose of the law. (Citation.) To determine that intent, we turn first to the words of the regulation, giving effect to the usual meaning of the language used, while avoiding an interpretation which renders any language mere surplusage. (Citation.) When statutory language is clear, we must apply that language without indulging in interpretation.<sup>117</sup>

When a regulation is ambiguous, a tribunal may use extrinsic evidence to construe the regulation and discern its intended meaning.<sup>118</sup>

The Parameters and Guidelines provide that local agencies are eligible to receive reimbursement for care and maintenance and prompt and necessary veterinary costs only for those animals "that die during the increased holding period or are ultimately euthanized." The plain language of the phrase "animals that die during the increased holding period or are ultimately euthanized" is vague and ambiguous because the word "die" can include both death by natural causes and death by euthanasia. Since the plain language is not clear, it is necessary to review the decisions adopted by the Commission on this issue and the statutory scheme of the test claim statutes.

The phrase "ultimately euthanized" was used in the Test Claim Statement of Decision only to identify those animals whose owners are unknown or are not adopted, meaning that the costs for care, treatment, and veterinary services during the holding period for this group of animals could not be recovered by fee revenue. The Statement of Decision states in relevant part:

Fee Authority – Government Code Section 17556, Subdivision (d). Government Code section 17556, subdivision (d), provides that there shall be no costs mandated by the state if the local agency has the authority to levy service charges, fees, or assessments sufficient to pay for the mandated program.

In the present case, local agencies do have the authority, under certain circumstances, to assess fees upon the owner of an impounded animal for the care and maintenance of the animal. For example, pursuant to Civil Code section 2080, any public agency that takes possession of an animal has the authority to charge the owner, *if known*, a reasonable charge for saving and taking care of the animal.

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<sup>116</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal. App. 4th 794, 799.

<sup>117</sup> *Brewer v. Patel* (1993) 20 Cal.App.4th 1017, 1021.

<sup>118</sup> *Von Northdurft v. Steck* (2014) 227 Cal.App.4th 524, 532.

Similarly, Penal Code sections 597f and 597.1 also allow local agencies to pass on the costs of caring for abandoned or seized animals to their owners by providing that “the cost of caring for the animal shall be a lien on the animal until the charges are paid.”

Moreover, Penal Code section 597f allows the cost of hospital and emergency veterinary services provided for impounded animals to be passed on to the owner, if known. [Footnote omitted.]

The fee authority granted under the foregoing authorities applies only if the owner is known. Thus, local agencies have the authority to assess a fee to care and provide treatment for animals relinquished by their owners pursuant to Food and Agriculture Code section 31754. Local agencies also have the authority to assess a fee for the care and treatment of impounded animals that are ultimately redeemed by their owners. Under such circumstances, the Commission finds that the fee authority is sufficient to cover the increased costs to care, maintain, and provide necessary veterinary treatment for the animal during the required holding period since the “cost of caring” for the animal can be passed on to the owner.

Accordingly, pursuant to Government Code section 17556, subdivision (d), the Commission finds that there are no costs mandated by the state for the care, maintenance and necessary veterinary treatment of animals relinquished by their owners or redeemed by their owners during the required holding period.

The Commission further finds that there are no costs mandated by the state under Government Code section 17556, subdivision (d), for the care, maintenance, and treatment of impounded animals that are ultimately adopted by a new owner; for the care, maintenance, and treatment of impounded animals that are requested by a nonprofit animal rescue or adoption organization; or for the administrative activities associated with releasing the animal to such organizations.

The test claim legislation gives local agencies the authority to assess a standard adoption fee, in addition to any spay or neuter deposit, upon nonprofit animal rescue or adoption organizations that request the impounded animal prior to the scheduled euthanization of the animal. [Footnote omitted.]

The claimant contends that the “standard adoption fee” is not sufficient to cover the costs for animals adopted or released to nonprofit animal rescue or adoption organizations. However, based on the evidence presented to date, the Commission finds that local agencies are not prohibited by statute from including in their “standard adoption fee” the costs associated with caring for and treating impounded animals that are ultimately adopted by a new owner or released to nonprofit animal rescue or adoption organizations, and the associated administrative costs. Rather, local agencies are only prohibited from charging nonprofit animal rescue or adoption organizations a higher fee than the amount charged to individuals seeking to adopt an animal.

However, the fees recovered by local agencies under the foregoing authorities do *not* reimburse local agencies for the care and maintenance of stray or abandoned



animals, or the veterinary treatment of stray or abandoned animals (other than cats and dogs) during the holding period required by the test claim legislation when:

- The owner is unknown;
- The animal is not adopted or redeemed; or
- The animal is not released to a nonprofit animal rescue or adoption organization.

*Thus, the fee authority is not sufficient to cover the increased costs for care, maintenance, and treatment during the required holding period for those animals that are ultimately euthanized.* Under such circumstances, the Commission finds that that Government Code section 17556, subdivision (d), does not apply to deny this claim. Rather, local agencies may incur increased costs mandated by the state to care for these animals during the required holding period.<sup>119</sup>

There was no discussion of animals that die during the increased holding period in the Test Claim Statement of Decision.

During the adoption of the Parameters and Guidelines, however, the County of Fresno requested reimbursement for animals that die during the increased holding period while being held pending adoption or euthanization as follows:

Fresno County recommends that reimbursements that apply to animals that are ultimately euthanized also apply to those animals that die while being held pending adoption or euthanization. If the animal dies pending adoption, obviously no adoption fees can be paid, and thus there is no revenue pertaining to that animal. If the animal dies pending euthanasia, the animal still had to be held until its untimely demise.<sup>120</sup>

The staff analysis adopted for the Parameters and Guidelines agreed with the request as follows:

If a stray or abandoned animal dies during the time an agency is required to hold that animal, the agency would still be required by the state to incur costs to care and maintain the animal, and to provide “necessary and prompt veterinary care” for the animal before the animal died. The agency cannot recover those costs from the adoptive owner since the animal was never adopted or released to a nonprofit adoption organization. Thus, staff agrees with the County that these costs are eligible for reimbursement.<sup>121</sup>

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<sup>119</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 66-67 (Test Claim Statement of Decision, pages 29-30 [emphasis added]).

<sup>120</sup> Exhibit H, Staff Analysis and Proposed Parameters and Guidelines, Item 4, February 28, 2002, page 83.

<sup>121</sup> Exhibit H, Staff Analysis and Proposed Parameters and Guidelines, Item 4, February 28, 2002, page 84.

Thus, the Parameters and Guidelines define the mandated population of animals for purposes of calculating reimbursement for the care and maintenance, and necessary and prompt veterinary care, as those that “die during the holding period or are ultimately euthanized.”

However, neither the Parameters and Guidelines, nor the analyses adopted for the Parameters and Guidelines, define what it means to “die” during the holding period. And the decisions do *not* limit reimbursement to animals that die of natural causes during the increased holding period. Such a limitation would be contrary to the statutory scheme.

Food and Agriculture Code section 17006 provides that the holding period does not apply to animals that are irremediably suffering from a serious illness or severe injury or to newborn animals that need maternal care and have been impounded without their mothers. Such animals may be euthanized without being held for owner redemption or adoption. A related statute addresses the issue of a “treatable” animal’s health changing over the course of impoundment. Food and Agricultural Code section 17005 reads in its entirety:

(a) It is the policy of the state that no adoptable animal should be euthanized if it can be adopted into a suitable home. Adoptable animals include only those animals eight weeks of age or older that, at or subsequent to the time the animal is impounded or otherwise taken into possession, have manifested no sign of a behavioral or temperamental defect that could pose a health or safety risk or otherwise make the animal unsuitable for placement as a pet, and have manifested no sign of disease, injury, or congenital or hereditary condition that adversely affects the health of the animal or that is likely to adversely affect the animal's health in the future.

(b) *It is the policy of the state that no treatable animal should be euthanized. A treatable animal shall include any animal that is not adoptable but that could become adoptable with reasonable efforts.* This subdivision, by itself, shall not be the basis of liability for damages regarding euthanasia.<sup>122</sup>

Section 17005, thus, expressly contemplates an animal’s health changing over the course of impoundment. Read together with section 17006, the two statutes require a shelter to hold an animal which is ill or injured— but not an animal which is irremediably suffering — for the relevant holding period on the ground that the animal’s health may improve. The stated intent of the test claim statute was to require shelters to care for all pets and to shift the focus from euthanasia to owner redemption or adoption:

According to the author, the purpose of this bill is: (1) to make it clear that animal shelters and private individuals have the same responsibility to animals under their care; (2) to reduce the number of adoptable animals euthanized at shelters by shifting the focus of shelters from killing to owner redemption and adoption; (3) to give owner-relinquished pets the same chance to live as stray animals by providing for uniform holding periods; (4) to establish clearer guidelines for the care and treatment of animals in shelters; and (5) *to require shelters to care for all pets.*

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<sup>122</sup> Emphasis added.

*The author argues that too many adoptable animals are euthanized by shelters and that the proposed changes will decrease the frequency of this tragedy.* Further, the author argues that taxpayers who own legally allowed pets other than cats and dogs should be treated the same as taxpayers who own cats and dogs.<sup>123</sup>

Consistent with the statutory scheme, the Parameters and Guidelines expressly contemplate an animal's health changing over the course of impoundment from "treatable" to "adoptable." Section IV. (B)(8) of the Parameters and Guidelines allows reimbursement for the initial physical examination of a stray or abandoned animal to determine the animal's baseline health status and classification as "adoptable, treatable, or non-rehabilitatable." The Parameters and Guidelines further authorize reimbursement for the administration of a wellness vaccine to "treatable" or "adoptable" animals, veterinary care to stabilize and/or relieve the suffering of a "treatable" animal, and veterinary care intended to remedy any applicable disease, injury, or congenital or hereditary condition that adversely affects the health of a "treatable" animal until the animal becomes "adoptable."

Even with veterinary care, the condition of the animal can change during the increased holding period and the animal can become non-rehabilitatable. If that occurs, the animal is not "adoptable" or "treatable" and may be euthanized under the law. Therefore, to deny reimbursement for the costs incurred during the increased holding period for an animal that becomes non-rehabilitatable and that has to be euthanized during, but before the end of, the increased holding period conflicts with the test claim statute and the Parameters and Guidelines. The Commission finds that reimbursement is required under these circumstances.

Therefore, to the extent the Controller's reduction includes costs incurred for the care and maintenance and prompt and necessary veterinary costs of stray or abandoned dogs, cats, and other animals that were initially classified as "adoptable" or "treatable," but became non-rehabilitatable and were euthanized during, but before the expiration of, the increased holding period, the reduction is incorrect as a matter of law.

In its comments on the Draft Proposed Decision, the Controller avers that the evidence created and stored by the claimant on its PawTrax database makes it "simply impossible" for the Controller to identify animals which fall into this category.<sup>124</sup> The Controller states the following:

Shelters across the State will delay euthanizing animals prematurely, as required by this mandate. This was evident from reviewing the animal records and statistics during the course of the audits for the Animal Adoption program. However, it is impossible to determine whether the animals euthanized for medical reasons would fit in the hypothetical scenario described in the DPD.<sup>125</sup>

The Controller also admits that the shelters' veterinarian could have records on the issue, but that such a review would be "most-time consuming:"

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<sup>123</sup> Exhibit H, Senate Judiciary Committee, Analysis of SB 1785 [1997-1998 Regular Session] as amended April 14, 1998, pages 118-119, emphasis added.

<sup>124</sup> Exhibit F, Controller's Comments on the Draft Proposed Decision, page 8.

<sup>125</sup> Exhibit F, Controller's Comments on the Draft Proposed Decision, page 8.

Hypothetically, the shelters' veterinarian could have records with such specific analysis as whether the animal was initially considered treatable and then changed to non-rehabilitatable. However, this task would be most-time consuming, without the potential of leading to any material results. We believe that such an exercise would be impractical and would include subjective bias.<sup>126</sup>

As indicated above, the Controller excluded from reimbursement *all* costs incurred for the care and maintenance and prompt and necessary veterinary care of dogs, cats, and other animals that were euthanized *during* the increased holding period, without determining whether those animals were initially classified as "adoptable" or "treatable," but became non-rehabilitatable and were euthanized during the increased holding period. Thus, the exclusion of all animals that were euthanized during the increased holding period is incorrect as a matter of law and is arbitrary, capricious, and entirely lacking in evidentiary support.

The record, does not identify how many animals were initially classified as "adoptable" or "treatable," but became non-rehabilitatable and were euthanized during the increased holding period. And the Controller's contention that another review of the record to determine the number of animals in this category would not lead to any material results, is not supported by the record and does not correct the Controller's error of law or lack of evidence in the record to support its reduction of these costs.

Nevertheless, reimbursement for the care and maintenance and veterinary costs for these animals is required only if the claimant has documentation to support the validity of the costs incurred for these animals. Section VI. of the Parameters and Guidelines require claimants to provide source documents that show the evidence of the validity of such costs and their relationship to the mandate. The supporting documentation must be kept on file by the agency during the audit period required by Government Code section 17558.5. In this respect, claimants are required by Food and Agriculture Code section 32003 to maintain records on animals that are taken up, euthanized, or impounded. Such records shall identify the date the animal was taken up, euthanized, or impounded; the circumstances surrounding these events; and the names of the personnel performing these activities. The Parameters and Guidelines also expressly authorize reimbursement for the initial physical examination of a stray or abandoned animal to determine the animal's baseline health status and classification as "adoptable, treatable, or non-rehabilitatable." Thus, as the Controller speculates, the claimant should have veterinary records to determine if a stray or abandoned animal was initially classified as adoptable or treatable, and falls within this category of eligible animals. If the claimant has no documentation to support these costs, reimbursement under the Parameters and Guidelines is not required. However, if claimant has such documents, the Controller's office must reinstate the costs incorrectly reduced since claimant is entitled to *all* of its costs mandated by the state.

Accordingly, *to the extent* the Controller's reduction includes costs incurred for the care and maintenance and prompt and necessary veterinary costs of stray or abandoned dogs, cats, and other animals that were initially classified as "adoptable" or "treatable," but became non-rehabilitatable and were euthanized during, the increased holding period, the reduction is incorrect as a matter of law.

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<sup>126</sup> Exhibit F, Controller's Comments on the Draft Proposed Decision, page 8.

- b) *The Commission and the Controller are bound by the Purifoy decision and, thus, the Controller's exclusion of animals that were euthanized too early, and during the holding period, because Saturday was counted as a business day for the required holding period, is correct as a matter of law. However, the Controller's recalculation of costs using an average number of reimbursable days is incorrect as a matter of law to the extent it results in an exclusion of "eligible animals" held for the time required under Purifoy.*

As indicated above, the Controller only included as eligible animals those dogs, cats, and other animals "euthanized after the holding period."<sup>127</sup> Animals may have been euthanized during the holding period because of claimant's misinterpretation of the required holding period in conflict with the Court of Appeal's decision in *Purifoy*, which held that Saturday is not a "business day" for purposes of calculating the required holding period under the test claim statutes before a stray or abandoned dog can be adopted or euthanized.<sup>128</sup> Before the decision was issued, many local agencies were operating under the assumption that, so long as they were open on Saturday, Saturday was a "business day" that could be counted as part of the holding period, which resulted in the euthanization of some animals too early and during the holding period.<sup>129</sup> Pursuant to the *Purifoy* decision, the Controller excluded those animals from the number of "eligible animals that die during the holding period or are ultimately euthanized" for purposes of calculating reimbursable costs for care and maintenance and necessary and prompt veterinary care. The Controller describes the effect of its recalculation under *Purifoy* with respect to care and maintenance costs in the Final Audit Report as follows:

The agency's comments are based on an assumption that allowable costs decreased because we determined that Saturday was not to be treated as a business day at any time during the audit period. We performed an alternate analysis to determine the effect on the agency's allowable costs for care and maintenance had we considered Saturday as a business day. We performed this analysis for FY 2008-09, the final year of the audit period. The results of this analysis revealed that allowable costs would decrease by \$15,953, from \$64,506 to \$48,553. This equates to a decrease in allowable costs of 24.7% if we included Saturday as a business day.

For purposes of this revised calculation, we reinstated all animals that were euthanized on day 6 of the holding period as "eligible animals" and reduced the number of reimbursable days from 6 days to 5 days for "other animals" and from 3 days to 2 days for dogs and cats.

The table below summarizes the differences in allowable care and maintenance costs for FY 2008-09:

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<sup>127</sup> Exhibit A, IRC, page 481 (Final Audit Report, page 16).

<sup>128</sup> *Purifoy v. Howell* (2010) 183 Cal.App.4th 166.

<sup>129</sup> Exhibit A, IRC, page 494 (Final Audit Report, page 29).

	Saturday--Not a Business Day		Saturday--A Business Day		
	Salaries & Benefits	Materials & Supplies	Salaries & Benefits	Materials & Supplies	
Dogs and cats:					
Cost per day	\$1.21	\$0.42	\$1.21	\$0.42	
Eligible dogs and cats	× 7,273	× 7,273	× 8,209	× 8,209	
Reimbursable days	× 3	× 3	× 2	× 2	
Subtotal	\$ 26,401	\$ 9,164	\$ 19,866	\$ 6,896	
Related indirect costs	20,165	6,999	15,174	5,266	
Total, dogs and cats	<u>\$ 46,566</u>	<u>\$ 16,163</u>	\$ 62,729	<u>\$ 35,040</u>	<u>\$ 12,162</u>
					\$ 47,202
Other animals:					
Cost per day	\$1.21	\$ 0.42	\$1.21	\$ 0.42	
Eligible other animals	× 103	× 103	× 103	× 94	
Reimbursable days	× 6	× 6	× 5	× 5	
Subtotal	748	\$ 260	569	\$ 197	
Related indirect costs	571	198	434	151	
Total, other animals	<u>\$ 1,319</u>	<u>\$ 458</u>	1,777	<u>\$ 1,003</u>	<u>\$ 348</u>
					1,351
Total allowable costs			<u>\$ 64,506</u>		<u>\$ 48,553</u>

The primary reason that allowable costs would go down is because the agency's animal shelter did not typically euthanize animals on day 6 of the required holding period. This means that the loss of one additional reimbursable day for the remaining population of animals outweighed the reinstatement of the animals euthanized on day 6 of the holding period as "eligible animals."<sup>130</sup>

The claimant does not comment or provide any specific argument to rebut the Controller's finding on the effect of the *Purifoy* decision, but generally protests the application of the decision. The claimant maintains that its calculation of the holding period was based on a reasonable interpretation of the test claim statute and the Parameters and Guidelines, and that the Controller's application of the *Purifoy* holding to recalculate the increased holding period, and the resulting adjustment to the population of eligible animals, is an unfair and unreasonable retroactive application of the law.<sup>131</sup>

Based on the evidence in the record, the Commission finds that the Controller's application of the *Purifoy* holding did not result in a reduction of costs in fiscal year 2008-2009 and, thus, the Commission makes no finding on the Controller's recalculation for that year.<sup>132</sup> In addition, the Controller increased reimbursable days for the holding period (from 5 days to 6 days for other animals, and from 2 days to 3 days for dogs and cats) as a result of the *Purifoy* decision, thereby

<sup>130</sup> Exhibit A, IRC, pages 494-495 (Final Audit Report, pages 29-30).

<sup>131</sup> Exhibit A, IRC, pages 19-20 (Written Narrative, pages 4-5).

<sup>132</sup> Government Code section 17551(d) gives the Commission jurisdiction only over a *reduction* of costs.

increasing costs. However, since the number of eligible animals is used as a multiplier in the calculation of actual costs for both cost components, then a decrease in the number of eligible animals would reduce costs.

As described below, the Commission finds that the court's interpretation of "business day" in *Purifoy* is binding, and that the Controller's exclusion of Saturday as a business day when calculating the increased holding period is correct as a matter of law. Thus, the Controller's exclusion of animals that were euthanized too early because Saturday was counted as a business day for the required holding period, is also correct as a matter of law. However, to the extent the Controller reduced costs for care and maintenance (Finding 1) for fiscal years 2001-2002, 2002-2003, 2006-2007, and 2007-2008, and necessary and prompt veterinary care (Finding 5) in all fiscal years of the audit period, using an average number of reimbursable days that results in an exclusion of "eligible animals" held for the time required under *Purifoy*, the recalculation and reduction of costs is not consistent with the Parameters and Guidelines and is, therefore, incorrect as a matter of law.

- 1) *The court's interpretation of "business day" in Purifoy is binding and, thus, the Controller's exclusion of Saturday as a business day when calculating the increased holding period is correct as a matter of law. Therefore, the exclusion of animals that were euthanized too early because Saturday was counted as a business day for the required holding period, is also correct as a matter of law.*

The court in *Purifoy* held that Saturday is not a "business day" for purposes of calculating the required holding period. In that case, Plaintiff Veena Purifoy's dog Duke was impounded on a Thursday, and adopted the following Wednesday by a new owner (Duke was returned to Purifoy). The shelter, Contra Costa County Animal Services, counted the required holding period for Duke under section 31108 beginning Friday (the day after impoundment), Saturday (day 2), Tuesday (day 3), and Wednesday (day 4). The shelter was closed on Sunday and Monday, and did not count those as business days, by its own admission.<sup>133</sup> The court examined the meaning of "business days" elsewhere in state law and in case law, and found that sometimes "business day" includes Saturdays, but sometimes it does not. The court reasoned that the purpose of the statute was to promote a longer holding period for animal adoption and redemption, and that excluding Saturday as a business day would generally mean extending the holding period by one day. Thus, the court held "in light of our obligation to choose a construction that most closely comports with the Legislature's intent and promotes, rather than defeats, the statute's general purposes, we conclude that 'business days' in section 31108(a) means Monday through Friday, the meaning most commonly used in ordinary discourse."<sup>134</sup> The court applied this interpretation to the case of Duke, and concluded that the shelter in question had not held the animal for the required number of business days before permitting his adoption to a new owner.<sup>135</sup>

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<sup>133</sup> *Purifoy v. Howell* (2010) 183 Cal.App.4th 166, 171-172.

<sup>134</sup> *Purifoy v. Howell* (2010) 183 Cal.App.4th 166, 182.

<sup>135</sup> *Purifoy v. Howell* (2010) 183 Cal.App.4th 166.

Thus, based on the *Purifoy* holding, a dog impounded on a Thursday, in a shelter that stays open weekend hours, would be subject to a four day holding period beginning on Friday, excluding Saturday and Sunday, and through the close of business on Wednesday; if the shelter counted Saturday as a business day, the holding period for the same dog would end a day earlier. The Controller maintains that application of the *Purifoy* decision is appropriate because the decision clarified the legal definition of a business day “as of the date that the applicable statute was enacted in 1998.”<sup>136</sup>

The claimant strenuously protests the Controller’s application of the *Purifoy* holding. The claimant maintains that its calculation of the holding period was based on a reasonable interpretation of the test claim statute and the Parameters and Guidelines, and that the Controller’s application of the *Purifoy* holding to recalculate the increased holding period, and the resulting adjustment to the population of eligible animals, is an unfair and unreasonable retroactive application of the law.<sup>137</sup>

The court’s interpretation of “business day” is binding. The interpretation of a statute is an exercise of the judicial power the Constitution assigned to the courts, and constitutes the authoritative statement of what the statute meant before as well as after the decision of the case giving rise to that construction.<sup>138</sup> This is why judicial decisions are normally said to have retroactive effect, because the court is interpreting the law, rather than making new law.<sup>139</sup> Moreover, where a judicial decision is limited to prospective effect, the court will exercise equitable authority and, based on the facts of a particular case, will so state that its decision operates prospectively only. Indeed, in the principal case cited by the claimants discussing retroactivity, the court explains that “[a] *court* may decline to follow the standard rule when retroactive application of a decision would raise substantial concerns about the effects of the new rule on the general administration of justice, or would unfairly undermine the reasonable reliance of parties on the previously existing state of the law.”<sup>140</sup> “In other words,” the Court continued, “*courts* have looked to the ‘hardships’ imposed on parties by full retroactivity, permitting an exception only when the circumstances of a case draw it apart from the usual run of cases.”<sup>141</sup> Unlike the courts, the Commission’s jurisdiction is limited, as a quasi-judicial agency created by statute, and the Commission has no authority to do equity.<sup>142</sup> Absent a statement by the court that *Purifoy* should be limited in its application, the Commission and the Controller are bound to apply the court’s definition of “business day” for purposes of the test claim statute particularly where, as here, it does not conflict with the Parameters and Guidelines. Under the doctrine of

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<sup>136</sup> Exhibit B, Controller’s Late Comments on the IRC, page 17.

<sup>137</sup> Exhibit A, IRC, pages 19-20.

<sup>138</sup> *McClung v. Employment Development Department* (2004) 34 Cal.4th 467, 473; *Carter v. California Department of Veteran Affairs* (2006) 38 Cal.4th 914, 922.

<sup>139</sup> See *Newman v. Emerson Radio Corp.*, (1989) 48 Cal.3d 973, 978 (“The general rule that judicial decisions are given retroactive effect is basic in our legal tradition.”).

<sup>140</sup> *Newman v. Emerson Radio Corp.*, (1989) 48, Cal.3d 973, 983, emphasis added.

<sup>141</sup> *Newman v. Emerson Radio Corp.*, (1989) 48 Cal.3d 973, 98, emphasis added.

<sup>142</sup> *Ferdig v. State Personnel Board* (1969) 71 Cal.2d 96, 103-104.



stare decisis, all tribunals exercising inferior jurisdiction are required to follow decisions of courts exercising superior jurisdiction.<sup>143</sup>

Furthermore, even though *Purifoy* only directly and expressly defines “business day” for purposes of section 31108 (the holding period for dogs), the court’s analysis and conclusion apply with equal force to sections 31752 and 31753 (holding periods for cats and for “other animals,” respectively). The California Supreme Court has declared that “[a] statute that is modeled on another, and that shares the same legislative purpose is in *pari materia* with the other, and should be interpreted consistently to effectuate congressional intent.”<sup>144</sup> Accordingly, Food and Agriculture sections 31752 and 31753 should be interpreted consistently with section 31108, because all three code sections provide for the same holding period for different animals, and all three were enacted within the test claim statute.

Moreover, even though the Legislature amended the code after the decision in *Purifoy* was issued to state that any day that a shelter is open for four or more hours is a “business day,” this later amendment by the Legislature cannot be interpreted as the Legislature’s declaration of the original existing law. When the court “‘finally and definitively’ interprets a statute, the Legislature does not have the power to then state that a later amendment merely declared existing law.”<sup>145</sup> The later amendment goes into effect only when the statute is operative and effective, in this case on January 1, 2012, many years after the fiscal years at issue in this IRC.

Accordingly, the Controller’s exclusion of Saturday as a business day when calculating the increased holding period is correct as a matter of law. Thus, to the extent that the Controller excluded from the population of “eligible animals” those animals that were euthanized too early because Saturday was counted as a business day for the required holding period, the exclusion is also correct as a matter of law.

- 2) *However, the Controller’s recalculation of costs for care and maintenance (Finding 1), and necessary and prompt veterinary care (Finding 8) using an average number of reimbursable days is incorrect as a matter of law to the extent it results in an exclusion of “eligible animals” held for the duration required under Purifoy.*

The Parameters and Guidelines provide for a formula for reimbursement of care and maintenance that requires multiplying the cost per animal per day by the number of “eligible animals,” and by “each reimbursable day.” But the actual number of calendar days of the holding period is not a constant, as it depends on the day of impoundment. The Parameters and Guidelines state that for dogs and cats the reimbursable holding period “shall be measured by calculating the difference between three days from the day of capture, and four or six business days from the day after impoundment” (four business days for shelters that choose to make animals available for owner redemption on a weekend day or weekday evening). For “other

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<sup>143</sup> *Auto Equity Sales, Inc. v. Superior Court (Heseflow)* (1962) 57 Cal.2d. 450, 454.

<sup>144</sup> *American Airlines, Inc. v. County of San Mateo* (1996) 12 Cal.4th 1110, 1129.

<sup>145</sup> *McClung v. Employment Development Department* (2004) 34 Cal.4th 467, 473; *Carter v. California Department of Veteran Affairs* (2006) 38 Cal.4th 914, 922.

animals,” the reimbursable holding period is four or six business days from the day after impoundment, because prior law did not define a specific holding period.<sup>146</sup>

Assuming a local agency, like the claimant, makes dogs and cats available for owner redemption on a weekend day or weekday evening and is thus subject to only the four business day holding period for dogs and cats, the increased holding period operates as follows (the 72 hour holding period for dogs and cats under prior law is shaded in each case, and the day of impoundment is indicated by “Imp”):

Mon	Tues	Wed	Thurs	Fri	Sat	Sun	Mon	Tues	Wed	Thurs
Imp	One	Two	Three	Four						
	Imp	One	Two	Three			Four			
		Imp	One	Two			Three	Four		
			Imp	One			Two	Three	Four	
				Imp			One	Two	Three	Four
					Imp		One	Two	Three	Four
						Imp	One	Two	Three	Four

The chart does not count Saturday as a business day, in accordance with *Purifoy*.<sup>147</sup> As it plainly appears, the *increased* holding period for dogs and cats ranges from two to four calendar days, depending on the day of the week that an animal is first impounded. An animal impounded on a Monday or Sunday would be subject to a two day increased holding period, while an animal impounded on a Thursday or a Friday would be subject to a four day increased holding period, because Saturday and Sunday cannot be counted.

For a local agency subject to the shortened four day holding period for “other animals,” the number of “reimbursable days” is as follows:

Mon	Tues	Wed	Thurs	Fri	Sat	Sun	Mon	Tues	Wed	Thurs	Fri
Imp	One	Two	Three	Four							
	Imp	One	Two	Three			Four				
		Imp	One	Two			Three	Four			
			Imp	One			Two	Three	Four		
				Imp			One	Two	Three	Four	
					Imp		One	Two	Three	Four	
						Imp	One	Two	Three	Four	

Again, this chart does not count Saturday and Sunday as business days, consistently with *Purifoy*. If the animal is impounded on a Monday, the reimbursable increased holding period is four calendar days. If the animal is impounded on a Saturday, the reimbursable increased holding period is five calendar days because Sunday cannot be counted. If the animal is impounded on a Tuesday, the reimbursable increased holding period is seven calendar days because Saturday and Sunday cannot be counted.

When recalculating the number of reimbursable days pursuant to *Purifoy*, the Controller calculated an *average* increased holding period for all dogs and cats of three days, and the

<sup>146</sup> Exhibit A, IRC, page 114 (2002 Parameters and Guidelines, page 6).

<sup>147</sup> *Purifoy v. Howell* (2010) 183 Cal.App.4th 166.

average increased holding period for all other “eligible” animals of six days, and did not determine the actual number of reimbursable days for each eligible animal based on the day of impoundment.<sup>148</sup>

However, even if the increased holding period averages three days for dogs and cats, or six days for other animals, the Parameters and Guidelines do not provide for reimbursement based on an average number of days. The Controller’s recalculation may also result in the exclusion of animals that are euthanized during the Controller’s defined “average” holding period, but the animals may have been held for the period required by law as set out in *Purifoy*. For example, as explained above, the Controller applied an increased holding period for dogs and cats of three days, after which the animal may be euthanized. However, if a stray or abandoned dog or cat is impounded on a Monday or Sunday, the actual increased holding period under the law is two calendar days, and not three days, and the dog or cat may be euthanized on day three (a day before the Controller’s average and, thus, as “during the holding period” as defined by the Controller). Similarly, for “other animals,” the Controller applied an increased holding period of six days. However, if a stray bird or rabbit is impounded on a Monday, the actual increased holding period under the law is four calendar days, and not six days, and the bird or rabbit may be euthanized on day five (a day before the Controller’s average and, thus, “during the holding period” as defined by the Controller). Similarly for “other animals,” an animal impounded on a Saturday has an increased holding period of five days under *Purifoy* and may be euthanized on day six, a Friday consistent with the mandated program.

Therefore, without taking into account the day of the week a stray or abandoned animal is impounded and calculating the actual number of days in the increased holding period for that animal, the Controller’s recalculation and use of the average number of reimbursable days results in an exclusion of “eligible animals” correctly held under the law.

In comments on the Draft Proposed Decision, the Controller agrees that the methodology excludes some eligible animals, but argues that a mathematical average provides the most reasonable and cost-effective way to analyze large quantities of data:

The Commission suggested that using an *average* reimbursable days potentially excludes a marginal amount of “eligible animals.” We concur. However, we believe that it is equally possible that the use of this *average* also included an equal number of non-eligible animals as well. The use of a mathematical average assumes some outliers. But in this case, it provides the most reasonable and cost-effective way to analyze unusually large quantities of animal data. In fact, the

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<sup>148</sup> Exhibit A, IRC, page 482 (“The agency claimed two increased holding days for dogs and cats and four increased holding days for other animals. In addition, the agency claimed three increased holding days for cats they determined to be feral in FY2006-07 and forward. We averaged the holding period claimed for FY 2006-07 and forward to fit the schedule. Refer to Schedule 2 for detail.”) (Final Audit Report, page 17). The aforementioned Schedule 2 can be found at Exhibit A, IRC, pages 472-474 (Final Audit Report, pages 7-9).

large size of the animal population (as previously noted) makes the use of an average value statistically more accurate and decreases the probability of error.<sup>149</sup>

The Controller does not express how much more accurate the use of an average number of days might be, but does explain that “claimant’s animal data averaged between 18,000 and 25,000 line items per fiscal year.”<sup>150</sup> The Controller continues: “In order to compute the *actual* increased holding period days for every animal on an individual basis, we would need to know what day of the week the animal was impounded. The auditor would then need to evaluate, based on the calendar of the specific week and year, the actual number of days in the increased holding period. Once the animal’s eligibility was established, the auditor would need to compute each animal’s allowable costs using the applicable number of reimbursable days. This task would be impractical and most likely would not produce results materially different from using an *average* calculation.”<sup>151</sup>

However, the Controller’s beliefs do not demonstrate as a matter of law that no animals were incorrectly excluded, nor does the Controller assert that the day of the week that an animal was impounded cannot be determined based on the claimant’s records (which include the dates of impoundment and death, euthanization or adoption). Accordingly, the Controller’s reductions based on an averaging method are incorrect as a matter of law and arbitrary, capricious, and entirely lacking in evidentiary support. The Commission acknowledges that the evidentiary requirements for claimant to support its costs and for the Controller to support its reductions are burdensome in this case, however, neither party has proposed an RRM, unit cost, or averaging method for inclusion in the Parameters and Guidelines. The Parameters and Guidelines, which are final and binding on the parties,<sup>152</sup> do not provide for reimbursement based on an average number of days in the increased holding period, but require the determination of the actual increased holding period for each animal. And based on the *Purifoy* decision, the increased holding period must be calculated from the day of the week the animal was impounded to ensure that Saturday and Sunday are not counted as business days. As the Controller acknowledges, “In order to compute the *actual* increased holding period days for every animal on an individual basis, we would need to know what day of the week the animal was impounded” via the method described above. As indicated, the Controller’s methodology results in an exclusion of any “eligible animal” properly held under the law but euthanized during the Controller’s average holding period. To the extent the Controller reduced costs for care and maintenance and necessary and prompt veterinary care because the Controller incorrectly excluded an animal under these circumstances, the reduction is incorrect as a matter of law.

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<sup>149</sup> Exhibit F, Controller’s Comments on the Draft Proposed Decision, pages 9-10 (emphases in original).

<sup>150</sup> Exhibit F, Controller’s Comments on the Draft Proposed Decision, page 9.

<sup>151</sup> Exhibit F, Controller’s Comments on the Draft Proposed Decision, page 9 (emphasis in original).

<sup>152</sup> *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

The Controller further argues that it is “equally *possible* that the use of this average also included an equal number of non-eligible animals,” which makes the methodology “reasonable.”<sup>153</sup> In addition, the Controller contends that the use of an average increased holding period benefits the claimant. To demonstrate this proposition, the Controller contends that it ran a “query” for the *first week* of fiscal years 2006-2007, 2007-2008, and 2008-2009, and found that the number of dogs, cats, and other animals impounded Tuesday through Friday (resulting in a holding period of less than the three or six day average provided by the Controller) far exceeded the number of dogs and cats impounded Sunday and Monday.<sup>154</sup>

There is no evidence in the record, however, that the Controller’s three- or six-day average number of reimbursable days accurately reflects or is representative of the actual increased holding period for all stray or abandoned animals held by the claimant *during the audit period*, or representative of the mandated costs incurred by the claimant. Government Code section 17559 and section 1187.5 of the Commission’s regulations require that all assertions of fact be based on substantial evidence in the record. Substantial evidence has been defined by the courts as follows:

“Substantial” is a term that clearly implies that such evidence must be of ponderable legal significance. Obviously the word cannot be deemed synonymous with “any” evidence. It must be reasonable in nature, credible, and of solid value; it must actually be “substantial proof” of the essentials which the law requires in a particular case.<sup>155</sup>

And a “possibility” of a fact does not constitute substantial evidence in the record.

Accordingly, the Commission finds that the Controller’s recalculation of the increased holding period using an average number of reimbursable days is incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support, to the extent the recalculation results in an exclusion of “eligible animals” properly held for the duration required under *Purifoy*.

c) *The Controller’s exclusion of animals that died after the increased holding period is consistent with the Parameters and Guidelines and is correct as a matter of law.*

The Commission finds that the Controller’s exclusion of animals that died after the increased holding period is consistent with the Parameters and Guidelines and is correct as a matter of law. The Parameters and Guidelines provide for reimbursement for dogs and cats, and other animals, that died during the increased holding period or were ultimately euthanized after the increased holding period.<sup>156</sup> Reimbursement is limited to: stray or abandoned dogs and cats and other animals are subject to reimbursement because their owners are not known, and cannot have fees levied against them; animals that are not adopted during the holding period, but are “ultimately

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<sup>153</sup> Exhibit F, Controller’s Comments on the Draft Proposed Decision, pages 9-10 (emphasis added).

<sup>154</sup> Exhibit F, Controller’s Comments on the Draft Proposed Decision, pages 9-12.

<sup>155</sup> *People v. Olmsted* (2000) 84 Cal.App.4th 270, 277.

<sup>156</sup> Exhibit A, IRC, pages 114, 116 (2002 Parameters and Guidelines, pages 6, 8).

euthanized” when the holding period expires, are subject to reimbursement on the theory that there is no new owner or redeemed owner from whom fees could be exacted; both of these situations were contemplated in the Test Claim Statement of Decision; and animals that die *during* the increased holding period.<sup>157</sup> And with respect to animals that die during the increased holding period, this issue arose during the consideration of Parameters and Guidelines, when the County of Fresno filed comments requesting reimbursement for the care and maintenance of stray or abandoned animals that die while being held pending adoption or euthanasia. As discussed above, the County requested reimbursement for animals that “die while being held pending adoption or euthanization [sic].”<sup>158</sup>

The Commission approved the request, clarifying that increased costs for the care and maintenance of animals that die during the increased holding period are eligible for reimbursement as follows:

[S]taff has inserted language in Sections IV (B) (1), (2), (3), (4), and (9) of the proposed Parameters and Guidelines clarifying that increased costs for the care and maintenance of animals that die during the increased holding period, and for providing “necessary and prompt veterinary care” to animals that die during the holding period are eligible for reimbursement.<sup>159</sup>

The Parameters and Guidelines, however, do not authorize reimbursement for animals that continue to be held by the local agency for adoption longer than the holding period and die *thereafter*. The Parameters and Guidelines are binding,<sup>160</sup> and no requests to amend the Parameters and Guidelines have been filed. Thus, the Controller’s interpretation is consistent with the plain language of the Parameters and Guidelines. Based on the foregoing, the Commission finds that this reduction of eligible animals on these grounds is correct as a matter of law.

2. Except as Determined in Section C.1. of this Decision, the Controller’s Remaining Findings for Care and Maintenance Costs (Finding 1) are Correct as a Matter of Law and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The actual cost method outlined in the Parameters and Guidelines for calculating the costs for care and maintenance require the claimant to determine the total annual cost of care and maintenance for all dogs and cats impounded at a facility. Total cost of care and maintenance includes labor and materials costs. The formula also requires the calculation of the yearly census of animals, or the total number of days that all animals are housed in the shelter. The Controller made the following findings on these components:

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<sup>157</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 56-57, 67-68 (Test Claim Statement of Decision, pages 19-20, 30-31) (emphasis added)).

<sup>158</sup> Exhibit H, Staff Analysis and Proposed Parameters and Guidelines, Item 4, February 28, 2002, page 83.

<sup>159</sup> Exhibit H, Staff Analysis and Proposed Parameters and Guidelines, Item 4, February 28, 2002, page 84-85.

<sup>160</sup> *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

- Salary and benefit costs. During the audit, the claimant provided actual salary and benefit costs for the audit period for three positions (animal care technicians, senior animal care technicians, and lead animal care technicians) that provide care and maintenance to the animals housed at the shelter. However, only a percentage of shelter staff time is devoted to care and maintenance. The claimant estimated that 89 percent of the animal care technician's and senior animal care technician's time and 60 percent of the lead animal care technician's time was devoted to care and maintenance. The Controller determined that the estimated percentages appeared reasonable based on the job descriptions provided.<sup>161</sup> Thus, the Controller multiplied the actual salary and benefit amounts provided by the claimant by the percentage of time spent on mandated care and maintenance activities, resulting in allowable salaries and benefits of \$952,445.<sup>162</sup>
- Material and supply costs claimed in the amount of \$7,690,644 were overstated by the claimant. The Controller, allowing \$288,726 in materials and supplies, determined that the claimant included total costs incurred to operate the shelter (such as shelter, kennel, veterinary, and administrative divisional expenses) instead of claiming costs specifically incurred for care for and maintain the animals. The Controller determined the allowable costs by reviewing the claimant's account #140 (special activities supplies for shelter operations). The claimant indicated that account #140 is specifically for the expenses related to the care and maintenance of animals and includes costs for animal food, cat litter, light bulbs, and cleaning supplies, and does not include expenses that are not eligible for reimbursement (such as euthanasia medication, microchip expenses, and medical supplies).<sup>163</sup>
- The claimant estimated the yearly census by assuming that the animals were held an average of five days in fiscal years 2001-2002 and 2002-2003, an average of seven days in fiscal years 2006-2007 and 2007-2008, and an average of six days in fiscal year 2008-2009. The Controller reviewed the claimant's Paw Trax software system, which detailed the actual total annual census of animals housed in the claimant's animal shelter in fiscal years 2006-2007 through 2008-2009. Since the information was not available for fiscal years 2001-2002 and 2002-2003, the Controller used an average of the information from fiscal years 2006-2007 through 2008-2009 for those earlier years. The Controller's recalculation resulted in an increase of yearly census numbers.<sup>164</sup>

The claimant does not directly address these adjustments to the total annual costs of care and maintenance.

The Commission finds that the Controller's recalculations are consistent with the Parameters and Guidelines and are based on the claimant's records. While the Parameters and Guidelines use inclusive language to describe costs for this component ("total cost of care and maintenance

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<sup>161</sup> Exhibit B, Controller's Late Comments on the IRC, pages 15, 110-120.

<sup>162</sup> Exhibit A, IRC, page 479 (Final Audit Report, page 14).

<sup>163</sup> Exhibit A, IRC, page 480 (Final Audit Report, page 15); Exhibit B, Controller's Late Comments on the IRC, pages 15, 120-125.

<sup>164</sup> Exhibit A, IRC, pages 480-481 (Final Audit Report, pages 15-16); Exhibit B, Controller's Late Comments on the IRC, pages 15, 126.

includes labor, materials, supplies...”) the care and maintenance costs cannot be interpreted beyond the reasonable scope of the approved activity, which is to provide care and maintenance during the increased holding period for impounded stray or abandoned animals that die during the increased holding period or are ultimately euthanized. General expenses of the animal shelter are beyond the scope of the mandated activity, and therefore reduction on this basis is correct as a matter of law. Moreover, the claimant agreed with the Controller that only a portion of salaries and benefits for the animal care technician and senior animal care technician should be reimbursable, and the claimant proposed the proportional reimbursable share for these classifications, which the Controller accepted. The Controller’s reduction on this basis is therefore not arbitrary, capricious, or entirely lacking in evidentiary support.

The Controller found that the claimant estimated the yearly census of animals, which does not comply with the Parameters and Guidelines. The Parameters and Guidelines require the claimant to identify the actual yearly census of animals. The Controller determined that number based on the claimant’s Paw Trax software system, which detailed the actual total annual census of animals housed in the claimant’s animal shelter in fiscal years 2006-2007 through 2008-2009. However, based on the formula in the Parameters and Guidelines for determining the costs for care and maintenance during the increased holding period, in which total annual costs are *divided* by the yearly animal census to arrive at a cost per animal per day, which is in turn multiplied by the remaining factors of eligible animals and reimbursable days, the adjustments made to the yearly animal census data did not in fact result in any reduction. Because total annual costs are *divided* by the yearly animal census, any decrease in the animal census data would result in a corresponding increase in the cost per animal per day, which would then be multiplied by the remaining factors. Thus, the adjustment to the yearly animal census factor is in the claimant’s favor.

Accordingly, except as determined in Section C.1 of this Decision, the remaining calculations for care and maintenance in Finding 1 are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

3. The Controller’s Reductions in Finding 2 Relating to Unallowable Employee Hours for Making Animals Available for Adoption or Owner Redemption are Correct as a Matter of Law and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Parameters and Guidelines provide that an agency desiring to apply the shortened holding period is eligible for reimbursement for making animals available for owner redemption on one weekday evening until at least 7:00 p.m., or one weekend day; or, for local agencies with fewer than three full-time employees or that are not open during all regular weekday business hours, for establishing a procedure for owners to reclaim their animals by appointment.<sup>165</sup> For dogs and cats, reimbursement for this activity begins July 1, 1999. For “other animals” specified in Food and Agriculture Code section 31753, reimbursement for this activity begins January 1, 1999.<sup>166</sup>

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<sup>165</sup> Exhibit A, IRC, page 118 (2002 Parameters and Guidelines, page 10), and pages 265-266 (2006 Parameters and Guidelines, pages 13-14).

<sup>166</sup> Exhibit A, IRC, page 118 (2002 Parameters and Guidelines, page 10).



The reimbursement claims included \$654,322 in costs for the audit period for this component, by adding together expenditures of the shelter division and kennel division and a portion of the expenditures of the administration division and veterinary division. The claimant then divided the total expenditures by the total number of hours the facility was open for operation to arrive at a cost per hour. The cost per hour was multiplied by the additional hours the shelter was open for owner redemption.<sup>167</sup>

The Controller determined that this calculation was not correct and included costs beyond the scope of the mandated activity. The Controller states that the mandate is limited to keeping the shelter open for purposes of owner redemption. “We believe that other animal services such as animal control officer duties, euthanasia, spay and neutering procedures, implanting microchips, licensing, processing animal adoptions, and certain other animal services do not become temporarily reimbursable activities just because the animal shelter is open for extra hours to make animals available for owner redemption. These activities are not reimbursable under any cost component of the mandated program at any time.”<sup>168</sup>

The Controller recalculated costs based on documentation provided by the claimant identifying the hours of operation for its animal shelter, and the hours the claimant made animals available for owner redemption. On Saturdays, the claimant’s shelter was open from 8:00 a.m. to 5:00 p.m. However, the shelter made the animals available for owner redemption only from 10:00 a.m. to 5:00 p.m., for a total of seven hours per week. Based on information provided by the claimant, the Controller determined the employee classifications and the number of employees on duty specifically to make animals available for owner redemption. The Controller did not include other employees on duty that performed reimbursable activities relating to the other cost components of care and maintenance, lost and found lists, maintaining non-medical records, and necessary and prompt veterinary care. The Controller applied the allowable hours by each employee’s productive hourly and benefit rates and determined that \$187,344 was allowable for salary and benefits.<sup>169</sup>

The Controller is correct that the reason to remain open on a Saturday, pursuant to the test claim statutes and the Commission’s Decision, is to promote owner redemption. Indeed, the express language of the reimbursable component at issue in Finding 2 is “Making the animal available for owner redemption...”<sup>170</sup> Therefore, the Controller’s attempt to limit reimbursement on Saturdays to those employees that are necessary to make animals available for owner redemption, and to reduce all other costs beyond the scope of this mandated activity, is consistent with the Parameters and Guidelines and the purpose of the test claim statute. Thus, the adjustments are correct as a matter of law. In addition, there is no evidence in the record to support a finding that the Controller’s recalculation of costs, based on documentation provided by the claimant, was arbitrary or capricious.

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<sup>167</sup> Exhibit A, IRC, page 501 (Final Audit Report, page 36).

<sup>168</sup> Exhibit B, Controller’s Late Comments on the IRC, page 26.

<sup>169</sup> Exhibit A, IRC, pages 502-503 (Final Audit Report, pages 37-38).

<sup>170</sup> Exhibit A, IRC, page 118 (2002 Parameters and Guidelines, page 10), and pages 265-266 (2006 Parameters and Guidelines, pages 13-14).

Based on the foregoing, the Controller's reductions in Finding 2 relating to unallowable costs to make the animal available for owner redemption is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

4. Except as Determined in Section C.1, There Is No Evidence that the Controller's Recalculation of Costs Based on a Time Study Conducted by the Claimant During the Audit for Lost and Found Lists (Finding 3), Maintaining Non-Medical Records (Finding 4), and Necessary and Prompt Veterinary Care, is Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

As indicated in the background, the claimant did not individually claim costs for lost and found lists, maintaining non-medical records, and providing necessary and prompt veterinary care, but included those costs in its overall calculation for care and maintenance. The Controller isolated those reimbursable costs in Findings 3 through 5, in part, by allowing the claimant to conduct a time study during the audit for the time spent performing the activities. In addition, for necessary and prompt veterinary care, the Controller allowed reimbursement for material and supply costs based on the actual cost of vaccines administered to each eligible animal.

Although the claimant requests that all costs reduced be reinstated, the claimant has not provided any argument or evidence in the record to support a finding that the Controller's recalculation of these costs based on the time studies conducted and the actual costs for vaccines, was arbitrary, capricious, or entirely lacking in evidentiary support.

Therefore, except as determined in Section C.1. of this Decision regarding Finding 5, there is no evidence that the Controller's recalculation of costs for lost and found lists (Finding 3), maintaining non-medical records (Finding 4), and necessary and prompt veterinary care (Finding 5), is arbitrary, capricious, or entirely lacking in evidentiary support.

5. The Controller's Reduction of Indirect Costs (Finding 6) Is Correct as a Matter of Law and Is Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Parameters and Guidelines amended in 2006 state that "Indirect costs are costs that are incurred for a common or joint purpose, benefiting more than one program, and are not directly assignable to a particular department or program without efforts disproportionate to the result achieved. Indirect costs may include both (1) overhead costs of the unit performing the mandate; and (2) the costs of the central government services distributed to the other departments based on a systematic and rational basis through a cost allocation plan." The original 2002 set of Parameters and Guidelines contained similar language. Both sets of Parameters and Guidelines further provide claimants with the option of using 10 percent of direct labor, excluding fringe benefits, or preparing an Indirect Cost Rate Proposal (ICRP) pursuant to the Office of Management and Budget (OMB) Circular A-87.<sup>171</sup>

In Finding 6 of the Final Audit Report, the Controller states that, while the claimant did not properly claim indirect costs of \$2,458,387, the Controller ultimately allowed \$336,205 in such

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<sup>171</sup> Exhibit A, IRC, pages 122-123 (2002 Parameters and Guidelines, pages 14-15); Exhibit A, IRC, pages 269-270 (2006 Parameters and Guidelines, pages 18-19).

costs, based on an indirect cost rate proposal (ICRP) of 76.38 percent, using allowable salaries and benefits from all the divisions within the claimant's organization.<sup>172</sup>

The Controller states that the agency did not directly claim reimbursement for indirect costs for any fiscal year in the audit period. Instead, the agency included a portion of its overhead costs in both the care and maintenance (Finding 1) and holding period (Finding 2) cost components. According to the Controller, the claimant calculated indirect costs by assuming that all costs incurred by the animal shelter, kennel, and veterinary divisions were direct mandate-related costs, and that all costs incurred within the animal control and license/canvassing divisions were direct non-mandate related costs. Using the two totals, the claimant determined the percentage of direct mandate-related costs and multiplied this percentage by the amount of costs incurred with the administration division. The Controller asserts that this method of calculating indirect costs is not consistent with the Parameters and Guidelines. The Controller also asserts that the claimant's assumption that all costs incurred within the animal shelter, kennel, and veterinary divisions were direct mandate-related costs, and that all costs incurred within the animal control and license/canvassing divisions were direct non-mandate related costs, is also incorrect. Thus, the Controller rejected the claimant's method of determining indirect costs.

During the audit, the Controller worked with the claimant to obtain necessary information for the development of an indirect cost rate proposal. The Controller included the following costs in the proposal, which the Controller states is consistent with OMB A-87:

- All costs included with the claimant's administrative support division.
- All utility expenditures in the shelter division recorded within accounts 550 through 579.
- All office supplies expenditures recorded within account 130 in the animal shelter and veterinary divisions.
- All small tools and implements expenditures recorded within account 290 in the animal shelter and veterinary divisions.
- All building rental costs recorded within account 361 in the animal shelter division.
- All building and computer maintenance costs incurred within accounts 360 and 410 in the animal shelter division.
- All staff development costs incurred within account 480, and costs incurred within the administrative support division.
- Ninety-nine percent of the salary and benefit costs for the front office supervisory position in the animal shelter.

The Controller further states that the other line item costs for services and supplies within divisions other than administrative support that are not mentioned above were direct costs to operate the claimant's core business to provide animal control services to its contracting partners.

Since the indirect cost rates were based on direct salaries and benefits, the Controller calculated direct salaries and benefits by adding up all salary and benefit costs incurred within all divisions, other than the administrative support division and the front office supervisory position in the

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<sup>172</sup> Exhibit A, IRC, page 516 (Final Audit Report, page 51).

animal shelter division. Although the claimant requested that the Controller include other supervisory and support positions within the animal shelter as partially indirect, the Controller asserts that claimant did not provide any actual cost data or documentation to base such a determination.<sup>173</sup> The claimant now seeks in its IRC to have indirect costs recalculated and increased to include wages of animal care takers whose wages are not treated as direct costs, the wages of shelter clerical support staff, and all office equipment and uniforms.<sup>174</sup> In addition, the claimant “now wishes to revise the indirect cost rates based on costs incurred only within its Animal Shelter Division rather than use rates based on the Authority as a whole.”<sup>175</sup> The claimant argues that “since 99% of the allowable costs are incurred in the Shelter Department, it is appropriate to calculate a rate specific to that department,” rather than to calculate an agency-wide indirect cost rate proposal that dilutes costs.<sup>176</sup>

The Controller responds to the claimant’s argument, that indirect cost rates should be based only on the costs incurred by the animal shelter division, as follows:

In its IRC response, the Authority is suggesting that its indirect cost rates be prepared using only the expenditures within the Animal Shelter Division. The Authority provided a sample of what such a calculation would look like for FY 2008-09, which results in an indirect cost rate of 150.83% for that year instead of the 76.38% indirect cost rate that was allowable during the audit. However, we believe that the Authority’s request is flawed.

Establishing indirect cost rates based only the Animal Shelter Division is an incorrect methodology. What the Authority is proposing is the development of a departmental rate that applies only to this Division. That would be appropriate if the Animal Shelter Division was the only department within the Authority in which mandated costs were incurred. For example, animal shelters that are operated by cities and counties function as a department within the context of the respective government as a whole. The main purpose of the respective government is to provide services to its citizens, of which animal control services is only a part. Therefore, these shelters operate as separate departments within those governments and are accounted for within their own budget units. Rather than prepare an indirect cost rate based on the entire government as a whole, it is more correct to prepare indirect cost rates based only on costs incurred within the animal shelter department.

In contrast, the Southeast Area Animal Control Authority has six Divisions. All six Divisions of the Authority work towards a common purpose, which is to provide animal control services for its participating cities. Allowable mandated costs were incurred within multiple Divisions of the Authority. The indirect cost rates that are identified as allowable in the audit report are based on the Authority as a whole. It would not be appropriate to prepare and allocate an indirect cost

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<sup>173</sup> Exhibit B, Controller’s Late Comments on the IRC, page 33.

<sup>174</sup> Exhibit C, Claimant’s Late Rebuttal Comments, pages 1-4.

<sup>175</sup> Exhibit B, Controller’s Late Comments on the IRC, page 32.

<sup>176</sup> Exhibit C, Claimant’s Late Rebuttal Comments, page 3.

rate based on one Division to allowable salaries and benefits costs incurred within other Divisions, which is what the Authority is proposing.<sup>177</sup>

The Controller further asserts that the claimant's proposal is incorrect as follows:

There is another flaw in the Authority's request. The Authority appears to believe that any mandate-related activities that an employee performs are direct costs, while time spent on activities that are not reimbursable are indirect costs. That is not consistent with the provisions of OMB A-87. Many of the activities performed by the employee classifications identified in the Authority's example for FY 2008-09 perform functions that are directly related to the Authority's common purpose of providing animal shelter services to the public. As identified in the parameters and guidelines section V.B-Indirect Costs, "Indirect costs are those that have incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved." For example, the Authority identifies Dispatchers and Clerks as being partially or entirely indirect. However, these employee classifications perform functions unique to their particular Divisions, not the Authority as a whole. The Authority has an entire Division (Administrative Services – Division 2510) that provides the common purpose activities as defined in the parameters and guidelines.<sup>178</sup>

The Commission finds that the Controller's reduction of indirect costs is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support. The claimant's original calculation of indirect costs does not comply with the Parameters and Guidelines, which provides that if a claimant seeks a reimbursement of indirect costs that is more than 10 percent of the total of direct costs, the claimant may submit an Indirect Cost Rate Proposal (ICRP) created in conformity with federal Office of Management and Budget Circular A-87. There are no provisions in the Parameters and Guidelines that provides a special reimbursement formula be applied to this claimant.

Moreover, the Controller's audit decisions and recalculation of indirect costs, so long as it is correct as a matter of law, is entitled to deference:

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

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<sup>177</sup> Exhibit B, Controller's Late Comments on the IRC, page 34.

<sup>178</sup> Exhibit B, Controller's Late Comments on the IRC, page 34.

between those factors, the choice made, and the purposes of the enabling statute.”  
[Citation.]’ ”<sup>179</sup>

The Commission finds that the Controller considered all the facts and documents maintained by the claimant in support of its reimbursement claims, and considered the claimant’s arguments and new proposals for calculating indirect costs. The Commission further finds that there is no evidence that the Controller’s recalculation of indirect costs is arbitrary or capricious.

The claimant argues that the Commission’s deference to the Controller on this issue is “simply rubber stamping SCO actions and denying local agencies to [*sic*] a complete and fair review.”<sup>180</sup> The law provides, however, that the Controller’s Office is expert at the art and science of governmental audits and that its institutional expertise will be deferred to except when the Controller’s Office acts in a manner which is contrary to law or is arbitrary, capricious, and entirely lacking in evidentiary support. The claimant — who bears the burden of submitting a persuasive claim with sufficient evidentiary foundation — has failed to establish on this issue that the Controller is not entitled to deference. While the claimant submits a series of questions in its comments on the Draft Proposed Decision,<sup>181</sup> the burden lies on the claimant to show, with evidence in the record, how the Controller’s recalculation is wrong, or is arbitrary, capricious, or entirely lacking in evidentiary support, and, on this subject, the claimant has failed to do so.

Accordingly, the Controller’s reduction of indirect costs is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

## V. Conclusion

Based on the foregoing analysis, the Commission partially approves this IRC, and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission’s regulations, that the Controller reinstate costs that relate to the following incorrect reductions to the extent the claimant can provide documentation to support the validity of the costs incurred. Section VI. of the Parameters and Guidelines require claimants to provide source documents that show the evidence of the validity of such costs and their relationship to the mandate. The supporting documentation must be kept on file by the agency during the audit period required by Government Code section 17558.5. In this respect, claimants are required by Food and Agriculture Code section 32003 to maintain records on animals that are taken up, euthanized, or impounded. Such records shall identify the date the animal was taken up, euthanized, or impounded; the circumstances surrounding these events; and the names of the personnel performing these activities.<sup>182</sup>

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<sup>179</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>180</sup> Exhibit G, Claimant’s Late Comments on the Draft Proposed Decision, pages 6.

<sup>181</sup> Exhibit G, Claimant’s Late Comments on the Draft Proposed Decision, pages 6.

<sup>182</sup> The record in this case shows that the claimant started maintaining records using the Pax Trax system in fiscal years 2006-2007 and 2008-2009, and that no records were available for the earlier fiscal years of 2001-2002 and 2002-2003. On remand, under its audit authority, the Controller should re-assess fiscal years 2001-2002 and 2002-2003 in conformity with its

- The reduction of costs relating to the exclusion of animals deemed treatable upon arrival at the shelter and later euthanized during the increased holding period because they became non-rehabilitatable.
- The reduction of costs relating to the Controller’s recalculation of costs following the *Purifoy* decision and its use of an average number of reimbursable days, to the extent the recalculation resulted in an exclusion of “eligible animals” correctly held under the law.

The Commission further finds that all other reductions made by the Controller are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support.

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reassessment of data for 2006-2007 and 2008-2009 for purposes of reinstating costs incorrectly reduced.



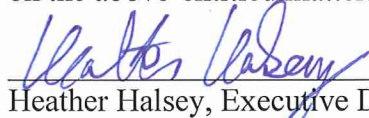
RE: **Decision**

*Animal Adoption*, 14-9811-I-03

Civil Code Sections 1834 and 1846; Food and Agriculture Code Sections 31108, 31752, 31752.5, 31753, 32001, and 32003; As Added or Amended by Statutes 1998, Chapter 752 (SB 1785)

Fiscal Years: 2001-2002, 2002-2003, 2006-2007, 2007-2008, and 2008-2009  
Southeast Area Animal Control Authority, Claimant

On January 27, 2017, the foregoing Decision of the Commission on State Mandates was adopted on the above-entitled matter.

  
\_\_\_\_\_  
Heather Halsey, Executive Director

Dated: February 1, 2017



BEFORE THE  
COMMISSION ON STATE MANDATES  
STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM  
ON:**

Government Code Sections 7571, 7572, 7572.5, 7572.55, 7576, 7581, and 7586 as added by Statutes 1984, Chapter 1747 (AB 3632); and as amended by Statutes 1985, Chapter 1274 (AB 882); Statutes 1994, Chapter 1128 (AB 1892); Statutes 1996, Chapter 654 (AB 2726);

California Code of Regulations, Title 2, Division 9, Chapter 1, Sections 60020, 60030, 60040, 60045, 60050, 60055, 60100, 60110, 60200 and 60550

(Emergency regulations effective January 1, 1986 [Register 86, No. 1 ], and re-filed June 30, 1986, designated effective July 12, 1986 [Register 86, No. 28]; and Emergency regulations effective July 1, 1998 [Register 98, No. 26]; final regulations effective August 9, 1999 [Register 99, No. 33])<sup>1</sup>

Fiscal Years 2006-2007, 2007-2008, and 2008-2009

County of San Diego, Claimant

Case No.: 15-9705-I-06

*Handicapped and Disabled Students (04-RL-4282-10); Handicapped and Disabled Students II (02-TC-40/02-TC-49); and Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services (97-TC-05)*

DECISION PURSUANT TO  
GOVERNMENT CODE SECTION 17500 ET  
SEQ.; CALIFORNIA CODE OF  
REGULATIONS, TITLE 2, DIVISION 2,  
CHAPTER 2.5, ARTICLE 7

*(Adopted May 26, 2017)*

**DECISION**

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during regularly scheduled hearings on March 25, 2016, October 28, 2016, and May 26, 2017.

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<sup>1</sup> Note that this caption differs from the Test Claim and the Parameters and Guidelines captions in that it includes only those sections that were approved for reimbursement in the Test Claim Decision. Generally, a parameters and guidelines caption should include only the statutes and executive orders and the specific sections approved in the test claim decision. However, that was an oversight in the case of the Parameters and Guidelines at issue in this case.

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

The Commission heard the County of San Diego's (claimant’s) appeal of the Executive Director’s decision to dismiss the Incorrect Reduction Claim (IRC) as untimely filed on March 25, 2016, and October 28, 2016. Ms. Lisa Macchione and Mr. Kyle Sand appeared for the claimant. Mr. Jim Spano appeared for the State Controller’s Office (Controller). During the March 25, 2016 hearing, a motion to grant the appeal resulted in a tie vote of the Commission and, thus, no action was taken. On October 28, 2016, the Commission granted the claimant’s appeal, finding that the IRC was timely filed by a vote of 5-2 as follows:

<b>Member</b>	<b>Vote</b>
Ken Alex, Director of the Office of Planning and Research	Yes
Richard Chivaro, Representative of the State Controller	No
Mark Hariri, Representative of the State Treasurer, Vice Chairperson	Yes
Sarah Olsen, Public Member	Yes
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	No
Carmen Ramirez, City Council Member	Yes
Don Saylor, County Supervisor	Yes

The Commission heard and decided this IRC on May 26, 2017. Mr. Kyle Sand appeared for the claimant. Mr. Jim Spano and Mr. Chris Ryan appeared for the State Controller’s Office. The Commission adopted the Proposed Decision to deny this IRC by a vote of 5 -1 as follows:

<b>Member</b>	<b>Vote</b>
Lee Adams, County Supervisor	Yes
Ken Alex, Director of the Office of Planning and Research	Yes
Richard Chivaro, Representative of the State Controller	Yes
Mark Hariri, Representative of the State Treasurer, Vice Chairperson	Yes
Sarah Olsen, Public Member	Absent
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	Yes
Carmen Ramirez, City Council Member	No

**Summary of the Findings**

This IRC challenges the Controller’s findings and reductions in Finding 2 of \$1,387,095, claimed for board and care and treatment services costs of seriously emotionally disturbed (SED) pupils provided by out-of-state, for-profit, residential facilities claimed for fiscal years 2006-2007

through 2008-2009 by the claimant under the *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services*<sup>2</sup> program.

The Commission's findings are as follows:

**A. The Claimant Timely Filed the IRC.**

On March 7, 2012, the Controller issued the Final Audit Report.<sup>3</sup> On December 18, 2012, the Controller issued the Revised Final Audit Report which "supersedes" the March 7, 2012 Final Audit Report.<sup>4</sup> The claimant filed this IRC on December 10, 2015, more than three years after the Final Audit Report was issued, but within three years after the Revised Final Audit Report was issued.<sup>5</sup> Based on this record, the Commission finds that a new statute of limitations began to accrue with the issuance of the Revised Final Audit Report. The conclusion on the statute of limitations is based on the plain language of the Revised Final Audit Report that it superseded the earlier March 7, 2012 report, the ambiguity in the Commission's regulations at the time the IRC was filed, and on the policy of reaching the merits of the claim as requested by the claimant. Although the claimant could have filed an IRC on the March 7, 2012 Final Audit Report as early as March 7, 2012 (and before the December 18, 2012 Revised Final Audit Report was issued), the claimant's IRC filing on December 10, 2015, following the superseding Revised Final Audit Report issued December 18, 2012, is timely.

**B. The Controller Timely Initiated the Audit.**

Government Code section 17558.5 requires the Controller to initiate an audit no later than three years after the reimbursement claim is filed or last amended. However, if no funds are appropriated or no payment is made to the claimant for the program for the fiscal year at issue, the time for the Controller to initiate the audit is tolled to three years after the date of the initial payment of the claim. The fiscal year 2006-2007 reimbursement claim was filed on April 9, 2008, but the claim was not paid until fiscal year 2009-2010. Thus the time for the Controller to initiate the claim was tolled, and the audit initiation date of either March 29, 2010, or April 14, 2010, as the parties assert, was within three years of the date of payment on the fiscal year 2006-2007 claim. As to the other two fiscal years, the audit was initiated within three years of the date the reimbursement claims were submitted.

**C. The Controller Timely Completed the March 7, 2012 Final Audit Report, But Did Not Timely Complete the December 18, 2012 Revised Final Audit Report and, Thus, the December 18, 2012 Revised Final Audit Report Is Void.**

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<sup>2</sup> Though the consolidated *Handicapped and Disabled Students; Handicapped and Disabled Students II*; and *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services* parameters and guidelines apply to the fiscal years at issue, this IRC solely involves the *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services* program.

<sup>3</sup> Exhibit B, Controller's Comments on the IRC, page 6.

<sup>4</sup> Exhibit A, IRC, page 76.

<sup>5</sup> Exhibit A, IRC, page 1.

Government Code section 17558.5 requires that an audit be completed no later than two years after the date that the audit was commenced. Here, the Controller's audit was commenced on either March 29, 2010, or April 14, 2010. Therefore, a timely audit must be completed as early as March 29, 2012.

An audit is complete under Government Code section 17558.5(c) when the Controller notifies the claimant of any adjustment to a claim for reimbursement that results from an audit or review. The "notification shall specify the claim components adjusted, the amounts adjusted, interest charges on claims adjusted to reduce the overall reimbursement to the local agency . . . , and the reason for the adjustment." Absent evidence to the contrary, the Commission finds that the date of the Final Audit Report provides evidence of when an audit is complete.

In this case, the Controller issued the Final Audit Report on March 7, 2012, notifying the claimant of the reduction in Finding 2, before the completion deadline of March 29, 2012. The claimant does not dispute that the reduction in Finding 2 was included in the March 7, 2012 Final Audit Report and that Finding 2 did not change in the later-dated revised report.<sup>6</sup> Thus, the March 7, 2012 Final Audit Report was timely completed.

The Controller issued the Revised Final Audit Report on December 18, 2012, after the two year deadline imposed by Government Code section 17558.5 to complete the audit. Therefore, the Commission finds that the Revised Final Audit Report, dated December 18, 2012, is not timely. Although Government Code section 17558.5 does not specify the consequences for failing to meet the deadlines imposed by the statute, the courts have ruled that when a deadline is for the protection of a person or class of persons, and the language of the statute as a whole indicates the Legislature's intent to enforce the deadline, the deadline is mandatory. Therefore, the Commission finds that the failure to meet the deadline makes the Revised Final Audit Report void.

**D. The Controller's Audit Conclusions and Reduction of Costs in Finding 2 for Board and Care and Treatment Services Costs for SED Pupils Provided by Out-of-State, For-Profit, Residential Programs Remains Valid When the Final Audit Report Is Timely, But the Superseding Revised Final Audit Report Is Void.**

Since the Revised Final Audit Report is void because it was not timely completed, the Commission must determine the effect on the March 7, 2012 Final Audit Report.

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<sup>6</sup> Exhibit F, pages 4-5 (March 25, 2016 Commission Hearing Transcript Excerpt).

**1. Although Claimant Now Requests Reinstatement of All Costs Reduced by the Controller, the Commission's Jurisdiction Is Limited to the Reductions for Board and Care and Treatment Services Under Finding 2 Because the Claimant Only Timely Filed an IRC to Challenge Reductions for Board and Care and Treatment Services Under Finding 2, and Did Not Plead the Remaining Audit Reductions in Its IRC.**

The claimant now requests that the Commission determine the effect of the void and superseding Revised Final Audit Report on *all* of the Controller's cost reductions in Findings 1, 2, 3, and 4, most of which the claimant did not challenge in the IRC.<sup>7</sup> The Commission finds that it does not have jurisdiction over costs reduced in the audit which were not alleged to be incorrect by the claimant in the IRC. The claimant's IRC challenged only the reductions in Finding 2 of \$1,387,095: board and care and treatment services for seriously emotionally disturbed pupils provided by out-of-state, for-profit, residential programs. To be timely, an additional IRC or an amendment to the existing IRC to challenge the Findings not challenged in this IRC, had to be filed in accordance with the Commission's regulations by December 18, 2015. No additional IRC or amendment to this IRC was filed.

Accordingly, the Commission's jurisdiction is limited to the reduction of costs in Finding 2 for board and care and treatment services for seriously emotionally disturbed pupils provided by out-of-state, for-profit, residential programs.

**2. The Commission Finds that the Timely Completion of the Audit Was Made with the Controller's March 7, 2012 Final Audit Report. Since the Revised Final Audit Report Was Not Timely Completed and Is Void, It Has No Effect on the March 7, 2012 Reductions Under Finding 2. Therefore, the Commission Must Reach the Merits of Finding 2, As Requested by Claimant in its Appeal of the Executive Director's Decision, 15-AEDD-01. On the Merits, the Commission Finds the Controller's Reduction of Costs Claimed for Board and Care and Treatment Services for Seriously Emotionally Disturbed Pupils Provided by Out-of-State Residential Programs that Are Organized and Operated on a For-Profit Basis, Is Correct as a Matter Of Law.**

- a) The Timely Completion of the Audit Was Made with the Controller's March 7, 2012 Final Audit Report and the Revised Final Audit Report Is Void and Can Have No Effect on the March 7, 2012 Reductions Under Finding 2.

On October 28, 2016, the Commission heard and decided the issue of whether the claimant timely filed this IRC in accordance with the Commission's regulations and found that the statute of limitations for filing the IRC began to accrue with the later December 18, 2012 Revised Final Audit Report. The conclusion on the statute of limitations was based on the policy of reaching the merits of the claim as requested by the claimant, the plain language of the Revised Final Audit Report that it superseded the earlier March 7, 2012 report (and hence provided notice to the claimant that it could commence an IRC proceeding), and the ambiguity in the Commission's regulations at the time the IRC was filed. However, the issue of whether the Controller timely

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<sup>7</sup> Exhibit E, Claimant's Late Comments on Draft Proposed Decision.

completed the audit in accordance with Government Code section 17558.5 was not before the Commission at the October 28, 2016 hearing. Thus, the Commission was not made aware of, and did not address, the timeliness of the Revised Final Audit Report and the effect of that untimely and void report with respect to the validity of the March 7, 2012 Final Audit Report and the reductions made therein. Thus, the Commission did *not* make a finding at that hearing that the March 7, 2012 Final Audit Report was void, as asserted by the claimant. The Commission, instead, agreed to reach the merits of the IRC.

Based on the evidence in the record, the Commission finds that the March 7, 2012 Final Audit Report provided notice to the claimant of the reasons for the reduction and the amount reduced in Finding 2 in accordance with Government Code section 17558.5. No changes were made in the Revised Final Audit Report to Finding 2 and the claimant does not dispute that the reduction amount and reasoning for the reduction in Finding 2 remained the same in the Revised Final Audit Report as it was in the March 7, 2012 Final Audit Report.<sup>8</sup>

Accordingly, the Commission finds that completion of the audit was made with the Controller's March 7, 2012 Final Audit Report and claimant could have filed an IRC at any time beginning on March 7, 2012 to contest the Finding 2 reductions at issue in this claim. Since the March 7, 2012 Final Audit Report was timely completed, and the Revised Final Audit Report is void and can have no effect on Finding 2 since it was completed past the statutory deadline, the Commission must now reach the merits of Finding 2.

b) The Controller's Reduction of Costs Claimed for Board and Care and Treatment Services for Seriously Emotionally Disturbed Pupils Provided by Out-Of-State Residential Programs That Are Organized and Operated on a For-Profit Basis, Is Correct as a Matter of Law.

During the entire reimbursement period for this program, state law and the Parameters and Guidelines required that out-of-state residential programs that provide board and care and treatment services to SED pupils shall be organized and operated on a nonprofit basis. The Parameters and Guidelines also require the claimant to provide supporting documentation for the costs claimed. In this case, the Controller concluded, based on a service agreement provided by the claimant, that the vendor payments made by the claimant to Mental Health Systems, Inc., a California nonprofit corporation, are not reimbursable because Mental Health Systems, Inc., contracted with Charter Provo Canyon School, a Delaware for-profit limited liability company, to provide board and care and treatment services for SED pupils. Since the facility providing the board and care and treatment services is a for-profit facility, the Controller correctly found that the costs were not eligible for reimbursement under the Parameters and Guidelines and state law.

The decisions issued by the Office of Administrative Hearings (OAH) and the United States Supreme Court that claimant relies upon to argue for subvention are not applicable in this case because those cases do not address the subvention requirement of article XIII B section 6 of the California Constitution. Moreover, the claimant has provided no documentation or evidence that the costs claimed in the subject reimbursement claims were incurred as a result of a court order finding that no other alternative placement was identified for

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<sup>8</sup> Exhibit F, pages 4-5 (March 25, 2016 Commission Hearing Transcript Excerpt).

a SED pupil during the audit years in question. Further, unlike the court’s equitable powers under the federal Individuals with Disabilities Education Act (IDEA), the reimbursement requirements of article XIII B, section 6, of the California Constitution must be strictly construed and not applied as an “equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities.”<sup>9</sup>

Accordingly, the Commission finds that the Controller’s reduction of costs in Finding 2 for board and care and treatment services costs for SED pupils provided by out-of-state, for-profit, residential programs is correct as a matter of law.

The Commission therefore denies this IRC.

## **I. Chronology**

- 04/09/2008 Claimant filed its fiscal year 2006-2007 annual reimbursement claim.<sup>10</sup>
- 02/10/2009 Claimant filed its fiscal year 2007-2008 annual reimbursement claim.<sup>11</sup>
- 02/08/2010 Claimant filed its fiscal year 2008-2009 annual reimbursement claim.<sup>12</sup>
- 03/29/2010 Date that claimant asserts the Controller initiated the audit of the fiscal year 2006-2007 through 2008-2009 reimbursement claims.<sup>13</sup>
- 04/14/2010 Date that Controller asserts that it initiated the audit of the fiscal years 2006-2007 through 2008-2009 reimbursement claims.<sup>14</sup>
- 03/07/2012 Controller issued the Final Audit Report.<sup>15</sup>
- 12/18/2012 Controller issued the Revised Final Audit Report, which “superseded” the Final Audit Report.<sup>16</sup>
- 12/10/2015 Claimant filed this IRC.<sup>17</sup>
- 12/18/2015 Commission issued a notice that the IRC was deemed untimely filed.

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<sup>9</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

<sup>10</sup> Exhibit A, IRC, page 123. In its audit report, the Controller noted the County received payment for their 2006-2007 claim from the 2009-10 budget (see also, Exhibit A, page 84).

<sup>11</sup> Exhibit A, IRC, page 133.

<sup>12</sup> Exhibit A, IRC, page 145.

<sup>13</sup> Exhibit E, Claimant’s Late Comments on the Draft Proposed Decision, page 3.

<sup>14</sup> Exhibit B, Controller’s Comments on the IRC, page 6.

<sup>15</sup> Exhibit A, IRC, page 8.

<sup>16</sup> Exhibit A, IRC, pages 8 and 76.

<sup>17</sup> Exhibit A, IRC, page 1.

- 12/28/2015 Claimant filed the *Appeal of Executive Director Decision*, 15-AEDD-01.
- 03/25/2016 Commission heard 15-AEDD-01, but took no action.
- 09/23/2016 Commission heard 15-AEDD-01, but took no action.<sup>18</sup>
- 10/28/2016 Commission heard 15-AEDD-01, and granted claimant’s Appeal, finding that the IRC was timely filed.<sup>19</sup>
- 12/05/2016 Controller filed comments on the IRC.<sup>20</sup>
- 01/20/2017 Commission staff issued the Draft Proposed Decision.<sup>21</sup>
- 02/01/2017 Controller filed comments on the Draft Proposed Decision.<sup>22</sup>
- 02/08/2017 Claimant requested an extension of time to file comments on the Draft Proposed Decision and postponement of hearing.
- 02/23/2017 Commission granted a limited approval of request for extension of time and postponement of hearing.
- 03/13/2017 Claimant filed late comments on the Draft Proposed Decision.<sup>23</sup>

## II. Background

### A. Out-of-State Residential Treatment for Seriously Emotionally Disturbed (SED) Pupils

This IRC addresses reimbursement claims for costs incurred by the County of San Diego for vendor services provided to SED pupils in out-of-state residential facilities from fiscal years 2006-2007, 2007-2008, and 2008-2009. During the audit period, the consolidated Parameters and Guidelines for *Handicapped and Disabled Students* (04-RL-4282-10); *Handicapped and Disabled Students II* (02-TC-40/02-TC-49); and *Seriously Emotionally Disturbed (SED) Pupils: Out of State Mental Health Services* (97-TC-05) governed the program.<sup>24</sup> The history of this program with respect to out-of-state residential treatment for SED pupils is described below.

Government Code sections (Gov. Code, §§ 7570, et seq.) and implementing regulations (Cal. Code Regs., tit. 2, §§ 60000, et seq.) were part of the state’s response to the federal Individuals with Disabilities Education Act (IDEA) that guaranteed to disabled pupils, including those with mental health needs, the right to receive a free and appropriate public education, including psychological and other mental health services, designed to meet the pupil’s unique educational

<sup>18</sup> 15-AEDD-01 was also set for hearing on May 26, 2016 but was continued, and again on July 22, 2016 but was postponed.

<sup>19</sup> Exhibit F, page 33 (October 28, 2016 Commission Hearing Transcript Excerpt).

<sup>20</sup> Exhibit B, Controller’s Comments on the IRC, page 1.

<sup>21</sup> Exhibit C, Draft Proposed Decision, issued January 20, 2017.

<sup>22</sup> Exhibit D, Controller’s Comments on the Draft Proposed Decision.

<sup>23</sup> Exhibit E, Claimant’s Late Comments on the Draft Proposed Decision.

<sup>24</sup> Exhibit A, IRC, page 30 (consolidated Parameters and Guidelines, adopted October 26, 2006).



needs.<sup>25</sup> As originally enacted, Government Code sections 7570, et seq. shifted to counties the responsibility and funding of mental health services required by a pupil’s individualized education plan (IEP), but the implementing regulations required that all services provided by the counties be provided *within* the State of California.<sup>26</sup> In 1996, the Legislature amended Government Code section 7576 to provide that the fiscal and program responsibilities of counties for SED pupils shall be the same regardless of the location of placement, and that the counties shall have fiscal and programmatic responsibility for providing or arranging the provision of necessary services for SED pupils placed in out-of-state residential facilities.<sup>27</sup>

On May 25, 2000, the Commission approved the *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services*, 97-TC-05 Test Claim, in which the claimant pled the 1996 amendment to Government Code section 7576 and the regulations that implemented the amendment, as a reimbursable state-mandated program (hereafter referred to as “SED”).<sup>28</sup> In the Test Claim Statement of Decision the Commission found that:

Before the enactment of Chapter 654, counties were only required to provide mental health services to SED pupils placed in out-of-home (in-state) residential facilities. However, section 1 now requires counties to have fiscal and programmatic responsibility for SED pupils regardless of placement – i.e., regardless of whether SED pupils are placed out-of-home (in-state) or out-of-state.

Chapter 654 also added subdivision (g) to Government Code section 7576, which provides:

“Referrals shall be made to the community mental health service in the county in which the pupil lives. If the pupil has been placed into residential care from another county, the community mental health service receiving the referral shall forward the referral immediately to the community mental health service of the county of origin, which shall have fiscal and programmatic responsibility for providing or arranging for provision of necessary services. . . .” (Emphasis added.)

California Code of Regulations, sections 60100 and 60200, amended in response to section 7576, further define counties’ “fiscal and programmatic responsibilities” for SED pupils placed in out-of-state residential care.

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<sup>25</sup> Former Government Code sections 7570, et seq., as enacted and amended by Statutes 1984, Chapter 1747; Statutes 1985, Chapter 1274; California Code of Regulations, title 2, sections 60000-60610 (emergency regulations filed December 31, 1985, designated effective January 1, 1986 (Register 86, No. 1) and refiled June 30, 1986, designated effective July 12, 1986 (Register 86, No. 28).

<sup>26</sup> Former California Code of Regulations, title 2, section 60200.

<sup>27</sup> Statutes 1996, chapter 654.

<sup>28</sup> Exhibit B, Controller’s Comments on the IRC, pages 22-30.

Specifically, section 60100 entitled “LEA Identification and Placement of a Seriously Emotionally Disturbed Pupil” reflects the Legislature’s intent behind the Test Claim statute by providing that residential placements for a SED pupil may be made out-of-state only when no in-state facility can meet the pupil’s needs. Section 60200 entitled “Financial Responsibilities” details county mental health and LEA financial responsibilities regarding the residential placements of SED pupils.

In particular, amended section 60200 removes the requirement that LEAs be responsible for the out-of-state residential placement of SED pupils. Subdivision (c) of section 60200 now provides that the county mental health agency of origin shall be “responsible for the provision of assessments and mental health services included in an IEP in accordance with [section 60100].” Thus, as amended, section 60200 replaces the LEA with the county of origin as the entity responsible for paying the mental health component of out-of-state residential placement for SED pupils.<sup>29</sup>

As relevant here, the Commission concluded that the following new costs were mandated by the state:

- Payment of out-of-state residential placements for SED pupils. (Gov. Code, § 7576; Cal. Code Regs., tit. 2, §§ 60100, 60110.)
- Program management, which includes parent notifications as required, payment facilitation, and all other activities necessary to ensure a county’s out-of-state residential placement program meets the requirements of Government Code section 7576 and Title 2, California Code of Regulations, sections 60000-60610. (Gov. Code, § 7576; Cal. Code of Regs., tit. 2, §§ 60100, 60110.)<sup>30</sup>

Parameters and Guidelines for the *SED* program were adopted on October 26, 2000,<sup>31</sup> and corrected on July 21, 2006,<sup>32</sup> with a period of reimbursement beginning January 1, 1997. The Parameters and Guidelines, as originally adopted, authorize reimbursement for the following costs:

To reimburse counties for payments to service vendors providing mental health services to SED pupils in out-of-state residential placements as specified in

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<sup>29</sup> Exhibit B, Controller’s Comments on the IRC, pages 141-142 (Statement of Decision, *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services*, 97-TC-05).

<sup>30</sup> Exhibit B, Controller’s Comments on the IRC, page 148.

<sup>31</sup> Exhibit F, Parameters and Guidelines, adopted October 26, 2000.

<sup>32</sup> Exhibit F, Corrected Parameters and Guidelines, dated July 21, 2006.

Government Code section 7576 and Title 2, California Code Regulations, [sections] 60100 and 60110.<sup>33</sup>

The correction adopted on July 21, 2006 added the following sentence: “Included in this activity is the cost for out-of-state residential board and care of SED pupils.” The correction was necessary to clarify the Commission’s finding when it adopted the Parameters and Guidelines, that the term “payments to service vendors providing mental health services to SED pupils in out-of-state residential placements” includes reimbursement for “residential costs” of out-of-state placements.<sup>34</sup>

Thus, the Parameters and Guidelines authorize reimbursement for payments to out-of-state service vendors providing board and care and treatment services for SED pupils “*as specified* in Government Code section 7576 and Title 2, California Code Regulations, [sections] 60100 and 60110.” Former section 60100(h) required that “[o]ut-of-state placements shall only be made in residential programs that meet the requirements of Welfare and Institutions Code sections 11460(c)(2) through (c)(3).” Welfare and Institutions Code section 11460, as amended by Statutes of 1995, chapter 724, governed the foster care program from 1996 to 2010. During those years, Welfare and Institutions Code section 11460(c)(3) provided that “State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home *organized and operated on a nonprofit basis.*” (Emphasis added.) Thus, the nonprofit rule applicable to out-of-state foster care group homes was made expressly applicable to out-of-state residential placements of SED pupils.

On October 26, 2006, the Commission consolidated the Parameters and Guidelines for *Handicapped and Disabled Students (04-RL-4282-10)*; *Handicapped and Disabled Students II (02-TC-40/02-TC-49)*; and *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services (97-TC-05)* for costs incurred commencing with the 2006-2007 fiscal year.<sup>35</sup> The reimbursable activities in the consolidated Parameters and Guidelines require counties to determine that the residential placement of SED pupils meets all the criteria established in Welfare and Institutions Code sections 18350 through 18356 before authorizing payment as follows:

G. Authorize payments to in-state or out-of-state residential care providers/ Issue payments to providers of in-state or out-of-state residential care for the residential and noneducational costs of seriously emotionally disturbed pupils (Gov. Code, § 7581; Cal. Code Regs., tit. 2, § 60200, subd. (e))

1. Authorize payments to residential facilities based on rates established by the Department of Social Services in accordance with Welfare and Institutions Code sections 18350 and 18356. *This activity requires counties to determine that the residential placement meets all the criteria established in Welfare and*

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<sup>33</sup> Exhibit F, Parameters and Guidelines, adopted October 26, 2000.

<sup>34</sup> Exhibit F, Corrected Parameters and Guidelines, dated July 21, 2006.

<sup>35</sup> Exhibit A, IRC, page 30 (consolidated Parameters and Guidelines, adopted October 26, 2006).

*Institutions Code sections 18350 through 18356 before authorizing payment.*<sup>36</sup>

At that time Welfare and Institutions Code section 18350(c) required that “[p]ayments for care and supervision shall be based on rates established in accordance with Sections 11460 to 11467, inclusive.”<sup>37</sup> And, as discussed above, section 11460(c) requires that out-of-state facilities where SED pupils are placed, shall be organized and operated on a nonprofit basis. Thus, under the Parameters and Guidelines, reimbursement for the cost of out-of-state residential placement of seriously emotionally disturbed pupils is contingent upon the placement being at a nonprofit facility.

Section V. of the consolidated Parameters and Guidelines instructs claimants to claim for contract services as follows:

Report the name of the contractor and services performed to implement the reimbursable activities. If the contractor bills for time and materials, report the number of hours spent on the activities and all costs charged. If the contract is a fixed price, report the services that were performed during the period covered by the reimbursement claim. If the contract services are also used for purposes other than the reimbursable activities, only the pro-rata portion of the services used to implement the reimbursable activities can be claimed. Submit contract consultant and attorney invoices with the claim and a description of the contract scope of services.<sup>38</sup>

Section IV. of the Parameters and Guidelines then requires that the costs claimed be supported with contemporaneous source documents. Pursuant to Section VI., the supporting documents shall be retained “during the period subject to audit.”<sup>39</sup>

Statutes 2011, chapter 43 (AB 114) eliminated the mandated programs for *Handicapped and Disabled Students (04-RL-4282-10)*; *Handicapped and Disabled Students II (02-TC-40/02-TC-49)*; and *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services (97-TC-05)*, by transferring responsibility for SED pupils to school districts, effective July 1, 2011.<sup>40</sup> Thus on September 28, 2012, the Commission adopted an amendment to the Parameters and Guidelines ending reimbursement for these programs effective July 1, 2011.

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<sup>36</sup> Exhibit A, IRC, page 37 (emphasis added) (consolidated Parameters and Guidelines, adopted October 26, 2006).

<sup>37</sup> Exhibit F, Welfare and Institutions Code section 18350, as amended by Statutes 1990, chapter 46, section 12, effective April 10, 1990.

<sup>38</sup> Exhibit A, IRC, pages 39-40 (consolidated Parameters and Guidelines, adopted October 26, 2006).

<sup>39</sup> Exhibit A, IRC, page 42 (consolidated Parameters and Guidelines, adopted October 26, 2006).

<sup>40</sup> Exhibit F, Assembly Bill No. 114 (2011-2012 Reg. Sess.), approved by the Governor, June 30, 2011.

## B. The Audit Findings of the Controller

The claimant submitted reimbursement claims totaling \$14,484,766 for fiscal years 2006-2007 through 2008-2009. The Controller audited the claims and reduced them by \$2,832,875 based on four findings.<sup>41</sup> The claimant only disputes the reductions in Finding 2 totaling \$1,387,095 (of the \$1,653,904 reduced in Finding 2) relating to ineligible vendor payments for board and care and treatment services for out-of-state residential placement of SED pupils in facilities that are “owned and operated *for-profit*.”<sup>42</sup> The Controller concluded that the vendor payments made by the claimant to Mental Health Systems, Inc., a California nonprofit corporation, are not allowable because Mental Health Systems, Inc., contracted with Charter Provo Canyon School, a Delaware for-profit limited liability company, to provide the out-of-state residential placement services. Since the facility providing the board and care treatment services is a for-profit facility, the Controller found that the costs are not eligible for reimbursement under the Parameters and Guidelines.<sup>43</sup>

## III. **Positions of the Parties**

### A. County of San Diego

The claimant contends that it timely filed its IRC on December 10, 2015, based on the Revised Final Audit Report dated December 18, 2012, which “superseded” the Final Audit Report dated March 7, 2012.

The claimant further contends that the Controller’s reductions for vendor payments for out-of-state residential placement of SED pupils in facilities that are owned and operated for-profit are incorrect and should be reinstated. For all fiscal years at issue, the claimant asserts that the requirements in the Parameters and Guidelines, based on California Code of Regulations, title 2, section 60100(h) and Welfare and Institutions Code section 11460(c)(3), are in conflict with the requirements of federal law, including the Individuals with Disabilities Education Act (IDEA) and section 472(c)(2) of the Social Security Act (42 U.S.C. 672(c)(2)).<sup>44</sup> In support of this position, the claimant argues the following:

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<sup>41</sup> The four findings are as follows: (1) overstated mental health services unit costs and indirect (administrative) costs of \$1,261,745; (2) overstated residential placement costs of \$1,653,904 (\$1,387,095 of which is disputed and is for ineligible board and care and treatment costs; the remaining reduction is based on adjustments for Local Revenue Funds applied to eligible board and care costs and for costs incurred outside of the clients’ authorization period); (3) duplicate due process hearing costs claimed of \$15,401; and (4) understated offsetting reimbursements of \$156,960. (Exhibit A, IRC, pages 85-97.)

<sup>42</sup> Exhibit A, IRC, page 9.

<sup>43</sup> Exhibit A, IRC, page 94; Exhibit B, Controller’s Comments on the IRC, pages 192-202 and 206-216 (see also the contract between Mental Health Systems, Inc., and Charter Provo Canyon School, LLC (later identified as UHS of Provo Canyon, Inc.)).

<sup>44</sup> Exhibit A, IRC, page 9.

- California law prohibiting placement in for-profit facilities is inconsistent with federal law, which no longer has such limitation, and with IDEA’s requirement that children with disabilities be placed in the most appropriate educational environment out-of-state and not be constrained by nonprofit status.<sup>45</sup>
- Counties will be subject to increased litigation without the same ability as parents to place seriously emotionally disturbed students in appropriate for-profit out-of-state facilities because the U.S. Supreme Court and the Office of Administrative Hearings (OAH) have found that parents were entitled to reimbursement for placing students in appropriate for-profit out-of-state facilities when the IEP prepared by the school district was found to be inadequate and the placement was otherwise proper under IDEA.<sup>46</sup>
- The County contracted with a nonprofit entity, Mental Health Services, Inc., to provide the out-of-state residential services subject to the disputed disallowances.<sup>47</sup>
- State and Federal law do not contain requirements regarding the tax identification status of mental health treatment service providers and the county has complied with the legal requirements regarding treatment services, so there is no basis to disallow treatment costs.<sup>48</sup> California Code of Regulations, title 2, section 60020(i) and (j) describes the type of mental health services to be provided to SED pupils, as well as who shall provide these services to special education students, with no mention of the tax identification status of the services provider.<sup>49</sup>

The claimant filed late comments on the Draft Proposed Decision asserting that the Controller’s audit of the County’s claims is invalid because it was not completed within the required two year statutory timeframe and therefore the Controller does not have the authority to impose the findings or to disallow the costs claimed by the County. Specifically, the claimant argues that because the Controller issued the Revised Final Audit Report on December 18, 2012, after the March 29, 2012 deadline to complete a timely audit, and the Commission determined that this report “superseded” the report dated March 7, 2012, the Controller failed to complete a timely audit pursuant to Government Code section 17558.5(a).<sup>50</sup>

#### B. State Controller’s Office

It is the Controller’s position that the audit adjustments are correct and that this IRC should be denied. The Controller asserts that the unallowable costs resulting from the out-of-state residential placement of SED pupils in for-profit facilities are correct because the Parameters and Guidelines only allow vendor payments for SED pupils placed in a group home organized and

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<sup>45</sup> Exhibit A, IRC, pages 12-13.

<sup>46</sup> Exhibit A, IRC, pages 14-16.

<sup>47</sup> Exhibit A, IRC, pages 16-17.

<sup>48</sup> Exhibit A, IRC, pages 17-18.

<sup>49</sup> Exhibit A, IRC, page 17.

<sup>50</sup> Exhibit E, Claimant’s Late Comments on the Draft Proposed Decision, pages 1-3.

operated on a nonprofit basis.<sup>51</sup> The Controller states that the unallowable treatment and board-and-care vendor payments claimed result from the claimant's placement of SED pupils in a prohibited for-profit out-of-state residential facility.<sup>52</sup>

The Controller does not dispute the assertion that California law is more restrictive than federal law in terms of out-of-state residential placement of SED pupils. The Controller also does not dispute that local educational agencies, unlike counties, are not restricted under the Education Code from contracting with for-profit schools for educational services. However the Controller maintains that under the mandated program, costs incurred at out-of-state for-profit residential programs are not reimbursable.<sup>53</sup>

The Controller also distinguishes the OAH case cited by the claimant, in which the administrative law judge found that not placing the student in an appropriate facility denied the student a free and appropriate public education under federal regulations, which the Controller argues has no bearing or precedent here because the decision does not address the issue of state mandated reimbursement for residential placements made outside of the regulations.<sup>54</sup> The Controller also cites an OAH case where the administrative law judge found, consistent with the Parameters and Guidelines, that the county Department of Health could *not* place a student in an out-of-state residential facility that is organized and operated for-profit because the county is statutorily prohibited from funding a residential placement in a for-profit facility. There, the administrative law judge also determined that the business relationship between the nonprofit entity, Aspen Solutions, and a for-profit residential facility, Youth Care, did not grant the latter nonprofit status.<sup>55</sup>

The Controller filed comments on the Draft Proposed Decision, agreeing with the staff recommendations and conclusion.<sup>56</sup>

#### **IV. Discussion**

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

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to a local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9

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<sup>51</sup> Exhibit B, Controller's Comments on the IRC, page 11.

<sup>52</sup> Exhibit B, Controller's Comments on the IRC, page 11.

<sup>53</sup> Exhibit B, Controller's Comments on the IRC, page 14.

<sup>54</sup> Exhibit B, Controller's Comments on the IRC, page 14.

<sup>55</sup> Exhibit B, Controller's Comments on the IRC, page 14 (citing OAH case Nos. N 2007090403 (Exhibit B of the IRC, pages 112-121) and 2005070683 (Tab 14 of the Controller's Comments on the IRC, pages 231-237)).

<sup>56</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.

of the Commission's regulations requires the Commission to send the decision to the Controller and request that the costs in the claim be reinstated.

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6 of the California Constitution.<sup>57</sup> The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."<sup>58</sup>

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.<sup>59</sup> Under this standard, the courts have found that:

When reviewing the exercise of discretion, "[t]he scope of review is limited, out of deference to the agency's authority and presumed expertise: 'The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]'"... "In general...the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support..." [Citations.] When making that inquiry, the " "court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "<sup>60</sup>

The Commission must review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with claimant.<sup>61</sup> In addition, section 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertions of fact by

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<sup>57</sup> *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

<sup>58</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

<sup>59</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space District* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

<sup>60</sup> *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>61</sup> *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.



the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.<sup>62</sup>

#### **A. The Claimant Timely Filed the IRC.**

On March 7, 2012, the Controller issued the Final Audit Report for all fiscal years at issue in this claim.<sup>63</sup> On December 18, 2012, the Controller issued the Revised Final Audit Report, which by its plain language "supersedes" the Final Audit Report because the Controller "recalculated EPSDT revenues for FY 2008-09 and revised Finding 4 to reflect the actual funding percentages based on the final settlement."<sup>64</sup> The revision had no fiscal effect on allowable total program costs, or on the adjustments in Finding 2, which is the subject of this IRC.<sup>65</sup> The claimant filed this IRC on December 10, 2015, challenging the Controller's reductions in Finding 2 for out-of-state, for-profit, vendor costs for room and board and treatment services incurred for SED pupils for fiscal years 2006-2007, 2007-2008, and 2008-2009.

In 2012, when the Final Audit Report and the Revised Final Audit Report were issued, section 1185.1(c) of the Commission's regulations required IRCs to be filed "no later than three (3) years following the date of the Office of State Controller's final state audit report, letter, remittance advice, or other written notice of adjustment notifying the claimant of a reduction."<sup>66</sup>

In this case, the IRC was filed more than three years after the Final Audit Report was issued, but within three years after the Revised Final Audit Report was issued. The claimant contends that the statute of limitations did not begin to accrue until after the Revised Final Audit Report was issued for the following reasons: the Commission's regulations did not clearly state that the statute of limitations began to accrue when the claimant *first* receives notice of a reduction; the December 18, 2012 Revised Final Audit Report "supersedes" the March 7, 2012 Final Audit Report; and therefore the Commission should reach the merits of the IRC.<sup>67</sup> As described below, the Commission finds that the claimant's IRC was timely filed.

A reimbursement claim for actual costs filed by a local agency is subject to the initiation of an audit by the Controller within the time periods specified in Government Code section 17558.5. Government Code section 17558.5(c) requires the Controller to notify the claimant of any adjustment to a claim for reimbursement that results from an audit or review. The "notification shall specify the claim components adjusted, the amounts adjusted, interest charges on claims

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<sup>62</sup> Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission's decision is not supported by substantial evidence in the record.

<sup>63</sup> Exhibit B, Controller's Comments on the IRC, page 6.

<sup>64</sup> Exhibit A, IRC, page 76.

<sup>65</sup> Exhibit A, IRC, page 76.

<sup>66</sup> California Code of Regulations, title 2, section 1185.1(c) (Register 2010, No. 44).

<sup>67</sup> Exhibit F, pages 126-128 (Exhibits to Item 2 of the October 28 Commission hearing); Exhibit F, page 5 (March 25, 2016 Commission Hearing Transcript Excerpt).

adjusted to reduce the overall reimbursement to the local agency . . . , and the reason for the adjustment.”<sup>68</sup> Government Code sections 17551 and 17558.7 then allow a claimant to file an IRC with the Commission if the Controller reduces a claim for reimbursement. Here, claimant received such a notification on two occasions: On March 7, 2012, with the issuance of the Final Audit Report, and again on December 18, 2012 with the issuance of the Revised Final Audit Report. Unlike under the current regulations, section 1185.1(c) of the Commission’s regulations, as it existed when the Final Audit Report and Revised Final Audit Report were issued in 2012 and when this IRC was filed on December 10, 2015, did not expressly state that the time for filing an IRC begins to accrue when the claimant *first* receives a notice of adjustment.<sup>69</sup>

In addition, the Controller’s Revised Final Audit Report issued December 18, 2012, states that the Revised Final Audit Report “supersedes” the March 7, 2012 Final Audit Report. The dictionary definition of supersede is: “1. To replace: supplant. 2. To cause to be set aside or replaced by another.”<sup>70</sup> Relying on the “supersedes” language, the claimant testified that it believed that the March 7, 2012 Final Audit Report was replaced by the December 18, 2012 Revised Final Audit Report and that it had three years from the date of the Revised Audit Report to file the IRC.<sup>71</sup>

Based on the circumstances of this case, including the language in the Revised Final Audit Report that it “supersedes” the earlier Final Audit Report, the ambiguity of the Commission’s regulations at the time the IRC was filed, and the policy expressed by the courts favoring disposition of cases based on the merits,<sup>72</sup> the Commission finds that the IRC was timely filed. Although the claimant could have filed an IRC on the March 7, 2012 Final Audit Report as early as March 7, 2012 (and before the December 18, 2012 Revised Final Audit Report was issued),

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<sup>68</sup> Government Code section 17558.5(c).

<sup>69</sup> California Code of Regulations, title 2, section 1185.1(c) (Register 2016, No. 48), which now states the following:

All incorrect reduction claims shall be filed with the Commission no later than three years following the date a claimant *first* receives from the Office of State Controller a final state audit report, letter, or other written notice of adjustment to a reimbursement claim, which complies with Government Code section 17558.5(c) by specifying the claim components adjusted, the amounts adjusted, interest charges on claims adjusted to reduce the overall reimbursement to the claimant, and the reason for the adjustment. The filing shall be returned to the claimant for lack of jurisdiction if this requirement is not met. (Emphasis added.)

<sup>70</sup> Webster’s II New College Dictionary (1995) page 1107.

<sup>71</sup> Exhibit F, page 4 (March 25, 2016 Commission Hearing Transcript Excerpt).

<sup>72</sup> *Fox v. Ethicon Endo-Surgery, Inc.* (2005) 35 Cal.4th 797, 806 (“A countervailing factor, of course, is the policy favoring disposition of cases on the merits rather than on procedural grounds.”); *Norgart v. Upjohn Company* (1999) 21 Cal.4th 383, 396; *Department of Corrections and Rehabilitations v. State Personnel Board* (2007) 147 Cal.App.4th 797, 805.

the claimant's IRC filing on December 10, 2015, which is based on the date of the superseding Revised Final Audit Report issued December 18, 2012, is timely.<sup>73</sup>

### **B. The Controller Timely Initiated the Audit.**

The claimant filed the 2006-2007 reimbursement claim on April 9, 2008,<sup>74</sup> the 2007-2008 reimbursement claim on February 10, 2009,<sup>75</sup> and the 2008-2009 reimbursement claim on February 8, 2010.<sup>76</sup> The claimant asserts that the audit was initiated on March 29, 2010, based on an entrance conference conducted by phone between the Controller's Office and the claimant, which is supported by an "entrance conference agenda," presumably prepared by the Controller's Office and submitted by the claimant.<sup>77</sup> The Controller asserts that it initiated the audit on April 14, 2010.<sup>78</sup> At the time the audit was initiated, either on March 29, 2010, or April 14, 2010, no payment had been made on the claims for fiscal years 2007-2008 and 2008-2009, and \$4,106,959 (appropriated from the fiscal year 2009-2010 budget) was paid on the 2006-2007 claim.<sup>79</sup>

When the reimbursement claims at issue in this IRC were submitted, Government Code section 17558.5 required the Controller to initiate an audit no later than three years after the claim is filed or last amended. However, if no funds are appropriated or no payment is made to the claimant for the program for the fiscal year at issue, the time for the Controller to initiate the audit is tolled to three years after the date of the initial payment of the claim. The statute reads as follows:

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.*<sup>80</sup>

The Commission finds that the Controller timely initiated the audit for all three fiscal years. The fiscal year 2006-2007 reimbursement claim was filed on April 9, 2008, but the claim was not paid until fiscal year 2009-2010. Thus, the time for the Controller to initiate the claim was

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<sup>73</sup> Exhibit F, page 33 (October 28, 2016 Commission Hearing Transcript Excerpt).

<sup>74</sup> Exhibit A, IRC, page 123.

<sup>75</sup> Exhibit A, IRC, page 133.

<sup>76</sup> Exhibit A, IRC, page 145.

<sup>77</sup> Exhibit E, Claimant's Late Comments on the Draft Proposed Decision, pages 3, 4-7.

<sup>78</sup> Exhibit B, Controller's Comments on the IRC, page 6.

<sup>79</sup> Exhibit A, IRC, pages 20, 84.

<sup>80</sup> Government Code section 17558.5 (as amended by Stats. 2004, ch. 890, eff. January 1, 2005, emphasis added).

toll, and the audit initiation date of either March 29, 2010, or April 14, 2010, was within three years of the date of payment on the fiscal year 2006-2007 claim. As to the other two fiscal years, the audit was initiated within three years of the date the reimbursement claims were submitted.

Therefore, the Controller's audit was timely initiated pursuant to Government Code section 17558.5(a).

**C. The Controller Timely Completed the March 7, 2012 Final Audit Report, But Did Not Timely Complete the December 18, 2012 Revised Final Audit Report and Thus, the December 18, 2012 Revised Final Audit Report Is Void.**

Government Code section 17558.5 requires that an audit be completed no later than two years after the date that the audit was commenced.<sup>81</sup> Here, the Controller's audit was commenced on either March 29, 2010, or April 14, 2010. Therefore, to be timely the audit must be completed as early as March 29, 2012 and no later than April 14, 2012.

The Controller asserts that the audit was timely completed on March 7, 2012, the date of the Final Audit Report.<sup>82</sup> The claimant argues that the Controller's Revised Final Audit Report, which supersedes the Final Audit Report and is dated December 18, 2012, completes the audit. The Revised Final Audit Report, however, was not completed within the required two year statutory deadline and the claimant asserts "therefore [the Controller] has no authority to impose the findings or disallow costs claimed and the County should be reimbursed for all disallowances."<sup>83</sup>

An audit is complete under Government Code section 17558.5(c) when the Controller notifies the claimant of any adjustment to a claim for reimbursement that results from an audit or review. The "notification shall specify the claim components adjusted, the amounts adjusted, interest charges on claims adjusted to reduce the overall reimbursement to the local agency . . . , and the reason for the adjustment." Absent evidence to the contrary, the Commission has found that the date of the final audit report provides evidence of when an audit is complete.<sup>84</sup>

In this case, the Controller issued the Final Audit Report on March 7, 2012, notifying the claimant of the reduction in Finding 2, before the earliest completion deadline of March 29, 2012.<sup>85</sup> The claimant does not dispute that the reduction in Finding 2 was included in the March 7, 2012 Final Audit Report and that Finding 2 did not change in the later-dated revised report.<sup>86</sup> Thus, the March 7, 2012 Final Audit Report was timely completed.

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<sup>81</sup> Government Code section 17558.5 (as amended by Stats. 2004, ch. 890, eff. January 1, 2005).

<sup>82</sup> Exhibit B, Controller's Comments on the IRC, page 6.

<sup>83</sup> Exhibit E, Claimant's Late Comments on the Draft Proposed Decision, page 1.

<sup>84</sup> *Collective Bargaining and Collective Bargaining Agreement Disclosure*, 08-4425-I-15, adopted December 5, 2014 (<http://www.csm.ca.gov/matters/08-4425-I-15/doc8.pdf>).

<sup>85</sup> Exhibit A, IRC, page 82.

<sup>86</sup> Exhibit F, pages 4-5 (March 25, 2016 Commission Hearing Transcript Excerpt).

The Controller issued the Revised Final Audit Report on December 18, 2012, after the two year deadline imposed by Government Code section 17558.5 to complete the audit. Therefore, the Commission finds that the Revised Final Audit Report, dated December 18, 2012, is not timely. Although Government Code section 17558.5 does not specify the consequences for failing to meet the deadlines imposed by the statute, the Commission finds that the failure to meet the deadline makes the Revised Final Audit Report void. Courts have ruled that when a deadline is for the protection of a person or class of persons, and the language of the statute as a whole indicates the Legislature’s intent to enforce the deadline, the deadline is mandatory.

[T]he intent must be gathered from the terms of the statute construed as a whole, from the nature and character of the act to be done, and from the consequences which would follow the doing or the failure to the particular act at the required time. (Citation.) When the provision is to serve some public purpose, the provision may be held directory or mandatory as will best accomplish that purpose (citation)....<sup>87</sup>

The California Supreme Court specifically rejected the notion that a statute could only be mandatory if it included a means of enforcement. Rather, the Court ruled that the important analysis is whether the purpose of the statute is to require an act.<sup>88</sup>

Here, the Legislature specifically amended section 17558.5 to require an audit be completed within two years, stating “[i]n any case, an audit shall be completed not later than two years after the date that the audit is commenced.” Because the structure and purpose of the statute suggests that it is mandatory, an audit report not completed by the deadline must be held void.

Accordingly, the Commission finds that the March 7, 2012 Final Audit Report was timely completed and that the December 18, 2012 Revised Final Audit Report, which was not completed by the deadline, is void.

**D. The Controller’s Audit Conclusions and Reduction of Costs in Finding 2 for Board and Care and Treatment Services Costs for SED Pupils Provided by Out-of-State, For-Profit, Residential Programs Remains Valid When the Final Audit Report Is Timely, But the Superseding Revised Final Audit Report Is Void.**

The claimant contends that the Commission has already decided, when it determined that this IRC was timely filed, that the Revised Final Audit Report superseded the March 7, 2012 Final Audit Report, and constitutes the last essential element and completion of the audit. Thus, the claimant asserts that since the March 7, 2012 Final Audit Report has been superseded it is void and cannot be used against the claimant. The claimant contends that since the Revised Final Audit Report is also void because it was not timely completed, claimant is “entitled to the full amount of costs claimed for reimbursement for the placement of pupils in certain out-of-state residential facilities that are organized and operated on a for-profit basis,” that were reduced in Finding 2. The claimant, for the first time, also requests in its comments on the Draft Proposed Decision the additional remedy of directing the Controller to reinstate all costs reduced in

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<sup>87</sup> *People v. McGee* (1977) 19 Cal.3d 948, 962, citing *Morris v. County of Marin* (1977) 18 Cal.3d 901, 909-910.

<sup>88</sup> *Id.*

Findings 1, 2, 3, and 4, most of which the claimant did not challenge in the IRC filing.<sup>89</sup> These issues are analyzed below.

**1. Although the Claimant Now Requests Reinstatement of All Costs Reduced by the Controller, the Commission's Jurisdiction Is Limited to the Reductions for Board and Care and Treatment Services Under Finding 2 Because the Claimant Only Timely Filed an IRC to Challenge Reductions for Board and Care and Treatment Services Under Finding 2, and Did Not Plead the Remaining Audit Reductions in its IRC.**

The claimant now requests that the Commission determine the effect of the void and superseding Revised Final Audit Report on *all* of the Controller's reduction of costs in Findings 1, 2, 3, and 4, most of which the claimant did not challenge in the IRC.<sup>90</sup> The Commission finds that it does not have jurisdiction over costs reduced in the audit which were not alleged to be incorrect in the IRC.

Government Code sections 17551(d) and 17558.7(a) allow a claimant to file an IRC if the Controller reduces a reimbursement claim, but requires the IRC to be filed in accordance with Commission regulations. Section 1185.1 of the Commission's regulations requires a claimant to specifically identify the alleged incorrect reduction. And, in this case, the claimant's IRC specifically challenges only \$1,387,095 of the \$1,653,904 reduced in Finding 2.<sup>91</sup> Section 1185.1 of the regulations allows a claimant to amend an IRC, but the amendment has to be filed within the three year statute of limitations. Section 1185.1(a) provides that "*all* incorrect reduction claims" shall be filed within the three year statute of limitations. Here, the Commission found that the statute of limitations began to accrue on December 18, 2012, with regard to the Revised Final Audit Report. Thus, any new IRC or amendment to the existing IRC to challenge all of Findings 1, 2, 3, and 4, had to be filed by December 18, 2015. No additional IRC or amendment to this IRC was filed.

Moreover, the record supports a finding that the claimant waived its right to challenge the remaining issues in Finding 2 and the reductions in Findings 1, 3, and 4. Waiver is the intentional relinquishment of a known right after knowledge of the facts.<sup>92</sup> The claimant's February 29, 2012 response to the Draft Audit Report, states the following:

There are four Findings in the above-referenced Draft Report and the County disputes Finding 2 – Overstated Residential Placement Costs. The County claims \$14,484,766 for the mandated programs for the audit period and \$4,106,959 has already been paid by the State. The State Controller's Office's audit found that \$11,651,891 is allowable and \$2,832,875 is unallowable. The unallowable costs as determined by State Controller's Office occurred primarily because the State

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<sup>89</sup> Exhibit E, Claimant's Late Comments on the Draft Proposed Decision.

<sup>90</sup> Exhibit E, Claimant's Late Comments on the Draft Proposed Decision.

<sup>91</sup> Exhibit A, IRC, page 1.

<sup>92</sup> *City of Ukiah v. Fones* (1966) 64 Cal.2d 104, 107.

alleges the County overstated residential placement costs by \$1,653,904 (the County disputes \$1,387,095) for the audit period. As stated above, the County disputes Finding 2 and asserts that \$1,387,095 are allowable costs that are due the County for the audit period.<sup>93</sup>

The claimant's IRC also states the following:

- “The County of San Diego (County) hereby submits an Incorrect Reduction Claim (IRC) challenging the State Controller’s disallowance of \$1,387,095.00 in costs claimed by the County for providing legislatively mandated Consolidated Handicapped and Disabled Students (HDS), HDS II, and Seriously Emotionally Disturbed Pupils Program for the period of July 1, 2006-June 30, 2009.”<sup>94</sup>
- “There were four Findings in the Audit Report and the County disputes only the second Finding which alleges the County overstated residential placement costs by \$1,653,904 for the audit period.”<sup>95</sup>
- The County disputes Finding 2 – Overstated residential placement costs – because the California Code of Regulations Title 2 section 60100(h) which was in effect during the audit period and Welfare and Institutions Code section 11460(c)(3) cited by the State is in conflict with requirements of federal law . . . .”<sup>96</sup>
- “The County specifically disputes the finding that it claimed ineligible vendor payments of \$1,387,095 (board and care costs of \$753,624 and treatment costs of \$633,471) for out-of-state residential placement of SED pupils owned and operated for profit.”<sup>97</sup>
- “The County asserts that it is entitled to the entire amount claimed less the sum already paid by the State and that its claim was incorrectly reduced by board and care costs of \$753,624 and treatment costs of \$633,471.”<sup>98</sup>
- “In conclusion, the County asserts that the costs claimed for the period of July 1, 2006 through June 30, 2009 was incorrectly reduced by \$1,387,095 as set forth in Exhibits A-1 through A-4 and the County should be reimbursed the full amount of these disputed costs.”<sup>99</sup>

Accordingly, the sole issue is whether the Controller’s audit conclusions and reduction of costs in Finding 2 for board and care and treatment services costs for SED pupils provided by out-of-

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<sup>93</sup> Exhibit A, IRC, pages 99-100.

<sup>94</sup> Exhibit A, IRC, page 1.

<sup>95</sup> Exhibit A, IRC, page 9.

<sup>96</sup> Exhibit A, IRC, page 9.

<sup>97</sup> Exhibit A, IRC, page 10.

<sup>98</sup> Exhibit A, IRC, page 10.

<sup>99</sup> Exhibit A, IRC, page 18.

state, for profit, residential programs remain valid when the Final Audit Report is timely, but the superseding Revised Final Audit Report is void.

**2. The Commission Finds That the Timely Completion of the Audit was Made with the Controller's March 7, 2012 Final Audit Report. Since the Revised Final Audit Report Was Not Timely Completed and Is Void, It Has No Effect on the March 7, 2012 Reductions Under Finding 2. Therefore, the Commission Must Reach the Merits of Finding 2, As Requested by Claimant in its Appeal of Executive Director Decision, 15-AEDD-01. On the Merits, the Commission Finds the Controller's Reduction of Costs Claimed for Board and Care and Treatment Services for Seriously Emotionally Disturbed Pupils Provided by Out-Of-State Residential Programs That Are Organized and Operated on a For-Profit Basis, Is Correct as a Matter of Law.**

- a) The Timely Completion of the Audit Was Made with the Controller's March 7, 2012 Final Audit Report and the Revised Final Audit Report Is Void and Can Have No Effect on the March 7, 2012 Reductions Under Finding 2.

The claimant contends that the Commission already determined that the Revised Final Audit Report superseded the March 7, 2012 Final Audit Report when it found that the IRC was timely filed, and further asserts that the Revised Final Audit Report constitutes the last essential element and completion of the audit. Thus, the claimant asserts that the March 7, 2012 Final Audit Report is void and cannot be used against the claimant. Since the December 18, 2012 Revised Final Audit Report is also void because it was not timely completed, the claimant contends that the IRC should be approved.<sup>100</sup> The claimant is wrong.

As described below, the audit was timely completed with the March 7, 2012 Final Audit Report. Since the Revised Final Audit Report is void, it has no effect on the March 7, 2012 reductions under Finding 2. On October 28, 2016, the Commission heard and decided the issue of whether the claimant timely filed this IRC in accordance with the Commission's regulations and found that the statute of limitations for filing the IRC began to accrue with the later December 18, 2012 Revised Final Audit Report. The conclusion on the statute of limitations was based on the policy of reaching the merits of the claim as requested by the claimant, the plain language of the Revised Final Audit Report that it superseded the earlier March 7, 2012 report (and hence provided notice to the claimant that it could commence an IRC proceeding), and the ambiguity in the Commission's regulations at the time the IRC was filed. However, the issue of whether the Controller timely completed the audit in accordance with Government Code section 17558.5 was not before the Commission at the October 28, 2016 hearing. Thus, the Commission was not made aware of, and did not address, the timeliness of the Revised Final Audit Report and the effect of that untimely and void report with respect to validity of the March 7, 2012 Final Audit Report and the reductions made therein. Thus, the Commission did *not* find at that hearing that the March 7, 2012 Final Audit Report was void, as asserted by the claimant. The Commission, instead, agreed to reach the merits of the IRC.

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<sup>100</sup> Exhibit E, Claimant's Late Comments on the Draft Proposed Decision, page 3.



As indicated above, an audit is complete under Government Code section 17558.5(c) when the Controller notifies the claimant of any adjustment to a claim for reimbursement that results from an audit or review. The “notification shall specify the claim components adjusted, the amounts adjusted, interest charges on claims adjusted to reduce the overall reimbursement to the local agency . . . , and the reason for the adjustment.” Based on the evidence in the record, the Commission finds that the March 7, 2012 Final Audit Report provided notice to the claimant of the reasons for the reduction and the amount reduced in Finding 2 in accordance with Government Code section 17558.5. No changes were made in the Revised Final Audit Report to Finding 2 and the claimant does not dispute that the reduction amount and reasoning for the reduction in Finding 2 remained the same in the Revised Final Audit Report as it was in the March 7, 2012 Final Audit Report.<sup>101</sup> Moreover, claimant is not prejudiced by the intervening Revised Audit Report as that simply extended the time for claimant to file this IRC.

Accordingly, the Commission finds that completion of the audit was made with the Controller’s March 7, 2012 Final Audit Report and claimant could have filed an IRC at any time beginning on March 7, 2012 to contest the Finding 2 reductions at issue in this claim. Since the March 7, 2012 Final Audit Report was timely completed, and the Revised Final Audit Report is void and can have no effect on Finding 2 since it was completed past the statutory deadline, the Commission must now reach the merits of Finding 2.

b) The Controller’s Reduction of Costs Claimed for Board and Care and Treatment Services for Seriously Emotionally Disturbed Pupils Provided by Out-Of-State Residential Programs That Are Organized and Operated on a For-Profit Basis, Is Correct as a Matter of Law.

As described below, the Commission finds that the Controller’s reduction for vendor service costs claimed for board and care and treatment services for SED pupils placed in facilities that are organized and operated for-profit is correct as a matter of law.

1) During all of the fiscal years at issue in these claims, the Parameters and Guidelines and state law required that SED pupils placed in out-of-state residential facilities be placed in nonprofit facilities and thus, costs claimed for vendor services provided by out-of-state service programs that are organized and operated on a for-profit basis are beyond the scope of the mandate.

Reimbursement claims filed with the Controller are required by law to be filed in accordance with the parameters and guidelines adopted by the Commission.<sup>102</sup> Parameters and guidelines

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<sup>101</sup> Exhibit F, pages 4-5 (March 25, 2016 Commission Hearing Transcript Excerpt).

<sup>102</sup> Government Code sections 17561(d)(1); 17564(b); and 17571; *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, 801, where the court ruled that parameters and guidelines adopted by the Commission are regulatory in nature and are “APA valid”; *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201, where the court found that the Commission’s quasi-judicial decisions are final and binding, just as judicial decisions.

provide instructions for eligible claimants to prepare reimbursement claims for direct and indirect costs of a state-mandated program.<sup>103</sup> Parameters and guidelines are regulatory in nature and “APA valid, and absent a court ruling setting them aside, are binding on the parties.”<sup>104</sup>

As indicated above, the consolidated Parameters and Guidelines authorize reimbursement for the payments made by counties to out-of-state care providers of a SED pupil for residential board and care treatment services costs based on rates established by the Department of Social Services in accordance with Welfare and Institutions Code sections 18350 and 18356. Counties are further required to determine that the residential placement “meets all the criteria established in Welfare and Institutions Code sections 18350 through 18356 before authorizing payment.”

As described in the Background, Welfare and Institutions Code section 18350(c) required that the payment “for care and supervision shall be based on rates established in accordance with Sections 11460 to 11467” of the Welfare and Institutions Code. Welfare and Institutions Code section 11460 governed the foster care program and subdivision (c)(3) provided that “State reimbursement for an AFDC-FC rate paid on or after January 1, 1993, shall only be paid to a group home *organized and operated on a nonprofit basis.*” (Emphasis added.) Thus, the nonprofit rule applicable to out-of-state foster care group homes was made expressly applicable to out-of-state residential placements of SED pupils. Consistent with these statutes, section 60100(h) of the regulations for this program states that out-of-state residential programs shall meet the requirements in Welfare and Institutions Code section 11640(c)(2) through (3) and, thus, be organized and operated on a nonprofit basis.

The claimant argues, however, that there is no requirement in state or federal law regarding the tax identification status of mental health treatment service providers and that the California Code of Regulations, at section 60020(i) and (j), describe the type of mental health services to be provided in the *SED* program, as well as who shall provide it, with no requirement regarding the providers’ tax identification status.<sup>105</sup> However, section 60020 of the regulations defines “psychotherapy and other mental health services” for SED pupils and is part of the same article containing the provisions in section 60100, which further specifies the requirements for out-of-state residential programs. The definition of “psychotherapy and other mental health services” in section 60020 does not change the requirement that an out-of-state residential facility providing board and care and treatment services for SED pupils is required to be organized and operated on a nonprofit basis under this program.

This is further evidenced by the regulatory history of section 60100. During the regulatory process for the adoption of California Code of Regulation section 60100, comments were filed by interested persons with concerns that referencing Welfare and Institutions Code section 11460 in section 60100 of the regulations to provide that “[o]ut-of-state placements shall only be made in residential programs that meet the requirements of Welfare and Institutions Code sections 11460(c)(2) through (c)(3)” was not clear since state reimbursement for special education

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<sup>103</sup> Government Code section 17557; California Code of Regulations, title 2, section 1183.7(e).

<sup>104</sup> *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, 801; *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

<sup>105</sup> Exhibit A, IRC, page 17-18.

residential placements is not an AFDC-Foster Care program. The Departments of Education and Mental Health responded as follows:

Board and care rates for children placed pursuant to Chapter 26.5 of the Government Code are linked in statute to the statutes governing foster care board and care rates. The foster care program and the special education pupils program are quite different in several respects. This creates some difficulties which must be corrected through statutory changes, and cannot be corrected through regulations. Rates are currently set for foster care payments to out-of-state facilities through the process described in WIC Sections 11460(c)(2) through (c)(3). The rates cannot exceed the current level 14 rate *and the program must be non-profit*, and because of the requirements contained in Section WIC 18350, placements for special education pupils must also meet these requirements. The Departments believe these requirements are clearly stated by reference to statute, but we will handbook WIC Sections 11460(c)(2) through (c)(3) for clarity.<sup>106</sup>

In addition, the departments specifically addressed the issue of “out-of-state group homes which are organized as for profit entities, but have beds which are leased by a non-profit shell corporation.”<sup>107</sup> The departments stated that the issue may need further legal review of documentation of group homes that claim to be nonprofit, but nevertheless “[t]he statute in WIC section 11460 states that state reimbursement shall only be paid to a group home organized and operated on a non-profit basis.”<sup>108</sup>

Subsequent to the adoption of the Test Claim Decision and Parameters and Guidelines for this program, legislation was introduced to address the issue of payment for placement of SED pupils in out-of-state for-profit facilities in light of the fact that the federal government eliminated the requirement that a facility be operated as nonprofit in order to receive federal funding. However, as described below, the legislation was not enacted and the law applicable to these claims remained unchanged during the reimbursement period of the program.

In the 2007-2008 legislative session, Senator Wiggins introduced SB 292, which would have authorized payments to out-of-state, for-profit residential facilities that meet applicable licensing requirements in the state in which they operate, for placement of SED pupils placed pursuant to an IEP. The committee analysis for the bill explained that since 1985, California law has tied the requirement for placement of a SED pupil placed out-of-home pursuant to an IEP, to state foster care licensing and rate provisions. However, the analysis notes that the funds for placement of SED pupils are not AFDC-FC funds. California first defined the private group homes that could receive AFDC-FC funding as nonprofits to parallel the federal funding requirement. Because of

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<sup>106</sup> Exhibit F, Final Statement of Reasons for Joint Regulations for Pupils with Disabilities, page 127 (emphasis added).

<sup>107</sup> Exhibit F, Final Statement of Reasons for Joint Regulations for Pupils with Disabilities, page 128.

<sup>108</sup> Exhibit F, Final Statement of Reasons for Joint Regulations for Pupils with Disabilities, page 128.

the connection between foster care and SED placement requirements, this prohibition applies to placements of SED pupils as well. The committee analysis further recognized that the federal government eliminated the requirement that a facility be operated as a nonprofit in order to receive federal funding in 1996.<sup>109</sup> However, the bill did not pass the assembly.<sup>110</sup>

In 2008, AB 1805, a budget trailer bill, containing identical language to SB 292 was vetoed by the governor.<sup>111</sup> In his veto message he wrote, "I cannot sign [AB 1805] in its current form because it will allow the open-ended reimbursement of claims, including claims submitted and denied prior to 2006-07. Given our state's ongoing fiscal challenges, I cannot support any bill that exposes the state General Fund to such a liability."<sup>112</sup>

Subsequently, during the 2009-2010 legislative session, Assembly Member Beall introduced AB 421, which authorized payment for 24-hour care of SED pupils placed in out-of-state, for-profit residential facilities. The bill analysis for AB 421 cites the Controller's disallowance of \$1.8 million in mandate claims from San Diego County based on the claims for payments for out-of-state, for-profit residential placement of SED pupils. The analysis states that the purpose of the proposed legislation was to incorporate the allowance made in federal law for reimbursement of costs of placement in for-profit group homes for SED pupils.<sup>113</sup> Under federal law, for-profit companies were originally excluded from receiving federal funds for placement of foster care children because Congress feared repetition of nursing home scandals in the 1970s, when public funding of these homes triggered growth of a badly monitored industry.<sup>114</sup> The bill analysis suggests that the reasoning for the current policy in California, limiting payments to nonprofit group homes, ensures that the goal of serving children's interests is not mixed with the goal of private profit. For these reasons, California has continually rejected allowing placements in for-profit group home facilities for both foster care and SED pupils.<sup>115</sup> The authors and supporters of the legislation contended that out-of-state, for-profit facilities are sometimes the only available placement to meet the needs of the child, as required by federal law.<sup>116</sup> The

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<sup>109</sup> Exhibit F, Assembly Committee on Human Services, analysis of SB 292 (2007-2008 Reg. Sess.), June 17, 2009, page 2.

<sup>110</sup> Exhibit F, Complete Bill History, SB 292 (2007-2008 Reg. Sess.).

<sup>111</sup> Exhibit F, Assembly Committee on Appropriations, analysis of AB 421 (2009-2010 Reg. Sess.), May 20, 2009, page 3.

<sup>112</sup> Exhibit F, Governor's Veto Message, AB 1885 (2007-2008), September 30, 2008.

<sup>113</sup> Exhibit F, Assembly Committee on Appropriations, analysis of AB 421 (2009-2010), May 20, 2009, page 2.

<sup>114</sup> Exhibit F, Assembly Committee on Appropriations, analysis of AB 421 (2009-2010), May 20, 2009, page 1.

<sup>115</sup> Exhibit F, Assembly Committee on Appropriations, analysis of AB 421 (2009-2010), May 20, 2009, page 2.

<sup>116</sup> Exhibit F, Assembly Committee on Appropriations, analysis of AB 421 (2009-2010), May 20, 2009, page 2.

author notes the discrepancy between California law and federal law, which allows federal funding of for-profit group home placements.<sup>117</sup> However, the bill did not pass the Assembly and therefore did not move forward.<sup>118</sup>

Thus, during the entire reimbursement period for this program, reimbursement was authorized only for out-of-state residential facilities organized and operated on a nonprofit basis. Although the claimant contends that state law conflicted with federal law during this time period, there is no law or evidence in the record that the nonprofit requirement for out-of-state residential programs conflicts with federal law or results in a failure for a pupil to receive a free and appropriate education. Absent a decision from the courts on this issue, the Commission is required by law to presume that the statutes and regulations for this program, which were adopted in accordance with the Administrative Procedures Act, are valid.<sup>119</sup>

Accordingly, pursuant to the law and the Parameters and Guidelines, reimbursement is required only if the out-of-state service vendor operates on a nonprofit basis. As indicated above, the Parameters and Guidelines are binding.<sup>120</sup> Therefore, costs claimed for out-of-state service vendors that are organized and operated on a for-profit basis are beyond the scope of the mandate.

- 2) *The claimant's reference to decisions issued by the Supreme Court and administrative bodies allowing placement in for-profit residential programs is misplaced.*

The claimant argues that:

In California, during the audit period, if counties were unable to access for-profit out-of-state programs, they may not be able to offer an appropriate placement for a pupil that had a high level of unique mental health needs that may only be treated in a specialized program. If that program was for-profit, that county would have been subject to litigation from parents, who through litigation, may access the appropriate program for their child regardless of the program's tax identification status.

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Consistent with IDEA, during the audit period, counties should have been able to place special education students in the most appropriate program that met their unique needs without consideration for the programs for-profit or nonprofit status

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<sup>117</sup> Exhibit F, Assembly Committee on Appropriations, analysis of AB 421 (2009-2010), May 20, 2009.

<sup>118</sup> Exhibit F, Complete Bill History, AB 421 (2009-2010).

<sup>119</sup> California Constitution, article III, section 3.5; *Robin J. v. Superior Court* (2004) 124 Cal.App.4th 414, 425.

<sup>120</sup> *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, 801; *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

so that students would be placed appropriately and counties would not be subject to needless litigation as evidenced in the Riverside case above.<sup>121</sup>

The Riverside OAH decision relied upon by claimants, involved a SED pupil who was deaf, had impaired vision, and an orthopedic condition, was assessed as having borderline cognitive ability, and had a long history of social and behavioral difficulties. His only mode of communication was American Sign Language. The parties agreed that the National Deaf Academy would provide the student with a free and appropriate public education, as required by federal law. The facility accepted students with borderline cognitive abilities and nearly all service providers are fluent in American Sign Language. However, the school district and county mental health department took the position that they could not place the student at the National Deaf Academy because it is operated by a for-profit entity. OAH found that the state was not prohibited from placing the student at this out-of-state for-profit facility because the facility was the only one identified as an appropriate placement.<sup>122</sup> Upon appeal, the District Court affirmed the OAH order directing the school district and the county mental health department to provide the student with compensatory education consisting of immediate placement at the National Deaf Academy and through the 2008-2009 school year.<sup>123</sup>

The claimant also relies on the U.S. Supreme Court decision in *Florence County School District Four v. Carter*,<sup>124</sup> for the proposition that local government will be subject to increased litigation with the Controller's interpretation. In the *Florence* case, the court held that parents can be reimbursed under IDEA when they unilaterally withdraw their child from an inappropriate placement in a public school and place their child in a private school, even if the placement in the private school does not meet all state standards or is not state approved. Although the court found that parents are entitled to reimbursement under such circumstances only if a federal court concludes both that the public placement violated IDEA and the private school placement was proper under IDEA, the court's decision in such cases is *equitable*. "IDEA's grant of equitable authority empowers a court 'to order school authorities to reimburse parents for their expenditures on private special education for a child if the court ultimately determines that such placement, rather than a proposed IEP, is proper under the Act.'"<sup>125</sup> Unlike the court's equitable powers under IDEA, the reimbursement requirements of article XIII B, section 6, of the

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<sup>121</sup> Exhibit A, IRC, pages 14-15.

<sup>122</sup> Exhibit A, IRC, pages 112-121 (*Student v. Riverside Unified School District and Riverside County Department of Mental Health*, OAH Case No. 2007090403, dated January 15, 2008).

<sup>123</sup> Exhibit F, *Riverside County Department of Mental Health v. Sullivan* (E.D.Cal. 2009) EDCV 08-0503-SGL.

<sup>124</sup> *Florence County School District v. Carter* (1993) 510 U.S. 7.

<sup>125</sup> *Florence County School District v. Carter* (1993) 510 U.S. 7, 12 (citing its prior decision in *School Comm. of Burlington v. Department of Ed. of Mass.* (1985) 471 U.S. 359, 369).

California Constitution must be strictly construed and not applied as an “equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities.”<sup>126</sup>

In this case, the claimant has provided no documentation or evidence that the costs claimed were incurred as a result of a court order finding that no other alternative placement was identified for a SED pupil during the audit years in question. Thus, the Commission does not need to reach the issue of whether reimbursement under article XIII B, section 6 of the California Constitution would be required in such cases. Therefore, these decisions do not support the claimant’s right to reimbursement.

Accordingly, the Commission finds that the Controller’s reduction of costs for vendor service payments for board and care and treatment services for SED pupils placed in out-of-state residential programs organized and operated for-profit, is consistent with the Commission’s Parameters and Guidelines and is correct as a matter of law.

3) *The documentation in the record supports the Controller’s findings that services were provided by for-profit residential programs.*

The claimant makes no argument disputing the Controller’s findings that Charter Provo Canyon School is a for-profit facility that provided the board and care and treatment services for its SED pupils. Claimant contends, however, that reimbursement is required because it contracted with Mental Health Systems, Inc., a nonprofit corporation, in accordance with the Parameters and Guidelines, and provides a copy of a letter from the IRS verifying that Mental Health Systems, Inc., is a nonprofit entity.<sup>127</sup> Claimant further argues that

The State never provided any guidance to counties as to how to access or contract with appropriate out-of-state facilities that meet State criteria or qualifications. The State never provided counties a list of appropriate out-of-state facilities that meet State requirements. County should not be penalized now for fulfilling the requirements of the law with little or no guidance from the State.<sup>128</sup>

In this case, the Controller concluded that the vendor payments made by the claimant to Mental Health Systems, Inc., a California nonprofit corporation are not reimbursable because Mental Health Systems, Inc., contracted with Charter Provo Canyon School, a Delaware for-profit limited liability company, to provide the board and care and treatment services for SED pupils. Since the facility providing the board and care and treatment services is a for-profit facility, the Controller found that the costs were not eligible for reimbursement under the Parameters and Guidelines.<sup>129</sup>

As indicated above, reimbursement is required only if the out-of-state service vendor that provides board and care and treatment services to SED pupils is organized and operated on a

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<sup>126</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281 (citing *City of San Jose v. State* (1996) 45 Cal.App.4th 1802, 1817).

<sup>127</sup> Exhibit A, IRC, page 24.

<sup>128</sup> Exhibit A, IRC, pages 16-17.

<sup>129</sup> Exhibit A, IRC, page 94.

nonprofit basis. Costs claimed for out-of-state service vendors that are organized and operated on a for-profit basis are beyond the scope of the mandate and are not eligible for reimbursement as a matter of law.

During the course of the audit, claimant provided a copy of the contracts between Mental Health Systems, Inc., and Charter Provo Canyon School, LLC (later identified as UHS of Provo Canyon) “for the provision of services pursuant to Chapter 26.5 of Division 7 of Title 1 of the Government Code” (the chapter Government Code that includes the test claim statute). The agreement demonstrates that Charter Provo Canyon School provided the services for the claimant, and confirms that Charter Provo Canyon School, LLC is a for-profit limited liability company. The contract title itself expresses that it is an “Agreement to Provide Mental Health Services” and the recitals state “Provo Canyon has agreed to provide the services of qualified professionals to provide care to those persons authorized to receive mental health services.”<sup>130</sup> In addition, the reimbursement claims filed for 2006-2007 and 2007-2008 identify the vendor as “Mental Health Systems-Provo Canyon” and for 2008-2009 as “MHS-Provo Canyon.”<sup>131</sup>

Accordingly, the evidence in the record supports the Controller’s finding that the services were provided by for-profit entities and are outside the scope of the mandate.

Therefore, the Commission finds that the Controller’s reduction for vendor service costs claimed for board and care and treatment services of SED pupils placed in facilities that are organized and operated for-profit is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

## **V. Conclusion**

Based on the foregoing, the Commission denies this IRC on the ground that the Controller’s audit was timely initiated on either March 29, 2010 or April 14, 2010, and timely completed with the March 7, 2012 Final Audit Report. Since the Revised Final Audit Report was not timely completed and is void, it has no effect on the March 7 2012 reductions under Audit Finding 2. Therefore, the Commission must reach the merits of Audit Finding 2, as requested by claimant in its *Appeal of Executive Director Decision*, 15-AEDD-01. On the merits, the Commission concludes that the Controller’s reduction of costs in Audit Finding 2 for board and care and treatment services costs for SED pupils provided by out-of-state, for-profit, residential programs is correct as a matter of law.

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<sup>130</sup> Exhibit B, Controller’s Comments on the IRC, pages 192-204 and 206-216.

<sup>131</sup> Exhibit A, IRC, pages 127, 138, and 150.





RE: **Decision**

*Handicapped and Disabled Students (04-RL-4282-10); Handicapped and Disabled Students II (02-TC-40/02-TC-49); and Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services (97-TC-05), 15-9705-I-06*

Government Code Sections 7571, 7572, 7572.5, 7572.55, 7576, 7581, and 7586 as added by Statutes 1984, Chapter 1747 (AB 3632); and as amended by Statutes 1985, Chapter 1274 (AB 882); Statutes 1994, Chapter 1128 (AB 1892); Statutes 1996, Chapter 654 (AB 2726);

California Code of Regulations, Title 2, Division 9, Chapter 1, Sections 60020, 60030, 60040, 60045, 60050, 60055, 60100, 60110, 60200, and 60550

(Emergency regulations effective January 1, 1986 [Register 86, No. 1], and refiled June 30, 1986, designated effective July 12, 1986 [Register 86, No. 28]; and Emergency regulations effective July 1, 1998 [Register 98, No. 26]; final regulations effective August 9, 1999 [Register 99, No. 33])

Fiscal Years: 2006-2007, 2007-2008, and 2008-2009

County of San Diego, Claimant

On May 26, 2017, the foregoing Decision of the Commission on State Mandates was adopted on the above-entitled matter.

Heather Halsey, Executive Director

Dated: May 31, 2017

BEFORE THE  
COMMISSION ON STATE MANDATES  
STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM  
ON:**

Former Education Code Section 72246  
(Renumbered as § 76355)<sup>1</sup>

Statutes 1984, Chapter 1 (1983-1984 2nd Ex.  
Sess.) (AB2X 1); and Statutes 1987, Chapter  
1118 (AB 2336)

Fiscal Years 2002-2003, 2003-2004, 2004-  
2005, 2005-2006, and 2006-2007

Yosemite Community College District,  
Claimant

Case No.: 09-4206-I-25

*Health Fee Elimination*

**DECISION PURSUANT TO  
GOVERNMENT CODE SECTION 17500 ET  
SEQ.; CALIFORNIA CODE OF  
REGULATIONS, TITLE 2, DIVISION 2,  
CHAPTER 2.5, ARTICLE 7**

*(Adopted March 24, 2017)*

*(Served March 28, 2017)*

**DECISION**

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on March 24, 2017. Ken Howell and Jim Spano appeared on behalf of the State Controller’s Office (Controller). Claimant did not appear at the hearing.

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

The Commission adopted the Proposed Decision to deny the IRC by a vote of 4 to 0.

<b>Member</b>	<b>Vote</b>
Ken Alex, Director of the Office of Planning and Research	Absent
Richard Chivaro, Representative of the State Controller, Vice Chairperson	Absent
Mark Hariri, Representative of the State Treasurer	Yes
Sarah Olsen, Public Member	Yes
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	Yes
Carmen Ramirez, City Council Member	Absent
Don Saylor, County Supervisor	Yes

<sup>1</sup> Statutes 1993, chapter 8.

## **Summary of the Findings**

This Decision addresses an IRC filed by the Yosemite Community College District (claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during fiscal years 2002-2003 through 2006-2007 under the *Health Fee Elimination* program. Reductions of \$451,873 were made based on overstated indirect costs claimed for fiscal years 2005-2006 and 2006-2007, understated offsetting student health service fees authorized to be collected, and understated offsetting savings or reimbursements from earned interest income on the student health fee revenue.

The Commission finds that the audit for fiscal years 2002-2003 and 2003-2004 was timely commenced from the date of initial payment of the claims in accordance with Government Code section 17558.5, and that the audit was timely completed within the two-year deadline.

The Commission also finds that the Controller's reduction and recalculation of indirect costs for is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support. The claimant used the FAM29-C methodology to calculate indirect costs for fiscal years 2005-2006 and 2006-2007, but used the prior year's CCFS-311 financial reporting information, instead of the claim year's CCFS-311 financial reporting information as required to report actual costs incurred. Thus, the Controller's reduction is correct as a matter of law. In addition, there is no evidence that the Controller's recalculation of indirect costs is arbitrary, capricious, or entirely lacking in evidentiary support.

Additionally, the Commission finds that the correct calculation and application of offsetting revenue from student health fees has been resolved by the court in *Clovis Unified School Dist.*, which found that to the extent the district "has the authority' to charge for the mandated program or increased level of service, that charge cannot be recovered as a state-mandated cost."<sup>2</sup> Thus a reduction based on fees *authorized* to be charged by Education Code section 76355, rather than fee revenue actually collected, is correct as a matter of law.

Finally, the Commission finds that the Controller's reduction of costs for interest earned on the student health fee revenue collected is correct as a matter of law. The revenue generated from the health fee, including the interest earned, does not constitute proceeds of taxes and is required by law and Section VIII. of the Parameters and Guidelines ("Offsetting Savings and Other Reimbursements") to be identified and deducted from the costs claimed.

Therefore, the Commission denies this IRC.

### **I. Chronology**

01/08/2004 Claimant signed the reimbursement claim for fiscal year 2002-2003.<sup>3</sup>

01/03/2005 Claimant signed the reimbursement claim for fiscal year 2003-2004.<sup>4</sup>

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<sup>2</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

<sup>3</sup> Exhibit A, IRC page 136. The claimant asserts this reimbursement claim was filed on January 12, 2004. (Exhibit A, page 24.)

<sup>4</sup> Exhibit A, IRC, page 149. The claimant asserts this reimbursement claim was filed on January 10, 2005. (Exhibit A, page 24.)

11/21/2005 Claimant signed the reimbursement claim for fiscal year 2004-2005.<sup>5</sup>  
10/25/2006 Claimant received its initial payment for 2002-2003.<sup>6</sup>  
01/02/2007 Claimant signed the reimbursement claim for fiscal year 2005-2006.<sup>7</sup>  
March 2008 Controller initiated the audit.<sup>8</sup>  
02/02/2009 Claimant signed the reimbursement claim for fiscal year 2006-2007.<sup>9</sup>  
03/12/2009 Controller issued the draft audit report.<sup>10</sup>  
03/24/2009 Claimant submitted comments on the draft audit report.<sup>11</sup>  
04/30/2009 Controller issued the final audit report.<sup>12</sup>  
10/05/2009 Claimant filed this IRC.<sup>13</sup>  
12/02/2014 Controller filed late comments on the IRC.<sup>14</sup>  
01/25/2017 Commission staff issued the Draft Proposed Decision.<sup>15</sup>  
02/01/2017 Controller filed comments on the Draft Proposed Decision.<sup>16</sup>

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<sup>5</sup> Exhibit A, IRC, page 158.

<sup>6</sup> Exhibit B, Controller's Late Comments on the IRC, page 26.

<sup>7</sup> Exhibit A, IRC, page 170.

<sup>8</sup> The Controller asserts that it initiated the audit on March 5, 2008. (Exhibit B, Controller's Late Comments on the IRC, page 26.) The claimant states the audit was commenced on March 24, 2008. (Exhibit A, IRC, page 27.)

<sup>9</sup> Exhibit A, IRC, page 178.

<sup>10</sup> Exhibit A, IRC, page 64.

<sup>11</sup> Exhibit A, IRC, pages 64, 86-93.

<sup>12</sup> Exhibit A, IRC, page 59.

<sup>13</sup> Exhibit A, IRC, page 1.

<sup>14</sup> Exhibit B, Controller's Late Comments on the IRC. Note that pursuant to Government Code section 17553(d) "the Controller shall have no more than 90 days after the claim is delivered or mailed to file any rebuttal to an incorrect reduction claim. The failure of the Controller to file a rebuttal to an incorrect reduction claim shall not serve to delay the consideration of the claim by the Commission." However, in this instance, due to the backlog of IRCs, these late comments have not delayed consideration of this item and so have been included in the analysis and Proposed Decision.

<sup>15</sup> Exhibit C, Draft Proposed Decision.

<sup>16</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.

## II. Background

### A. The Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts that voluntarily provided health supervision and services, direct and indirect medical and hospitalization services, or operation of student health centers to charge almost all students a health service fee not to exceed \$7.50 for each semester or \$5 for each quarter or summer session, to fund these services.<sup>17</sup> In 1984, the Legislature repealed the community colleges' fee authority for health services.<sup>18</sup> However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, to reauthorize the fee at \$7.50 for each semester (or \$5 per quarter or summer session).<sup>19</sup>

In addition to temporarily repealing community college districts' fee authority, Statutes 1984, chapter 1 required any district that provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain the health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.<sup>20</sup> As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987,<sup>21</sup> the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.<sup>22</sup> In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than \$7.50 for each semester, or \$5 for each quarter or summer session.<sup>23</sup> As a result, beginning January 1, 1988 all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services.<sup>24</sup> In 1992,

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<sup>17</sup> Former Education Code section 72246 (Stats. 1981, ch. 763). Low-income students, students that depend upon prayer for healing, and students attending a college under an approved apprenticeship training program, were exempt from the fee.

<sup>18</sup> Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4, repealing Education Code section 72246.

<sup>19</sup> Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4.5.

<sup>20</sup> Education Code section 72246.5 (Stats. 1984, 2d. Ex. Sess., ch. 1, § 4.7).

<sup>21</sup> Statutes 1987, chapter 1118.

<sup>22</sup> Education Code section 72246 (as amended, Stats. 1987, ch. 1118). See also former Education Code section 72246.5 (Stats. 1984, 2d Ex. Sess., ch. 1, § 4.7).

<sup>23</sup> Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

<sup>24</sup> In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar. (Education Code section 72246 (as amended, Stats. 1992, ch. 753). In

section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.<sup>25</sup>

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

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

#### B. Controller's Audit and Summary of the Issues

For fiscal years 2002-2003 through 2006-2007, the claimant sought \$1,203,995 (\$1,213,995 less a \$10,000 penalty for filing a late claim) in reimbursement for costs incurred under the *Health Fee Elimination* program. The Controller found that \$752,122 was allowable and \$451,873 was unallowable. The following issues are in dispute:

- Reduction of indirect costs based on asserted faults in the development and application of indirect cost rates;
- The amount of offsetting revenue to be applied from health service fee authority; and
- Whether interest earned on the health service fee revenue must be identified and deducted from the reimbursement claims.

The claimant also argues that the audit of the fiscal year 2002–2003 and 2003–2004 reimbursement claims was not commenced within the deadline required by Government Code section 17558.5.

### III. **Positions of the Parties**

#### A. Yosemite Community College District

The claimant argues that the Controller's Finding 2 on indirect cost rates is incorrect for fiscal years 2004 through 2007 because only the claiming instructions were amended to reflect the changed indirect cost calculation in fiscal years 2002-2004, but not the Parameters and Guidelines. Because the claiming instructions do not comply with the APA, the claimant argues that they are not enforceable. As to the use of the prior year's CCFS-311 (for community college financial reporting) to calculate indirect cost rates, the claimant argues that the CCFS-311 for the current fiscal year is often not available at the time reimbursement mandates are due, so the claimant must rely on the prior year's data. The claimant points out that the claiming

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1993, former Education Code section 72246, was renumbered as Education Code section 76355 (Stats. 1993, ch. 8).

<sup>25</sup> Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355 (Stats. 1993, ch. 8).

instructions are silent on whether the prior or current year CCFS-311 should be used in the FAM-29C methodology.<sup>26</sup>

The claimant also argues that the audit did not conclude whether the claimant's indirect cost rates for 2005-2007 were excessive, unreasonable, or inconsistent with cost accounting principles, and that only the standards in Government Code section 17561(d)(2) (correctness, legality and sufficient provisions of law for payment) apply to this claim, not the more general standard in section 12410. Also, the claimant argues that the Controller has not shown that the audit adjustments were made in accordance with the standard in section 12410.<sup>27</sup>

Further, the claimant contests Finding 4 that offsetting health fees authorized to be collected must be used to offset the claims rather than fees actually collected. According to the claimant, the fees collected is the standard required by the Parameters and Guidelines. The claimant also argues that case law relied on by the Controller to justify Finding 4 is not on point.<sup>28</sup>

As to Finding 5 regarding understated offsetting savings and reimbursements, the claimant does not contest the \$14,411 reduction of supplemental service fees, but does contest the \$84,431 reduction of interest income paid by the Stanislaus County Treasurer, where the claimant deposits its cash in a pooled money investment fund. The claimant argues that this interest income is not identified in the Parameters and Guidelines or applicable regulations as a required offset.<sup>29</sup>

Finally, the claimant alleges that the audit of fiscal years 2002-2003 and 2003-2004 was commenced after the audit initiation deadline had passed, and the clause in Government Code section 17558.5 that tolls the commencement period to initiate audits (to the date of initial payment) is void because it is impermissibly vague.<sup>30</sup>

The claimant did not file any rebuttal to the Controller's Late Comments on the IRC or any comments on the Draft Proposed Decision.

#### B. State Controller's Office

The Controller's position is that the audit is correct and that the IRC should be denied. The Controller found that unallowable costs were claimed primarily because the claimant overstated indirect costs and understated authorized health service fees and offsetting reimbursements.

In response to the claimant's argument (on Finding 2) that requirements in the claiming instructions violate the APA, the Controller points to authority in section VI. of the Parameters and Guidelines that "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." The Controller also cites regulations that authorize claimants to request Commission review of the claiming instructions and that provide for public

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<sup>26</sup> Exhibit A, IRC, pages 11-14.

<sup>27</sup> Exhibit A, IRC, pages 15-17.

<sup>28</sup> Exhibit A, IRC, pages 17-21.

<sup>29</sup> Exhibit A, IRC, pages 22-23.

<sup>30</sup> Exhibit A, IRC, page 24.

comment during the review.<sup>31</sup> The Controller also argues that claimants are required to report actual costs, which are of the current fiscal year, so using the prior fiscal year's CCFS-311 to calculate indirect costs is incorrect. And the Controller maintains that the October 10 regulatory deadline for the CCFS-311 makes it available at the time the mandate reimbursement claims are due on January 15 (later amended to February 15), refuting the claimant's argument to the contrary.

The Controller contends that it did conclude, contrary to the claimant's arguments, that the district's claim was excessive, which is in accordance with the Controller's authority in Government Code sections 17558.5 and 12410. The Controller argues that the claimant did not follow the Parameters and Guidelines' requirement to comply with the claiming instructions on the indirect cost calculation.

As to understated authorized health service fees in Finding 4, the Controller points to the Parameters and Guidelines that require claimants to deduct authorized health fees from costs claimed, as well as Government Code sections 17514 and 17556 as the basis for this adjustment. The Controller also defends its use of CCCCCO data in calculating the authorized fees, and argues that the case law it relies on affirms the rule that mandated costs exclude expenses that are recoverable from sources other than taxes, such as the authority to assess health service fees.

Audit Finding 5 was that the claimant understated offsetting savings and reimbursements, including \$84,431 for interest earned. The Controller argues that this finding is consistent with the Parameters and Guidelines, Government Code section 17514, and the Commission's regulations.

The Controller also addressed the claimant's allegation that the audit of fiscal years 2002-2003 and 2003-2004 was commenced after the time limitation had passed, and the clause in Government Code section 17558.5 that delays the commencement period to initiate audits (to the date of initial payment) is void because it is impermissibly vague. According to the Controller, the claimant has no authority to adjudicate statutory language, and has presented no evidence to support its assertion that the existing statutory language is void. The Controller maintains that the timing of the audit complies with Government Code section 17558.5(a).

On February 1, 2017, the Controller filed comments agreeing with the Draft Proposed Decision.<sup>32</sup>

#### **IV. Discussion**

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

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to the local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9

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<sup>31</sup> Exhibit B, Controller's Late Comments on the IRC, page 15.

<sup>32</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.



of the Commission's regulations requires the Commission to send the decision to the Controller and request that the costs in the claim be reinstated.

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

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

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

The Commission must review also the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.<sup>37</sup> In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertions

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

<sup>34</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

<sup>35</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space District* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

<sup>36</sup> *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California*, 162 Cal.App.4th 534, 547-548.

<sup>37</sup> *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.<sup>38</sup>

A. The Audit Was Timely Initiated and Timely Completed.

The claimant alleges that the audit for fiscal years 2002-2003 and 2003-2004 was beyond the three-year commencement deadline required by Government Code section 17558.5 when the Controller initiated the audit in March 2008. Because the reimbursement claims were filed on January 12, 2004 (for the 2002-2003 claim) and January 10, 2005 (for the 2003-2004 claim),<sup>39</sup> the claimant argues that the applicable deadlines for the audit were January 12, 2007 and January 10, 2008, respectively, three years from the dates the claims were filed.

Although the claimant and the Controller disagree on the date in March 2008 when the audit was commenced,<sup>40</sup> it is unnecessary to determine the exact commencement date in this case because the Commission finds that the audit was initiated within the deadline in Government Code section 17558.5, regardless of which date in March 2008 the audit commenced.

When the claimant filed its fiscal year 2002-2003 and 2003-2004 reimbursement claims in 2004 and 2005, Government Code section 17558.5(a) stated in relevant part the following:

*A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than 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.*<sup>41</sup>

The Controller contends that it timely initiated the audit based on the italicized sentence in section 17558.5 as follows:

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 [State Controller] had until October 24, 2009, to initiate an audit of this claim. For its FY 2003-04 claim, the district received no payment. Pursuant

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

<sup>39</sup> Exhibit A, IRC, pages 92-93. The dates are when the claims were submitted. The record indicates that the claims were signed on January 8, 2004 (for 2002-2003) and January 2, 2005 for (2003-2004). See Exhibit A, IRC, pages 136 and 149.

<sup>40</sup> The Controller states that the audit was initiated on March 5, 2008. Exhibit B, Controller's Late Comments on the IRC, page 26. The claimant states that the audit was initiated on March 24, 2008. See Exhibit A, IRC, page 27.

<sup>41</sup> Statutes 2002, chapter 1128, effective January 1, 2003, emphasis added.

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.<sup>42</sup>

The claimant nevertheless argues that this tolling provision in section 17558.5 is “impermissibly vague” and void:

The two versions of Section 17558.5 applicable to the FY 2002-03 and FY 2003-04 annual reimbursement claims both provide that the time limitation for audit "shall commence to run from the date of initial payment" if no payment is made. However, this provision is void because it is impermissibly vague. At the time a claim is filed, the claimant has no way of knowing when payment will be made or how long the records applicable to that claim must be maintained. The current backlog in mandate payments, which continues to grow every year, could potentially require claimants to maintain detailed supporting documentation for decades. Additionally, it is possible for the Controller to unilaterally extend the audit period by withholding payment or directing appropriated funds only to those claims that have already been audited.

Therefore, the only specific and enforceable time limitation to commence an audit is three years from the date the claim was filed, and the annual reimbursement claims for FY 2002-03 and FY 2003-04 were past this time period when the audit commenced on March 24, 2008.<sup>43</sup>

However, Article III, section 3.5 of the California Constitution states that an administrative agency has no power “[t]o declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional...” The claimant argues that the tolling provision in section 17558.5 allows the Controller to delay payment. However, when mandate program funds are appropriated for the fiscal year(s) at issue, the Government Code requires the Controller to pay any eligible claim within 15 days and does not authorize delayed payments.<sup>44</sup> If this appropriation is insufficient to pay all of the Controller-approved claims, the Controller is required “to prorate claims in proportion to the dollar amount of approved claims timely filed and on hand at the time of proration.”<sup>45</sup> The legal presumption is that the Controller performs these duties.<sup>46</sup>

The claimant’s argument also focuses on how long it must keep documentation,<sup>47</sup> but a statute “cannot be held void for uncertainty if any reasonable and practical construction can be given to

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<sup>42</sup> Exhibit A, IRC, page 84 (final audit report).

<sup>43</sup> Exhibit A, IRC, pages 26-27.

<sup>44</sup> Government Code section 17561(d).

<sup>45</sup> Government Code section 17567.

<sup>46</sup> Evidence Code section 664: “It is presumed that official duty has been regularly performed.”

<sup>47</sup> Exhibit A, IRC, pages 27-28.

its language”<sup>48</sup> and “if the language of the statute is clear and unambiguous, there is no need for construction.”<sup>49</sup> The Commission, like a court, may not substitute its judgement for that of the Legislature.<sup>50</sup> Accordingly, the plain language of section 17558.5 controls.

The record indicates that the claimant received initial payment for fiscal year 2002-2003 on October 25, 2006 and received no payment for fiscal year 2003-2004,<sup>51</sup> making the deadline to initiate the fiscal year 2002-2003 audit October 25, 2009, and imposing no deadline for 2003-2004. The Legislature deferred payment for the *Health Fee Elimination* program in fiscal year 2003-2004 by appropriating a nominal \$1,000 in the State Budget Act for the program.<sup>52</sup> The Fourth District Court of Appeal in *California School Boards Assoc.* concluded that “the Legislature’s practice of nominal funding of state mandates [by appropriating \$1,000] with the intention to pay the mandate in full with interest at an unspecified time *does not constitute a funded mandate under the applicable constitutional and statutory provisions.*”<sup>53</sup> Thus, the \$1,000 appropriation was not considered a constitutionally sufficient appropriation to fund the program and essentially amounts to no appropriation. The final audit report states that the allowable amount to be reimbursed for the 2003-2004 claim will be paid “contingent upon available appropriations.”<sup>54</sup> Therefore, the Commission finds that the audit, initiated in March 2008, was timely.

The Commission also finds that the audit was timely completed. Effective January 1, 2005, Government Code section 17558.5(a) was amended to require the Controller to complete the audit “not later than two years after the date that the audit is commenced.”<sup>55</sup> In this case, the audit was initiated in March 2008, and was completed when the final audit report was issued on April 30, 2009, well within the two-year deadline.

Accordingly, the Controller’s audit was timely.

**B. The Controller’s Reduction and Recalculation of Indirect Costs in Finding 2 Is Correct as a Matter of Law and Is Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.**

The Controller reduced the claimant’s indirect costs for 2005-2006 and 2006-2007 by a total of \$63,675 (the claimant does not dispute the indirect cost rate adjustments for fiscal years 2002-

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<sup>48</sup> *Personal Watercraft Coalition v. Board of Supervisors* (2002) 100 Cal.App.4th 129, 137.

<sup>49</sup> *Maryland Cas. Co. v. Andreini & Co. of Southern California* (2000) 81 Cal.App.4th. 1413, 1420.

<sup>50</sup> *County of San Diego v. State of California* (2008) 164 Cal.App.4th 580, 597.

<sup>51</sup> Exhibit B, Controller’s Late Comments on the IRC, page 26.

<sup>52</sup> Statutes 2003, chapter 157, Item 6870-295-0001, schedule 1.

<sup>53</sup> *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 791, emphasis added.

<sup>54</sup> Exhibit A, IRC, page 64.

<sup>55</sup> Statutes 2004, chapter 890.

2004, and there was no reduction for 2004-2005).<sup>56</sup> Two main reasons are cited for the reduction of indirect costs claimed. First, the claimant used the prior year's expenses as reported in the CCFS-311 rather than the current year's expenses.<sup>57</sup> Second, the claimant did not comply with the claiming instructions.<sup>58</sup> Specifically, the claimant included capital costs rather than depreciation in calculating indirect costs, and did not allocate direct and indirect costs as specified in the claiming instructions. The Controller recalculated the indirect costs for the two fiscal years using the FAM-29C methodology in accordance with the claiming instructions.<sup>59</sup>

The claimant disputes these adjustments, arguing that there is no enforceable requirement to use the most current CCFS-311, and that the claiming instructions as a whole are not enforceable. The claimant asserts that “[n]either state law nor the parameters and guidelines make compliance with the Controller’s claiming instructions a condition of reimbursement.”<sup>60</sup> The claimant further asserts that the Controller has not made a determination that the claimed indirect cost rates were excessive or unreasonable, and that the only available audit standard requires such a determination.<sup>61</sup>

Government Code section 17561(d) authorizes the Controller to audit the claims filed by local agencies and school districts and to reduce any claim for reimbursement of state mandated costs that the Controller determines is excessive or unreasonable. The Commission’s review is limited to determining whether the Controller’s audit decision was arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency, in the case of an adjudicatory decision for which the agency is not required to hold an evidentiary hearing.<sup>62</sup> Under this standard, the courts have found that:

When reviewing the exercise of discretion, “[t]he scope of review is limited, out of deference to the agency’s authority and presumed expertise: ‘The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]’” ... “In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . .” [Citations.] When making that inquiry, the “ ‘ ‘court must ensure that an agency has

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<sup>56</sup> The claimant contests the Controller’s indirect cost adjustment for 2004-2005 that increased the claimant’s allowable indirect costs by \$6,953. The Commission, however, has jurisdiction only over whether the “the Controller has incorrectly reduced payments to the local agency or school district . . . .” (Gov. Code, § 17551(d)), not over increases in allowable costs.

<sup>57</sup> Exhibit A, IRC, pages 13-14.

<sup>58</sup> Exhibit A, IRC, page 69 and Exhibit B, Controller’s Late Comments on the IRC, page 11.

<sup>59</sup> Exhibit A, IRC, page 69; Exhibit B, Controller’s Late Comments on the IRC, page 17.

<sup>60</sup> Exhibit A, IRC, page 10.

<sup>61</sup> Exhibit A, IRC, page 15.

<sup>62</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space District* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute.” [Citation.]’ ”<sup>63</sup>

Based on this standard of review, and giving due consideration to the Controller’s audit authority, the Commission finds that the Controller’s reduction and recalculation of indirect costs for fiscal years 2005-2006 and 2006-2007 is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support, because the claimant was required to use the current claim year’s CCFS-311 financial reporting information to claim actual costs for the claim year.

1. *The reduction of indirect costs for fiscal years 2005-2006 and 2006-2007 based on the claimant’s use of expenditures from the prior year’s CCFS-311 reports, instead of the expenditures incurred in the claim year, is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.*

The Parameters and Guidelines adopted for this program, in addition to identifying the reimbursable activities, provide instructions for eligible claimants to prepare reimbursement claims for the direct and indirect costs of a state-mandated program, and state that “Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions.”<sup>64</sup> The Commission’s adoption of parameters and guidelines is quasi-judicial and, therefore, the parameters and guidelines are final and binding on the parties unless set aside by a court pursuant to Government Code section 17559 or amended by the filing of a request pursuant to Government Code section 17557.<sup>65</sup> In this case, the Parameters and Guidelines for the *Health Fee Elimination* program have not been challenged, and no party has requested they be amended. The Parameters and Guidelines are therefore binding and must be applied to the reimbursement claims here.

The Controller issues claiming instructions for mandated programs, which provide greater detail than the parameters and guidelines. The claiming instructions specific to the *Health Fee Elimination* mandate are found in the Community Colleges Mandated Cost Manual, which is revised each year and contains claiming instructions applicable to all school and community college mandated programs.

The mandated cost manual and claiming instructions issued in December 2006 for 2005-2006, require claimants claiming under the state’s FAM-29C method to use total expenditures that districts report in their California Community Colleges Annual Financial and Budget Report

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<sup>63</sup> *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>64</sup> Government Code section 17557; California Code of Regulations, title 2, section 1183.7.

<sup>65</sup> *California School Boards Assoc. v. State of California* (2009) 171 Cal.App.4th 1183, 1200, which stated the following: “[U]nless a party to a quasi-judicial proceeding challenges the agency’s adverse findings made in that proceeding, by means of a mandate action in superior court, those findings are binding in later civil actions.” [Citation omitted.] See also, Government Code section 17557.

(CCFS-311), exclude capital outlay, and include depreciation expenses, in an effort to align with the policies of the OMB Circular A-21:

A CCD may claim indirect costs using the Controller's methodology (FAM-29C) outlined in the following paragraphs. If specifically allowed by a mandated program's P's & G's, 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.

The SCO developed FAM-29C to be consistent with OMB Circular A-21, cost accounting principles as they apply to mandated cost programs. The objective is to determine an equitable rate to allocate administrative support to personnel who performed the mandated cost activities. The FAM-29C methodology uses a direct cost base comprised of salary and benefit costs and operating expenses. Form FAM-29C provides a consistent indirect cost rate methodology for all CCD's mandated cost programs.

FAM-29C uses total expenditures that districts report in their California Community Colleges Annual Financial and Budget Report (CCFS-311), Expenditures by Activity for the General Fund – Combined. The computation excludes Capital Outlay and Other Outgo in accordance with OMB Circular A-21. The indirect cost rate computation includes any depreciation or use allowance applicable to district buildings and equipment. Districts calculate depreciation or use allowance costs separately from the CCFS-311 report and should calculate them in accordance with OMB Circular A-21.<sup>66</sup>

The claiming instructions for fiscal year 2006-2007 continue to provide similarly, with respect to the option for claiming a federal rate, and the exclusion of capital costs and inclusion of depreciation expenses.<sup>67</sup>

The claimant used the FAM-29C methodology, but used the expenditures from the prior year's CCFS-311 reports instead of the expenditures for the claim year.<sup>68</sup> The Commission finds that the Controller's reduction, based on the claimant's use of expenditures from the prior year's CCFS-311 reports, instead of the expenditures incurred in the claim year, is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

Regulations governing "Budgets and Reports," adopted by the Chancellor's Office require the governing board of each community college district, by September 15 of each year, to prepare and keep on file for public inspection a statement of all receipts and expenditures for the *preceding fiscal year* and a statement of the estimated expenses for the current fiscal year.<sup>69</sup> After a public hearing, the district is required to adopt a final budget on or before September 15,

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<sup>66</sup> Exhibit E, Community Colleges Mandated Cost Manual excerpt, issued December 2006.

<sup>67</sup> Exhibit E, Community Colleges Mandated Cost Manual excerpt, issued October 2007.

<sup>68</sup> Exhibit A, IRC, page 13.

<sup>69</sup> California Code of Regulations, title 5, section 58300.

and complete and adopt the annual financial and budget report (CCFS-311) by September 30 of each year. The annual CCFS-311 identifies all the district's actual revenues and expenditures from *the preceding fiscal year* and the estimated revenues and expenditures for the current fiscal year, and is considered a public record pursuant to the Government Code.<sup>70</sup> By October 10 of each year, the district is required to submit a copy of its adopted CCFS-311 to the Chancellor.

Thus, by October 10, 2006, the claimant was required to submit its adopted CCFS-311 to the Chancellor, which identified all the expenditures for the 2005-2006 fiscal year – four months *before* the reimbursement claim was due for fiscal year 2005-2006. Reimbursement claims for fiscal year 2005-2006 were due to the Controller by January 15, 2007.<sup>71</sup> Government Code section 17560 was amended by Statutes 2007, chapter 179, to change the deadline for filing reimbursement claims from January 15 to February 15, effective August 24, 2007. This amendment affected the reimbursement claims for costs incurred in fiscal year 2006-2007, which were then due on February 15, 2008. Thus, the actual expenditures for the claim years subject to audit were known and were required to be made available to the public before the deadline for filing the reimbursement claims at issue in this case.

Moreover, the Government Code and the Parameters and Guidelines for this program require community college districts to claim reimbursement for the costs incurred for the fiscal year being claimed. Government Code section 17560 authorizes local agencies and school districts to file an annual reimbursement claim “that details the costs actually incurred *for that fiscal year....*” Government Code section 17564(b) states that “[c]laims for direct and indirect costs filed pursuant to Section 17561 shall be in the manner described in the parameters and guidelines....” Further, the Parameters and Guidelines require that “[a]ctual costs for one fiscal year should be included in each claim.”<sup>72</sup> Thus, the requirement to calculate indirect costs for the claim year based on that year's actual expenses, which are known by the claimant, is supported by the law and evidence in the record.

The Commission finds that the Controller's reduction of indirect costs is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

2. *The Controller's recalculation of indirect costs using the FAM-29C is not arbitrary, capricious, or entirely lacking in evidentiary support.*

Even though the claimant incorrectly calculated indirect costs, the Controller did not reduce indirect costs to \$0. Instead, the Controller recalculated the indirect cost rate for the two fiscal years using the FAM-29C methodology in accordance with the claiming instructions.<sup>73</sup> The Controller's recalculation resulted in indirect cost rates of 33.23 percent and 34.71 percent for fiscal years 2005-2006 and 2006-2007, respectively.<sup>74</sup>

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<sup>70</sup> California Code of Regulations, title 5, section 58305; California Community Colleges, Budget and Accounting Manual (2012), page 1-8.

<sup>71</sup> Former Government Code section 17560 (as amended, Stats. 1998, ch. 681 (AB 1963)).

<sup>72</sup> Exhibit A, IRC, page 38.

<sup>73</sup> Exhibit A, IRC, page 69; Exhibit B, Controller's Late Comments on the IRC, page 17.

<sup>74</sup> Exhibit A, IRC, page 69.



The claimant disputes the recalculation, which excludes capital costs from the calculation and replaces capital costs with depreciation expenses.<sup>75</sup> However, there is no evidence in the record that the Controller's recalculation is arbitrary, capricious, or entirely lacking in evidentiary support. Since the claimant's calculation of indirect costs was based on its CCFS-311 from the preceding year, that calculation is incorrect, and the Controller had the choice of recalculating in accordance with FAM-29C or reducing to zero. In accordance with the claiming instructions, the Controller excluded capital costs as required by OMB Circular A-21 (and as dictated by the FAM-29C) and recalculated the indirect costs based on the claimant's actual costs.

As previously stated, the standard of review which the Commission employs to review the Controller's audit decisions provides that the Commission may "not reweigh the evidence or substitute its judgment for that of the agency."<sup>76</sup>

Accordingly, the Commission finds the recalculation of indirect costs for fiscal years 2005-2006 and 2006-2007 is not arbitrary, capricious, or entirely lacking in evidentiary support.

C. The Controller's Reduction in Finding 4 for Underreported Offsetting Fees Authorized to be Charged Is Correct as a Matter of Law, and the Recalculation of Authorized Fees Is Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller found that \$316,222 in authorized health service fees was not reported for the audit period because the claimant reported only fees collected rather than fees authorized to be collected. The Controller also found that the claimant did not charge students the fully authorized fee in 2005-2006 and 2006-2007.<sup>77</sup>

The claimant argues that "[i]n order for the district to 'experience' these 'offsetting savings' the district must actually have collected these fees." The claimant states that "[s]tudent fees actually collected must be used to offset costs, but not student fees that could have been collected and were not."<sup>78</sup>

The Commission finds that the correct calculation and application of offsetting revenue from student health service fees has been resolved by *Clovis Unified School Dist.*,<sup>79</sup> and that the Controller's reduction of costs in this case is consistent with the court's decision and is correct as a matter of law.

After the claimant filed its IRC, the *Clovis* court specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge students, whether or not districts choose to impose those fees. As expressed by the court, the "Health Fee Rule" states in pertinent part:

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<sup>75</sup> Exhibit A, IRC, page 69; Exhibit B, Controller's Late Comments on the IRC, page 17.

<sup>76</sup> *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>77</sup> Exhibit A, IRC, page 74.

<sup>78</sup> Exhibit A, IRC, pages 19.

<sup>79</sup> *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794.

Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.<sup>80</sup> (Underline in original.)

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

(a)(1) The governing board of a district maintaining a community college may require community college students to pay a fee in the total amount of not more than ten dollars (\$10) for each semester, seven dollars (\$7) for summer school, seven dollars (\$7) for each intersession of at least four weeks, or seven dollars (\$7) for each quarter for health supervision and services, including direct or indirect medical and hospitalization services, or the operation of a student health center or centers, or both.

(a)(2) The governing board of each community college district may increase [the health service fee] by the same percentage increase as the Implicit Price Deflator for State and Local Government Purchase of Goods and Services. Whenever that calculation produces an increase of one dollar (\$1) above the existing fee, the fee may be increased by one dollar (\$1).<sup>81</sup>

Pursuant to the plain language of Education Code section 76355(a)(2), the fee authority given to districts automatically increases at the same rate as the Implicit Price Deflator; when that calculation produces an increase of one dollar above the existing fee, the fee may be increased by one dollar.<sup>82</sup> The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered.<sup>83</sup> The claimant argues that the Controller cannot rely on the Chancellor's notice to adjust the claim for 'collectible' student health services fees because the fees levied on students are raised by the governing board of the community college district.<sup>84</sup> But the *authority* to impose the health service fees increases automatically with the Implicit Price Deflator, as noticed by the Chancellor. Accordingly, the court in *Clovis Unified* upheld the Controller's use of the Health

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<sup>80</sup> *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 811.

<sup>81</sup> Education Code section 76355(d)(2) (Stats. 1993, ch. 8 (AB 46); Stats. 1993, ch. 1132 (AB 39); Stats. 1994, ch. 422 (AB 2589); Stats. 1995, ch. 758 (AB 446); Stats. 2005, ch. 320 (AB 982)) [Formerly Education Code section 72246(e) (Stats. 1987, ch. 118)].

<sup>82</sup> See Education Code section 76355 (Stats. 1995, ch. 758 (AB 446)). The Implicit Price Deflator for State and Local Purchase of Goods and Services is a number computed annually (and quarterly) by the United States Department of Commerce as part of its statistical series on measuring national income and product, and is used to adjust government expenditure data for the effect of inflation.

<sup>83</sup> Exhibit A, IRC, California Community Colleges Chancellor's Office, Student Health Fee Increase, March 5, 2001, pages 148-149.

<sup>84</sup> Exhibit A, IRC, pages 23-27.

Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. The court held that:

To the extent a local agency or school district “has the authority” to charge for the mandated program or increased level of service, that charge cannot be recovered as a state-mandated cost.<sup>85</sup>

The court also noted that, “this basic principle flows from common sense as well. As the Controller succinctly puts it, ‘Claimants can choose not to require these fees, but not at the state’s expense.’”<sup>86</sup> Additionally, in responding to the claimant’s argument that, “since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission’s P&G’s,”<sup>87</sup> the court held:

To accept this argument, though, we would have to ignore, and so would the Controller, the fundamental legal principles underlying state-mandated costs. We conclude *the Health Fee Rule is valid*.<sup>88</sup> (Italics added.)

Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.<sup>89</sup> In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.<sup>90</sup> Collateral estoppel applies when (1) the issue necessarily decided in the previous proceeding is identical to the one that is currently being decided; (2) the previous proceeding terminated with a final judgment on the merits; (3) the party against whom collateral estoppel is asserted is a party to or in privity with a party in the previous proceeding; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue.<sup>91</sup> Although the claimant to this IRC was not a party to the *Clovis* action, the claimant is in privity with the petitioners in *Clovis*. “A party is adequately represented for purposes of the privity rule if his or her interests are so similar to a party’s interest that the latter was the former’s virtual representative in the earlier action.”<sup>92</sup>

The Commission further finds that the Controller’s calculation of the claimant’s authorized offsetting fee revenue is not arbitrary, capricious or entirely lacking in evidentiary support, since

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<sup>85</sup> *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 812.

<sup>86</sup> *Ibid.*

<sup>87</sup> *Ibid.* Italics in original.

<sup>88</sup> *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 812.

<sup>89</sup> *Fenske v. Board of Administration* (1980) 103 Cal.App.3d 590, 596.

<sup>90</sup> The petitioners in the *Clovis* case included Clovis Unified School District, El Camino Community College District, Fremont Unified School District, Newport-Mesa Unified School District, Norwalk-La Mirada Unified School District, Riverside Unified School District, San Mateo Community College District, Santa Monica Community College District, State Center Community College District, and Sweetwater Union High School District.

<sup>91</sup> *Roos v. Red* (2006) 130 Cal.App.4th 870, 879-880.

<sup>92</sup> *Rodgers v. Sargent Controls & Aerospace* (2006) 136 Cal.App.4th 82, 91.

the Controller used the enrollment data available and reported by the claimant. The Controller obtained student enrollment and Board of Governors Grant (BOGG) recipient data from the California Community College's Chancellor's Office and calculated the authorized health service fees using the authorized rates that the Chancellor's Office noticed during the fiscal years at issue.<sup>93</sup>

Therefore, the Commission finds that the Controller's reduction of \$316,222 based on the claimant's unreported offsetting fee authority is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

D. The Controller's Reduction in Finding 5 for Offsetting Earned Interest Income on Health Service Fees Is Correct as a Matter of Law.

The Controller found that the claimant did not report \$84,431 in earned interest income on health service fees as offsetting savings or reimbursements and, thus, reduced the claims by this amount.<sup>94</sup>

The claimant disputes the reduction and contends that the interest income should not be offset against this program. In response to the draft audit report, the claimant argued as follows:

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 [section] 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.<sup>95</sup>

The Controller contends that the claimant's response to the draft audit report 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."<sup>96</sup>

In response to the IRC, the Controller further explained how it came to its conclusion:

The portion of understated revenue that the district is contesting relates to interest earned on student health service fees totaling \$84,431. During the audit, we found several line items in the district's General Ledger described as "StanCo Interest." In an email dated April 16, 2008 (Tab 8), the district explained that its health fund is maintained at Stanislaus County (StanCo) along with most of the

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<sup>93</sup> Exhibit A, IRC, page 74.

<sup>94</sup> Exhibit A, IRC, page 81.

<sup>95</sup> Exhibit A, IRC, pages 91-92.

<sup>96</sup> Exhibit A, IRC, page 82.

district's other funds. The county posts interest earned on a quarterly basis to each district fund.

During our review of the authorized health service fees, we noted that the district included interest and other miscellaneous revenue in its mandated cost claims for FY 2003-04 and FY 2006-07. We created a schedule called, "Analysis of Health Service Fees Differences," which documents all of the revenue line items for both Modesto and Columbia College for each fiscal year of the audit period. We highlighted the amounts that are related to interest earned on health service fees. We created another schedule called "Review of Cost Reduction/Offsetting Revenue," which identifies the grand totals of interest earned by the district during the audit period. We also obtained relevant copies of the district's Income Ledger and Detail Budget Status Report which support the amounts of interest the district earned on its health service fees. (Tab 9.)<sup>97</sup>

The claimant, in its IRC filing, does not rebut the amount of interest income found by the Controller or rebut the finding that the interest was earned on health service fees that were collected under Education Code section 76355 for the *Health Fee Elimination* program. The claimant argues, however, that the Parameters and Guidelines do not identify interest earned as offsetting savings or reimbursements. The claimant also asserts that the interest revenue is not included in the definition of offsetting savings or revenues in the Commission's regulations.<sup>98</sup>

The Commission finds that the Controller's reduction of costs for interest earned on the fee revenue authorized by Education Code section 76355 is correct as a matter of law.

Education Code section 76355(d) states that "All fees collected pursuant to this section shall be deposited in the fund of the district designated by the California Community Colleges Budget and Accounting Manual. These fees shall be expended *only* to provide health services as specified in regulations adopted by the board of governors." (Emphasis added.) To the extent the fee revenue earns interest, that revenue shall be identified and deducted as offsetting revenue. In this respect, Section VIII. of the Parameters and Guidelines ("Offsetting Savings and Other Reimbursements") states that "reimbursement for this mandate received from *any source* . . . shall be identified and deducted from this claim."<sup>99</sup>

Moreover, the Controller's adjustment is consistent with the purpose of article XIII B, section 6 of the California Constitution. Article XIII B, section 6 was only designed to protect the tax revenues of local governments from state mandates that would require expenditure of such revenues. Tax revenues, or proceeds of taxes, are limited to those proceeds that raise general tax revenues for the entity, and do not include fees authorized to be collected for the costs "reasonably borne" by local government to pay for a mandated program. Proceeds from fees are only defined as a tax when they *exceed* the costs reasonably borne by local government in

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<sup>97</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>98</sup> Exhibit A, IRC, page 23, referring to California Code of Regulations, title 2, 1183.1.

<sup>99</sup> Exhibit A, IRC, page 43 (emphasis added).

providing the service.<sup>100</sup> And, here, the claimant contends that the program operates at a loss, which required it to file a reimbursement claim.<sup>101</sup> This assertion is consistent with the final audit report, which shows that \$481,873 is allowable as mandate reimbursement after applying the offsetting revenue from Education Code section 76355 and the interest earned on that revenue.<sup>102</sup> Thus, the earned interest income from on health service fees collected under Education Code section 76355 for the *Health Fee Elimination* program is not a tax, and is not protected by article XIII B, section 6. Such revenue is required by law to be identified and deducted from the claim for reimbursement.

Accordingly, the Commission finds that the Controller's reduction of costs for interest earned on the student health fee revenue authorized by Education Code section 76355 is correct as a matter of law. The revenue generated from the health fee, including the interest earned, does not constitute proceeds of taxes and is required by law and Section VIII of the Parameters and Guidelines ("Offsetting Savings and Other Reimbursements") to be identified and deducted from the costs claimed.

## **V. Conclusion**

The Commission finds that the Controller's reduction of costs is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

Based on the foregoing, the Commission denies this IRC.

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<sup>100</sup> *Placer v. Corin* (1980) 113 Cal.App.3d 443, 451-452; *County of Fresno v. State of California* (1991) 53 Cal.3d 482, 487; Article XIII B, section 8(c) of the California Constitution.

<sup>101</sup> Exhibit A, IRC, pages 91-92.

<sup>102</sup> Exhibit A, IRC, page 59.



RE: **Decision**

*Health Fee Elimination*, 09-4206-I-25

Former Education Code Section 72246 (Renumbered as 76355)<sup>1</sup>

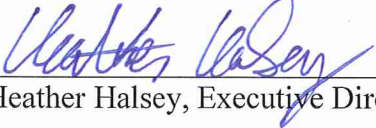
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1);

and Statutes 1987, Chapter 1118 (AB 2336)

Fiscal Years: 2002-2003, 2003-2004, 2004-2005, 2005-2006, and 2006-2007

Yosemite Community College District, Claimant

On March 24, 2017, the foregoing Decision of the Commission on State Mandates was adopted on the above-entitled matter.

  
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Heather Halsey, Executive Director

Dated: March 28, 2017

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<sup>1</sup> Statutes 1993, chapter 8.

BEFORE THE  
 COMMISSION ON STATE MANDATES  
 STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM  
 ON:**

Former Education Code Section 72246  
 (Renumbered as 76355)<sup>1</sup>

Statutes 1984, Chapter 1 (1983-1984 2nd Ex.  
 Sess.) (AB2X 1); and Statutes 1987, Chapter  
 1118 (AB 2336)

Fiscal Years 2002-2003, 2003-2004, 2004-  
 2005, 2005-2006, and 2006-2007

State Center Community College District,  
 Claimant

Case No.: 10-4206-I-32

*Health Fee Elimination*

DECISION PURSUANT TO  
 GOVERNMENT CODE SECTION 17500  
 ET SEQ.; CALIFORNIA CODE OF  
 REGULATIONS, TITLE 2, DIVISION 2,  
 CHAPTER 2.5. ARTICLE 7

*(Adopted July 28, 2017)*

*(Served August 1, 2017)*

**DECISION**

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on July 28, 2017. Claimant, State Center Community College District, did not attend the hearing. Jim Venneman appeared for the State Controller’s Office.

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

The Commission adopted the Proposed Decision to partially approve the IRC by a vote of 6-0 as follows:

<b>Member</b>	<b>Vote</b>
Lee Adams, County Supervisor	Yes
Ken Alex, Director of the Office of Planning and Research	Yes
Richard Chivaro, Representative of the State Controller, Vice Chairperson	Absent
Mark Hariri, Representative of the State Treasurer	Yes
Sarah Olsen, Public Member	Yes
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	Yes
Carmen Ramirez, City Council Member	Yes

<sup>1</sup> Statutes 1993, chapter 8.



## **Summary of the Findings**

This Decision addresses the IRC filed by State Center Community College District (claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for fiscal years 2002-2003 through 2006-2007 under the *Health Fee Elimination* program. Over the five fiscal years in question, the Controller reduced costs totaling \$902,744. The Controller made reductions based on overstated indirect costs and understated health fees authorized to be collected. The Controller in Findings 1, 4, and 5 also made additional findings that did not result in any reductions of costs claimed.

The Commission finds that the Controller timely initiated the audit of the fiscal year 2002-2003, 2003-2004, and 2004-2005 reimbursement claims pursuant to Government Code section 17558.5, since the first payment on the 2002-2003 reimbursement claim was made within three years of the date the audit was initiated, and no payment had been made for the 2003-2004 and 2004-2005 claims at the time the audit was initiated. The audit was complete for all reimbursement claims before the two-year deadline.

On the merits, the Commission finds as follows:

- The Controller's reduction of indirect costs is partially correct. The district claimed indirect costs for fiscal years 2002-2003 and 2003-2004 under the OMB Circular A-21 method, but did not obtain federal approval of the indirect cost rates used for the calculation as required by the OMB itself. Thus, the reduction for these fiscal years is correct as a matter of law. There is no evidence that the Controller's recalculation of indirect costs using the FAM-29C method is arbitrary, capricious, or entirely lacking in evidentiary support.

The reduction of indirect costs for fiscal years 2005-2006 and 2006-2007, however, is incorrect as a matter of law. The Controller adjusted indirect costs claimed using a federally approved indirect cost rate based solely on the ground that the claiming instructions were changed beginning fiscal year 2004-2005 to disallow the use of a federally approved rate to claim indirect costs unless specifically approved in the Commission's Parameters and Guidelines. The Controller's new indirect cost rate rule is included in the Controller's Mandated Cost Manuals, updated December 27, 2005, November 15, 2006, and November 7, 2007, which applied to the fiscal year 2004-2005, 2005-2006, and 2006-2007 reimbursement claims to be filed by January 15, 2006, January 15, 2007, and February 15, 2008, respectively.<sup>2</sup>

Although the new rule allows the use of the federal OMB Circular A-21 "if specifically allowed by a mandated program's Ps & Gs," the Parameters and Guidelines for the *Health Fee Elimination* Program do not contain that language and, thus, the Controller's change to the rule effectively prohibits the use of the federal method for calculating indirect costs for this program. Parameters and guidelines are regulatory in nature and may validly incorporate manuals and other documents by reference as long the

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<sup>2</sup> Exhibit F, Excerpts of Mandated Cost Manuals for 2004-2005, 2005-2006, and 2006-2007 reimbursement claims; Government Code section 17560, as amended by Statutes 1998, chapter 681 and Statutes 2007, chapter 129.

incorporated document is adequately identified and available for comment.<sup>3</sup> However, if the manual or document that is incorporated by reference later changes without notice or opportunity for comment, then the new rule or standard of general application in the incorporated document may become an invalid underground regulation.<sup>4</sup> There is no evidence in the record, such as a proof of service or certificate of mailing, that the Controller provided notice of the change in the rule to the claimant or that the claimant received the updated Mandated Cost Manuals prior to filing its 2005-2006 and 2006-2007 reimbursement claims. The record suggests that the claimant first received notice of the change in the rule when the draft audit report was issued in March 2010. By that time, however, the claimant could not file a request to amend the Parameters and Guidelines or a request to review the claiming instructions to specifically allow the use of the federal OMB method to calculate indirect costs retroactively for the fiscal year 2005-2006 and 2006-2007 claims. Accordingly, under these circumstances, the Commission finds that the Controller's reduction of indirect costs by \$124,261 for fiscal years 2005-2006 and 2006-2007, based solely on the Controller's change to the claiming instructions with regard to the calculation of indirect cost rates, is incorrect as a matter of law.

Since the Controller's adjustment to indirect costs for fiscal year 2004-2005 does not result in a reduction, the Commission has no jurisdiction under Government Code section 17551(d) to review the Controller's audit adjustment for that fiscal year.

- The Controller's reduction based on the claimant's unreported offsetting fee authority is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support. This issue has been conclusively decided in *Clovis Unified School District*,<sup>5</sup> in which the court held that local government is required to identify and deduct the total amount of fees authorized to be charged, and not only the fee revenue actually collected. The court stated that local government could choose not to exercise statutory fee authority to its maximum extent, but not at the state's expense. The Commission further finds that the Controller's calculation of the claimant's authorized offsetting fee revenue is not arbitrary, capricious, or entirely lacking in evidentiary support, since the Controller used the enrollment data available and reported by the claimant. The Controller obtained student enrollment and Board of Governors Grant (BOGG) recipient data from the California Community College's Chancellor's Office and calculated the authorized health service fees using the authorized rates approved by the Chancellor's Office for the fiscal years at issue.<sup>6</sup>
- The Commission has no jurisdiction under Government Code section 17551(d) to hear and determine whether Findings 1, 4, and 5, are incorrect because these findings did not result in any reductions of costs claimed. These findings address the Controller's conclusions that \$89,593 in salaries, benefits, services and supplies, and related indirect

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<sup>3</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 799; *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 220.

<sup>4</sup> *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 219-220.

<sup>5</sup> *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794.

<sup>6</sup> Exhibit A, IRC, page 76.

costs for psychological interns and costs funded with Lottery revenue could have been claimed in fiscal year 2004-2005, but were not; and the advisory findings regarding the claimant's reporting of base-year and current-year services, and alleged insufficient documentation of services provided.

The Commission, therefore, partially approves this IRC and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, that the Controller reinstate indirect costs of \$124,261 for fiscal years 2005-2006 and 2006-2007 to the claimant.

### **COMMISSION FINDINGS**

#### **I. Chronology**

- 01/08/2004 The claimant signed and dated its reimbursement claim for fiscal year 2002-2003. The claim was submitted with a cover letter dated January 9, 2004.<sup>7</sup>
- 12/08/2004 The claimant signed and dated its reimbursement claim for fiscal year 2003-2004. The claim was submitted with a cover letter dated December 13, 2004.<sup>8</sup>
- 11/22/2005 The claimant signed and dated its reimbursement claim for fiscal year 2004-2005. The claim was submitted with a cover letter dated December 5, 2005.<sup>9</sup>
- 12/17/2007 The claimant signed and dated its amended reimbursement claim for fiscal year 2005-2006. The claim was submitted with a cover letter dated December 17, 2007.<sup>10</sup>
- 12/17/2007 The claimant signed and dated its reimbursement claim for fiscal year 2006-2007. The claims were submitted with a cover letter dated December 17, 2007.<sup>11</sup>
- 10/25/2006 The Controller issued a payment of \$615,935 for fiscal year 2002-2003.<sup>12</sup>
- 06/09/2009 The entrance conference for the audit of the 2002-2003, 2003-2004, 2004-2005, 2005-2006, and 2006-2007 reimbursement claims was held.<sup>13</sup>
- 04/23/2010 The Controller issued the draft audit report.<sup>14</sup>
- 05/12/2010 The claimant submitted comments on the draft audit report.<sup>15</sup>

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<sup>7</sup> Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2002-2003, pages 108, 109.

<sup>8</sup> Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2003-2004, pages 117, 118.

<sup>9</sup> Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2004-2005, pages 127, 128.

<sup>10</sup> Exhibit A, IRC, Claimant's Amended Reimbursement Claim for FY 2005-2006, pages 136, 137.

<sup>11</sup> Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2006-2007, pages 145, 146.

<sup>12</sup> Exhibit A, IRC, page 32; Exhibit B, Controller's Late Comments on the IRC, pages 6, 29.

<sup>13</sup> Exhibit A, IRC, page 25; Exhibit B, Controller's Late Comments on the IRC, pages 6, 29.

<sup>14</sup> Exhibit A, IRC, page 69.

<sup>15</sup> Exhibit A, IRC, page 92-99.

- 06/11/2010 The Controller issued the final audit report.<sup>16</sup>
- 09/01/2010 The claimant filed this IRC.<sup>17</sup>
- 12/02/2014 The Controller filed late comments on the IRC.<sup>18</sup>
- 05/19/2017 Commission staff issued the Draft Proposed Decision.<sup>19</sup>
- 06/06/2017 The Controller filed comments supporting the Draft Proposed Decision.<sup>20</sup>
- 06/19/2017 The claimant filed comments on the Draft Proposed Decision.<sup>21</sup>

## **II. Background**

### **A. The Health Fee Elimination Program**

Prior to 1984, former Education Code section 72246 authorized community college districts that voluntarily provided health supervision and services, direct and indirect medical and hospitalization services, or operation of student health centers to charge almost all students a health service fee not to exceed \$7.50 for each semester or \$5 for each quarter or summer session, to fund these services.<sup>22</sup> In 1984, the Legislature repealed the community colleges' fee authority for health services.<sup>23</sup> However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, to reauthorize the fee at \$7.50 for each semester (or \$5 per quarter or summer session).<sup>24</sup>

In addition to temporarily repealing community college districts' fee authority, Statutes 1984, chapter 1 required any district that provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain the health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.<sup>25</sup> As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

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<sup>16</sup> Exhibit A, IRC, page 64.

<sup>17</sup> Exhibit A, IRC.

<sup>18</sup> Exhibit B, Controller's Late Comments on the IRC.

<sup>19</sup> Exhibit C, Draft Proposed Decision.

<sup>20</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.

<sup>21</sup> Exhibit E, Claimant's Comments on the Draft Proposed Decision.

<sup>22</sup> Former Education Code section 72246 (Stats. 1981, ch. 763). Low-income students, students that depend upon prayer for healing, and students attending a college under an approved apprenticeship training program, were exempt from the fee.

<sup>23</sup> Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4, repealing Education Code section 72246.

<sup>24</sup> Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4.5.

<sup>25</sup> Education Code section 72246.5 (Stats. 1984, 2d. Ex. Sess., ch. 1, § 4.7).

In 1987,<sup>26</sup> the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.<sup>27</sup> In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than \$7.50 for each semester, or \$5 for each quarter or summer session.<sup>28</sup> As a result, beginning January 1, 1988, all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services.<sup>29</sup> In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.<sup>30</sup>

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

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

#### B. Controller's Audit and Summary of the Issues

The Controller reduced \$902,744 from the costs claimed for fiscal years 2002-2003, 2003-2004, 2004-2005, 2005-2006, and 2006-2007 as follows:

Finding 1. The claimant under-claimed allowable salaries, benefits, and services and supply costs by \$506,433 as follows:

- For fiscal years 2003-2004 and 2004-2005, the claimant did not claim mandate-related psychological interns' costs.
- For fiscal years 2002-2003, 2003-2004, and 2004-2005, the claimant did not claim mandate-related health service costs that it funded with California Lottery Revenue. The

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<sup>26</sup> Statutes 1987, chapter 1118.

<sup>27</sup> Education Code section 72246 (as amended, Stats. 1987, ch. 1118). See also former Education Code section 72246.5 (Stats. 1984, 2d Ex. Sess., ch. 1, § 4.7).

<sup>28</sup> Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

<sup>29</sup> In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar. (Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355 (Stats. 1993, ch. 8).

<sup>30</sup> Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355 (Stats. 1993, ch. 8).

Controller found that because claimant's lottery revenue does not result from the statute that established the mandated program and is not specifically intended to fund mandated program costs, it is not offsetting revenue for this mandated program.

- For fiscal year 2006-2007, the claimant did not claim mandate-related costs for North Centers locations. The claimant believed that these costs were not mandate-related because the North Centers locations did not exist in the 1986-87 base year. However, the Controller concluded that the mandated program requires that the district provide the same level of health services provided in the base year, regardless of location.<sup>31</sup>

The Controller applied the understated costs that it found could have been claimed to offset the audit reductions.<sup>32</sup> The claimant does not dispute these findings or actions. For fiscal year 2004-2005, however, the understated costs (and recalculated increased indirect costs), exceeded the amount claimed for that year after adjusting for the reduction from authorized health service fee revenue, by \$89,593.<sup>33</sup> Even though the audit did not result in a reduction of costs for fiscal year 2004-2005, the claimant requests the Commission to review this adjustment.<sup>34</sup>

Finding 2. Reduction of \$381,532 for overstated indirect costs.

For fiscal years 2002-2003 and 2003-2004, the claimant calculated indirect costs using the OMB Circular A-21 method, but did not obtain federal approval for the indirect cost rates used for the calculation.

For fiscal years 2004-2005, 2005-2006, and 2006-2007, the claimant used a federally approved rate under the OMB Circular A-21. However, the Controller recalculated indirect costs for these years based on the FAM-29C methodology because the claiming instructions, beginning fiscal year 2004-2005, do not allow the use of a federally approved rate to claim indirect costs unless specifically approved in the Parameters and Guidelines (which is not the case here).

The Controller's recalculation resulted in a reduction of indirect costs for fiscal years 2002-2003, 2003-2004, 2005-2006, and 2006-2007 and an increase in allowable indirect costs for fiscal year 2004-2005.<sup>35</sup>

Finding 3. Reduction of \$938,052 for understated offsetting health service fee authority. The claimant reported only the fee revenues collected, and not the total amount of fees authorized to be collected. The Controller recalculated offsetting fee authority by multiplying the fees authorized by statute to be charged and identified by the Chancellor's Office, by student enrollment and BOGG recipient data reported by the district to the Chancellor's Office.<sup>36</sup>

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<sup>31</sup> Exhibit A, IRC, pages 73-74.

<sup>32</sup> Exhibit A, IRC, page 72.

<sup>33</sup> Exhibit A, IRC, page 71.

<sup>34</sup> Exhibit A, IRC, page 29.

<sup>35</sup> Exhibit A, IRC, pages 74-76.

<sup>36</sup> Exhibit A, IRC, pages 76-82.

Findings 4 and 5. The Controller's Findings 4 and 5 address the claimant's reporting of base-year and current-year services and alleged insufficient documentation of services provided. These findings were strictly advisory and did not result in any reductions.<sup>37</sup>

Finally, the claimant contends that the Controller did not timely audit the 2002-2003, 2003-2004, and 2004-2005 reimbursement claims and, thus asserts that the Controller's audit of those reimbursement claims is void.

### **III. Positions of the Parties**

#### **A. State Center Community College District**

The claimant asserts that the audit of the 2002-2003, 2003-2004, and 2004-2005 reimbursement claims was not timely initiated based on the date that it asserts that the claims were filed (January 9, 2004; December 13, 2004; and December 5, 2005, respectively), and the date the audit entrance conference took place (June 9, 2009). The claimant contends that the clause in Government Code section 17558.5 that delays the commencement of the time to audit to the date of initial payment is impermissibly vague and, therefore, void.<sup>38</sup>

The claimant contends that the Controller's reductions are incorrect and should be reinstated. The claimant argues that the Controller's reduction of indirect costs is incorrect, and amounts to an underground regulation. The claimant further states that the Controller simply stopped accepting federally approved rates, retroactively beginning fiscal year 2004-2005, with no justification or opportunity for public comment.<sup>39</sup>

The claimant also contends that it is only required to report as offsetting revenues, the health fee revenue actually collected.<sup>40</sup>

The claimant also requests reimbursement for the \$89,593 in salaries, benefits, services and supplies, and related indirect costs for psychological interns and costs funded with Lottery revenue that the Controller found during the audit could have been claimed for fiscal year 2004-2005.<sup>41</sup>

Finally, the claimant requests the Commission to review Findings 4 and 5, which provided recommendations on the claimant's reporting of base-year and current-year services and alleged insufficient documentation of services provided, but which made no reductions to costs claimed. The claimant alleges that the Controller's interpretation of the Parameters and Guidelines is not legally correct.<sup>42</sup>

The claimant filed comments on the Draft Proposed Decision, agreeing with the conclusion that the reduction of indirect costs for fiscal years 2005-2006 and 2006-2007 is incorrect. However, the claimant continues to disagree with the findings regarding the timeliness of the audit and the

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<sup>37</sup> Exhibit A, IRC, pages 83-87.

<sup>38</sup> Exhibit A, IRC, pages 25-28.

<sup>39</sup> Exhibit A, IRC, pages 11-15.

<sup>40</sup> Exhibit A, IRC, pages 15-23.

<sup>41</sup> Exhibit A, IRC, pages 23-24.

<sup>42</sup> Exhibit A, IRC, pages 22, 23.

findings upholding the Controller's remaining reduction of costs, which are summarized in the Discussion below.<sup>43</sup>

#### B. State Controller's Office

The Controller argues that, pursuant to Government Code section 17558.5, it timely conducted the audit of reimbursement claims. The Controller also contends that it correctly reduced costs because the claimant did not correctly calculate its indirect cost rate or its offsetting revenue (which should be all offsetting health service fees authorized by statute, rather than the amount collected). The Controller asserts that it has no authority to reimburse the claimant \$89,593 in salaries, benefits, services and supplies, and related indirect costs for psychological interns and costs funded with Lottery revenue that it found could have been claimed in fiscal year 2004-2005, but was not. And the Controller contends that it correctly interpreted the Parameters and Guidelines with respect to Findings 4 and 5. The Controller urges the Commission to deny the IRC.<sup>44</sup>

The Controller filed comments supporting the Draft Proposed Decision.<sup>45</sup>

#### IV. Discussion

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

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

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6 of the California Constitution.<sup>46</sup> The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."<sup>47</sup>

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<sup>43</sup> Exhibit E, Claimant's Comments on the Draft Proposed Decision.

<sup>44</sup> Exhibit B, Controller's Late Comments on the IRC.

<sup>45</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.

<sup>46</sup> *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

<sup>47</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.



With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.<sup>48</sup> Under this standard, the courts have found that:

When reviewing the exercise of discretion, “[t]he scope of review is limited, out of deference to the agency’s authority and presumed expertise: ‘The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]’” ... “In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . .” [Citations.] When making that inquiry, the “ ‘ ‘court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute.’ ”<sup>49</sup>

The Commission must also review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.<sup>50</sup> In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.<sup>51</sup>

**A. The Audit of the 2002-2003, 2003-2004, and 2004-2005 Reimbursement Claims Was Timely Initiated and Timely Completed.**

The claimant argues that the audit of the 2002-2003, 2003-2004, and 2004-2005 reimbursement claims was not timely initiated. Government Code section 17558.5 requires an audit to be initiated no later than three years after the date the reimbursement claim is filed or last amended. However, section 17558.5 also provides that *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.”<sup>52</sup> “In any case,” section 17558.5 requires the audit to be completed no later than two years after it is commenced.<sup>53</sup>

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<sup>48</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space District* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

<sup>49</sup> *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California*, 162 Cal.App.4th 534, 547-548.

<sup>50</sup> *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

<sup>51</sup> Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission's decision is not supported by substantial evidence in the record.

<sup>52</sup> Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

<sup>53</sup> Government Code section 17558.5 (as amended, Stats. 2004, ch. 890 (AB 2856)).

### 1. The Audit Was Timely Initiated.

The claimant asserts that the audit of the 2002-2003, 2003-2004, and 2004-2005 reimbursement claims was not timely initiated based on the date that it asserts that the claims were filed (January 9, 2004; December 13, 2004; and December 5, 2005, respectively), and the date the audit entrance conference took place (June 9, 2009). However, the Controller points out that the claimant did not receive a payment for the 2002-2003 reimbursement claim until October 25, 2006, and had not received payment for the fiscal year 2003-2004 and 2004-2005 claims when the audit was initiated. Therefore, the Controller's initiation of the audit with the entrance conference on June 9, 2009, was timely.<sup>54</sup>

Government Code section 17558.5 states that “[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 . . . .” However, if funds are not appropriated or no payment is made to the claimant for a given year, section 17558.5 states the “time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.”<sup>55</sup>

The claimant nevertheless argues that this tolling provision in section 17558.5 is “impermissibly vague” and void as follows:

Section 17558.5 provides that the time limitation for audit “shall commence to run from the date of initial payment” if no payment is made. However, this provision is void because it is impermissibly vague. At the time a claim is filed, the claimant has no way of knowing when payment will be made or how long the records applicable to that claim must be maintained. The current two billion-dollar backlog in mandate payments, which continues to grow every year, could potentially require claimants to maintain detailed supporting documentation for decades. Additionally, it is possible for the Controller to unilaterally extend the audit period by withholding payment as long as the three-year life of each appropriation.<sup>56</sup>

The Commission finds that the plain language of section 17558.5 controls. Article III, section 3.5 of the California Constitution states that an administrative agency, such as the Commission, has no power “[t]o declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional. . . .”<sup>57</sup> The claimant nevertheless argues that the tolling provision in section 17558.5 allows the Controller to delay payment. However, the Government Code does not allow the Controller to unilaterally delay payment. When mandate program funds are appropriated, Government Code section 17561(d), during the fiscal years in question, required the Controller to pay any eligible claim within 15 days after the date the appropriation for the

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<sup>54</sup> Exhibit A, IRC, pages 25-28; Exhibit B, Controller's Late Comments on the IRC, page 26.

<sup>55</sup> Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

<sup>56</sup> Exhibit A, IRC, page 28.

<sup>57</sup> California Constitution, article III, section 3.5 (added June 6, 1978, by Proposition 5).

claim was effective.<sup>58</sup> If the appropriation was insufficient to pay all of the Controller-approved claims, the Controller was required “to prorate claims in proportion to the dollar amount of approved claims timely filed and on hand at the time of proration.”<sup>59</sup> Moreover, there is no assertion or evidence in the record that the Controller failed to comply with the law when making payments for this program. Thus, the legal presumption is that the Controller performed the duties required by the Government Code.<sup>60</sup>

The claimant’s argument also focuses on how long it must keep documentation, but a statute “cannot be held void for uncertainty if any reasonable and practical construction can be given to its language”<sup>61</sup> and “if the language of the statute is clear and unambiguous, there is no need for construction.”<sup>62</sup> The Commission, like a court, may not substitute its judgement for that of the Legislature.<sup>63</sup>

In this case, the fiscal year 2002-2003, 2003-2004, and 2004-2005 reimbursement claims were mailed on January 9, 2004, December 13, 2004, and December 5, 2005, respectively. But, the record shows that payment on the 2002-2003 reimbursement claim was not made until October 25, 2006,<sup>64</sup> within three years of the date the audit was initiated on June 9, 2009 with the audit entrance conference, and no payment had been made for the 2003-2004 and 2004-2005 claim when the audit entrance conference took place on June 9, 2009.<sup>65</sup> The Legislature deferred payment for the *Health Fee Elimination* program in fiscal years 2003-2004 and 2004-2005 by appropriating a nominal \$1,000 in the State Budget Act for the program.<sup>66</sup> The Fourth District Court of Appeal in *California School Boards Assoc.* concluded that “the Legislature’s practice of nominal funding of state mandates [by appropriating \$1,000] with the intention to pay the mandate in full with interest at an unspecified time *does not constitute a funded mandate under the applicable constitutional and statutory provisions.*”<sup>67</sup> Thus, the \$1,000 appropriation was

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<sup>58</sup> Government Code section 17561(d) (as amended, Stats. 2004, ch. 890).

<sup>59</sup> Government Code section 17567 (as added, Stats.1986, ch. 879).

<sup>60</sup> Evidence Code section 664: “It is presumed that official duty has been regularly performed.”

<sup>61</sup> *Personal Watercraft Coalition v. Board of Supervisors* (2002) 100 Cal.App.4th 129, 137.

<sup>62</sup> *Maryland Cas. Co. v. Andreini & Co. of Southern California* (2000) 81 Cal.App.4th. 1413, 1420.

<sup>63</sup> *County of San Diego v. State of California* (2008) 164 Cal.App.4th 580, 597.

<sup>64</sup> Exhibit A, IRC, page 32 (letter from the Controller’s Office dated June 24, 2010, showing a prior payment of \$615,935 on October 25, 2006); Exhibit B, Controller’s Late Comments on the IRC, page 67 (computer printout showing a net payment of \$615,935 for fiscal year 2002-2003, issued October 25, 2006).

<sup>65</sup> Exhibit A, IRC, pages 33, 37-38 (letters from the Controller’s Office dated June 24, 2010, and July 14, 2010 showing no prior payments for the fiscal year 2003-2004 and 2004-2005 claims).

<sup>66</sup> Statutes 2003, chapter 157, Item 6870-295-0001, schedule 1; Statutes 2004, chapter 208, Item 6870-295-0001, schedule 1.

<sup>67</sup> *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 791, emphasis added.

not considered a constitutionally sufficient appropriation to fund the program and essentially amounts to no appropriation by the Legislature and no funds to be disbursed by the Controller pursuant to Government Code section 17561(d).

The claimant now contends that the *California School Boards Assoc.* case does not apply since it did not address the Controller's timely audit under Government Code section 17558.5. The claimant argues that a nominal appropriation by the Legislature, while insufficient to meet the reimbursement requirements of article XIII B, section 6, still triggers the time for the Controller to initiate the audit as follows:

Although it is true that the Court of Appeal in *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 791 held that the appropriations did not "constitute a funded mandate," the Court of Appeal did not interpret section 17558.5 or hold that there were in fact "no appropriations" made for purposes of that statute. Thus, the appropriations, while insufficient to meet the State's Constitutional responsibilities, triggered the statute of limitations making the audits of fiscal years 2002-03, 2003-04, and 2004-05 untimely.<sup>68</sup>

The claimant is wrong. The court in the *California School Boards Assoc.* case, specifically held that a nominal appropriation of \$1,000 for a mandated program, which amounted to an estimated appropriation of \$1 per school district for each state-mandated program, violates article XIII B, section 6 and the Government Code statutes that implement the Constitution, including section 17561, which governs the payment of state-mandated costs by the Controller following an appropriation by the Legislature. The court recognized that Government Code section 17561 "is the primary code section that sets forth the State's duties once a mandate is determined by the Commission." Section 17561(a) provides that the state shall reimburse each local agency and school district for all costs mandated by the state. Section 17561(b) states that "For the initial fiscal year during which costs are incurred . . . any statute mandating these costs shall provide an appropriation therefor." Section 17561(b) further states "In subsequent fiscal years appropriations for these costs shall be included in the annual Governor's Budget and in the accompanying budget bill." Section 17561(c) provides that "The amount appropriated to reimburse local agencies and school districts for costs mandated by the state shall be appropriated to the Controller for disbursement."<sup>69</sup> And, as stated above, when mandate program funds are appropriated, Government Code section 17561(d), during the fiscal years in question, required the Controller to pay any eligible claim within 15 days after the date the appropriation for the claim was effective.<sup>70</sup> The court held that the purpose of article XIII B, section 6 and these implementing statutes is to

. . . . require each branch of government to live within its means, and to prohibit the entity having superior authority (the State) from circumventing this restriction by forcing local agencies . . . to bear the State's costs, even for a limited time period. By imposing on local school districts the financial obligation to provide

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<sup>68</sup> Exhibit E, Claimant's Comments on the Draft Proposed Decision, pages 1-2.

<sup>69</sup> *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 786-787, emphasis added.

<sup>70</sup> Government Code section 17561(d) (as amended, Stats. 2004, ch. 890).

state-mandated programs on an indeterminate and open-ended basis, the State is requiring school districts to use their own revenues to fund programs or services imposed by the state. Under this deferral practice, *the State* has exercised its authority to order many new programs and services, but *has declined to pay* for them until some indefinite time in the future. This essentially is a compelled loan and directly contradicts the language and the intent of article XIII B, section 6 and the implementing statutes.<sup>71</sup>

Accordingly, the court upheld the lower court's declaration that the state's practice of paying only a nominal amount for a mandated program while deferring the balance of the cost "constitutes a *failure to provide a subvention of funds* for the mandates as required by article XIII B, section 6 and violates the constitutional rights conferred by that provision and the specific procedures set forth at sections 17500 et seq."<sup>72</sup>

Therefore, in fiscal years 2003-2004 and 2004-2005, the Controller could not have made a payment under Government Code section 17561(d) because the Legislature failed to provide a subvention of funds under Government Code section 17561(c). The plain language of Government Code section 17558.5 tolls the time to initiate the audit "*if funds are not appropriated or no payment is made.*" (Emphasis added.)

Therefore, pursuant to the plain language of Government Code section 17558.5, the audit of the 2002-2003 claim had to be initiated no later than October 25, 2009, based on the October 25, 2006 payment. The Controller initiated the audit for all fiscal year claims with an entrance conference on June 9, 2009, before the deadline to audit the 2002-2003 claim and before any payments were made on the 2003-2004 and 2004-2005 claims. Accordingly, the audit was timely initiated.

## 2. The Audit Was Timely Completed.

Government Code section 17558.5 also prescribes the time in which an audit must be completed: "In any case, an audit shall be completed not later than two years after the date that the audit is commenced."<sup>73</sup> As indicated above, the audit was initiated no later than June 9, 2009, the date of the entrance conference and, thus, had to be completed no later than June 9, 2011. An audit is completed when the Controller issues the final audit report to the claimant. The final audit report constitutes the Controller's final determination on the subject claims and provides written notice of the claim components adjusted, the amounts adjusted, and the reasons for the adjustment, as required by Government Code section 17558.5(c), allowing the claimant to thereafter file an IRC. Here, the final audit report was issued June 11, 2010, a year prior to the expiration of the two year deadline on June 9, 2011.

Based on the foregoing, the Commission finds that the Controller's audit was timely completed in accordance with Government Code section 17558.5.

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<sup>71</sup> *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 787, emphasis added.

<sup>72</sup> *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 790-791, emphasis added.

<sup>73</sup> Government Code section 17558.5 (Stats. 2004, ch. 890).

**B. The Controller's Reduction of Indirect Costs for Fiscal Years 2002-2003, 2003-2004, 2005-2006, and 2006-2007 Is Partially Correct; and the Commission Does Not Have Jurisdiction to Review the Controller's Adjustment of Indirect Costs That Resulted in Increased Reimbursement for Fiscal Year 2004-2005.**

For fiscal years 2002-2003 and 2003-2004, the claimant calculated indirect costs using the OMB Circular A-21 method, but did not obtain federal approval for the indirect cost rates used for the calculation.

For fiscal years 2004-2005, 2005-2006, and 2006-2007, the claimant used a federally approved rate under the OMB Circular A-21. However, the Controller adjusted indirect costs in these years because, beginning fiscal year 2004-2005, the claiming instructions do not allow the use of a federally approved rate to claim indirect costs unless specifically approved in the Parameters and Guidelines (which is not the case here).

The Controller, therefore, recalculated indirect costs based on the FAM-29C methodology for all fiscal years, resulting in a reduction totaling \$381,532 for fiscal years 2002-2003, 2003-2004, 2005-2006, and 2006-2007. The Controller's recalculation increased allowable indirect costs for fiscal year 2004-2005.<sup>74</sup>

Since the Controller's adjustment to indirect costs for fiscal year 2004-2005 increased costs, the Commission has no jurisdiction to review the Controller's audit adjustment for that fiscal year. Government Code section 17551(d), which requires the Commission to hear and decide IRCs, applies only to claims that the Controller incorrectly *reduced* payments to the claimant as follows:

The commission, pursuant to the provisions of this chapter, shall hear and decide upon a claim by a local agency or school district filed on or after January 1, 1985, that the Controller has incorrectly reduced payments to the local agency or school district pursuant to paragraph (2) of subdivision (d) of Section 17561.

As described below, the Commission finds that the Controller's reduction and recalculation of indirect costs for fiscal years 2002-2003 and 2003-2004 is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support. However, the Controller's reduction of indirect costs for fiscal year 2005-2006 and 2006-2007 is incorrect as a matter of law.

1. The Controller's reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

The claimant contends that the Controller's reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 is incorrect because the Controller never explained or made findings that the amount of indirect costs claimed was excessive or unreasonable.<sup>75</sup>

However, the Parameters and Guidelines, in addition to identifying the reimbursable activities, provide instructions for eligible claimants to prepare reimbursement claims for the direct and

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<sup>74</sup> Exhibit A, IRC, pages 74-76.

<sup>75</sup> Exhibit E, Claimant's Comments on the Draft Proposed Decision, page 2.

indirect costs of a state-mandated program.<sup>76</sup> The Commission’s adoption of parameters and guidelines is quasi-judicial and, therefore, the parameters and guidelines are final and binding on local government claimants and the Controller unless set aside by a court pursuant to Government Code section 17559 or amended by the filing of a request pursuant to Government Code section 17557.<sup>77</sup> In this case, the Parameters and Guidelines for the *Health Fee Elimination* program have not been challenged, and no party has requested they be amended. The Parameters and Guidelines are therefore binding and must be applied to the reimbursement claims here.

Section VI. of the Parameters and Guidelines provide that “indirect costs may be claimed in the manner described by the State Controller in his claiming instructions.”<sup>78</sup> Claimant argues that the word “may” in the indirect cost language of the Parameters and Guidelines is permissive, and that therefore the Parameters and Guidelines do not require that indirect costs be claimed in the manner described by the Controller.<sup>79</sup>

Claimant’s argument is unsound: the Parameters and Guidelines plainly state that “indirect costs may be claimed in the manner described by the State Controller in his claiming instructions.” The interpretation that is consistent with the plain language of the Parameters and Guidelines is that “indirect costs may be claimed,” or may not, but if a claimant chooses to claim indirect costs, the claimant must adhere to the Parameters and Guidelines and claim indirect costs in the manner described in the Controller’s claiming instructions.

The claiming instructions specific to the *Health Fee Elimination* mandate are found in the Community Colleges Mandated Cost Manual, which is revised each year and contains claiming instructions applicable to all school and community college mandated programs. The cost manual issued by the Controller’s Office in September 2003 governs the reimbursement claim filed for fiscal year 2002-2003.<sup>80</sup> This cost manual provides two options for claiming indirect costs by either using the OMB Circular A-21, or the FAM-29C:

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 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

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<sup>76</sup> Government Code section 17557; California Code of Regulations, title 2, section 1183.7.

<sup>77</sup> *California School Boards Assoc. v. State of California* (2009) 171 Cal.App.4th 1183, 1200, which stated the following: “[U]nless a party to a quasi-judicial proceeding challenges the agency's adverse findings made in that proceeding, by means of a mandate action in superior court, those findings are binding in later civil actions.” [Citation omitted.] See also, Government Code section 17557.

<sup>78</sup> Exhibit A, IRC, page 47.

<sup>79</sup> Exhibit A, IRC, page 13.

<sup>80</sup> Exhibit B, Controller’s Late Comments on the IRC, page 35.

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. . . .

[¶]

The [FAM-29C] 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 costs activities and those costs that are directly related to instructional activities of the college. Accounts that should be classified as indirect costs are: Planning and Policy Making, Fiscal Operations, General Administrative Services, and Logistical Services. If any costs included in these accounts are claimed as a mandated cost, i.e., salaries of employee 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 Services, 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 expense percentage is allowable if the college can support its allocation basis.

The indirect cost rate, derived by determining the ratio of total indirect expenses and total direct expenses when applied to the direct costs claimed, will result in an equitable distribution of the college’s mandate related indirect costs. . . .<sup>81</sup>

The OMB Circular A-21 establishes principles for determining costs applicable to grants, contracts, and other agreements between the federal government and educational institutions.

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<sup>81</sup> Exhibit B, Controller’s Late Comments on the IRC, page 31.



Section G(11) of the OMB Circular A-21 governs the determination of indirect cost rates and requires the federal approval of a proposed rate by the “cognizant federal agency,” which is normally either the federal Department of Health and Human Services or the Department of Defense’s Office of Naval Research.<sup>82</sup> If a claimant chooses to use the OMB Circular A-21 methodology, the claimant must obtain federal approval for the rate calculated through formal negotiation, an informal correspondence process, or a simplified method which sets the indirect cost rate using a salaries and wage base.<sup>83</sup> The end result of the negotiation process is a sponsored agreement in which final approval lies with the federal government negotiating the rate and must be supported by “adequate documentation to support costs charged to sponsored agreements.”<sup>84</sup>

The cost manual issued by the Controller’s Office in September 2004 governs the reimbursement claim filed for fiscal year 2003-2004. This cost manual similarly provides the option for claiming indirect costs by either using the OMB Circular A-21, or the FAM-29C.<sup>85</sup>

Here, claimant used the methodology in the OMB Circular A-21 for fiscal years 2002-2003 and 2003-2004, and asserts that that the Controller cannot recalculate the rate according to its unenforceable ministerial preferences.<sup>86</sup> That assertion is in essence a challenge to the Controller’s entire claiming instructions as an underground regulation adopted without complying with the APA.

However, the Commission does not need to reach the alleged underground regulation issue for these reductions because the claimant failed to obtain federal approval for its use of the OMB Circular A-21 methodology as required by the OMB Circular A-21 itself.

Since the claimant did not negotiate with a federal agency to determine the appropriate direct costs to use for the calculation of the indirect costs rate, it cannot be determined whether the claimed rates would have received federal approval. Federal approval is clearly required by both the claiming instructions and the OMB methodology itself, and the claimant failed to obtain that approval.

Accordingly, the Controller’s reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 is correct as a matter of law. Moreover, there is no evidence that the Controller’s recalculation of indirect costs using the FAM 29-C methodology is arbitrary, capricious, or entirely lacking in evidentiary support. Therefore, the reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 is correct.

2. The Controller’s reduction of indirect costs for fiscal years 2005-2006 and 2006-2007, based solely on the Controller’s change to the claiming instructions without notice or opportunity to comment, is incorrect as a matter of law.

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<sup>82</sup> Exhibit F, OMB Circular A-21.

<sup>83</sup> Exhibit F, OMB Circular A-21, pages 37-39.

<sup>84</sup> Exhibit F, OMB Circular A-21, page 6.

<sup>85</sup> Exhibit F, Mandated Cost Manual for fiscal year 2003-2004 reimbursement claims (Revised September 2004).

<sup>86</sup> Exhibit A, IRC, page 13.

For fiscal years 2005-2006 and 2006-2007, the Controller reduced indirect costs because the annual claiming instructions, beginning fiscal year 2004-2005, do not allow the use of the federally approved rate developed under the OMB Circular A-21 to claim indirect costs unless specifically approved in the Commission's parameters and guidelines. The Parameters and Guidelines for the *Health Fee Elimination* program provide only that "indirect costs may be claimed in the manner described by the State Controller in his claiming instructions."<sup>87</sup> Thus, the Controller recalculated indirect costs using the FAM-29C methodology, resulting in a reduction of \$124,261 for fiscal years 2005-2006 and 2006-2007.

The claiming instructions specific to the *Health Fee Elimination* mandate are found in the Controller's Mandated Cost Manual, which, as described above, is revised each year. The Mandated Cost Manual for fiscal year 2004-2005 claims, dated December 27, 2005, for the first time changed the indirect cost rate language to prohibit the use of the federal OMB Circular A-21 unless specifically allowed by the Parameters and Guidelines:

A CCD may claim indirect costs using the Controller's methodology (FAM-29C), outlined in the following paragraphs. If specifically allowed by a mandated program's Ps &Gs, 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.<sup>88</sup>

The Mandated Cost Manuals for fiscal year 2005-2006 and 2006-2007 claims, dated November 15, 2006 and November 7, 2007, respectively contain the same language.<sup>89</sup> At that time, Government Code section 17560 required annual reimbursement claims to be filed by January 15 for 2005-2006 claims,<sup>90</sup> and February 15 for 2006-2007 claims.<sup>91</sup>

The claimant contends that the reduction is incorrect, and that the Controller simply stopped accepting federally approved rates, retroactively beginning fiscal year 2004-2005, with no justification or opportunity for public comment and in violation of the Administrative Procedures Act.<sup>92</sup>

The Controller relies on the plain language of the Parameters and Guidelines to contend that the reduction is correct as a matter of law. The Controller states the following:

The district states, "No particular indirect cost rate calculation is required by law." The district infers that it may calculate an indirect cost rate in any manner that it chooses. We disagree with the district's interpretation of the parameters and

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<sup>87</sup> Exhibit A, IRC, page 47.

<sup>88</sup> Exhibit F, Mandated Cost Manual for fiscal year 2004-2005 reimbursement claims (Revised December 2005).

<sup>89</sup> Exhibit F, Mandated Cost Manuals for fiscal year 2005-2006 and 2006-2007 reimbursement claims; Exhibit B, Controller's Late Comments on the IRC, page 17.

<sup>90</sup> As amended by Statutes 1998, chapter 681.

<sup>91</sup> As amended by Statutes 2007, chapter 179 (eff. Aug. 24, 2007).

<sup>92</sup> Exhibit A, IRC, pages 13-15.

guidelines. The phrase “may be claimed” simply permits the district to claim indirect costs. However, if the district chooses to claim indirect costs, then the parameters and guidelines require that it comply with the SCO’s claiming instructions. If the district believes that the program’s parameters and guidelines are deficient, it should initiate a request to amend the parameters and guidelines . .

[¶]

The district believes that the SCO incorrectly interprets the parameters and guidelines. We disagree. The parameters and guidelines are clear and unambiguous. They state, “Indirect costs may be claimed *in the manner described by the State Controller in his claiming instructions.*” In this case, the parameters and guidelines specifically identify the claiming instructions as authoritative criteria for indirect costs. The district also states: “The Controller’s staff interpretation of Section VI of the parameters and guidelines would, in essence, subject claimants to underground rulemaking. . .The Controller’s claiming instructions are unilaterally created and modified without public notice or comment . . .” We disagree. Title 2, CCR, Section 1186 allows districts to request that the Commission review the SCO’s claiming instructions. Section 1186, subdivisions (e) through (h), provides districts an opportunity for public comment during the review process. Neither this district nor any other district requested that the Commission review the SCO’s claiming instructions (i.e. the district did not exercise its right for public comment). The district may not now request a review of the claiming instructions applicable to the audit period. Title 2, CCR, section 1186, subdivision (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.”<sup>93</sup>

As indicated above, the Parameters and Guidelines state that “indirect costs may be claimed in the manner described by the State Controller in his claiming instructions.” Parameters and guidelines are regulatory in nature and may validly incorporate manuals and other documents by reference as long the incorporated document is adequately identified and available for comment.<sup>94</sup> This is consistent with the Administrative Procedures Act (APA), which requires public notice and an opportunity to comment on all proposed rules that apply generally, and that implement, interpret, or make the specific the law.<sup>95</sup> The purpose of the APA is to ensure that those persons or entities affected by a regulation have a voice in its creation, as well as notice of the law’s requirements so that they can conform their conduct accordingly.<sup>96</sup> Thus, if the manual or document that is incorporated by reference later changes without notice or opportunity for

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<sup>93</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 14-15 (emphasis in original).

<sup>94</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 799; *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 220.

<sup>95</sup> Government Code sections 11346, et seq.

<sup>96</sup> *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 570.

comment, then the new rule or standard of general application in the incorporated document may become an invalid underground regulation.<sup>97</sup>

For example, the case of *Union of American Physicians & Dentists v. Kizer* addressed regulations adopted by the Department of Health Services, which incorporated by reference separate bulletins and a provider manual setting forth *current* documentation requirements for reimbursement claims filed by providers under the Medi-Cal program.<sup>98</sup> The Department acknowledged that it “used the manual to evaluate whether a provider’s progress notes satisfy the appropriateness and quality of medical services requirements.”<sup>99</sup> The court determined that the documentation requirements in the manual were standards of general application to providers statewide, which interpreted or made specific the law enforced by the Department, and were therefore invalid underground regulations.<sup>100</sup>

Similarly, in *California Association of Nursing Homes v. Williams*, the court addressed a class action challenge by nursing homes to the validity of regulations adopted by the Department of Health Care Services, which incorporated by reference a pamphlet (“State Schedule of Maximum Allowances”) published by the Department of Finance, to reimburse nursing and convalescent homes based on the schedule of allowances in effect at the time services were provided. Based on the language, the regulation attempted to incorporate future changes in reimbursement standards adopted by the Department of Finance.<sup>101</sup> The court found that the Schedule of Maximum Allowances “appears to be the result of ex parte studies by staff personnel of the Department of Finance,” and changes were made “without public or judicial access.”<sup>102</sup> The court concluded that the documentation requirements in the manual were invalid underground regulations.<sup>103</sup>

In 2010, the Third District Court of Appeal in the *Clovis Unified School District* case, addressed the Controller’s contemporaneous documentation rules contained in the Controller’s claiming instructions. The court determined that the claiming instructions are non-regulatory, and that any rule requiring additional documentation that is contained in the claiming instructions that did not go through the regulatory process required by the APA, but was used by the Controller in an audit to reduce costs, invalidates the audit to the extent the Controller used the underground rule to reduce costs.<sup>104</sup>

Based on the cases cited above, the Commission finds that the Controller’s reduction of indirect costs for fiscal years 2005-2006 and 2006-2007, based solely on the Controller’s change to the claiming instructions and its use of the new indirect cost rate rule, without evidence that notice

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<sup>97</sup> *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 219-220.

<sup>98</sup> *Union of American Physicians & Dentists v. Kizer* (1990) 223 Cal.App.3d 490, 495.

<sup>99</sup> *Union of American Physicians & Dentists* (1990), 223 Cal.App.3d 490, 501.

<sup>100</sup> *Union of American Physicians & Dentists* (1990), 223 Cal.App.3d 490, 506.

<sup>101</sup> *California Assn. of Nursing Homes v. Williams* (1970) 4 Cal.App.3d 800, 808.

<sup>102</sup> *California Assn. of Nursing Homes* (1970) 4 Cal.App.3d 800, 813-814.

<sup>103</sup> *California Assn. of Nursing Homes* (1970) 4 Cal.App.3d 800, 816.

<sup>104</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 799, 805.

and an opportunity for comment was provided to the claimant each time the claiming instructions were issued, is invalid because the reduction is based on an underground regulation.

Although the new rule allows the use of the federal OMB Circular A-21 “if specifically allowed by a mandated program’s Ps & Gs,” the Parameters and Guidelines for the *Health Fee Elimination* Program do not contain that language and, thus, the Controller’s change to the rule effectively prohibits the use of the federal method for calculating indirect costs for this program. There is no evidence in the record, such as a proof of service or certificate of mailing, that the Controller provided notice of the change in the rule with each updated cost manual to the claimant. To comply with procedural due process requirements, notice must, at a minimum, be reasonably calculated to afford affected claimants the realistic opportunity to protect their interests.<sup>105</sup> And the claimant here asserts that it received no prior notice regarding the change in the indirect cost rate rule for the fiscal years in question.<sup>106</sup>

In addition, the record suggests that the claimant was first made aware of the change in the rule when the Controller’s draft audit report was received by the claimant for this matter on May 3, 2010, years after the annual reimbursement claims were due.<sup>107</sup> By this time, the claimant could not have filed a request to amend the Parameters and Guidelines to specifically allow the use of the federal OMB method for the fiscal year 2005-2006 and 2006-2007 reimbursement claims, as suggested by the Controller. Government Code section 17557(d) states that “[a] parameters and guidelines amendment filed more than 90 days after the claiming deadline for initial claims . . . and on or before the claiming deadline following a fiscal year, shall establish reimbursement eligibility for that fiscal year.” Thus, even if the claimant filed a request to amend the Parameters and Guidelines on May 3, 2010 (the day claimant states notice was received) and the Commission approved the request, the amendment would only apply to reimbursement claims beginning 2009-2010.<sup>108</sup> Nor would a request to review the Controller’s claiming instructions, filed on or after May 3, 2010 (the day claimant states notice was received), have any effect on the 2005-2006 and 2006-2007 reimbursement claims. A request to review claiming instructions filed after the initial claiming deadline must be submitted on or before the annual reimbursement claim filing deadline set out in Government Code section 17560 following a fiscal year in order to establish eligibility for reimbursement for that fiscal year.<sup>109</sup> The claiming deadline for fiscal year 2005-2006 claims was January 15, 2007.<sup>110</sup> The claiming

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<sup>105</sup> *Mullane v. Central Hanover B. & T. Co.* (1950) 339 U.S. 306, 313.

<sup>106</sup> Exhibit A, IRC, page 14 [“The Controller’s claiming instructions are unilaterally created and modified without public notice or comment.”].

<sup>107</sup> Exhibit A, IRC, pages 91 and 93 [claimant’s response to draft audit report, where claimant states the following: “The District used a federal approved cost study rate for FY 2004-05, FY 2005-06, and FY 2006-07. The Controller has decided, but has not stated a basis for this decision, to discontinue, retroactively to FY 2004-05, the use of federal rates, approved or not.”].

<sup>108</sup> The Controller agrees with this finding. (Exhibit B, Controller’s Late Comments on the IRC, page 14 [“However, any such amendment would not apply to this audit period.”].)

<sup>109</sup> California Code of Regulations, title 2, section 1184.1(m)(2).

<sup>110</sup> Government Code section 17560 (as amended by Stats. 1998, ch. 681).

deadline for 2006-2007 claims was February 15, 2008.<sup>111</sup> Thus, a request to review claiming instructions would have had to be filed by January 15, 2007 and February 15, 2008, respectively, to have any effect on the 2005-2006 and 2006-2007 reimbursement claims.<sup>112</sup> Thus, by the time notice was provided, the claimant had no opportunity to comment in time to affect the reimbursement claims for these fiscal years.

Due process requires, at a minimum, that notice be reasonably calculated to afford affected claimants the realistic opportunity to protect their interests.<sup>113</sup> Under similar circumstances, when parameters and guidelines are amended, the Legislature has found that notice of an extra 120 days after the revised claiming instructions are issued to local government is required before annual reimbursement claims are due.<sup>114</sup> Thus, in those cases, a full regulatory hearing is conducted to amend the parameters and guidelines *and* claimants are provided an additional four months before claims are due. In this case, there is no evidence that claimants received any notice prior to the audit.

Accordingly, under these circumstances, the Commission finds that the Controller's reduction of indirect costs by \$124,261 in fiscal years 2005-2006 and 2006-2007, based solely on the Controller's change to the calculation of indirect cost rates, is incorrect as a matter of law.<sup>115</sup>

**C. The Controller's Reduction for Understated Offsetting Revenues Is Correct as a Matter of Law, and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.**

The Controller reduced costs by \$938,052 because the claimant understated its offsetting health service fee authority. In each fiscal year, the claimant reported only those health service fees actually collected, and not the total amount of fees authorized to be charged. Using enrollment and BOGG exemption data, the Controller calculated the health fees that the claimant was authorized to charge, which resulted in a reduction of costs claimed.<sup>116</sup>

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<sup>111</sup> Government Code section 17560 (as amended by Stats. 2007, ch. 179, eff. Aug. 24, 2007).

<sup>112</sup> The Controller agrees with this finding. (Exhibit B, Controller's Late Comments on the IRC, page 15 ["The district may not now request a review of the claiming instructions applicable to the audit period."].)

<sup>113</sup> *Mullane v. Central Hanover B. & T. Co.* (1950) 339 U.S. 306, 313; *In re Cindy B.* (1987) 192 Cal.App.3d 771, 783-784.

<sup>114</sup> Government Code section 17560(c).

<sup>115</sup> The facts of this case are distinguishable from the Commission's decision in *Health Fee Elimination*, 08-4206-I-17 (Santa Monica Community College; adopted December 3, 2015). In the Santa Monica IRC, the Controller reduced indirect costs in 2003-2004, 2004-2005, and 2005-2006 because the claimant used the federal OMB Circular A-21, but did not obtain federal approval for its indirect cost rate proposals as required by the OMB Circular. In this case, the only reason for the reduction of indirect costs in 2005-2006 and 2007-2008 was the Controller's change to the claiming instructions.

<sup>116</sup> Exhibit A, IRC, page 76.

The claimant contends that it is only required to report as offsetting revenues, the fee revenue actually collected.<sup>117</sup>

The Commission finds that the correct calculation and application of offsetting revenue from student health fees has been resolved by the *Clovis Unified* decision, and that a reduction to the extent of the fee *authority*, rather than fee revenue actually collected, is correct as a matter of law.<sup>118</sup>

After the claimant filed its IRC, the court in *Clovis Unified* specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge students, whether or not districts choose to impose those fees. As expressed by the court, the "Health Fee Rule" states in pertinent part:

Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.<sup>119</sup> (Underline in original.)

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

(a)(1) The governing board of a district maintaining a community college may require community college students to pay a fee in the total amount of not more than ten dollars (\$10) for each semester, seven dollars (\$7) for summer school, seven dollars (\$7) for each intersession of at least four weeks, or seven dollars (\$7) for each quarter for health supervision and services, including direct or indirect medical and hospitalization services, or the operation of a student health center or centers, or both.

(a)(2) The governing board of each community college district may increase [the health service fee] by the same percentage increase as the Implicit Price Deflator for State and Local Government Purchase of Goods and Services. Whenever that calculation produces an increase of one dollar (\$1) above the existing fee, the fee may be increased by one dollar (\$1).<sup>120</sup>

Pursuant to the plain language of Education Code section 76355(a)(2), the fee authority given to districts automatically increases at the same rate as the Implicit Price Deflator; when that calculation produces an increase of one dollar above the existing fee, the fee may be increased by one dollar.<sup>121</sup> The Chancellor of the California Community Colleges issues a notice to the

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<sup>117</sup> Exhibit A, IRC, pages 15-21.

<sup>118</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794.

<sup>119</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 811.

<sup>120</sup> Education Code section 76355(d)(2) (Stats. 1993, ch. 8 (AB 46); Stats. 1993, ch. 1132 (AB 39); Stats. 1994, ch. 422 (AB 2589); Stats. 1995, ch. 758 (AB 446); Stats. 2005, ch. 320 (AB 982)) [Formerly Education Code section 72246(e) (Stats. 1987, ch. 118)].

<sup>121</sup> See Education Code section 76355 (Stats. 1995, ch. 758 (AB 446)). The Implicit Price Deflator for State and Local Purchase of Goods and Services is a number computed annually (and quarterly) by the United States Department of Commerce as part of its statistical series on

governing boards of all community colleges when a fee increase is triggered. Accordingly, the court in *Clovis Unified* upheld the Controller’s use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. The court held that:

To the extent a local agency or school district “has the authority” to charge for the mandated program or increased level of service, that charge cannot be recovered as a state-mandated cost.<sup>122</sup>

The court also noted that, “this basic principle flows from common sense as well. As the Controller succinctly puts it, ‘Claimants can choose not to require these fees, but not at the state’s expense.’”<sup>123</sup> Additionally, in responding to the claimant’s argument that, “since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission’s P&G’s,”<sup>124</sup> the court held:

To accept this argument, though, we would have to ignore, and so would the Controller, the fundamental legal principles underlying state-mandated costs. We conclude *the Health Fee Rule is valid*.<sup>125</sup> (Italics added.)

Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.<sup>126</sup> In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.<sup>127</sup> Collateral estoppel applies when (1) the issue necessarily decided in the previous proceeding is identical to the one that is currently being decided; (2) the previous proceeding terminated with a final judgment on the merits; (3) the party against whom collateral estoppel is asserted is a party to or in privity with a party in the previous proceeding; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue.<sup>128</sup> The claimant was a party to the *Clovis* action.

The Commission further finds that the Controller’s calculation of the claimant’s authorized offsetting fee revenue is not arbitrary, capricious, or entirely lacking in evidentiary support, since the Controller used the enrollment data available and reported by the claimant. The Controller obtained student enrollment and Board of Governors Grant (BOGG) recipient data from the

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measuring national income and product, and is used to adjust government expenditure data for the effect of inflation.

<sup>122</sup> *Clovis Unified School Dist. v. Chiang* (2010)188 Cal.App.4th 794, 812.

<sup>123</sup> *Clovis Unified School Dist. v. Chiang* (2010)188 Cal.App.4th 794, 812.

<sup>124</sup> *Clovis Unified School Dist. v. Chiang* (2010)188 Cal.App.4th 794, 812 (italics in original).

<sup>125</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

<sup>126</sup> *Fenske v. Board of Administration* (1980) 103 Cal.App.3d 590, 596.

<sup>127</sup> The petitioners in the *Clovis* case included Clovis Unified School District, El Camino Community College District, Fremont Unified School District, Newport-Mesa Unified School District, Norwalk-La Mirada Unified School District, Riverside Unified School District, San Mateo Community College District, Santa Monica Community College District, State Center Community College District, and Sweetwater Union High School District.

<sup>128</sup> *Roos v. Red* (2006) 130 Cal.App.4th 870, 879-880.



California Community Colleges Chancellor's Office and calculated the authorized health service fees using the authorized rates that the Chancellor's Office noticed during the fiscal years at issue.<sup>129</sup>

Therefore, the Commission finds that the Controller's reduction of \$938,052 based on the claimant's unreported offsetting fee authority is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

**D. The Commission Does Not Have Jurisdiction to Hear and Determine Whether Findings 1, 4, and 5 Are Incorrect Because These Findings Did Not Result in a Reduction of Costs Claimed.**

In Finding 1, the Controller found that the claimant under-claimed allowable salaries, benefits, and services and supply costs as follows:

- For fiscal years 2003-2004 and 2004-2005, the claimant did not claim mandate-related psychological interns' costs.
- For fiscal years 2002-2003, 2003-2004, and 2004-2005, the claimant did not claim mandate-related health service costs that it funded with California Lottery Revenue. The claimant's lottery revenue does not result from the statute that established the mandated program. In addition, the claimant does not receive lottery revenue specifically to fund mandated program costs. Thus, the Controller determined that lottery revenue is not offsetting revenue for this mandated program.
- For fiscal year 2006-2007, the claimant did not claim mandate-related costs for North Centers locations. The claimant believed that these costs were not mandate-related because the North Centers locations did not exist in the 1986-87 base year. However, the Controller concluded that the mandated program requires that the *district* provide the same level of health services provided in the base year, regardless of location.

The Controller applied the under-claimed costs to offset the audit reductions. The claimant does not dispute these adjustments.

However, for fiscal year 2004-2005, the under-claimed costs (and recalculated and related increased indirect costs), exceeded the amount claimed for that year after adjusting for the reduction from authorized health service fee revenue, by \$89,593.<sup>130</sup> Even though the audit did not result in a reduction of costs for fiscal year 2004-2005, the claimant requests the Commission "make findings of fact and law on each and every adjustment made by the Controller and each and every procedural and jurisdictional issue raised in this claim, and order the Controller to correct its audit report findings therefrom."<sup>131</sup> Thus, the claimant requests reimbursement for the \$89,593 in salaries, benefits, services and supplies, and related indirect costs for psychological interns and costs funded with Lottery revenue that the Controller found could have been claimed for fiscal year 2004-2005.<sup>132</sup>

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<sup>129</sup> Exhibit A, IRC, page 76.

<sup>130</sup> Exhibit A, IRC, pages 71-74.

<sup>131</sup> Exhibit A, IRC, page 29; Exhibit E, Claimant's Comments on the Draft Proposed Decision.

<sup>132</sup> Exhibit A, IRC, pages 23-24.

The Controller argues that it has no authority to reimburse these unclaimed costs as follows:

The district is responsible for filing its mandated cost claim. The SCO conducted an audit of the district's FY 2004-05 mandated cost claim and concluded that the claimed costs are allowable. The SCO also identified additional costs that would be allowable under the mandated program. However, the SCO has no authority to file an amended claim on the district's behalf. In addition, the district may not now file an amended claim, because the statutory time allowed to file an amended claim has passed.<sup>133</sup>

The Commission finds that it has no jurisdiction to make the determination sought by claimant, since there has been *no reduction* of costs claimed.

The Government Code places the burden on the claimant to timely claim reimbursement for the increased costs mandated by the state. Government Code section 17561(c)(2) provides that in subsequent fiscal years, after the initial reimbursement claim is filed, "each local agency or school district shall submit its claim as specified in Section 17560." Government Code section 17560(a), as it stated in fiscal year 2004-2005, provided that a school district may file an annual reimbursement claim that details the costs actually incurred by January 15 following the fiscal year in which costs were incurred. Thus, reimbursement claims for fiscal year 2004-2005 costs had to be filed by January 15, 2006. Amended reimbursement claims may thereafter be filed. However, Government Code sections 17568 and 17561(c)(3) provide that "in no case shall a reimbursement claim be paid that is submitted more than one year after the deadline" specified in section 17560 and the Controller's claiming instructions. Thus, the deadline to file an amended 2004-2005 reimbursement claim was one year after the January 15, 2006 deadline, or by January 15, 2007. Claimant never claimed these costs until filing this IRC, many years past that deadline.

Moreover, Government Code section 17551(d) provides that the Commission "shall hear and decided upon a claim by a local agency or school district . . . that the Controller has incorrectly reduced payments to the local agency or school district pursuant to paragraph (2) of subdivision (d) of Section 17561." Here there has been no reduction.

Similarly, the Controller's Findings 4 and 5 address the claimant's reporting of base-year and current-year services and alleged insufficient documentation of services provided. The Controller's recommendation on Finding 4 states the following:

We recommend that the district accurately report health services that it provided in the 1986-87 base year and during the current year for which it intends to claim mandate-related costs. We recommend that the district refrain from claiming any mandated costs if it does not provide one or more services that it provided during the 1986-87 base year. In addition, we recommend that the district deduct the actual cost of any current-year services that exceed the services that the district provided during the 1986-87 base year.<sup>134</sup>

The Controller's Finding 5 states the following:

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<sup>134</sup> Exhibit A, IRC, page 83.

Fresno City College and the district's North Centers (Clovis Center, Madera Center, and Oakhurst Center) did not sufficiently document actual health services that they provided. These locations maintained health service records that do not identify the services provided consistent with the parameters and guidelines. The records either identified the services provided using general, vague descriptions or did not identify a specific service provided.<sup>135</sup>

These findings were advisory and did not result in any reductions to costs claimed. The claimant admits there is no fiscal effect from these findings,<sup>136</sup> but argues that the Controller's interpretation of the Parameters and Guidelines is not legally correct.<sup>137</sup>

The Commission does not have jurisdiction to review the Controller's interpretation of the Parameters and Guidelines with respect to these findings. Government Code section 17551(d) provides that the Commission "shall hear and decided upon a claim by a local agency or school district . . . that the Controller has *incorrectly reduced* payments to the local agency or school district pursuant to paragraph (2) of subdivision (d) of Section 17561." (Emphasis added.)

Accordingly, the Commission has no jurisdiction under Government Code section 17551(d) to hear and determine whether Findings 1, 4, and 5 are incorrect since no reductions were made.

## **V. Conclusion**

Based on the foregoing, the Commission partially approves this IRC. The Commission finds that the Controller's reduction of indirect costs of \$124,261 for fiscal years 2005-2006 and 2006-2007, based solely on the change to the claiming instructions and its use of the new indirect cost rate rule, without evidence that notice and an opportunity for comment was provided to the claimant, is incorrect as a matter of law and requests that the Controller reinstate these costs to the claimant.

The Commission denies the remaining allegations in the IRC for the following reasons:

- The reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support. The Commission has no jurisdiction under Government Code section 17551(d) to hear and determine whether the Controller's findings on indirect costs for fiscal year 2004-2005 is incorrect because the findings and adjustments increased costs to the claimant.
- The reductions relating to understated offsetting health service fees authorized by the state to be charged, are correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.
- The Commission has no jurisdiction under Government Code section 17551(d) to hear and determine whether Findings 1, 4, and 5 are incorrect because the Controller's findings did not result in any reductions.

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<sup>135</sup> Exhibit A, IRC, page 86.

<sup>136</sup> Exhibit A, IRC, pages 21, 23.

<sup>137</sup> Exhibit A, IRC, pages 22, 23.



RE: **Decision**

*Health Fee Elimination*, 10-4206-I-32

Former Education Code Section 72246 (Renumbered as 76355)<sup>1</sup>

Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1);

and Statutes 1987, Chapter 1118 (AB 2336)

Fiscal Years: 2002-2003, 2003-2004, 2004-2005, 2005-2006, and 2006-2007

State Center Community College District, Claimant

On July 28, 2017, the foregoing Decision of the Commission on State Mandates was adopted on the above-entitled matter.

Heather Halsey, Executive Director

Dated: August 1, 2017

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<sup>1</sup> Statutes 1993, chapter 8.

BEFORE THE  
 COMMISSION ON STATE MANDATES  
 STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM  
 ON:**

Former Education Code Section 72246  
 (Renumbered as 76355)<sup>1</sup>

Statutes 1984, Chapter 1 (1983-1984 2nd Ex.  
 Sess.) (AB2X 1); and Statutes 1987, Chapter  
 1118 (AB 2336)

Fiscal Years 2002-2003, 2003-2004, 2004-  
 2005, 2005-2006, and 2006-2007

San Mateo County Community College  
 District, Claimant

Case No.: 10-4206-I-35

*Health Fee Elimination*

DECISION PURSUANT TO  
 GOVERNMENT CODE SECTION 17500  
 ET SEQ.; CALIFORNIA CODE OF  
 REGULATIONS, TITLE 2, DIVISION 2,  
 CHAPTER 2.5. ARTICLE 7

*(Adopted May 26, 2017)*

**DECISION**

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on May 26, 2017. Claimant, San Mateo County Community College District, did not attend the hearing. Ken Howell and Jim Spano appeared for the State Controller’s Office.

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

The Commission adopted the Proposed Decision to partially approve the IRC by a vote of 5 to 0.

<b>Member</b>	<b>Vote</b>
Lee Adams, County Supervisor	Yes
Ken Alex, Director of the Office of Planning and Research	Yes
Richard Chivaro, Representative of the State Controller, Vice Chairperson	Absent
Mark Hariri, Representative of the State Treasurer	Yes
Sarah Olsen, Public Member	Absent
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	Yes
Carmen Ramirez, City Council Member	Yes

<sup>1</sup> Statutes 1993, chapter 8.

## **Summary of the Findings**

This Decision addresses the IRC filed by San Mateo County Community College District (claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for fiscal years 2002-2003 through 2006-2007 under the *Health Fee Elimination* program. Over the five fiscal years in question, the Controller reduced costs totaling \$781,934, of which \$732,846 is in dispute. The Controller made reductions based on its findings of unallowable costs for services and supplies (gift certificates, food, and other promotional items distributed during health fairs); unallowable costs for uncollected student health fees as a bad debt expense; overstated indirect costs; and understated health fees authorized to be collected.

The Commission finds that the Controller timely initiated the audit of the fiscal year 2002-2003 and 2003-2004 reimbursement claims pursuant to Government Code section 17558.5, since payment on the 2002-2003 reimbursement claim was made within three years of the date the audit was initiated, and no payment had been made for the 2003-2004 claim at the time the audit was initiated. The audit was complete for all reimbursement claims before the two-year deadline.

On the merits, the Commission finds as follows:

- The Controller's reduction of costs for gift certificates, food, and other promotional items distributed during health fairs is correct as a matter of law, and is not arbitrary, capricious, or without evidentiary support. The Parameters and Guidelines authorize reimbursement for the costs to provide health services to students in the claim year, including the costs for health fairs to distribute information to students, *to the extent* the district provided the service in fiscal year 1986-1987.<sup>2</sup> Thus, to the extent that these promotional items were not provided by the district in the base year, these costs go beyond the scope of the mandate. Here, the record contains invoices supporting the costs incurred in the claim year for gift certificates, food, and other promotional items distributed during health fairs.<sup>3</sup> However, claimant has not argued or submitted any evidence, as required by the Parameters and Guidelines, that it provided these promotional items in the base year as an integral part of its health fairs.
- The Controller's reduction of costs claimed as a bad debt expense resulting from uncollected student health fees is correct as a matter of law. The Parameters and Guidelines authorize reimbursement for the costs of providing health supervision and services and direct and indirect medical and hospitalization services to students, and the operation of student health centers, to the extent the community college provided these services in fiscal year 1986-1987. Health service fees authorized by statute to be charged, but uncollectible, are not costs identified in the Parameters and Guidelines as eligible for reimbursement.
- The Controller's reduction of indirect costs is partially correct. The district claimed indirect costs for all fiscal years under the OMB Circular A-21 based on a federally approved rate of 30 percent, developed using a base of "Direct salaries and wages

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<sup>2</sup> Exhibit A, IRC, page 40, emphasis added.

<sup>3</sup> Exhibit B, Controller's Late Comments on the IRC, pages 89-109.

including all fringe benefits.”<sup>4</sup> For fiscal years 2002-2003 and 2003-2004, the Controller found that the claimant overstated indirect costs because it incorrectly applied the indirect cost rate to a base of total direct costs, rather than to a base of salaries and benefits only, as approved by the federal government. This reduction is correct as a matter of law. Section H(2)(e) of the OMB Circular A-21 requires the rate to be applied only to direct salaries and wages.<sup>5</sup> Thus, the claimant did not comply with the OMB Circular A-21 or the negotiated agreement with the federal government and, instead, applied the rate to all direct costs. Moreover, there is no evidence that the Controller’s recalculation is arbitrary, capricious, or entirely lacking in evidentiary support.

The reduction for fiscal year 2004-2005, however, is incorrect as a matter of law. The Controller adjusted indirect costs based solely on the ground that the claiming instructions were changed beginning with the fiscal year 2004-2005 reimbursement claims, to not allow the use of a federally approved rate to claim indirect costs unless specifically approved in the Commission’s Parameters and Guidelines. The Controller’s new indirect cost rate rule is included in the Controller’s Mandated Cost Manual, “updated December 27, 2005,” which applied to fiscal year 2004-2005 reimbursement claims to be filed by January 15, 2006, just two weeks later.<sup>6</sup> Although the new rule allows the use of the federal OMB Circular A-21 “if specifically allowed by a mandated program’s Ps & Gs,” the Parameters and Guidelines for the *Health Fee Elimination* Program do not contain that language and, thus, the Controller’s change to the rule effectively prohibits the use of the federal method for calculating indirect costs for this program in fiscal year 2004-2005. Parameters and guidelines are regulatory in nature and may validly incorporate manuals and other documents by reference as long the incorporated document is adequately identified and available for comment.<sup>7</sup> However, if the manual or document that is incorporated by reference later changes without notice or opportunity for comment, then the new rule or standard of general application in the incorporated document may become an invalid underground regulation.<sup>8</sup> There is no evidence in the record, such as a proof of service or certificate of mailing, that the Controller provided notice of the change in the rule to the claimant or that the Claimant received the updated Mandated Cost Manual prior to filing its 2004-2005 reimbursement claim. Even if the updated Mandated Cost Manual was, in fact, issued to community college districts on December 27, 2005 (the date of the manual), the claimant would not have had sufficient notice or opportunity to comment before the 2004-2005

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<sup>4</sup> Exhibit A, IRC, pages 13, and 109 and 120 (federal approval letter of indirect cost rate, dated March 11, 2003, and effective for the period of July 1, 2003, through June 30, 2008); Exhibit B, Controller’s Late Comments on the IRC, pages 48-51 (federal approval letter of indirect cost rate, dated February 4, 1999, and effective for the period of July 1, 1999 through June 30, 2004).

<sup>5</sup> Exhibit F, OMB Circular A-21, page 39 (emphasis added).

<sup>6</sup> Exhibit F, Mandated Cost Manual updated December 27, 2005; Government Code section 17560, as amended by Statutes 1998, chapter 681.

<sup>7</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 799; *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 220.

<sup>8</sup> *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 219-220.

reimbursement claim was due on January 15, 2006. Thus, the Commission finds that the Controller's reduction of indirect costs in fiscal year 2004-2005, based solely on the Controller's change to the claiming instructions and its use of the new indirect cost rate rule, without evidence that notice and an opportunity for comment was provided to the claimant, is an invalid underground regulation and the costs reduced should be reinstated to the claimant.

Since the Controller's adjustment to indirect costs in fiscal years 2005-2006 and 2006-2007 does not result in a reduction, the Commission has no jurisdiction under Government Code section 17551(d) to review the Controller's audit adjustment for those fiscal years.

- The Controller's reduction based on the claimant's unreported offsetting fee authority is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support. This issue has been conclusively decided in *Clovis Unified School District*,<sup>9</sup> in which the court held that local government is required to identify and deduct the total amount of fees authorized to be charged, and not only the fee revenue actually collected. The court stated that local government could choose not to exercise statutory fee authority to its maximum extent, but not at the state's expense. The Commission further finds that the Controller's calculation of the claimant's authorized offsetting fee revenue is not arbitrary, capricious, or entirely lacking in evidentiary support, since the Controller used the enrollment data available and reported by the claimant. The Controller obtained student enrollment and Board of Governors Grant (BOGG) recipient data from the California Community College's Chancellor's Office and calculated the authorized health service fees using the authorized rates approved by the Chancellor's Office for the fiscal years at issue.<sup>10</sup>

The Commission, therefore, partially approves this IRC and requests that the Controller reinstate \$4,896 to the claimant.

## **COMMISSION FINDINGS**

### **I. Chronology**

- 01/10/2005 Claimant signed and dated its reimbursement claims for fiscal years 2002-2003 and 2003-2004. The claims were submitted with a cover letter dated January 12, 2005.<sup>11</sup>
- 01/10/2006 Claimant signed and dated its reimbursement claim for fiscal year 2004-2005. The claim was submitted with a cover letter dated January 12, 2006.<sup>12</sup>

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<sup>9</sup> *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794.

<sup>10</sup> Exhibit A, IRC, page 80.

<sup>11</sup> Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2002-2003 and 2003-2004, pages 117, 118.

<sup>12</sup> Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2004-2005, pages 128,129.



- 10/25/2006 The Controller issued a payment of \$307,148 for fiscal year 2002-2003.<sup>13</sup>
- 12/20/2007 Claimant signed and dated its reimbursement claim for fiscal year 2005-2006. The claim was submitted with a cover letter dated December 20, 2007.<sup>14</sup>
- 01/17/2008 Claimant signed and dated its reimbursement claim for fiscal year 2006-2007. The claim was submitted with a cover letter dated January 25, 2007.<sup>15</sup>
- 09/08/2008 The entrance conference for the audit of the 2002-2003, 2003-2004, 2004-2005, 2005-2006, and 2006-2007 reimbursement claims was held.<sup>16</sup>
- 07/22/2009 The Controller issued the draft audit report.
- 08/07/2009 Claimant submitted comments on the draft audit report.<sup>17</sup>
- 09/23/2009 The Controller issued the final audit report.<sup>18</sup>
- 11/29/2010 Claimant filed this IRC.<sup>19</sup>
- 12/02/2014 Controller filed late comments on the IRC.<sup>20</sup>
- 03/17/2017 Commission staff issued the Draft Proposed Decision.<sup>21</sup>
- 03/24/2017 The Controller filed comments on the Draft Proposed Decision.<sup>22</sup>
- 04/06/2017 Claimant filed comments on the Draft Proposed Decision.<sup>23</sup>

## II. Background

### A. The Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts that voluntarily provided health supervision and services, direct and indirect medical and hospitalization services, or operation of student health centers to charge almost all students a health service fee not to exceed \$7.50 for each semester or \$5 for each quarter or summer

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<sup>13</sup> Exhibit A, IRC, page 36.

<sup>14</sup> Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2005-2006, pages 138, 139.

<sup>15</sup> Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2006-2007, page 148.

<sup>16</sup> Exhibit B, Controller's Late Comments on the IRC, page. 15.

<sup>17</sup> Exhibit A, IRC, page 91-97.

<sup>18</sup> Exhibit A, IRC, page 63.

<sup>19</sup> Exhibit A, IRC.

<sup>20</sup> Exhibit B, Controller's Late Comments on the IRC.

<sup>21</sup> Exhibit C, Draft Proposed Decision.

<sup>22</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.

<sup>23</sup> Exhibit E, Claimant's Comments on the Draft Proposed Decision.

session, to fund these services.<sup>24</sup> In 1984, the Legislature repealed the community colleges' fee authority for health services.<sup>25</sup> However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, to reauthorize the fee at \$7.50 for each semester (or \$5 per quarter or summer session).<sup>26</sup>

In addition to temporarily repealing community college districts' fee authority, Statutes 1984, chapter 1 required any district that provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain the health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.<sup>27</sup> As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987,<sup>28</sup> the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.<sup>29</sup> In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than \$7.50 for each semester, or \$5 for each quarter or summer session.<sup>30</sup> As a result, beginning January 1, 1988, all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services.<sup>31</sup> In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.<sup>32</sup>

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<sup>24</sup> Former Education Code section 72246 (Stats. 1981, ch. 763). Low-income students, students that depend upon prayer for healing, and students attending a college under an approved apprenticeship training program, were exempt from the fee.

<sup>25</sup> Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4, repealing Education Code section 72246.

<sup>26</sup> Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4.5.

<sup>27</sup> Education Code section 72246.5 (Stats. 1984, 2d. Ex. Sess., ch. 1, § 4.7).

<sup>28</sup> Statutes 1987, chapter 1118.

<sup>29</sup> Education Code section 72246 (as amended, Stats. 1987, ch. 1118). See also former Education Code section 72246.5 (Stats. 1984, 2d Ex. Sess., ch. 1, § 4.7).

<sup>30</sup> Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

<sup>31</sup> In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar. (Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355 (Stats. 1993, ch. 8).

<sup>32</sup> Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355 (Stats. 1993, ch. 8).

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

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

#### B. Controller's Audit and Summary of the Issues

The Controller reduced \$781,934 from the costs claimed for fiscal years 2002-2003, 2003-2004, 2004-2005, 2005-2006, and 2006-2007, \$732,846 of which is in dispute as follows:

- Reduction of \$61,288 for unallowable services and supplies. This finding includes a reduction of \$7,976 for health fair promotional items, including food, rental fees for a popcorn cart, and other promotional items (mood lamps, curling ribbons, and tattoo bracelets). The Controller states that these are not expenditures the district is required to make in order to maintain the base-year level of health services.<sup>33</sup> This finding also includes a reduction of \$53,312 claimed as a bad debt expense resulting from uncollected student health fees, which the Controller found was beyond the scope of the mandate and not reimbursable.<sup>34</sup>
- Reductions for overstated indirect costs. The district claimed indirect costs for all fiscal years based on a federally approved rate of 30 percent, developed using "a base of "Direct salaries and wages including all fringe benefits."<sup>35</sup> For fiscal years 2002-2003 and 2003-2004, the Controller found that the claimant overstated indirect costs because it incorrectly applied the indirect cost rate to a base of total direct costs, rather than to a base of salaries and benefits only, as approved by the federal government. This resulted in a reduction of \$21,298 for these two fiscal years.

The claimant used the same methodology for claiming indirect costs for fiscal years 2004-2005, 2005-2006, and 2006-2007.<sup>36</sup> However, the Controller adjusted indirect costs in these years because the claiming instructions, beginning for fiscal year 2004-2005 reimbursement claims, do not allow the use of a federally approved rate to claim indirect costs unless specifically approved in the Commission's Parameters and Guidelines (which is not the case here). The Controller, therefore, recalculated indirect

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<sup>33</sup> Exhibit A, IRC, page 72.

<sup>34</sup> Exhibit A, IRC, page 74.

<sup>35</sup> Exhibit A, IRC, pages 13, and 109 and 120 (federal approval letter of indirect cost rate, dated March 11, 2003, and effective for the period of July 1, 2003, through June 30, 2008); Exhibit B, Controller's Late Comments on the IRC, pages 48-51 (federal approval letter of indirect cost rate, dated February 4, 1999, and effective for the period of July 1, 1999 through June 30, 2004).

<sup>36</sup> Exhibit A, IRC, pages 13 and 128-156 (reimbursement claims for fiscal years 2004-2005, 2005-2006, and 2006-2007).

costs based on the FAM-29C methodology, the only method allowed, resulting in a reduction of \$4,896 for fiscal year 2004-2005, and an increase of \$25,303 for fiscal years 2005-2006 and 2006-2007.<sup>37</sup>

- Reduction of \$694,471 for understated offsetting health service fee authority.<sup>38</sup>

The Controller also reduced \$49,088 for miscellaneous revenue that was incorrectly reported as authorized health service fees,<sup>39</sup> and \$74,372 for understated offsetting savings and reimbursements.<sup>40</sup> The claimant does not dispute these reductions.<sup>41</sup>

Finally, the claimant contends that the Controller did not timely initiate the audit of the 2002-2003 and 2003-2004 reimbursement claims and, thus asserts that the Controller's audit of those reimbursement claims is void.

### **III. Positions of the Parties**

#### **A. San Mateo County Community College District**

The claimant contends that the Controller did not timely initiate the audit of the 2002-2003 and 2003-2004 reimbursement claims. The claimant asserts that it filed these reimbursement claims on January 12, 2005 and, pursuant to Government Code section 17558.5, the Controller had until January 12, 2008 to audit. However, the audit entrance conference for all fiscal year claims did not take place until September 8, 2008, after the three-year deadline. The claimant contends that the clause in Government Code section 17558.5 that delays the commencement of the time to audit to the date of initial payment is impermissibly vague and, therefore, void.<sup>42</sup>

The claimant contends that the Controller's reductions are incorrect and should be reinstated. The claimant argues that food and promotional expenditures are reimbursable and included in the costs for health fairs, which is a reimbursable activity. The claimant states that the purpose of health fairs is to effectively communicate health information to the student population in general, which requires that students attend. Promotional materials are intended to promote attendance at the health fair.<sup>43</sup>

The claimant also contends that bad debt expense for uncollectible health service fees is reimbursable, arguing that "[a]s a practical matter, college districts do not incur this cost as a discretionary activity, the cost is forced upon the districts by those students who do not pay their fees."<sup>44</sup> The claimant further contends that it reported gross student health service fee income as

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<sup>37</sup> Exhibit A, IRC, pages 74-76.

<sup>38</sup> Exhibit A, IRC, page 80.

<sup>39</sup> Exhibit A, IRC, pages 78-79.

<sup>40</sup> Exhibit A, IRC, page 83.

<sup>41</sup> Exhibit A, IRC, pages 19 and 26.

<sup>42</sup> Exhibit A, IRC, pages 30-33.

<sup>43</sup> Exhibit A, IRC, pages 10-12.

<sup>44</sup> Exhibit A, IRC, pages 10-11.

offsetting revenue and the uncollected amounts as an expense; “an appropriate application of generally accepted accounting principles.”<sup>45</sup>

The claimant argues that the Controller’s reduction of indirect costs is incorrect, and amounts to an underground regulation. The claimant contends that the Parameters and Guidelines do not contain any limitation or direction to apply the federally approved rate only to salaries and benefits. The claimant further states that the Controller simply stopped accepting federally approved rates, retroactively beginning fiscal year 2004-2005, with no justification or opportunity for public comment.<sup>46</sup>

Finally, the claimant contends that it is only required to report as offsetting revenues, the fee revenue actually collected.<sup>47</sup>

On April 6, 2017, the claimant filed comments on the Draft Proposed Decision, agreeing with the finding that the reduction of indirect costs for fiscal year 2004-2005 is incorrect as a matter of law. However, the claimant disagrees with the remaining findings for the same reasons originally asserted in the IRC. In addition, the claimant clarified the amount reduced by the Controller in Finding 1, and asked for those numbers to be corrected.<sup>48</sup>

#### B. State Controller’s Office

The Controller argues that, pursuant to Government Code section 17558.5, it timely conducted the audit of the fiscal year 2002-2003 and 2003-2004 reimbursement claims. The Controller also contends that it correctly reduced costs. The Controller argues that the claimed costs reduced for services and supplies did not relate to the mandated program. The Controller further contends that the claimant did not correctly calculate its indirect cost rate. The Controller also asserts that the correct calculation of offsetting revenue is all offsetting health service fee revenue authorized by statute, rather than the amount collected. Thus, the Controller urges the Commission to deny the IRC.<sup>49</sup>

On March 24, 2017, the Controller filed comments agreeing with the Draft Proposed Decision.<sup>50</sup>

### IV. Discussion

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

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to the local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9

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<sup>45</sup> Exhibit A, IRC, page 11.

<sup>46</sup> Exhibit A, IRC, pages 14-19.

<sup>47</sup> Exhibit A, IRC, pages 19-26.

<sup>48</sup> Exhibit E, Claimant’s Comments on the Draft Proposed Decision. The amount reduced by the Controller in Finding 1 has been corrected.

<sup>49</sup> Exhibit B, Controller’s Late Comments on the IRC.

<sup>50</sup> Exhibit D, Controller’s Comments on the Draft Proposed Decision.

of the Commission's regulations requires the Commission to send the decision to the Controller and request that the costs in the claim be reinstated.

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6 of the California Constitution.<sup>51</sup> The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."<sup>52</sup>

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.<sup>53</sup> Under this standard, the courts have found that:

When reviewing the exercise of discretion, "[t]he scope of review is limited, out of deference to the agency's authority and presumed expertise: 'The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]'" ... "In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . ." [Citations.] When making that inquiry, the " "court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "<sup>54</sup>

The Commission must also review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.<sup>55</sup> In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.<sup>56</sup>

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<sup>51</sup> *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

<sup>52</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

<sup>53</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space District* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

<sup>54</sup> *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California*, 162 Cal.App.4th 534, 547-548.

<sup>55</sup> *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

<sup>56</sup> Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil

A. The Audit of the 2002-2003 and 2003-2004 Reimbursement Claims Was Timely Initiated and Timely Completed.

The claimant argues that the audit of the 2002-2003 and 2003-2004 reimbursement claims was not timely initiated. Section 17558.5 requires an audit to be initiated no later than three years after the date the reimbursement claim is filed or last amended. However, section 17558.5 also provides that *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.”<sup>57</sup> “In any case,” section 17558.5 requires the audit to be completed no later than two years after it is commenced.<sup>58</sup>

1. *The Audit Was Timely Initiated.*

The claimant asserts that the audit of the 2002-2003 and 2003-2004 reimbursement claims was not timely initiated based on the date that it asserts that the claims were filed (January 12, 2005), and the date that the audit entrance conference took place (December 8, 2008). However, the Controller points out that the claimant did not receive a payment for the 2002-2003 reimbursement claim until October 25, 2006, and had not received payment for the fiscal year 2003-2004 when the audit was initiated. Therefore, the Controller’s initiation of the audit with the entrance conference on December 8, 2008, was timely.<sup>59</sup>

Government Code section 17558.5 states that “[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 . . . .” However, if funds are not appropriated or no payment is made to the claimant for a given year, section 17558.5 states the “time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.”<sup>60</sup>

The claimant argues that this provision “is void because it is impermissibly vague,” and that “the only specific and enforceable time limitation to commence an audit is three years from the date the claim was filed.”<sup>61</sup> However, article III, section 3.5 of the California Constitution states that an administrative agency has no power “[t]o declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional. . . .”<sup>62</sup> Thus, the statute is presumed constitutional and must be followed.

Here, the fiscal year 2002-2003 and 2003-2004 reimbursement claims were filed on January 12, 2005. But, the record shows that payment on the 2002-2003 reimbursement claim

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Procedure to set aside a decision of the Commission on the ground that the Commission’s decision is not supported by substantial evidence in the record.

<sup>57</sup> Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

<sup>58</sup> Government Code section 17558.5 (as amended, Stats. 2004, ch. 890 (AB 2856)).

<sup>59</sup> Exhibit A, IRC, page 88; Exhibit B, Controller’s Late Comments on the IRC, page 32.

<sup>60</sup> Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

<sup>61</sup> Exhibit A, IRC, page 30.

<sup>62</sup> California Constitution, article III, section 3.5 (added June 6, 1978, by Proposition 5).

was not made until October 25, 2006,<sup>63</sup> and no payment had been made for the 2003-2004 claim when the audit entrance conference took place on December 8, 2008.<sup>64</sup> Therefore, pursuant to the plain language of Government Code section 17558.5, the audit of the 2002-2003 claim had to be initiated no later than October 25, 2009. Since the Controller initiated the audit for all fiscal years on December 8, 2008, with the audit entrance conference, the audit was timely initiated.

*2. The Audit Was Timely Completed.*

Government Code section 17558.5 also prescribes the time in which an audit must be completed: “In any case, an audit shall be completed not later than two years after the date that the audit is commenced.”<sup>65</sup> As indicated above, the audit was initiated no later than December 8, 2008, the date of the entrance conference and, thus, had to be completed no later than December 8, 2010. An audit is completed when the Controller issues the final audit report to the claimant. The final audit report constitutes the Controller’s final determination on the subject claims and provides written notice of the claim components adjusted, the amounts adjusted, and the reasons for the adjustment, as required by Government Code section 17558.5(c), allowing the claimant to thereafter file an IRC. Here, the final audit report was issued September 23, 2009, more than a year prior to the expiration of the two year deadline on December 8, 2010.

Based on the foregoing, the Commission finds that the Controller’s audit was timely completed in accordance with Government Code section 17558.5.

**B. The Controller’s Reduction of Costs for Gift Certificates, Health Fair Food, and Other Promotional Items Is Correct as a Matter of Law and Is Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.**

The Controller reduced \$7,976 claimed for health fair promotional items, including food, rental fees for a popcorn cart, and other promotional items (mood lamps, curling ribbons, and tattoo bracelets). The Controller states that these are not expenditures the district is required to make in order to maintain the base-year level of health services.<sup>66</sup>

The claimant contends that since the Commission has determined that health fair activities are reimbursable, then these costs are necessary and reimbursable. The claimant further contends that the Controller has not determined that these costs are excessive or unreasonable. The intent of the promotional items, the claimant asserts, is to induce attendance at the health fair in order for interested students to receive the information.<sup>67</sup>

Based on the evidence in the record, the Commission finds that the reduction is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

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<sup>63</sup> Exhibit A, IRC, page 36 (adjustment letter dated October 28, 2009, for fiscal year 2002-2003 showing prior payment for that fiscal year of \$307,148 on October 25, 2006).

<sup>64</sup> Exhibit A, IRC, page 37 (adjustment letter dated October 28, 2009, for fiscal year 2003-2004, showing no payments for that fiscal year).

<sup>65</sup> Government Code section 17558.5 (Stats. 2004, ch. 890).

<sup>66</sup> Exhibit A, IRC, page 72.

<sup>67</sup> Exhibit A, IRC, page 12.



The Parameters and Guidelines for the *Health Fee Elimination* program authorize reimbursement for the costs of providing health supervision and services and direct and indirect medical and hospitalization services to students, and the operation of student health centers, *to the extent* the community college provided these services in fiscal year 1986-1987. Section V. lists the types of services and costs that are eligible for reimbursement to the extent they were provided in fiscal year 1986-1987, including “health talks or fairs – information,” as follows:

#### HEALTH TALKS OR FAIRS – INFORMATION

- Sexually Transmitted Disease
- Drugs
- Aids
- Child Abuse
- Birth Control/Family Planning
- Stop Smoking
- Etc.
- Library – videos and cassettes

Section VI.B.2 of the Parameters and Guidelines, which governs Claim Preparation for services and supplies, states that “[o]nly expenditures which can be identified as a direct cost of the mandate can be claimed.”

And, Section VII. governs the supporting data for the claim, which states the following:

For auditing purposes, all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs. *This would include documentation for the fiscal year 1986-87 program to substantiate a maintenance of effort.* These documents must be kept on file by the agency submitting the claim for a period of no less than three years from the date of the final payment of the claim pursuant to this mandate, and made available on the request of the State Controller of his agent.<sup>68</sup>

The plain language of the Parameters and Guidelines allows reimbursement to provide health talks and fairs to distribute information to students regarding various health issues, but is silent regarding reimbursement for the cost of promotional items given away by the district to encourage attendance. However, the Parameters and Guidelines do specify that approved cost items listed in section V.B. “are reimbursable *to the extent* they were provided by the community college district in fiscal year 1986-87.”<sup>69</sup> Thus, to the extent that these promotional items were not provided by the district in the base year, these costs go beyond the scope of the mandate. Here, the record contains invoices supporting the costs incurred in the claim year for food and promotional items distributed during health fairs.<sup>70</sup> However, the claimant has not argued or provided any evidence, as required by the Parameters and Guidelines, that it provided these promotional items in the base year as an integral part of its health fairs.

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<sup>68</sup> Exhibit A, IRC, pages 42-48.

<sup>69</sup> Exhibit A, IRC, page 43, emphasis added.

<sup>70</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 89-109.

Accordingly, the Controller's reduction of costs for gift certificates, health fair food, and other promotional items is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

C. The Controller's Reduction of Costs Claimed as a Bad Debt Expense for Uncollected Student Health Fees Is Correct as a Matter of Law.

The Controller reduced \$53,312 claimed as a bad debt expense resulting from uncollected student health fees, on the ground that these costs go beyond the scope of the mandate and are not reimbursable.<sup>71</sup> Claimant contends that the bad debt expense for uncollectible health service fees is reimbursable, arguing that "[a]s a practical matter, college districts do not incur this cost as a discretionary activity, the cost is forced upon the districts by those students who do not pay their fees."<sup>72</sup> The claimant further states that it reported gross student health service fee income as offsetting revenue and the uncollected amounts as an expense; "an appropriate application of generally accepted accounting principles."<sup>73</sup>

The Commission finds that reduction is correct as a matter of law. The Parameters and Guidelines for the *Health Fee Elimination* program authorize reimbursement for the costs of providing health supervision and services and direct and indirect medical and hospitalization services to students, and the operation of student health centers, to the extent the community college provided these services in fiscal year 1986-1987. Health service fees authorized by statute to be charged, but remain uncollectible, are not costs identified in the Parameters and Guidelines as eligible for reimbursement.

Therefore, the Controller's reduction of these costs is correct as a matter of law.

D. The Controller's Reduction of Indirect Costs for Fiscal Years 2002-2003, 2003-2004, and 2004-2005 Is Partially Correct; and the Commission Does Not Have Jurisdiction to Review the Controller's Adjustment of Indirect Costs That Resulted in Increased Reimbursement in Fiscal Years 2005-2006 and 2006-2007.

The district claimed indirect costs for all fiscal years based on a federally approved rate of 30 percent, developed using "a base of 'Direct salaries and wages including all fringe benefits.'"<sup>74</sup> For fiscal years 2002-2003 and 2003-2004, the Controller found that the claimant overstated indirect costs because it incorrectly applied the indirect cost rate to a base of total direct costs,

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<sup>71</sup> Exhibit A, IRC, page 74.

<sup>72</sup> Exhibit A, IRC, pages 10-11.

<sup>73</sup> Exhibit A, IRC, page 11.

<sup>74</sup> Exhibit A, IRC, pages 13, and 109 and 120 (federal approval letter of indirect cost rate, dated March 11, 2003, and effective for the period of July 1, 2003, through June 30, 2008); Exhibit B, Controller's Late Comments on the IRC, pages 48-51 (federal approval letter of indirect cost rate, dated February 4, 1999, and effective for the period of July 1, 1999 through June 30, 2004).

rather than to a base of salaries and benefits only, as approved by the federal government. This resulted in a reduction of \$21,298 for the two fiscal years.<sup>75</sup>

For fiscal years 2004-2005, 2005-2006, and 2006-2007, the Controller adjusted indirect costs because the claiming instructions, beginning for the fiscal year 2004-2005 reimbursement claims, do not allow the use of a federally approved rate to claim indirect costs unless specifically approved in the Commission's Parameters and Guidelines. The Parameters and Guidelines for the *Health Fee Elimination* program provide only that "indirect costs may be claimed in the manner described by the State Controller in his claiming instructions."<sup>76</sup> The Controller recalculated indirect costs using the FAM-29C methodology, resulting in a reduction of \$4,896 for fiscal year 2004-2005, and an increase of \$25,303 for fiscal years 2005-2006 and 2006-2007.<sup>77</sup>

Since the Controller's adjustment to indirect costs for fiscal years 2005-2006 and 2006-2007 does not result in a reduction, the Commission has no jurisdiction to review the Controller's audit adjustment for those fiscal years. Government Code section 17551(d), which requires the Commission to hear and decide IRCs, applies only to claims that the Controller incorrectly *reduced* payments to the claimant as follows:

The commission, pursuant to the provisions of this chapter, shall hear and decide upon a claim by a local agency or school district filed on or after January 1, 1985, that the Controller has incorrectly reduced payments to the local agency or school district pursuant to paragraph (2) of subdivision (d) of Section 17561.

As described below, the Commission finds that the Controller's reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 is correct as a matter of law. However, the Controller's reduction of indirect costs for fiscal year 2004-2005 is incorrect as a matter of law.

1. *The Controller's reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 is correct as a matter of law.*

The Controller reduced indirect costs for fiscal years 2002-2003 and 2003-2004 because the claimant applied its federally approved indirect cost rate of 30 percent to total direct costs, instead of to salaries and benefits only as approved by the federal government. The claimant contends that this reduction is incorrect, arguing that neither the Parameters and Guidelines nor the claiming instructions restrict the application of the rate only to salaries and benefits.<sup>78</sup> The Controller responds as follows:

The district implies that it may apply its federally approved rate to whatever direct cost base that it chooses. The district draws a distinction between federal approvals of the rate itself versus the allocation base. There is no such distinction. The federal approval letter (Tab 6) defines both the rate and the applicable base;

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<sup>75</sup> Exhibit A, IRC, pages 74-76; Exhibit B, Controller's Late Comments on the IRC, pages 48-51 (federal approval letter of indirect cost rate, dated February 4, 1999, and effective for the period of July 1, 1999 through June 30, 2004).

<sup>76</sup> Exhibit A, IRC, page 47.

<sup>77</sup> Exhibit A, IRC, pages 74-76.

<sup>78</sup> Exhibit A, IRC, page 15.

they are inseparable. Government Code section 17561, subdivision (d)(2)(B), states that the SCO may reduce any excessive or unreasonable claim. It is clearly unreasonable to calculate mandate-related indirect costs by applying a federally approved rate to a direct cost base other than the base used to calculate the rate.<sup>79</sup>

The Commission finds that the Controller's reduction of indirect costs for these fiscal years is correct as a matter of law.

The Parameters and Guidelines provide that "indirect costs may be claimed in the manner described by the State Controller in his claiming instructions."<sup>80</sup> The claiming instructions specific to the *Health Fee Elimination* mandate, are found in the Community Colleges Mandated Cost Manual which contains claiming instructions applicable to all school and community college mandated programs. The cost manual issued by the Controller's Office in September 2003 governs the reimbursement claim filed for fiscal year 2002-2003.<sup>81</sup> This cost manual provides two options for claiming indirect costs by either using the federal OMB Circular A-21, or the FAM-29C:

A community 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.

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. . . .

[¶]

The [FAM-29C] 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.<sup>82</sup>

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<sup>79</sup> Exhibit B, Controller's Late Comments on the IRC, page 18.

<sup>80</sup> Exhibit A, IRC, page 44.

<sup>81</sup> Exhibit B, Controller's Late Comments on the IRC, page 35.

<sup>82</sup> Exhibit B, Controller's Late Comments on the IRC, page 35.

The cost manual issued by the Controller's Office in September 2004 for fiscal year 2003-2004 costs contains the same language.<sup>83</sup>

In this case, the claimant used a federally approved indirect cost rate under the OMB Circular A-21. The OMB Circular A-21 establishes principles for determining costs applicable to grants, contracts, and other agreements between the federal government and educational institutions. Sections G(11) and H of the OMB Circular A-21 govern the determination of indirect cost rates and require the federal approval of a proposed rate by the "cognizant federal agency," which is normally either the federal Department of Health and Human Services or the Department of Defense's Office of Naval Research.<sup>84</sup> If a claimant chooses to use the OMB Circular A-21 methodology, the claimant must obtain federal approval of the rate calculated through formal negotiation, an informal correspondence process, or a simplified method which sets the indirect cost rate using a salaries and wage base.<sup>85</sup> Section H(2) governs the simplified method using a salaries and wage base, which the claimant used here, and which resulted in an indirect cost rate of 30 percent.<sup>86</sup> The letter issued by the federal Department of Health and Human Services containing the negotiated agreement with the claimant, effective from July 1, 1999 to June 30, 2004, shows the 30 percent rate with a base of "Direct salaries and wages including all fringe benefits" for all programs.<sup>87</sup> Section H(2)(e) of the OMB Circular A-21 then directs the community college district to "apply the F&A cost rate *to direct salaries and wages* for individual agreements to determine the F&A costs allocable to such agreements."<sup>88</sup> Thus, the OMB Circular A-21 itself requires the rate to be applied only to direct salaries and wages. Here, the claimant did not comply with the OMB Circular A-21 or the negotiated agreement with the federal government and, instead, applied the rate to all direct costs.

Accordingly, the Controller's reduction of indirect costs in fiscal years 2002-2003 and 2003-2004 is correct as a matter of law. Moreover, there is no evidence that the Controller's recalculation of indirect costs arbitrary, capricious, or entirely lacking in evidentiary support. Therefore, the reduction of indirect costs in fiscal years 2002-2003 and 2003-2004 is correct.

2. *The Controller's reduction of indirect costs for fiscal year 2004-2005, based solely on the Controller's change to the claiming instructions without notice or opportunity to comment, is incorrect as a matter of law.*

For fiscal year 2004-2005, the Controller reduced indirect costs because the claiming instructions, beginning with the fiscal year 2004-2005 reimbursement claims, do not allow the use of the federally approved rate developed under the OMB Circular A-21 to claim indirect

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<sup>83</sup> Exhibit B, Controller's Late Comments on the IRC, pages 42-43.

<sup>84</sup> Exhibit F, OMB Circular A-21.

<sup>85</sup> Exhibit F, OMB Circular A-21, pages 37-39.

<sup>86</sup> Exhibit F, OMB Circular A-21, pages 38-39, which describes the calculation of the "simplified procedure – salaries and wages base" as subtracting from the total amount of salaries and wages paid to all employees of the institution, the expenditures for general administration, operation and maintenance of the physical plant, the library, and department administration expenses.

<sup>87</sup> Exhibit B, Controller's Late Comments on the IRC, pages 48-49.

<sup>88</sup> Exhibit F, OMB Circular A-21, page 39 (emphasis added).

costs unless specifically approved in the Commission's parameters and guidelines. The Parameters and Guidelines for the *Health Fee Elimination* program provides only that "indirect costs may be claimed in the manner described by the State Controller in his claiming instructions."<sup>89</sup> Thus, the Controller recalculated indirect costs using the FAM-29C methodology, resulting in a reduction of \$4,896 for fiscal year 2004-2005.

The claiming instructions specific to the *Health Fee Elimination* mandate are found in the Controller's Mandated Cost Manual. The Mandated Cost Manual for fiscal year 2004-2005 claims, dated December 27, 2005, for the first time changed the indirect cost rate language to prohibit the use of the federal OMB Circular A-21 unless specifically allowed by the Parameters and Guidelines:

A CCD may claim indirect costs using the Controller's methodology (FAM-29C), outlined in the following paragraphs. If specifically allowed by a mandated program's Ps & Gs, 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.<sup>90</sup>

At that time, Government Code section 17560 required annual reimbursement claims to be filed by January 15.<sup>91</sup> In this case, the claimant's fiscal year 2004-2005 reimbursement claim was signed on January 10, 2006, and was mailed to the Controller's Office on January 12, 2006, approximately two weeks after the date on the December 27, 2005 revised claiming instructions.<sup>92</sup>

The claimant contends that the reduction is incorrect, and that the Controller simply stopped accepting federally approved rates, retroactively beginning fiscal year 2004-2005, with no justification or opportunity for public comment and in violation of the Administrative Procedures Act.<sup>93</sup>

The Controller relies on the plain language of the Parameters and Guidelines to contend that the reduction is correct as a matter of law. The Controller states the following:

We disagree with the district's interpretation of the parameters and guidelines, which are clear and unambiguous. They state, "Indirect costs may be claimed *in the manner described by the State Controller in his claiming instructions.*" [Emphasis in original.] In this case, the parameters and guidelines specifically identify the claiming instructions as authoritative criteria for indirect costs. The phrase "may be claimed" simply permits the district to claim indirect costs. If the district chooses to claim indirect costs, then the parameters and guidelines require that it comply with the SCO's claiming instructions. If the district believes that

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<sup>89</sup> Exhibit A, IRC, page 47.

<sup>90</sup> Exhibit F, Mandated Cost Manual updated December 27, 2005; Exhibit B, Controller's Late Comments on the IRC, page 17.

<sup>91</sup> As last amended by Statutes 1998, chapter 681.

<sup>92</sup> Exhibit A, IRC, pages 30 and 128.

<sup>93</sup> Exhibit A, IRC, pages 14-19.

the program's parameters and guidelines are deficient, it should initiate a request to amend the parameters and guidelines pursuant to Government Code section 17557, subdivision (d). However, any such amendment would not apply to this audit period.

The district states that it "claimed these indirect costs 'in the manner' described by the Controller." The district did *not* claim indirect costs in accordance with the SCO's claiming instructions.<sup>94</sup>

For the reasons below, the Commission finds that the Controller's reduction is incorrect as a matter of law.

As indicated above, the Parameters and Guidelines state that "indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." Parameters and guidelines are regulatory in nature and may validly incorporate manuals and other documents by reference as long the incorporated document is adequately identified and available for comment.<sup>95</sup> This is consistent with the Administrative Procedures Act (APA), which requires public notice of all proposed rules that apply generally, and that implement, interpret, or make the specific the law.<sup>96</sup> The purpose of the APA is to ensure that those persons or entities affected by a regulation have a voice in its creation, as well as notice of the law's requirements so that they can conform their conduct accordingly.<sup>97</sup> Thus, if the manual or document that is incorporated by reference later changes without notice or opportunity for comment, then the new rule or standard of general application in the incorporated document may become an invalid underground regulation.<sup>98</sup>

For example, the case of *Union of American Physicians & Dentists v. Kizer* addressed regulations adopted by the Department of Health Services, which incorporated by reference separate bulletins and a provider manual setting forth *current* documentation requirements for reimbursement claims filed by providers under the Medi-Cal program.<sup>99</sup> The Department acknowledged that it "used the manual to evaluate whether a provider's progress notes satisfy the appropriateness and quality of medical services requirements."<sup>100</sup> The court determined that the documentation requirements in the manual were standards of general application to providers statewide, which interpreted or made specific the law enforced by the Department, and were therefore invalid underground regulations.<sup>101</sup>

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<sup>94</sup> Exhibit B, Controller's Late Comments on the IRC, pages 18-19 (emphasis in original).

<sup>95</sup> *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 799; *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 220.

<sup>96</sup> Government Code sections 11346, et seq.

<sup>97</sup> *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 570.

<sup>98</sup> *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 219-220.

<sup>99</sup> *Union of American Physicians & Dentists v. Kizer* (1990) 223 Cal.App.3d 490, 495.

<sup>100</sup> *Union of American Physicians & Dentists* (1990), 223 Cal.App.3d 490, 501.

<sup>101</sup> *Union of American Physicians & Dentists* (1990), 223 Cal.App.3d 490, 506.

Similarly, in *California Association of Nursing Homes v. Williams*, the court addressed a class action challenge by nursing homes to the validity of regulations adopted by the Department of Health Care Services, which incorporated by reference a pamphlet (“State Schedule of Maximum Allowances”) published by the Department of Finance, to reimburse nursing and convalescent homes based on the schedule of allowances in effect at the time services were provided. Based on the language, the regulation attempted to incorporate future changes in reimbursement standards adopted by the Department of Finance.<sup>102</sup> The court found that the Schedule of Maximum Allowances “appears to be the result of ex parte studies by staff personnel of the Department of Finance,” and changes were made “without public or judicial access.”<sup>103</sup> The court concluded that the documentation requirements in the manual were invalid underground regulations.<sup>104</sup>

In 2010, the Third District Court of Appeal in the *Clovis Unified School District* case, addressed the Controller’s contemporaneous documentation rules contained in the Controller’s claiming instructions. The court determined that the claiming instructions are non-regulatory, and that any rule requiring additional documentation that is contained in the claiming instructions that did not go through the regulatory process required by the APA, but was used by the Controller in an audit to reduce costs, invalidates the audit to the extent the Controller used the underground rule to reduce costs.<sup>105</sup>

Based on the cases cited above, the Commission finds that the Controller’s reduction of indirect costs, based solely on the Controller’s change to the claiming instructions and its use of the new indirect cost rate rule, without evidence that notice and an opportunity for comment was provided to the claimant, is an invalid underground regulation.

The Controller’s new indirect cost rate rule is included in the Controller’s Mandated Cost Manual, “updated December 27, 2005,” which applied to the fiscal year 2004-2005 reimbursement claims due to be filed just two weeks later. Although the new rule allows the use of the federal OMB Circular A-21 “if specifically allowed by a mandated program’s Ps & Gs,” the Parameters and Guidelines for the *Health Fee Elimination* Program do not contain that language and, thus, the Controller’s change to the rule effectively prohibits the use of the federal method for calculating indirect costs for this program in fiscal year 2004-2005. There is no evidence in the record, such as a proof of service or certificate of mailing, that the Controller provided notice of the change in the rule to the claimant. The claimant asserts that it received no notice for the fiscal years in question and, in fact, it continued to calculate indirect costs using the federal method as it had for the previous two fiscal years.<sup>106</sup> The record also shows that the claimant was first made aware of the change in the rule when the Controller’s draft audit report was received by the claimant for this matter on July 27, 2009.<sup>107</sup> By this time, the claimant

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<sup>102</sup> *California Assn. of Nursing Homes v. Williams* (1970) 4 Cal.App.3d 800, 808.

<sup>103</sup> *California Assn. of Nursing Homes* (1970) 4 Cal.App.3d 800, 813-814.

<sup>104</sup> *California Assn. of Nursing Homes* (1970) 4 Cal.App.3d 800, 816.

<sup>105</sup> *Clovis Unified School Dist.* (2010) 188 Cal.App.4th 794, 799, 805.

<sup>106</sup> Exhibit A, IRC, pages 17.

<sup>107</sup> Exhibit A, IRC, pages 91 and 93 [claimant’s response to draft audit report, where claimant states the following: “In prior years, federally approved indirect cost rates have been accepted



could not have filed a request to amend the Parameters and Guidelines to specifically allow the use of the federal OMB method for the fiscal year 2004-2005 reimbursement claim, as suggested by the Controller. Government Code section 17557(d) states that “[a] parameters and guidelines amendment filed more than 90 days after the claiming deadline for initial claims . . . and on or before the claiming deadline following a fiscal year, shall establish reimbursement eligibility for that fiscal year.” Thus, even if the claimant filed a request to amend the Parameters and Guidelines on July 27, 2009 (the day the notice was received) and the Commission approved the request, the amendment would only apply to fiscal year 2008-2009 claims.

Moreover, *if* the updated Mandated Cost Manual was, in fact, issued to community college districts on December 27, 2005 (the date of the manual), the claimant would not have had sufficient notice or an opportunity to comment before the 2004-2005 reimbursement claim was due on January 15, 2006. Due process requires that a claimant have reasonable notice of any change that affects the substantive rights and liabilities of the parties.<sup>108</sup> Under similar circumstances, when parameters and guidelines are amended, the Government Code requires notice of an extra 120 days after the revised claiming instructions are issued to local government before annual reimbursement claims are due.<sup>109</sup> Thus, in those cases, a full regulatory hearing is conducted to amend the parameters and guidelines *and* claimants are provided an additional four months before claims are due. In this case, if the Controller issued notice on December 27, 2005, notice, if it was actually provided at all, was at most only two weeks during the holiday season when most community colleges are not in session and many employees are on vacation.

Accordingly, under these circumstances, the Commission finds that the Controller’s reduction of indirect costs in fiscal year 2004-2005, based solely on the Controller’s change to the calculation of indirect cost rates, is incorrect as a matter of law.<sup>110</sup>

E. The Controller’s Reduction for Understated Offsetting Revenues Is Correct as a Matter of Law, and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced costs by \$694,471 because the claimant understated its offsetting health service fee authority. In each fiscal year, the claimant reported only those health service fees actually collected, and not the total amount of fees authorized to be charged. Using enrollment

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by the Controller. The draft audit report contains no explanation as to why suddenly federally approved rates are no longer permissible.”].

<sup>108</sup> *In re Cindy B.* (1987) 192 Cal.App.3d 771, 783-784.

<sup>109</sup> Government Code section 17560(c).

<sup>110</sup> The facts of this case are distinguishable from the Commission’s decision in *Health Fee Elimination*, 08-4206-I-17 (Santa Monica Community College; adopted December 3, 2015). In the Santa Monica IRC, the Controller reduced indirect costs in 2003-2004, 2004-2005, and 2005-2006 because the claimant used the federal OMB Circular A-21, but did not obtain federal approval for its indirect cost rate proposals as required by the OMB Circular. In this case, the only reason for the reduction of indirect costs in 2004-2005 was the Controller’s change to the claiming instructions.

and BOGG exemption data, the Controller calculated the health fees that the claimant was authorized to charge, which resulted in a reduction of costs claimed.<sup>111</sup>

The claimant contends that it is only required to report as offsetting revenues, the fee revenue actually collected.<sup>112</sup>

The Commission finds that the correct calculation and application of offsetting revenue from student health fees has been resolved by the *Clovis Unified* decision, and that a reduction to the extent of the fee *authority*, rather than fee revenue actually collected, is correct as a matter of law.<sup>113</sup>

After the claimant filed its IRC, the court in *Clovis Unified* specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge students, whether or not districts choose to impose those fees. As expressed by the court, the "Health Fee Rule" states in pertinent part:

Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.<sup>114</sup> (Underline in original.)

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

(a)(1) The governing board of a district maintaining a community college may require community college students to pay a fee in the total amount of not more than ten dollars (\$10) for each semester, seven dollars (\$7) for summer school, seven dollars (\$7) for each intersession of at least four weeks, or seven dollars (\$7) for each quarter for health supervision and services, including direct or indirect medical and hospitalization services, or the operation of a student health center or centers, or both.

(a)(2) The governing board of each community college district may increase [the health service fee] by the same percentage increase as the Implicit Price Deflator for State and Local Government Purchase of Goods and Services. Whenever that calculation produces an increase of one dollar (\$1) above the existing fee, the fee may be increased by one dollar (\$1).<sup>115</sup>

Pursuant to the plain language of Education Code section 76355(a)(2), the fee authority given to districts automatically increases at the same rate as the Implicit Price Deflator; when that calculation produces an increase of one dollar above the existing fee, the fee may be increased by

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<sup>111</sup> Exhibit A, IRC, page 80.

<sup>112</sup> Exhibit A, IRC, pages 19-26.

<sup>113</sup> *Clovis Unified School Dist.* (2010) 188 Cal.App.4th 794.

<sup>114</sup> *Clovis Unified School Dist.* (2010) 188 Cal.App.4th 794, 811.

<sup>115</sup> Education Code section 76355(d)(2) (Stats. 1993, ch. 8 (AB 46); Stats. 1993, ch. 1132 (AB 39); Stats. 1994, ch. 422 (AB 2589); Stats. 1995, ch. 758 (AB 446); Stats. 2005, ch. 320 (AB 982)) [Formerly Education Code section 72246(e) (Stats. 1987, ch. 118)].

one dollar.<sup>116</sup> The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered. Accordingly, the court in *Clovis Unified* upheld the Controller’s use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. The court held that:

To the extent a local agency or school district “has the authority” to charge for the mandated program or increased level of service, that charge cannot be recovered as a state-mandated cost.<sup>117</sup>

The court also noted that, “this basic principle flows from common sense as well. As the Controller succinctly puts it, ‘Claimants can choose not to require these fees, but not at the state’s expense.’”<sup>118</sup> Additionally, in responding to the claimant’s argument that, “since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission’s P&G’s,”<sup>119</sup> the court held:

To accept this argument, though, we would have to ignore, and so would the Controller, the fundamental legal principles underlying state-mandated costs. We conclude *the Health Fee Rule is valid*.<sup>120</sup> (Italics added.)

Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.<sup>121</sup> In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.<sup>122</sup> Collateral estoppel applies when (1) the issue necessarily decided in the previous proceeding is identical to the one that is currently being decided; (2) the previous proceeding terminated with a final judgment on the merits; (3) the party against whom collateral estoppel is asserted is a party to or in privity with a party in the previous proceeding; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue.<sup>123</sup> The claimant was a party to the *Clovis* action.

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<sup>116</sup> See Education Code section 76355 (Stats. 1995, ch. 758 (AB 446)). The Implicit Price Deflator for State and Local Purchase of Goods and Services is a number computed annually (and quarterly) by the United States Department of Commerce as part of its statistical series on measuring national income and product, and is used to adjust government expenditure data for the effect of inflation.

<sup>117</sup> *Clovis Unified School Dist.* (2010)188 Cal.App.4th 794, 812.

<sup>118</sup> *Ibid.*

<sup>119</sup> *Ibid.* Italics in original.

<sup>120</sup> *Clovis Unified School Dist.* (2010) 188 Cal.App.4th 794, 812.

<sup>121</sup> *Fenske v. Board of Administration* (1980) 103 Cal.App.3d 590, 596.

<sup>122</sup> The petitioners in the *Clovis* case included Clovis Unified School District, El Camino Community College District, Fremont Unified School District, Newport-Mesa Unified School District, Norwalk-La Mirada Unified School District, Riverside Unified School District, San Mateo County Community College District, Santa Monica Community College District, State Center Community College District, and Sweetwater Union High School District.

<sup>123</sup> *Roos v. Red* (2006) 130 Cal.App.4th 870, 879-880.

The Commission further finds that the Controller's calculation of the claimant's authorized offsetting fee revenue is not arbitrary, capricious, or entirely lacking in evidentiary support, since the Controller used the enrollment data available and reported by the claimant. The Controller obtained student enrollment and Board of Governors Grant (BOGG) recipient data from the California Community Colleges Chancellor's Office and calculated the authorized health service fees using the authorized rates that the Chancellor's Office noticed during the fiscal years at issue.<sup>124</sup>

Therefore, the Commission finds that the Controller's reduction of \$694,471 based on the claimant's unreported offsetting fee authority is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

## **V. Conclusion**

Based on the foregoing, the Commission partially approves this IRC. The Commission finds that the Controller's reduction of indirect costs of \$4,896 for fiscal year 2004-2005, based solely on the change to the claiming instructions and its use of the new indirect cost rate rule, without evidence that notice and an opportunity for comment was provided to the claimant, is incorrect as a matter of law and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, that the Controller reinstate costs to the claimant.

The Commission further finds that the remaining reductions are correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

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<sup>124</sup> Exhibit A, IRC, page 80.



RE: **Decision**

*Health Fee Elimination*, 10-4206-I-35

Former Education Code Section 72246 (Renumbered as 76355)<sup>1</sup>

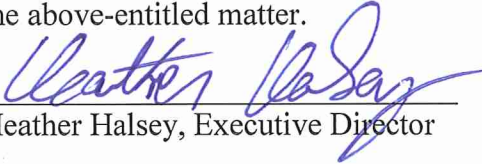
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1);

and Statutes 1987, Chapter 1118 (AB 2336)

Fiscal Years: 2002-2003, 2003-2004, 2004-2005, 2005-2006, and 2006-2007

San Mateo County Community College District, Claimant

On May 26, 2017, the foregoing Decision of the Commission on State Mandates was adopted on the above-entitled matter.

  
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Heather Halsey, Executive Director

Dated: June 5, 2017

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<sup>1</sup> Statutes 1993, chapter 8.

BEFORE THE  
COMMISSION ON STATE MANDATES  
STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM  
ON:**

Public Resources Code Sections 40148, 40196.3, 42920-42928; Public Contract Code Sections 12167 and 12167.1; Statutes 1992, Chapter 1116 (AB 3521); Statutes 1999, Chapter 764 (AB 75); State Agency Model Integrated Waste Management Plan (February 2000)

Fiscal Years 1999-2000, 2000-2001, 2003-2004, 2004-2005, 2005-2006, 2006-2007, 2007-2008, 2008-2009, and 2009-2010

Sierra Joint Community College District,  
Claimant

Case No.: 13-0007-I-02

*Integrated Waste Management*

DECISION PURSUANT TO  
GOVERNMENT CODE SECTION  
17500 ET SEQ.; CALIFORNIA CODE OF  
REGULATIONS, TITLE 2, DIVISION 2,  
CHAPTER 2.5, ARTICLE 7

*(Adopted July 28, 2017)*

*(Served August 1, 2017)*

**DECISION**

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on July 28, 2017. Claimant, Sierra Joint Community College District, did not attend the hearing. Lisa Kurokawa appeared for the State Controller’s Office (Controller).

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

The Commission adopted the Proposed Decision to partially approve the IRC by a vote of 6-0 as follows:

<b>Member</b>	<b>Vote</b>
Lee Adams, County Supervisor	Yes
Ken Alex, Director of the Office of Planning and Research	Yes
Richard Chivaro, Representative of the State Controller, Vice Chairperson	Absent
Mark Hariri, Representative of the State Treasurer	Yes
Sarah Olsen, Public Member	Yes
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	Yes
Carmen Ramirez, City Council Member	Yes

## **Summary of the Findings**

This IRC addresses the Controller's reductions to reimbursement claims of the Sierra Joint Community College District (claimant) for fiscal years 1999-2000, 2000-2001, and 2003-2004 through 2009-2010 under the *Integrated Waste Management* program, 00-TC-07. The reductions were made because the claimant did not identify and deduct from its claims offsetting savings from its diversion of solid waste and the associated reduced or avoided costs of landfill disposal fees. The Commission finds that the audit reductions are partially incorrect.

The Controller correctly presumed, consistent with the test claim statutes and the court's interpretation of those statutes, and without any evidence to the contrary, that cost savings, resulting from the diversion of waste from landfills, were realized by the claimant during the audit period. Therefore, the finding of cost savings and the associated reduction of costs claimed is correct as a matter of law.

The Commission further finds, based on the evidence in the record, that the Controller's calculation of offsetting cost savings for fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and fiscal years 2004-2005 through 2009-2010 is not arbitrary, capricious, or entirely lacking evidentiary support. In these fiscal years, the claimant exceeded the mandate and diverted more solid waste than required by law. Thus, instead of using 100 percent of the diversion percentage actually achieved, the Controller's cost savings formula "allocated" the diversion percentage by dividing the percentage of solid waste required to be diverted, either 25 or 50 percent, by the actual percentage of solid waste diverted, as reported by the claimant to California Integrated Waste Management Board (CIWMB). The resulting quotient is then multiplied by the tons of solid waste diverted, as annually reported by the claimant to CIWMB, multiplied by the avoided landfill disposal fee (based on the statewide average fee).<sup>1</sup> The formula allocates cost savings based on the mandated levels of diversion, and is intended to prevent penalizing the claimant for diverting more solid waste than the amount mandated by law.<sup>2</sup> The claimant has not filed any evidence to rebut the statutory presumption of cost savings or to show that the statewide average disposal fee is incorrect, or arbitrary. Thus, the Controller's reduction of costs claimed for these fiscal years is correct.

However, the Controller's reduction of costs claimed for the *first* half of fiscal year 2003-2004 is incorrect as a matter of law and is arbitrary, capricious, and entirely lacking in evidentiary support. The Controller found that the claimant did not achieve the mandated "50 percent" diversion for the first half of fiscal year 2003-2004, when the mandated diversion rate for all of 2003 was in fact 25 percent, which the claimant exceeded.<sup>3</sup> As a result of applying the wrong mandated diversion rate, the Controller used 100 percent of the tonnage diverted by the claimant

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<sup>1</sup> Exhibit A, IRC, pages 33-35; Exhibit B, Controller's Late Comments on the IRC, pages 19 and 20.

<sup>2</sup> Exhibit B, Controller's Late Comments on the IRC, page 19.

<sup>3</sup> Exhibit B, Controller's Late Comments on the IRC, page 71.

to calculate offsetting cost savings, resulting in a reduction of \$7,513 (204 tons of diverted waste multiplied by the avoided statewide average landfill disposal fee of \$36.83).<sup>4</sup>

The Controller admits that “as there is no state mandate to exceed solid waste diversion for amounts in excess of 25% for calendar years 2000 through 2003 or 50% for calendar year 2004 and later, there is no basis for calculating offsetting savings realized for actual diversion percentages that exceed the levels set by statute.”<sup>5</sup> However, in comments on the Draft Proposed Decision, the Controller now argues for the first time that calculating offsetting savings for the first half of fiscal year 2003-2004 at \$7,513, using 100 percent of the actual diversion rate achieved by the claimant of 45.59 percent, rather than an allocated rate, is correct because there is no evidence that the claimant prorated or allocated the direct costs claimed to perform the mandate.<sup>6</sup> However, the deadline to complete the audit or give new reasons for reductions has long past.

Additionally, the Controller’s position is not supported by the Parameters and Guidelines or the record. Although the Controller is correct that there is no evidence that the claimant prorated or allocated the direct costs claimed for the first half of fiscal year 2003-2004, there is no evidence that the claimant did so for any other years in the audit period. The Parameters and Guidelines require claimants to report in their reimbursement claims all costs incurred to comply with the reimbursable activities (which includes the activities and costs to divert at least 25 or 50 percent of all solid waste from landfill disposal) and the cost savings from the avoided landfill disposal fees, to claim the net increased costs.<sup>7</sup> It is presumed that the reimbursement claim, submitted under penalty of perjury, claimed only those direct costs mandated by the state, absent any finding by the Controller in the audit to the contrary. And here, there is no indication in the audit report that direct costs were over claimed, nor was over claiming of direct costs a reason given for the reduction in the audit report. In this case, the claimant failed to report cost savings, despite evidence in the record that it diverted solid waste; and for all fiscal years in the audit *except* the first half of fiscal year 2003-2004, the Controller’s offsetting savings formula allocated the diversion percentage based on the mandated percentage to prevent penalizing the claimant for exceeding the diversion requirement.<sup>8</sup> There is no evidence in the record, nor does the Controller specify any reason, to conclude that the calculation of offsetting savings for the first half of fiscal year 2003-2004 should be treated differently than the other fiscal years in the audit period.

Applying the Controller’s formula for the calculation of cost savings (for years when the claimant exceeds the mandate) to the first half of fiscal year 2003-2004, results in offsetting cost savings of \$4,120 (25 percent mandated diversion rate divided by 45.59 percent actual diversion rate, multiplied by 204 tons diverted, multiplied by the avoided statewide average landfill

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<sup>4</sup> Exhibit A, IRC, page 31, footnote 2 (Final Audit Report); Exhibit B, Controller’s Late Comments on the IRC, page 71.

<sup>5</sup> Exhibit B, Controller’s Late Comments on the IRC, page 19.

<sup>6</sup> Exhibit D, Controller’s Comments on the Draft Proposed Decision.

<sup>7</sup> Exhibit A, IRC, page 54 (Parameters and Guidelines).

<sup>8</sup> Exhibit B, Controller’s Late Comments on the IRC, page 19.



disposal fee of \$36.83),<sup>9</sup> rather than the \$7,513 calculated by the Controller, and the difference of \$3,393 has been incorrectly reduced. Accordingly, the Commission finds that the reduction of \$7,513 for the first half of fiscal year 2004-2004 is incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support.

Therefore, the Commission partially approves this IRC and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, that the Controller reinstate \$3,393 to the claimant.

## COMMISSION FINDINGS

### I. Chronology

- 09/28/2005 The claimant signed its 1999-2000, 2000-2001, 2003-2004, and 2004-2005 reimbursement claims.<sup>10</sup>
- 01/09/2007 The claimant signed its 2005-2006 reimbursement claim.<sup>11</sup>
- 01/09/2008 The claimant signed its 2006-2007 reimbursement claim.<sup>12</sup>
- 12/05/2008 The claimant signed its 2007-2008 reimbursement claim.<sup>13</sup>
- 02/08/2011 The claimant signed its 2008-2009 reimbursement claim.<sup>14</sup>
- 02/08/2011 The claimant signed its 2009-2010 reimbursement claim.<sup>15</sup>
- 05/10/2013 The claimant was notified of the audit.<sup>16</sup>
- 07/22/2013 The Controller issued the Final Audit Report.<sup>17</sup>
- 06/19/2014 The claimant filed this IRC.<sup>18</sup>

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<sup>9</sup> Exhibit B, Controller's Late Comments on the IRC, pages 37 and 71.

<sup>10</sup> Exhibit A, IRC, pages 205, 214, 224, and 234. Though these reimbursement claims were filed in 2005, as of August 4, 2013, the Controller had not yet issued any payment on them and therefore the audit was timely initiated in May 2013, when the claimant was notified of the audit. (Exhibit B, p. 73).

<sup>11</sup> Exhibit A, IRC, page 244.

<sup>12</sup> Exhibit A, IRC, page 251.

<sup>13</sup> Exhibit A, IRC, page 260.

<sup>14</sup> Exhibit A, IRC, page 269.

<sup>15</sup> Exhibit A, IRC, page 279.

<sup>16</sup> Exhibit B, Controller's Late Comments on the IRC, page 73 (email from the Controller to the claimant).

<sup>17</sup> Exhibit A, IRC, page 24 (Final Audit Report).

<sup>18</sup> Exhibit A, IRC.

- 10/30/2015 The Controller filed late comments on the IRC.<sup>19</sup>
- 05/19/2017 Commission staff issued the Draft Proposed Decision.<sup>20</sup>
- 06/06/2017 The Controller filed comments on the Draft Proposed Decision.<sup>21</sup>

## II. Background

### A. The *Integrated Waste Management Program*

The test claim statutes require community college districts<sup>22</sup> to adopt and implement, in consultation with the California Integrated Waste Management Board (CIWMB), now the California Department of Resources Recycling and Recovery, or CalRecycle), integrated waste management (IWM) plans to reduce solid waste, reuse materials whenever possible, recycle recyclable materials, and procure products with recycled content in all agency offices and facilities.<sup>23</sup> To implement their plans, districts must divert from landfill disposal at least 25 percent of generated solid waste by January 1, 2002, and at least 50 percent by January 1, 2004. To divert means to “reduce or eliminate the amount of solid waste from solid waste disposal...”<sup>24</sup>

The CIWMB developed and adopted a model IWM plan on February 15, 2000, and the test claim statutes provide that if a district does not adopt an IWM plan, the CIWMB model plan governs the community college.<sup>25</sup> Each district is also required to report annually to CIWMB on its progress in reducing solid waste; and the reports’ minimum contents are specified in statute.<sup>26</sup> The test claim statutes also require a community college, when entering into or renewing a lease, to ensure that adequate areas are provided for and adequate personnel are available to oversee collection, storage, and loading of recyclable materials in compliance with CIWMB’s

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<sup>19</sup> Exhibit B, Controller’s Late Comments on the IRC. Note that Government Code section 17553(d) states: “the Controller shall have no more than 90 days after the claim is delivered or mailed to file any rebuttal to an incorrect reduction claim. The failure of the Controller to file a rebuttal to an incorrect reduction claim shall not serve to delay the consideration of the claim by the Commission.” However, in this instance, due to the backlog of IRCs, these late comments have not delayed consideration of this item and so have been included in the analysis and Proposed Decision.

<sup>20</sup> Exhibit C, Draft Proposed Decision.

<sup>21</sup> Exhibit D, Controller’s Comments on the Draft Proposed Decision.

<sup>22</sup> The test claim statutes apply to “state agencies” and define them to include “the California Community Colleges” (Pub. Res. Code, § 40196.3).

<sup>23</sup> Public Resources Code section 42920(b).

<sup>24</sup> Public Resources Code section 40124.

<sup>25</sup> Public Resources Code section 42920(b)(3).

<sup>26</sup> Public Resources Code section 42926.

requirements.<sup>27</sup> Additionally, the test claim statutes added Public Resources Code section 42925(a), which addressed cost savings from IWM plan implementation:

Any cost savings realized as a result of the state agency integrated waste management plan shall, to the extent feasible, be redirected to the agency's integrated waste management plan to fund plan implementation and administration costs, in accordance with Sections 12167 and 12167.1 of the Public Contract Code.

The Public Contract Code sections referenced in section 42925(a) require that revenue received as a result of the community college's IWM plan be deposited in CIWMB's Integrated Waste Management Account. After July 1, 1994, CIWMB is authorized to spend the revenue upon appropriation by the Legislature to offset recycling program costs. Annual revenue under \$2,000 is to be continuously appropriated for expenditure by the community colleges, whereas annual revenue over \$2,000 is available for expenditures upon appropriation by the Legislature.<sup>28</sup>

On March 24, 2004, the Commission adopted the *Integrated Waste Management* Statement of Decision and determined that the test claim statutes impose a reimbursable state-mandated program on community college districts. The Commission also found that cost savings under Public Resources Code section 42925(a) did not preclude a reimbursable mandate under Government Code section 17556(e) because there was no evidence that offsetting savings would result in no net costs to a community college implementing an IWM plan, nor was there evidence that revenues received from plan implementation would be "in an amount sufficient to fund" the cost of the state-mandated program. The Commission found that any revenues received would be identified as offsetting revenue in the Parameters and Guidelines.

The Parameters and Guidelines were adopted on March 30, 2005, and authorize reimbursement for the increased costs to perform the following activities:

- A. One-Time Activities (*Reimbursable starting January 1, 2000*)
1. Develop the necessary district policies and procedures for the implementation of the integrated waste management plan.
  2. Train district staff on the requirements and implementation of the integrated waste management plan (one-time per employee). Training is

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<sup>27</sup> Public Resources Code section 42924(b).

<sup>28</sup> Public Contract Code sections 12167 and 12167.1 are part of the State Assistance for Recycling Markets Act, which was originally enacted in 1989 to foster the procurement and use of recycled paper products and other recycled resources in daily state operations (See Pub. Contract Code, §§ 12153, 12160; Stats. 1989, ch. 1094). The Act, including sections 12167 and 12167.1, applies to California community colleges only to the limited extent that these sections are referenced in Public Resources Code section 42925. Community colleges are not defined as state agencies or otherwise subject to the Act's provisions for the procurement and use of recycled products in daily state operations. See Exhibit B, Controller's Late Comments on the IRC, page 105 (*State of California, Department of Finance, California Integrated Waste Management Board v. Commission on State Mandates, et al.* (Sacramento County Superior Court, Case No. 07CS00355)).

limited to the staff working directly on the plan.

B. Ongoing Activities (*Reimbursable starting January 1, 2000*)

1. Complete and submit to the [Integrated Waste Management] Board the following as part of the State Agency Model Integrated Waste Management Plan (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.):
  - a. state agency or large state facility information form;
  - b. state agency list of facilities;
  - c. state agency waste reduction and recycling program worksheets that describe program activities, promotional programs, and procurement activities, and other questionnaires; and
  - d. state agency integrated waste management plan questions.

NOTE: Although reporting on promotional programs and procurement activities in the model plan is reimbursable, implementing promotional programs and procurement activities is not.

2. Respond to any Board reporting requirements during the approval process. (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.)
3. Consult with the Board to revise the model plan, if necessary. (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.)
4. Designate one solid waste reduction and recycling coordinator for each college in the district to perform new duties imposed by chapter 18.5 (Pub. Resources Code, §§ 42920 – 42928). The coordinator shall implement the integrated waste management plan. The coordinator shall act as a liaison to other state agencies (as defined by section 40196.3) and coordinators. (Pub. Resources Code, § 42920, subd. (c).)
5. Divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004, through source reduction, recycling, and composting activities. Maintain the required level of reduction, as approved by the Board. (Pub. Resources Code, §§ 42921 & 42922, subd. (i).)

C. Alternative Compliance (*Reimbursable from January 1, 2000 – December 31, 2005*)

1. Seek either an alternative requirement or time extension if a community college is unable to comply with the January 1, 2002 deadline to divert 25 percent of its solid waste, by doing the following: (Pub. Resources Code, §§ 42927 & 42923 subds. (a) & (c).)

- a. Notify the Board in writing, detailing the reasons for its inability to comply.
  - b. Request of the Board an alternative to the January 1, 2002 deadline.
  - c. Provide evidence to the Board that the college is making a good faith effort to implement the source reduction, recycling, and composting programs identified in its integrated waste management plan.
  - d. Provide information that describes the relevant circumstances that contributed to the request for extension, such as lack of markets for recycled materials, local efforts to implement source reduction, recycling and composting programs, facilities built or planned, waste disposal patterns, and the type of waste disposed of by the community college.
  - e. Submit a plan of correction that demonstrates that the college will meet the requirements of Section 42921 [the 25 and 50 percent diversion requirements] before the time extension expires, including the source reduction, recycling, or composting steps the community college will implement, a date prior to the expiration of the time extension when the requirements of Section 42921 will be met, the existing programs that it will modify, any new programs that will be implemented to meet those requirements, and the means by which these programs will be funded.
2. Seek either an alternative requirement or time extension if a community college is unable to comply with the January 1, 2004 deadline to divert 50 percent of its solid waste, by doing the following: (Pub. Resources Code, §§ 42927 & 42922, subds. (a) & (b).)
- a. Notify the Board in writing, detailing the reasons for its inability to comply.
  - b. Request of the Board an alternative to the 50-percent requirement.
  - c. Participate in a public hearing on its alternative requirement.
  - d. Provide the Board with information as to:
    - (i) the community college's good faith efforts to implement the source reduction, recycling, and composting measures described in its integrated waste management plan, and demonstration of its progress toward meeting the alternative requirement as described in its annual reports to the Board;
    - (ii) the community college's inability to meet the 50 percent diversion requirement despite implementing the measures in its plan;
    - (iii) how the alternative source reduction, recycling, and composting requirement represents the greatest diversion amount that the community college may reasonably and feasibly achieve; and,

- (iv) the circumstances that support the request for an alternative requirement, such as waste disposal patterns and the types of waste disposed by the community college.<sup>29</sup>

D. Accounting System (*Reimbursable starting January 1, 2000*)

Developing, implementing, and maintaining an accounting system to enter and track the college's source reduction, recycling and composting activities, the cost of those activities, the proceeds from the sale of any recycled materials, and such other accounting systems which will allow it to make its annual reports to the state and determine waste reduction. Note: only the pro-rata portion of the costs incurred to implement the reimbursable activities can be claimed.

E. Annual Report (*Reimbursable starting January 1, 2000*)

Annually prepare and submit, by April 1, 2002, and by April 1 each subsequent year, a report to the Board summarizing its progress in reducing solid waste. The information in the report must encompass the previous calendar year and shall contain, at a minimum, the following as outlined in section 42926, subdivision (b): (Pub. Resources Code, §§ 42926, subd. (a) & 42922, subd. (i).)

1. calculations of annual disposal reduction;
2. information on the changes in waste generated or disposed of due to increases or decreases in employees, economics, or other factors;
3. a summary of progress made in implementing the integrated waste management plan;
4. the extent to which the community college intends to use programs or facilities established by the local agency for handling, diversion, and disposal of solid waste (If the college does not intend to use those established programs or facilities, it must identify sufficient disposal capacity for solid waste that is not source reduced, recycled or composted.);
5. for a community college that has been granted a time extension by the Board, it shall include a summary of progress made in meeting the integrated waste management plan implementation schedule pursuant to section 42921, subdivision (b), and complying with the college's plan of correction, before the expiration of the time extension;
6. for a community college that has been granted an alternative source reduction, recycling, and composting requirement by the Board pursuant to section 42922, it shall include a summary of progress made towards meeting the alternative requirement as well as an explanation of current

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<sup>29</sup> These alternative compliance and time extension provisions in part C were sunset on January 1, 2006, but were included in the adopted Parameters and Guidelines.

circumstances that support the continuation of the alternative requirement.

F. Annual Recycled Material Reports (*Reimbursable starting July 1, 1999*)

Annually report to the Board on quantities of recyclable materials collected for recycling. (Pub. Contract Code, § 12167.1.) (See Section VII. regarding offsetting revenues from recyclable materials.)

The Parameters and Guidelines further require that each claimed reimbursable cost be supported by contemporaneous source documentation.<sup>30</sup>

And as originally adopted, the Parameters and Guidelines required community college districts to identify and deduct from their reimbursement claims all of the offsetting revenues received from the sale of recyclable materials, limited by the provisions of Public Resources Code section 42925 and Public Contract Code section 12167.1. The original Parameters and Guidelines did not require community colleges to identify and deduct from their claims any offsetting cost savings resulting from the solid waste diversion activities required by the test claim statutes.<sup>31</sup>

**B. Superior Court Decision Regarding Cost Savings and Offsets Under the Program**

After the Parameters and Guidelines were adopted, the Department of Finance (Finance) and the CIWMB filed a petition for a writ of mandate requesting the court to direct the Commission to set aside the Test Claim Statement of Decision and Parameters and Guidelines and to issue a new Decision and Parameters and Guidelines that give full consideration to the cost savings and offsetting revenues community college districts will achieve by complying with the test claim statutes, including all cost savings realized from avoided landfill disposal fees and revenues received from the collection and sale of recyclable materials. The petitioners further argued that Public Contract Code sections 12167 and 12167.1 do not require community college districts to deposit revenues received from the collection and sale of recyclable materials into the Integrated Waste Management Account, as determined by the Commission, but instead allow community college districts to retain all revenues received. The petitioners argued that such revenues must be identified as offsetting revenues and applied to the costs of the program, without the community college district obtaining the approval of the Legislature or the CIWMB.

On May 29, 2008, the Sacramento County Superior Court granted the petition for writ of mandate, finding that the Commission's treatment of cost savings and revenues in the Parameters and Guidelines was erroneous and required that the Parameters and Guidelines be amended. The court said:

There is no indication in the administrative record or in the legal authorities provided to the court that, as respondent [Commission] argues, a California Community College might not receive the full reimbursement of its actual increased costs required by section 6 if its claims for reimbursement of IWM plan costs were offset by realized cost savings and all revenues received from the plan activities.<sup>32</sup>

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<sup>30</sup> Exhibit A, IRC, page 41 (Parameters and Guidelines, adopted March 30, 2005).

<sup>31</sup> Exhibit A, IRC, page 41-47 (Parameters and Guidelines, adopted March 30, 2005).

<sup>32</sup> Exhibit B, Controller's Late Comments on the IRC, page 63 (Ruling on Submitted Matter).

Instead, the court recognized that community colleges are “likely to experience costs savings in the form of reduced or avoided costs of landfill disposal” as a result of the mandated activities in Public Resources Code section 42921 because reduced or avoided costs “are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided.”<sup>33</sup> The court noted that “diversion is defined in terms of landfill disposal for purposes of the IWM plan mandates” and cited the statutory definition of diversion: “activities which reduce or eliminate the amount of solid waste from solid waste disposal for purposes of this division [i.e., division 30, including § 42920 et seq.]” as well as the statutory definition of disposal: “the management of solid waste through landfill disposal or transformation at a permitted solid waste facility.”<sup>34</sup> The court explained that:

[R]eduction or avoidance of landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs of the IWM plan implementation . . . The amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(1) of Public Resources Code section 42926.<sup>35</sup>

The court harmonized section 42925(a) with Public Contract Code sections 12167 and 12167.1:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs “in accordance with Sections 12167 and 12167.1 of the Public Contract Code,” section 42925 assures that cost savings realized from state agencies’ IWM plans are handled in a manner consistent with the handling of revenues received from state agencies’ recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for

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<sup>33</sup> Exhibit B, Controller’s Late Comments on the IRC, page 63 (Ruling on Submitted Matter). Emphasis added.

<sup>34</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 63-64 (Ruling on Submitted Matter).

<sup>35</sup> Exhibit B, Controller’s Late Comments on the IRC, page 64 (Ruling on Submitted Matter). Emphasis added.



expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>36</sup>

The court issued a writ of mandate directing the Commission to amend the Parameters and Guidelines to require community college districts claiming reimbursable costs of an integrated waste management plan to:

1. Identify and offset from their claims, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1, cost savings realized as a result of implementing their plans; and
2. Identify and offset from their claims all of the revenue generated as a result of implementing their plans, without regard to the limitations or conditions described in sections 12167 and 12167.1 of the Public Contract Code.<sup>37</sup>

### **C. Parameters and Guidelines Amendment Pursuant to the Writ**

In compliance with the writ, the Commission amended the Parameters and Guidelines on September 26, 2008 to add section VIII. Offsetting Cost Savings, which states:

Reduced or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans shall be identified and offset from this claim as cost savings, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1. Pursuant to these statutes, community college districts are required to deposit cost savings resulting from their Integrated Waste Management plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the California Integrated Waste Management Board for the purpose of offsetting Integrated Waste Management plan costs. Subject to the approval of the California Integrated Waste Management Board, cost savings by a community college that do not exceed two thousand dollars (\$2,000) annually are continuously appropriated for expenditure by the community college for the purpose of offsetting Integrated Waste Management program costs. Cost savings exceeding two thousand dollars (\$2,000) annually may be available for expenditure by the community college only when appropriated by the Legislature. To the extent so approved or appropriated and applied to the college, these amounts shall be identified and offset from the costs claimed for implementing the Integrated Waste Management Plan.<sup>38</sup>

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<sup>36</sup> Exhibit B, Controller's Late Comments on the IRC, pages 65-66 (Ruling on Submitted Matter).

<sup>37</sup> Exhibit B, Controller's Late Comments on the IRC, page 30 (Judgment Granting Petition for Writ of Administrative Mandamus).

<sup>38</sup> Exhibit A, IRC, page 59 (Amended Parameters and Guidelines, adopted Sept. 26, 2008).

Section VII. of the Parameters and Guidelines, on Offsetting Revenues, was amended as follows (amendments in strikeout and underline):

Reimbursement for this mandate from any source, including but not limited to, services fees collected, federal funds, and other state funds allocated to any service provided under this program, shall be identified and ~~deducted~~ offset from this claim. Offsetting revenue shall include all revenues generated from implementing the Integrated Waste Management Plan. ~~the revenues cited in Public Resources Code section 42925 and Public Contract Code sections 12167 and 12167.1.~~

~~Subject to the approval of the California Integrated Waste Management Board, revenues derived from the sale of recyclable materials by a community college that do not exceed two thousand dollars (\$2,000) annually are continuously appropriated for expenditure by the community college for the purpose of offsetting recycling program costs. Revenues exceeding two thousand dollars (\$2,000) annually may be available for expenditure by the community college only when appropriated by the Legislature. To the extent so approved or appropriated and applied to the college, these amounts are a reduction to the recycling costs mandated by the state to implement Statutes 1999, chapter 764.~~

In addition, revenue from a building-operating fee imposed pursuant to Education Code section 76375, subdivision (a) if received by a claimant and the revenue is applied to this program, shall be deducted from the costs claimed.<sup>39</sup>

All other requirements in the Parameters and Guidelines remained the same.

The CIWMB requested additional amendments to the Parameters and Guidelines at this September 2008 hearing, including a request to alter the offsetting savings provision to require community college districts to provide offsetting savings information *whether or not* the offsetting savings generated in a fiscal year exceeded the \$2,000 continuous appropriation required by Public Contract Code sections 12167 and 12167.1. The Commission denied the request because the proposed language went beyond the scope of the court's judgment and writ.<sup>40</sup> As the court found:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs "in accordance with Sections 12167 and 12167.1 of the Public Contract Code," section 42925 assures that cost savings realized from state agencies' IWM plans are handled in a manner consistent with the handling of revenues received from state agencies' recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit

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<sup>39</sup> Exhibit A, IRC, pages 58-59 (Amended Parameters and Guidelines, adopted Sept. 26, 2008).

<sup>40</sup> Exhibit E, Commission on State Mandates, Excerpt from the Minutes for the September 26, 2008 Meeting.

cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>41</sup>

The CIWMB also requested adding a requirement for community college districts to analyze specified categories of potential cost savings when filing their reimbursement claims. The Commission found that the court determined that the amount or value of cost savings is already available from the annual reports the community college districts provide to the CIWMB pursuant to Public Resources Code section 42926(b). This report is required to include the district's "calculations of annual disposal reduction" and "information on the changes in waste generated or disposed of due to increases or decreases in employees, economics, or other factors." Thus, the Commission denied the CIWMB's request and adopted the staff analysis finding that the request was beyond the scope of the court's writ and judgment. The Commission also noted that the request was the subject of separate pending request filed by CIWMB to amend the Parameters and Guidelines and would therefore be further analyzed for that matter.

#### **D. Subsequent Request by the CIWMB to Amend the Parameters and Guidelines to Require Detailed Reports on Cost Savings and Revenues**

The CIWMB filed a request to amend the Parameters and Guidelines to require community college districts to submit with their reimbursement claims a separate worksheet and report analyzing the costs incurred and avoided and any fees received relating to staffing, overhead, materials, storage, transportation, equipment, the sale of commodities, avoided disposal fees, and any other revenue received relating to the mandated program as specified by the CIWMB. At its January 30, 2009 meeting, the Commission denied the request for the following reasons: there is no requirement in statute or regulation that community college districts perform the analysis specified by the CIWMB; the Commission has no authority to impose additional requirements on community college districts regarding this program; the offsetting cost savings paragraph in the Parameters and Guidelines already identifies the offsetting savings consistent with the language of Public Resources Code section 42925(a), Public Contract Code sections 12167 and 12167.1, and the court's judgment and writ; and information on cost savings is already available in the

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<sup>41</sup> Exhibit B, Controller's Late Comments on the IRC, pages 65-66 (Ruling on Submitted Matter).

community colleges' annual reports submitted to CIWMB, as required by Public Resources Code section 42926(b)(1).<sup>42</sup>

### E. The Controller's Audit

The Controller audited the reimbursement claims for the 1999-2000, 2000- 2001, and 2003-2004 through 2009-2010 fiscal years (the audit period). Of the \$238,419 claimed for the mandated program, the Controller found that \$98,784 is allowable and \$139,635 is unallowable because the claimant did not report offsetting savings of \$171,209 related to implementation of its IWM plan.<sup>43</sup>

The Controller's audit finding is based on the court's ruling, which states that "the amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(l) of Public Resources Code section 42926,"<sup>44</sup> and the resulting amendment to the Parameters and Guidelines.

The Controller determined that for every year except the first half of fiscal year 2003-2004,<sup>45</sup> the claimant diverted more solid waste than the amount mandated by the test claim statute.<sup>46</sup> Therefore, for those years when the claimant exceeded the mandate, the Controller "allocated" the diversion percentage based on the mandated level and used the following formula to calculate offsetting cost savings:

$$\begin{array}{rcccl}
 & \text{Allocated Diversion \%} & & & \\
 & \text{-----} & & & \\
 & \text{Maximum} & & & \text{Avoided} \\
 & \text{Allowable} & & & \text{Landfill} \\
 \text{Offsetting} & = & \frac{\text{Diversion \%}}{\text{Actual}} & \times & \text{Disposal Fee} \\
 \text{Savings} & & \text{Diversion \%} & \times & \text{(per Ton)} \\
 \text{Realized} & & & \times & \\
 & & \text{Tonnage} & & \\
 & & \text{Diverted} & & 
 \end{array}$$

This formula divides the percentage of solid waste required to be diverted (the Controller used 25 percent for fiscal years 1999-2000 and 2000-2001 and 50 percent for fiscal years 2003-2004, through 2010-2011) by the actual percentage of solid waste diverted (as reported by the claimant to CIWMB). The resulting quotient is then multiplied by the tons of solid waste diverted (as

<sup>42</sup> Exhibit E, Commission on State Mandates, Item 9, Final Staff Analysis of Proposed Amendments to the Parameters and Guidelines for *Integrated Waste Management*, 05-PGA-16, January 30, 2009, pages 2-3.

<sup>43</sup> Because the audit adjustment exceeded the amount claimed in three fiscal years (2007 – 2010) an excess of \$31,574 was subtracted from the offset amount, leaving a net audit adjustment of \$139,635. Exhibit A, IRC, pages 16-17, 24, and 29 (Final Audit Report). Exhibit B, Controller's Late Comments on the IRC, page 26.

<sup>44</sup> Exhibit B, Controller's Late Comments on the IRC, page 64 (Ruling on Submitted Matter).

<sup>45</sup> The Controller calculated halves of fiscal years because reports to the CIWMB were based on the calendar year. See Exhibit B, Controller's Late Comments on the IRC, page 71.

<sup>46</sup> Exhibit A, IRC, pages 33-34. Exhibit B, Controller's Late Comments on the IRC, page 71.

annually reported by the claimant to the CIWMB), multiplied by the avoided landfill disposal fee (based on the statewide average fee). The Controller states that “[t]his calculation determines the cost that the district did not incur for solid waste disposal as a result of implementing its IWM plan.”<sup>47</sup>

The Controller provided an example of how this formula works. In calendar year 2007, the claimant reported that it diverted 591.3 tons of solid waste and disposed of 389.8 tons, which totals 981.1 tons of solid waste generated for that year. Diverting 591.3 tons out of the 981.1 tons of total waste generated results in a diversion rate of 60.3 percent (more than the 50 percent required).<sup>48</sup> The Controller did not want to penalize the claimant for diverting more solid waste than the amount mandated<sup>49</sup> and thus, instead of using 100 percent of the amount actually diverted, the Controller allocated the diversion percentage by dividing the mandated diversion percentage (50 percent) by the actual percent diverted (60.27 percent), which equals 82.96 percent. The allocated diversion percentage of 82.96 percent is then multiplied by the 591.3 tons diverted that year, which equals 490.5 tons of diverted solid waste, instead of the 591.3 tons actually diverted. The allocated 490.5 tons of diverted waste is then multiplied by the statewide average disposal fee per ton, which in calendar year 2007 was \$48, for “offsetting cost savings” for calendar year 2007 of \$23,546.<sup>50</sup> The audit report states that the claimant did not provide documentation supporting a different disposal fee.<sup>51</sup>

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<sup>47</sup> Exhibit A, IRC, pages 33-34 (Final Audit Report).

<sup>48</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 19-20, 71 (Controller’s calculations of offsetting savings for the audit period).

<sup>49</sup> Exhibit B, Controller’s Late Comments on the IRC, page 19.

<sup>50</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 19, 71 (Controller’s calculations of offsetting savings for the audit period). The formula used for the calculation is described differently on page 19 of the Controller’s Late Comments on the IRC than in the audit report, but the result is the same. The Controller’s Late Comments on the IRC state that cost savings can be calculated by multiplying the total tonnage generated (solid waste diverted + disposed) by the mandated diversion percentage (25 or 50 percent), times the avoided landfill disposal fee, as follows:

For example, in calendar year 2007, the district reported to CalRecycle that it diverted 591.3 tons of solid waste and disposed of 389.8 tons, which results in an overall diversion percentage of 60.3% [**Tab 4, page 13**]. Because the district was required to divert 50% for that year to meet the mandated requirements and comply with the Public Resources Code, it needed to divert only 490.55 tons (981.1 total tonnage generated x 50%) in order to satisfy the 50% requirement. Therefore, we adjusted our calculation to compute offsetting savings based on 490.55 tons of diverted solid waste rather than a total of 591.3 tons diverted.

Using this formula also results in cost savings for calendar year 2007 of \$23,546 (981.1 tons generated x 50 percent = 490.55 tons x \$48 = \$23,546).

<sup>51</sup> Exhibit A, IRC, page 34 (Final Audit Report). Exhibit B, Controller’s Late Comments on the IRC, page 19.

For the first half of fiscal year 2003-2004, the Controller found that the claimant did not achieve the mandated percentage of diversion and therefore, the Controller did not allocate the diversion percentage, but used 100 percent of the diversion reported by the claimant to calculate offsetting savings.<sup>52</sup>

In 2008, the CIWMB stopped requiring community college districts to report the actual amount of tonnage diverted (CIWMB changed focus to "per-capita disposal" instead of a "diversion percentage"). Consequently, the Controller used the claimant's reported 2007 diversion percentage to calculate the offsetting savings for the last half of fiscal year 2007-2008, as well as for fiscal years 2008-2009 and 2009-2010. According to the Controller, the claimant did not provide documentation supporting a different diversion percentage.<sup>53</sup>

The Controller calculated total offsetting savings for the audit period at \$171,209,<sup>54</sup> but because the adjustment exceeded the amount claimed for three fiscal years (2007- 2008 through 2009-2010) an excess of \$31,574 was subtracted from the offset amount, leaving a net audit adjustment of \$139,635.<sup>55</sup>

### **III. Positions of the Parties**

#### **A. Sierra Joint Community College District**

The claimant maintains that the audit reductions are incorrect and requests the reinstatement of the full amount reduced. The claimant alleges that it did not realize any cost savings as a result of the mandate and quotes the Superior Court decision (discussed above) that cost savings will "most likely" occur as a result of reduced or avoided costs of landfill disposal. Claimant argues that:

The court presupposes a previous legal requirement for districts to incur landfill disposal fees to divert solid waste. Thus, potentially relieved of the need to incur new or additional landfill fees for increased waste diversion, a cost savings would occur. There is no finding of fact or law in the court decision or from the Commission Statement of Decision for the test claim for this assumed duty to use landfills.<sup>56</sup>

The claimant further argues that the offsetting savings provision in the Parameters and Guidelines does not assume that the cost savings occurred, but instead requires that the cost savings be *realized*. For the savings to be realized, the claimant contends that the following chain of events are required:

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<sup>52</sup> Exhibit A, IRC, page 31, footnote 2 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 71.

<sup>53</sup> Exhibit A, IRC, page 34 (Final Audit Report).

<sup>54</sup> Exhibit A, IRC, page 32 (Final Audit Report).

<sup>55</sup> Exhibit A, IRC, pages 16-17, 24, and 29 (Final Audit Report). Exhibit B, Controller's Late Comments on the IRC, page 26.

<sup>56</sup> Exhibit A, IRC, page 11.

The cost savings must exist (avoided landfill costs); be converted to cash; amounts in excess of \$2,000 per year deposited in the state fund; and, these deposits by the districts appropriated by the Legislature to districts for purposes of mitigating the cost of implementing the plan. None of those prerequisite events occurred so no cost savings were "realized" by the District. Regardless, the adjustment cannot be applied to the District since no state appropriation of the cost savings was made to the District.<sup>57</sup>

The claimant also argues that the Parameters and Guidelines are silent as to how to calculate the avoided costs, but that the court provided two alternative methods, either disposal reduction or diversion reported by districts. The Controller used the diversion percentage, which assumes, without findings of fact, that all diversion tonnage is landfill disposal tonnage reduction. The claimant contends that the Controller's calculation of cost savings is wrong because: (1) the formula is a standard of general application that was not adopted pursuant to the Administrative Procedure Act and is therefore an unenforceable underground regulation; (2) the Controller's formula assumes facts not in evidence, such as applying the same percentage of waste diverted in 2007 to all subsequent years without evidence in the record, and assumes that all tonnage diverted would have been disposed in a landfill, although some waste may have been composted or may not apply to the mandate (e.g. paint); and (3) the landfill disposal fee, a statewide average calculated by the CIWMB, does not include the data used to generate the average fee amounts, so the average is unknown and unsupported by the audit findings.<sup>58</sup>

Claimant also argues that application of the formula is incorrect. Since no landfill costs were claimed, none can be offset, so the offsets are not properly matched to relevant costs. Moreover, the Controller's calculation method prevents the claimant from receiving full reimbursement for its actual increased program costs. Claimant contends, using audit results for 23 other claimants under the *Integrated Waste Management* program, the application of the Controller's formula has arbitrary results because the percentages of allowed costs for those claimants ranges from zero to 83.4 percent.<sup>59</sup>

Finally, the claimant argues: (1) the Controller used the wrong standard of review in that the claimed costs were not found to be excessive or unreasonable, as required by Government Code section 17561(d)(2); and (2) the Controller has the burden of proof 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 evidence regarding its auditing methods and procedures, as well as the specific facts relied upon for its audit findings."<sup>60</sup>

The claimant did not file comments on the Draft Proposed Decision.

### **B. State Controller's Office**

The Controller maintains that the audit findings are correct and that the offsetting savings were correctly deducted from the costs claimed. The Controller notes that the claimant does not

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<sup>57</sup> Exhibit A, IRC, page 13. Emphasis in original.

<sup>58</sup> Exhibit A, IRC, pages 14-16.

<sup>59</sup> Exhibit A, IRC, pages 16-18.

<sup>60</sup> Exhibit A, IRC, pages 20-21.

indicate how undiverted solid waste would be disposed of if not at a landfill. In addition, the claimant does not state that it disposed of its solid waste at any location other than a landfill or used any other means to dispose of its waste rather than to contract with a commercial waste hauler.<sup>61</sup>

The Controller concludes that the claimant's comments relating to alternatives for the disposal of solid waste are irrelevant. The Controller cites the claimant's annual reports of tonnage disposed for each year of the audit period, and argues that the claimant "does not indicate in these annual reports that it used any other methodology to dispose of solid waste."<sup>62</sup> The Controller also cites the narrative in some of the claimant's annual reports that indicates that the claimant disposed of waste in a landfill.<sup>63</sup> According to the Controller:

Unless the district had an arrangement with its waste hauler that it did not disclose to us or CalRecycle, the district did not dispose of its solid waste at a landfill for no cost. Sierra Joint Community College is located in Rocklin, California. An internet search for landfill fees revealed that the Western Placer Waste Management Authority in Lincoln, California (12 miles from Sierra Joint Community College), currently charges \$69.00 per ton to dispose of solid waste [citation omitted]. Thus, the higher rate of diversion results in less trash that is disposed at a landfill, which creates cost savings for the district.<sup>64</sup>

As to the claimant not remitting cost savings from the implementation of its IWM plan into the Integrated Waste Management Account in compliance with the Public Contract Code, the Controller asserts that the claimant is not precluded from the requirement to do so, as indicated in the Parameters and Guidelines and the court ruling. The Controller says the evidence supports that the claimant realized cost savings that should have been remitted to the state and that must be used to fund IWM plan costs.<sup>65</sup>

In response to the claimant's argument that the Controller's formula is a standard of general application that is an underground regulation, the Controller responds that the calculation is a "court approved methodology" to determine the "required offset." The Controller also states that the claimant did not amend any of its reimbursement claims after the Parameters and Guidelines were amended in September 2008. According to the Controller: "We believe that this "court-identified" approach provides a reasonable methodology to identify the required offset."<sup>66</sup>

The Controller also states that it "allocated" the offsetting savings to avoid penalizing the claimant for diverting more than the minimum percentage of diversion required. According to the Controller:

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<sup>61</sup> Exhibit B, Controller's Late Comments on the IRC, page 16.

<sup>62</sup> Exhibit B, Controller's Late Comments on the IRC, page 17.

<sup>63</sup> Exhibit B, Controller's Late Comments on the IRC, pages 16-17.

<sup>64</sup> Exhibit B, Controller's Late Comments on the IRC, page 17.

<sup>65</sup> Exhibit B, Controller's Late Comments on the IRC, pages 17-18.

<sup>66</sup> Exhibit B, Controller's Late Comments on the IRC, page 18.



As there is no State mandate to exceed solid waste diversion for amounts in excess of 25% for calendar years 2002 through 2003 or 50% for calendar year 2004 and later, there is no basis for calculating offsetting savings realized for actual diversion percentages that exceeded the levels set by statute.<sup>67</sup>

The Controller notes that after the passage of Statutes 2008, chapter 343, the CIWMB no longer required districts to report their tonnage or percentage diverted, but they are still required to divert 50 percent of their solid waste.

Defending its use of the claimant's 2007 reported diversion to calculate claimant's offsets for 2007-2008 through 2009-2010, the Controller calls the 2007 report a "fair representation" of 2008 -2010 "because the district's recycling processes have already been established and committed to." The Controller notes that the claimant's reported per-capita disposal rate is well below the target rate for 2008, 2009, and 2010, so "the district is meeting its requirement to divert 50% of its solid waste."<sup>68</sup> The Controller also cites the claimant's 2008 report that states: "There has been less waste disposed of in 2008. We have been more proactive in increasing awareness of what materials can be recycled and therefore not placed in our solid waste stream. Our cardboard, metals and wood pallet recycling increased in 2008."<sup>69</sup> Based on these claimant statements, the Controller states that its savings calculations for 2007-2008 through 2009-2010 may be understated.<sup>70</sup>

The Controller also responded to claimant's argument against the assumption that all tonnage diverted would have been disposed in a landfill, even though some waste may have been composted or may not apply to the mandate (e.g. paint). Noting that it was not until 2010 (the last year of the audit period) that claimant reported that it was composting grass clippings, and that none of the narratives in the annual reports for 2000 through 2009 mention composting performed by the claimant, the Controller concludes that composted material was not a significant amount of the tonnage diverted. The Controller also states that claimant's reference to paint disposal is irrelevant because hazardous waste is not included in the diversion amounts that claimant reported, and therefore, are not included in the Controller's offsetting savings calculation.<sup>71</sup>

Regarding the data for the statewide disposal fee, the Controller states the information was provided by the CIWMB, is included in the record, and is based on private surveys of a large percentage of landfills across California. In addition, the claimant "did not provide any information, such as its contract with or invoices received from its commercial waste hauler to support either the landfill fees actually incurred by the district or to confirm that the statewide average landfill fee was greater than the actual landfill fees incurred by the district."<sup>72</sup>

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<sup>67</sup> Exhibit B, Controller's Late Comments on the IRC, page 19.

<sup>68</sup> Exhibit B, Controller's Late Comments on the IRC, page 20.

<sup>69</sup> Exhibit B, Controller's Late Comments on the IRC, pages 20 and 48.

<sup>70</sup> Exhibit B, Controller's Late Comments on the IRC, page 20.

<sup>71</sup> Exhibit B, Controller's Late Comments on the IRC, page 21.

<sup>72</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

In response to the claimant's argument that it "did not claim landfill costs, so there are none to be offset," the Controller answers that the mandated program does not reimburse claimants for landfill costs incurred to dispose of solid waste, so none would be claimable. Rather, the claimant's costs to divert solid waste from disposal are reimbursable, which according to the Controller, results in both a reduction of solid waste going to a landfill in compliance with its IWM plan, and the associated costs of having the waste hauled there, which are required to offset reimbursement claims.<sup>73</sup>

In response to the claimant's argument that "the adjustment method does not match or limit the landfill costs avoided to landfill costs, if any, actually claimed," the Controller quotes Public Resources Code section 42925 that "cost savings realized as a result of the IWM plan are to "fund plan *implementation and administration costs*." The Controller argues that offsetting savings applies to the whole program and is not limited to solid waste diversion activities. The Controller also cites the reimbursable activities in the Parameters and Guidelines that refer to "implementation of the IWM plan," concluding that it is reasonable that offsetting savings from implementing the plan be offset against direct costs to implement the plan. The Controller also asserts, in response to claimant's reference to other IWM audits, that other audits are irrelevant to the current issue.<sup>74</sup>

The Controller also disagrees with claimant's assertion that the Controller used the wrong standard of review because it did conclude that the claims were excessive. As to the burden of proof, the Controller states that it used data from the claimant's annual reports from implementing its IWM program.<sup>75</sup>

In comments on the Draft Proposed Decision, the Controller agrees with the part of the analysis upholding the reductions, but disagrees that the Controller's reduction of costs for the first half of fiscal year 2003-2004 is incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support. For that time period, the Controller found that the claimant did not achieve the mandated "50 percent" diversion. Therefore, the Controller did not allocate the actual diversion percentage by the mandated diversion percentage as it did for the other fiscal years in the audit, but used 100 percent of the diversion percentage to calculate offsetting savings, which resulted in a reduction of \$7,513. The Controller states:

For the first half of FY 2003-2004, we agree that the district diverted 45.59% of its solid waste, which is above the mandated level of 25%. However, there is no evidence in its FY 2003-2004 mandated cost claim that the district pro-rated the direct costs to claim only 54.84% ( $25\% \div 45.59\%$ ) of the total diversion costs incurred. In fact, on its FY 2003-2004 Form IWM-2, the district reported time for "diverting solid waste from landfill disposal or transformation facilities - source reduction/recycling/composting" (Exhibit D, page 230). No proration or allocation was noted. Based on the information provided in the claim, we believe the district claimed 100% of the direct cost incurred to perform the mandated activities. Therefore, we believe the correlated offsetting savings

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<sup>73</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>74</sup> Exhibit B, Controller's Late Comments on the IRC, pages 22-23.

<sup>75</sup> Exhibit B, Controller's Late Comments on the IRC, pages 25-26.

should also be calculated at 100% of the actual diversion rate of 45.59%, totaling \$7,513.<sup>76</sup>

#### **IV. Discussion**

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

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

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6 of the California Constitution.<sup>77</sup> The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 of the California Constitution and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."<sup>78</sup>

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.<sup>79</sup> Under this standard, the courts have found that:

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

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<sup>76</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision, pages 1-2.

<sup>77</sup> *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

<sup>78</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

<sup>79</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space Dist.* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

connection between those factors, the choice made, and the purposes of the enabling statute.” [Citation.]’ ”<sup>80</sup>

The Commission must review the Controller’s audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.<sup>81</sup> In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission’s regulations require that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission’s ultimate findings of fact must be supported by substantial evidence in the record.<sup>82</sup>

**The Controller’s Reduction of Costs Is Generally Correct as a Matter of Law, However, the Reduction of Costs for the First Half of Fiscal Year 2003-2004, Based on the Incorrect Mandated Diversion Rate, Is Incorrect as a Matter of Law, and Is Arbitrary, Capricious, and Entirely Lacking in Evidentiary Support.**

- A. The test claim statutes define cost savings as avoided landfill fees and, thus, presume that by complying with the mandate to reduce and divert solid waste through the IWM program, landfill fees are reduced or avoided and cost savings are realized.

The test claim statute added Public Resources Code section 42925(a), which provides that “Any cost savings realized as a result of the state agency integrated waste management plan shall, to the extent feasible, be redirected to the agency’s integrated waste management plan to fund plan implementation and administration costs, in accordance with Sections 12167 and 12167.1 of the Public Contract Code.”

The court’s Ruling on Submitted Matter, states that community colleges are “likely to experience costs savings in the form of reduced or avoided costs of landfill disposal” as a result of the mandated activities in Public Resources Code section 42921 because reduced or avoided costs “are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided.” The court noted that “diversion is defined in terms of landfill disposal for purposes of the IWM plan mandates.” The statutory definition of diversion provides that “activities which reduce or eliminate the amount of solid waste from solid waste disposal for purposes of this division.” And the statutory definition of disposal is “the management of solid waste through landfill disposal or transformation at a permitted solid waste facility.”<sup>83</sup> The court explained that:

[R]eduction or avoidance of landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs of the IWM

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<sup>80</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>81</sup> *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

<sup>82</sup> Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission’s decision is not supported by substantial evidence in the record.

<sup>83</sup> Exhibit B, Controller’s Late Comments on the IRC, page 63 (Ruling on Submitted Matter).

plan implementation . . . The amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(l) of Public Resources Code section 42926.<sup>84</sup>

The court harmonized section 42925(a) with Public Contract Code sections 12167 and 12167.1:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs “in accordance with Sections 12167 and 12167.1 of the Public Contract Code,” section 42925 assures that cost savings realized from state agencies’ IWM plans are handled in a manner consistent with the handling of revenues received from state agencies’ recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>85</sup>

Thus, the court found that offsetting savings are, by statutory definition, likely to occur as a result of implementing the mandated activities. Reduced or avoided costs “are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided.”<sup>86</sup> As the court held, “landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs. . . .”<sup>87</sup>

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<sup>84</sup> Exhibit B, Controller’s Late Comments on the IRC, page 64 (Ruling on Submitted Matter). Emphasis added.

<sup>85</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 65-66 (Ruling on Submitted Matter).

<sup>86</sup> Exhibit B, Controller’s Late Comments on the IRC, page 63 (Ruling on Submitted Matter).

<sup>87</sup> Exhibit B, Controller’s Late Comments on the IRC, page 64 (Ruling on Submitted Matter). Emphasis added.

The statutes, therefore, presume that by complying with the mandate to reduce and divert solid waste through the IWM program, landfill fees are reduced or avoided and cost savings are realized. As indicated in the court's ruling, the amount or value of the cost savings may be determined from the calculations of annual solid waste disposal reduction or diversion, which community colleges are required to annually report to the CIWMB. The amount of cost savings realized must be identified by the claimant and used to offset the costs incurred to comply with IWM plan implementation and administration activities approved for reimbursement in the Parameters and Guidelines. Accordingly, the court's ruling requires claimants to report in their reimbursement claims the costs incurred to comply with the reimbursable activities (which includes the activities and costs to divert at least 25 or 50 percent of all solid waste from landfill disposal) and the cost savings from the avoided landfill disposal fees, to claim the net increased costs.

The Parameters and Guidelines are consistent with the court's ruling and require in Section IV. that "[t]he claimant is only allowed to claim and be reimbursed for increased costs for reimbursable activities identified below. Increased cost is limited to the cost of an activity that the claimant is required to incur as a result of the mandate."<sup>88</sup> Section VIII. requires that "[r]educed or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans shall be identified and offset from this claim as cost savings, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1."<sup>89</sup> The court's decision and the amended Parameters and Guidelines are binding.<sup>90</sup>

B. During the audit period, the claimant exceeded the mandated diversion rate for solid waste, but has filed no evidence to rebut the presumption that cost savings, based on avoided landfill costs, were realized.

In this case, the claimant reported no cost savings in its reimbursement claims and asserts that no cost savings were realized, but does not explain why.<sup>91</sup>

The record shows that the claimant complied with the mandate and diverted more solid waste during the audit period than the amount mandated by the state. The mandate requires community colleges to divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, through source reduction, recycling, and composting activities, and divert at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004.<sup>92</sup> The claimant's annual reports to the CIWMB for calendar years 2000, 2001, and 2003 report diversion percentages from 28.62 percent to 45.59 percent of the total tonnage of waste generated, which exceeds the mandated diversion requirement of 25 percent.<sup>93</sup> The

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<sup>88</sup> Exhibit A, IRC, page 54 (Parameters and Guidelines).

<sup>89</sup> Exhibit A, IRC, page 59 (Parameters and Guidelines).

<sup>90</sup> *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

<sup>91</sup> Exhibit A, IRC, page 7.

<sup>92</sup> Exhibit A, IRC, pages 51 and 55 (Parameters and Guidelines, section IV.(B)(5)); Public Resources Code sections 42921 and 42922(i).

<sup>93</sup> Exhibit B, Controller's Late Comments on the IRC, pages 33-37 and 71.

claimant's annual reports to the CIWMB for calendar years 2004 through 2007 also report diversion percentages that exceed the mandated diversion requirement of 50 percent, and range from 53.98 percent to 60.27 percent of the total tonnage of waste generated.<sup>94</sup>

In 2008, the CIWMB stopped requiring community college districts to report the actual amount and percentage of tonnage diverted, and instead required community colleges to report the "per-capita disposal" of waste as a result of 2008 legislation.<sup>95</sup> As amended, each community college now has a disposal target that is the equivalent to a 50 percent diversion, and is expressed on a per capita basis. Thus, if the district's per-capita disposal rate is less than the target, it means that the district is meeting the requirement to divert 50 percent of its solid waste.<sup>96</sup>

In this case, the reports for 2008, 2009, and 2010 show that the claimant's annual per capita disposal rate for both the employee and student populations to be equivalent to, or below the target rate and thus, the claimant satisfied the requirement to divert 50 percent of its solid waste during these years.<sup>97</sup> In addition, the claimant's 2008, 2009, and 2010 reports continue to show that the claimant had solid waste reduction programs in place, such as the following programs reported in 2008:

Business Source Reduction, Material Exchange, CRV beverage containers, cardboard, glass, newspaper, mixed office paper, scrap metal, collection at special events, grasscycling, commercial pickup of compostable yard wastes, tires, white/brown goods, wood waste, concrete/asphalt demolition, oil rendering and utilizing the Placer County MRF [material recovery facility]. We also continue to collect and recycle electronic wastes, batteries, CFL's/light tubes and mercury containing bulbs/switches. Newly implemented were collection of all plastics PETE 1-7, pressed board, non CRV glass and tin cans at the Nevada County Campus.<sup>98</sup>

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<sup>94</sup> Exhibit B, Controller's Late Comments on the IRC, pages 38-54 and 71.

<sup>95</sup> Statutes 2008, chapter 343 (SB 1016).

<sup>96</sup> Exhibit B, Controller's Late Comments on the IRC, page 79 ["Understanding SB 1016 Solid Waste Per Capita Disposal Measurement Act", <http://www.calrecycle.ca.gov/lgcentral/goalmeasure/Tools/SimplePresen.pdf>.]

<sup>97</sup> Exhibit B, Controller's Late Comments on the IRC, pages 47 (2008 report, showing an employee population target of 2.00, and 1.40 was achieved; and a student population target of .10, which the claimant met); 49 (2009 report, showing an employee population target of 2.00, and .90 was achieved; and a student population target of .10, which the claimant met); and 52-53 (2010 report, showing an employee population target of 2.00, and 1.30 was achieved; and a student population target of .10, and .09 was achieved).

<sup>98</sup> Exhibit B, Controller's Late Comments on the IRC, pages 48; 51 (2009 report); and 54 (2010 report).

The 2008 report also states: “The District has continued to work towards creating a sustainable environment and looks for opportunities to divert more of it’s [sic] solid wastes from the landfill. . . .”<sup>99</sup>

The record also shows that the tonnage of solid waste that was not diverted was disposed at a landfill. The annual reports filed by the claimant with the CIWMB during the audit period identify the total tonnage of waste disposed and the use of a disposal waste hauler.<sup>100</sup> Moreover, there are statements in the claimant’s 2001, 2003, 2004, 2005, and 2006 annual reports regarding decreased landfill disposal, indicating that the claimant used a landfill.<sup>101</sup> The avoided landfill disposal fee was based on the statewide average disposal fee provided by the CIWMB for each fiscal year in the audit period, since the claimant did not provide any information about the landfill fees it was charged.<sup>102</sup>

Based on this documentation, the Controller correctly presumed, consistent with the presumption in the test claim statutes and the court’s interpretation of those statutes and without any evidence to the contrary, that the percentage of waste diverted results in offsetting savings in an amount equal to the avoided landfill fee per ton of waste diverted.

The statutory presumption of cost savings controls unless the claimant files evidence to rebut the presumption and shows that cost savings were not realized.<sup>103</sup> The claimant has the burden of proof on this issue. Under the mandates statutes and regulations, the claimant is required to show that it has incurred increased costs mandated by the state when submitting a reimbursement claim to the Controller’s Office, and the burden to show that any reduction made by the Controller is incorrect.<sup>104</sup> The Parameters and Guidelines, as amended pursuant to the court’s

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<sup>99</sup> Exhibit B, Controller’s Late Comments on the IRC, page 48.

<sup>100</sup> The 2000 report to CIWMB states: “We will continue to work closely with our local waste haulers to further reduce our solid wastes.” See Exhibit B, Controller’s Late Comments on the IRC, page 34. The 2009 and 2010 reports state, in response to the question regarding how the annual tons disposed was calculated: “The tonnage number was received from our waste hauler.” See Exhibit B, Controller’s Late Comments on the IRC, pages 50 and 53.

<sup>101</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 36, 38, 40, 42, and 44.

<sup>102</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 22, 91-103, 115-119.

<sup>103</sup> Government Code section 17559, which requires that the Commission’s decisions be supported by substantial evidence in the record. See also, *Coffy v. Shiomoto* (2015) 60 Cal.4th 1198, 1209, a case interpreting the rebuttable presumption in Vehicle Code section 23152 that if a person had 0.08 percent or more, by weight, of alcohol in the blood at the time of testing, then it is presumed by law that he or she had 0.08 percent or more, by weight, of alcohol in the blood at the time of driving, unless he or she files evidence to rebut the presumption. The court states that unless and until evidence is introduced that would support a finding that the presumption does not exist, the statutory presumption that the person was driving over the legal limit remains the finding of fact.

<sup>104</sup> Evidence Code section 500, which states the following: “Except as otherwise provided by law, a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting.” See also, *Simpson Strong-Tie*



writ, also require claimants to show the costs incurred to divert solid waste and to perform the administrative activities, and *to report and identify* the costs saved or avoided by diverting solid waste: “Reduced or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans *shall be* identified and offset from this claim as cost savings.”<sup>105</sup> Thus, the claimant has the burden to rebut the statutory presumption and to show, with substantial evidence in the record, that the costs of complying with the mandate exceed any cost savings realized by diverting solid waste.

An example of when cost savings may not have been realized is the claimant’s costs to divert waste through a material recovery facility (MRF). The record shows that beginning in 2000, the claimant reported that:

All solid waste generated in Placer County is processed at the Nor tech Material Recovery Facility (MRF) at Lincoln. At this facility, the Districts solid wastes are again processed to recover additional recyclable materials prior to being landfilled. As a customer and participant, the District shall accept the additional 16% credit for recycling through the MRF.<sup>106</sup>

A MRF is a “permitted solid waste facility where solid wastes or recyclable materials are sorted or separated, by hand or by use of machinery, for the purposes of recycling or composting.”<sup>107</sup>

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*Co., Inc. v. Gore* (2010) 49 Cal.4th 12, 24, where the court recognized that “the general principle of Evidence Code 500 is that a party who seeks a court's action in his favor bears the burden of persuasion thereon.” This burden of proof is recognized throughout the architecture of the mandates statutes and regulations. Government Code section 17551(a) requires the Commission to hear and decide a claim filed by a local agency or school district that it is entitled to reimbursement under article XIII B, section 6. Section 17551(d) requires the Commission to hear and decide a claim by a local agency or school district that the Controller has incorrectly reduced payments to the local agency or school district. In these claims, the claimant must show that it has incurred increased costs mandated by the state. (Gov. Code, §§ 17514 [defining “costs mandated by the state”], 17560(a) [“A local agency or school district may . . . file an annual reimbursement claim that details the costs actually incurred for that fiscal year.”]; 17561 [providing that the issuance of the Controller’s claiming instructions constitutes a notice of the right of local agencies and school districts to file reimbursement claims based upon the parameters and guidelines, and authorizing the Controller to audit the records of any local agency or school district to “verify the actual amount of the mandated costs.”]; 17558.7(a) [“If the Controller reduces a claim approved by the commission, the claimant may file with the commission an incorrect reduction claim pursuant to regulations adopted by the commission.”]. By statute, only the local agency or school district may bring these claims, and the local entity must present and prove its claim that it is entitled to reimbursement. (See also, Cal. Code Regs., tit. 2, §§ 1185.1, et seq., which requires that the IRC contain a narrative that describes the alleged incorrect reductions, and be signed under penalty of perjury.)

<sup>105</sup> Exhibit A, IRC, page 95. Emphasis added.

<sup>106</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 33-34.

<sup>107</sup> California Code of Regulations, title 14, section 18720(a)(36). Another definition of MRF (in and limited to Pub. Res. Code, § 50000(a)(4)) is “a transfer station that is designed to, and, as a

Information in a CalRecycle report on landfill tipping fees indicates a *higher cost* to dispose of waste at a MRF (\$61 statewide average per ton) than in a landfill (\$45 per ton), probably due to higher costs to process and transport waste at a MRF.<sup>108</sup>

Although the claimant's annual reports identify tonnage diverted to the MRF in calendar years 2003, 2004, 2005, 2006 and 2007,<sup>109</sup> the claimant did not identify any costs incurred to divert waste to the MRF (which is expressly allowed as a reimbursable cost under Section IV.(B)(5) of

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condition of its permit, shall, recover for reuse or recycling at least 15 percent of the total volume of material received by the facility." MRF is also defined as "An intermediate processing facility that accepts source-separated recyclables from an initial collector and processes them for wholesale distribution. The recyclable material is accumulated for shipment to brokers or recycled content manufacturers, or for export out of state." See California Department of Resources Recycling and Recovery, "Landfill Tipping Fees in California" February 2015, page 44.

<sup>108</sup> Exhibit E, California Department of Resources Recycling and Recovery, "Landfill Tipping Fees in California" February 2015, pages 12-13. MRFs and transfer stations were treated together in the survey. According to the report (page 14):

Transfer stations charge a median fee of \$61 per ton for MSW [municipal solid waste], which is \$16 more per ton than the median that landfills charge for MSW. This higher fee may be a result of transportation costs as well as tipping fees incurred by the transfer station for final disposal at the landfill. The range of transfer station tipping fees, from \$0 to \$178, is higher than all other facility types surveyed. The maximum of the transfer station tipping fee data set is \$50 higher than any other facility. This suggests that transfer stations have additional costs that lead to higher tipping fees.

The report also states:

Most landfills have more than one tipping fee. They usually have a publicly posted fee for individuals or businesses "self-hauling" waste, but they also negotiate rates with solid waste haulers, cities, counties, and other facility operators. This is an important distinction because in California, only about 20 percent of disposal is self-hauled waste. The other 80 percent of disposal is transported to landfills by solid waste haulers and thus would be more likely to be subject to negotiated disposal rates. . . . Disposal tipping fees in California are as complex and varied as the state itself. Tipping fees vary due to the unique circumstances at each landfill, such as location, owner, size, proximity to other landfills, and other operational factors.

The range for tipping fees in the report was \$0 to \$125 per ton, with a \$45 per ton median. (*Id.*, page 3).

<sup>109</sup> Exhibit B, Controller's Late Comments on the IRC, pages 38, 40, 42, 44, and 46.

the Parameters and Guidelines);<sup>110</sup> nor has claimant identified any costs avoided if it had disposed of the waste in a landfill instead of a MRF.

Accordingly, the Commission finds that the claimant has not filed any evidence to rebut the statutory presumption of cost savings. Therefore, the Controller’s presumption of cost savings is correct as a matter of law.

C. For fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and fiscal years 2004-2005 through 2009-2010, the Controller’s calculation of cost savings is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

The Controller determined that for every year of the audit period except the first half of fiscal year 2003-2004, the claimant diverted more solid waste than the amount mandated by the test claim statute. Therefore, for those years where the claimant exceeded the mandate, the Controller allocated the actual diversion percentage based on the mandated diversion percentage to calculate offsetting savings. Instead of using 100 percent of the amount actually diverted, the Controller allocates the diversion rate, taking the percentage of solid waste required to be diverted (either 25 percent or 50 percent) divided by the actual percentage of solid waste diverted (as reported by the claimant to CIWMB). The resulting quotient is then multiplied by the tons of solid waste diverted (as annually reported by the claimant to the CIWMB), multiplied by the avoided landfill disposal fee (based on the statewide average fee).<sup>111</sup>

$$\begin{array}{rcccl}
 & \text{Allocated Diversion \%} & & & \\
 & \text{-----} & & & \\
 & \text{Maximum} & & & \text{Avoided} \\
 & \text{Allowable} & & & \text{Landfill} \\
 \text{Offsetting} & = & \frac{\text{Diversion \%}}{\text{Actual}} & \times & \text{Disposal Fee} \\
 \text{Savings} & & \text{Diversion \%} & \times & \text{(per Ton)} \\
 \text{Realized} & & & \times & \\
 & & \text{Tonnage} & & \\
 & & \text{Diverted} & & 
 \end{array}$$

The formula, for these years, works to allocate or reduce cost savings based on the mandated levels, and is intended to prevent penalizing the claimant for diverting more solid waste than the amount mandated by law.<sup>112</sup>

The claimant raises several arguments to assert that the Controller’s calculation of cost savings is incorrect. These arguments, however, are not supported by the law or evidence in the record.

<sup>110</sup> Exhibit A, IRC, pages 223 – 258 (reimbursement claims). See also page 91. The Parameters and Guidelines authorize reimbursement to: “Divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004, through source reduction, recycling, and composting activities.” Maintain the required level of reduction, as approved by the Board. (Pub. Resources Code, §§ 42921 & 42922 (i).)”

<sup>111</sup> Exhibit A, IRC, pages 33-35; Exhibit B, Controller’s Late Comments on the IRC, pages 19 and 20.

<sup>112</sup> Exhibit B, Controller’s Late Comments on the IRC, page 19.

The claimant first alleges that cost savings cannot be realized because the chain of events required by Public Contract Code sections 12167 and 12167.1 did not occur: that savings have to be converted to cash, and amounts in excess of \$2000 per year must be deposited in the state fund and appropriated back by the Legislature to mitigate the costs.<sup>113</sup> Because the Controller agrees that the claimant did not remit to the state any savings realized from the implementation of the IWM plan, this fact is undisputed.<sup>114</sup> However, as indicated above, cost savings are presumed by the statutes and the claimant has not filed evidence to rebut that presumption. Thus, based on the evidence in the record, the claimant should have deposited the cost savings into the state's account as required by the test claim statutes, but failed to do so. The claimant's failure to comply with the law does not make the Controller's calculations of cost savings incorrect as a matter of law, or arbitrary or capricious. Since cost savings are presumed by the statutes, the claimant has the burden to show increased costs mandated by the state. As the court determined, "[r]eimbursement is not available under section 6 and section 17514 to the extent that a local government or school district is able to provide the mandated program or increased level of service without actually incurring increased costs."<sup>115</sup>

The claimant next asserts that the Controller's formula is an underground regulation.<sup>116</sup> The Commission disagrees. Government Code section 11340.5 provides that no state agency shall enforce or attempt to enforce a rule or criterion which is a regulation, as defined in section 11342.600, unless it has been adopted pursuant to the Administrative Procedures Act. As indicated above, however, the formula is consistent with the statutory presumption of cost savings, as interpreted by the court for this program. Interpretations that arise in the course of case-specific adjudication are not regulations.<sup>117</sup>

The claimant also contends that using landfill fees in the calculation of offsetting savings is not relevant because "[t]he District did not claim landfill costs, so there are none to be offset."<sup>118</sup> The claimant's interpretation of the cost savings requirement is not correct. The cost of disposing waste at a landfill is not eligible for reimbursement. Reimbursement is authorized to *divert* solid waste from the landfill through source reduction, recycling, and composting activities.<sup>119</sup> As explained by the court:

In complying with the mandated solid waste diversion requirements of Public Resources Code section 42921, California Community Colleges are likely to experience cost savings in the form of reduced or avoided costs of landfill disposal. The reduced or avoided costs are a direct result and an integral part of the mandated IWM plan ....

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<sup>113</sup> Exhibit A, IRC, page 13.

<sup>114</sup> Exhibit B, Controller's Late Comments on the IRC, page 17.

<sup>115</sup> Exhibit B, Controller's Late Comments on the IRC, page 63 (Ruling on Submitted Matter).

<sup>116</sup> Exhibit A, IRC, page 14.

<sup>117</sup> *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 571.

<sup>118</sup> Exhibit A, IRC, page 17.

<sup>119</sup> Exhibit A, IRC, page 55 (Parameters and Guidelines).

Such reduction or avoidance of landfill fees and costs resulting from solid waste diversion activities under § 42920 et seq. represent savings which must be offset against the costs of the diversion activities to determine the reimbursable costs of IWM plan implementation -- i.e., the actual increased costs of diversion -- under section 6 and section 17514.<sup>120</sup>

The court also noted that diversion “means activities which reduce or eliminate the amount of solid waste from solid waste disposal.”<sup>121</sup>

In addition, the claimant argues that the formula assumes facts without evidence in the record. For example, the claimant questions the Controller’s assumption that the diversion percentage achieved in 2007 applies equally to subsequent years, that all diverted waste would have been disposed in a landfill, and that the statewide average cost to dispose of waste at a landfill actually applied to the claimant.<sup>122</sup> However, the Controller’s assumption is in fact supported by evidence in the record. The Controller applied the diversion percentage achieved in 2007 to subsequent years because the CIWMB stopped requiring community college districts to report the actual amount and percentage of tonnage diverted in 2008. As the Controller notes, the claimant’s diversion program was well-established by 2007, and the claimant’s reports of subsequent years reflect increased diversion. For example, the 2008 report notes that:

There has been *less waste disposed of* in 2008. We have been more proactive in increasing awareness of what materials can be recycled and therefore not placed in our solid waste stream. . . . [And in describing new programs for 2008] . . . we were able to obtain new collection containers for our Nevada County campus and we are able to comingle a lot of our recyclable materials. Also, *the types of materials acceptable for recycling was increased* at that campus.<sup>123</sup>

Likewise, the 2009 report states: “We have added many more recycling containers to help increase the recycled materials,”<sup>124</sup> and “*There was a decrease in the per capita disposal.*”<sup>125</sup> Additionally, the 2010 report states, in response to a question about changes in waste reduction programs during the report year: “*We are now composting the grass clippings.*”<sup>126</sup> Thus, there is evidence in the record that for 2008-2010 claimant exceeded the diversion rates recorded in 2007.

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<sup>120</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 63-64 (Ruling on Submitted Matter).

<sup>121</sup> Exhibit B, Controller’s Late Comments on the IRC, page 63 (Ruling on Submitted Matter).

<sup>122</sup> Exhibit A, IRC, pages 15-16.

<sup>123</sup> Exhibit B, Controller’s Late Comments on the IRC, page 48, emphasis added.

<sup>124</sup> Exhibit B, Controller’s Late Comments on the IRC, page 50.

<sup>125</sup> Exhibit B, Controller’s Late Comments on the IRC, page 51, emphasis added.

<sup>126</sup> Exhibit B, Controller’s Late Comments on the IRC, page 53, emphasis added.

The Controller obtained the statewide average cost for landfill disposal fees from the CIWMB, which was based on private surveys of a large percentage of landfills across California.<sup>127</sup> The Controller's audit report indicates that the claimant did not provide documentation to support a different disposal fee.<sup>128</sup> In addition, the Controller states:

The district did not provide any information, such as its contract with or invoices received from its commercial waste hauler, to support either the landfill fees actually incurred by the district or to confirm that the statewide average landfill fee was greater than the actual landfill fees incurred by the district.<sup>129</sup>

On these audit issues, the Commission may not reweigh the evidence or substitute its judgment for that of the Controller. The Commission must only ensure that the Controller's decision is not arbitrary, capricious, or entirely lacking in evidentiary support, but adequately considered all relevant factors.<sup>130</sup> There is no evidence that the Controller's assumptions are wrong or arbitrary or capricious with regard to the statewide average landfill fee.

The claimant also points to the Controller's audits of other community college districts, arguing that the costs allowed by the Controller in those cases vary and are arbitrary.<sup>131</sup> The Controller's audits of other community college district reimbursement claims are not relevant to the Controller's audit here. Each audit depends on the documentation and evidence provided by the claimant to show increased costs mandated by the state.

Accordingly, the Controller's calculation of cost savings for fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and fiscal years 2004-2005 through 2009-2010 is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

D. The Controller's finding that the claimant's diversion of solid waste for the first half of fiscal year 2003-2004 did not achieve the mandated diversion percentage, and its recalculation of cost savings for that time period using 100 percent of diversion reported by the claimant, rather than the allocated diversion percentage used for all other fiscal years in the audit period, is incorrect as a matter of law and is arbitrary, capricious, and entirely lacking in evidentiary support.

The Controller found that the claimant did not achieve the mandated "50 percent" diversion in the first half of fiscal year 2003-2004. Therefore, the Controller did not allocate the diversion percentage to reflect the mandate, but used 100 percent of the diversion reported by the claimant to calculate offsetting savings, which resulted in a reduction of \$7,513 for this time period (204

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<sup>127</sup> Exhibit B, Controller's Late Comments on the IRC, page 21-22.

<sup>128</sup> Exhibit A, IRC, page 34.

<sup>129</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>130</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>131</sup> Exhibit A, IRC, pages 17-18.

tons of diverted waste multiplied by the avoided statewide average landfill disposal fee of \$36.83).<sup>132</sup>

As indicated in the Parameters and Guidelines, the mandate is to divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004, through source reduction, recycling, and composting activities.<sup>133</sup> Thus, from July 1, 2003, through December 31, 2003, community college districts were mandated to achieve diversion levels of only 25 percent. The Controller's comments admit that "as there is no state mandate to exceed solid waste diversion for amounts in excess of 25% for calendar years 2000 through 2003 or 50% for calendar year 2004 and later, there is no basis for calculating offsetting savings realized for actual diversion percentages that exceed the levels set by statute."<sup>134</sup>

However, the Controller's calculation of cost savings incorrectly applied a 50 percent diversion level to July 1, 2003, through December 31, 2003, instead of the mandated 25 percent diversion level.<sup>135</sup> The claimant's 2003 report to the CIWMB shows a diversion percentage of 45.6 percent, and the Controller's calculation for July 1, 2003, through December 31, 2003 shows "the actual diversion percentage" of 45.59 percent.<sup>136</sup> This percentage not only achieves, but *exceeds* the mandated diversion level of 25 percent. Therefore, the Controller's finding that the claimant's diversion of solid waste for the first half of fiscal year 2003-2004 did not achieve the mandated diversion percentage is incorrect as a matter of law.

Moreover, the Controller's calculation of offsetting savings, which did not reduce cost savings by allocating the diversion percentage to reflect the mandate as it did for other years when the claimant exceeded the mandate, is arbitrary, capricious, and entirely lacking in evidentiary support.

In comments on the Draft Proposed Decision, the Controller disagrees with this finding and argues, for the first time, that:

For the first half of FY 2003-2004, we agree that the district diverted 45.59% of its solid waste, which is above the mandated level of 25%. However, there is no evidence in its FY 2003-2004 mandated cost claim that the district pro-rated the direct costs to claim only 54.84% (25% ÷ 45.59%) of the total diversion costs incurred. In fact, on its FY 2003-2004 Form IWM-2, the district reported time for "diverting solid waste from landfill disposal or transformation facilities - source reduction/recycling/composting" (Exhibit D, page 230). No proration or allocation was noted. Based on the information provided in the claim, we believe the district claimed 100% of the direct cost incurred to perform the

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<sup>132</sup> Exhibit A, IRC, page 31, footnote 2 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 71.

<sup>133</sup> Exhibit A, IRC, page 91 (Parameters and Guidelines). This is based on Public Resources Code sections 42921.

<sup>134</sup> Exhibit B, Controller's Late Comments on the IRC, page 19.

<sup>135</sup> Exhibit B, Controller's Late Comments on the IRC, page 71.

<sup>136</sup> Exhibit B, Controller's Late Comments on the IRC, pages 37 and 71.

mandated activities. Therefore, we believe the correlated offsetting savings should also be calculated at 100% of the actual diversion rate of 45.59%, totaling \$7,513.<sup>137</sup>

However, the deadline to complete the audit or give new reasons for reductions has long past.

Additionally, the Controller's position is not supported by the Parameters and Guidelines or the record. Although the Controller is correct that there is no evidence that the claimant prorated or allocated the direct costs claimed for the first half of fiscal year 2003-2004, there is no evidence that the claimant did so for any other years in the audit period.<sup>138</sup> Nor is there a specific requirement in the Parameters and Guidelines to prorate. The Parameters and Guidelines require claimants to report in their reimbursement claims all costs incurred to comply with the reimbursable activities (which includes the activities and costs to divert at least 25 or 50 percent of all solid waste from landfill disposal) and the cost savings from the avoided landfill disposal fees, to claim the net increased costs.<sup>139</sup> It is presumed that the reimbursement claim, filed under penalty of perjury, claimed only those direct costs mandated by the state, absent any finding by the Controller in the audit to the contrary. And here, there is no indication in the audit report that direct costs were over claimed, nor was over claiming of direct costs the reason given for the reduction. There is no evidence in the record to conclude that the calculation of offsetting savings for the first half of fiscal year 2003-2004 should be treated differently than the other fiscal years in the audit period.

Therefore, applying the Controller's formula for the calculation of cost savings (for years when the claimant exceeds the mandate) to the first half of fiscal year 2003-2004, results in a finding of offsetting costs savings of \$4,120, rather than \$7,513 (25 percent divided by 45.59 percent, multiplied by 204 tons diverted, multiplied by the avoided statewide average landfill disposal fee of \$36.83). Thus, the difference of \$3,393 has been incorrectly reduced.<sup>140</sup>

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<sup>137</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision, pages 1-2.

<sup>138</sup> For all of fiscal year 2003-2004, the claimant claimed costs for "Development of Policies and Procedures (\$47.69) Staff Training (\$333.83), Completion and Submission of Plan to the Board (\$286.14), Designation of Waste Reduction and Recycling Coordinator (\$2,336.81), Diversion and Maintenance of Approved Level of Reduction (\$14,431.43), Accounting System (\$619.97), Annual Recycled Material Reports (\$524.59) and Indirect Costs (\$6,276.85) for a total of \$24,857.31, with no indication that these amounts were prorated. Claimant did not subtract offsetting savings from its claims. Exhibit A, IRC, page 225, (Reimbursement Claim for 2003-2004). The other reimbursement claims were similarly prepared. Exhibit A, IRC, pages 205-212 (Reimbursement Claim for 1999-2000), 214-222 (Reimbursement Claim for 2000-2001), 234-242 (Reimbursement Claim for 2004-2005), 244-249 (Reimbursement Claim for 2005-2006), 251-258 (Reimbursement Claim for 2006-2007), 260-267 (Reimbursement Claim for 2007-2008), 269-277 (Reimbursement Claim for 2008-2009), 279-287 (Reimbursement Claim for 2009-2010).

<sup>139</sup> Exhibit A, IRC, page 54 (Parameters and Guidelines).

<sup>140</sup> Exhibit B, Controller's Late Comments on the IRC, pages 37 and 71.



Accordingly, the Commission finds that the reduction of costs for the first half of fiscal year 2003-2004 based on a 45.59 percent, rather than a 25 percent, diversion rate is incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support.

## **V. Conclusion**

Based on the foregoing, the Commission concludes that the Controller's reduction of costs claimed for fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and fiscal years 2004-2005 through 2009-2010 is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

The Commission further concludes that the Controller's reduction of costs claimed for the first half of fiscal year 2003-2004 based on a 45.59 percent, rather than a 25 percent, diversion rate is incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support. The law and the record support offsetting cost savings for the first half of fiscal year 2003-2004 of \$4,120, rather than \$7,513, and that the difference of \$3,393 has been incorrectly reduced and should be reinstated to claimant.

Accordingly, the Commission partially approves this IRC and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, that the Controller reinstate \$3,393 to the claimant.



RE: **Decision**

*Integrated Waste Management*, 13-0007-I-02

Public Resources Code Section 40418, 40196.3, 42920-42928;

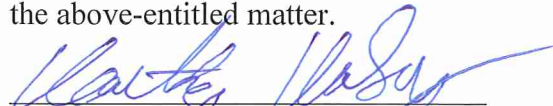
Public Contract Code Section 12167 and 12167.1

Statutes 1992, Chapter 1116 (AB 3521); Statutes 1999, Chapter 764 (AB 75)

Fiscal Years: 1999-2000, 2000-2001, 2003-2004, 2004-2005, 2005-2006, 2006-2007,  
2007-2008, 2008-2009, and 2009-2010

Sierra Joint Community College District, Claimant

On July 28, 2017, the foregoing Decision of the Commission on State Mandates was adopted on the above-entitled matter.

  
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Heather Halsey, Executive Director

Dated: August 1, 2017

BEFORE THE  
COMMISSION ON STATE MANDATES  
STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM  
ON:**

Public Resources Code Sections 40148, 40196.3, 42920-42928; Public Contract Code Sections 12167 and 12167.1; Statutes 1992, Chapter 1116 (AB 3251); Statutes 1999, Chapter 764 (AB 75); State Agency Model Integrated Waste Management Plan (February 2000)

Fiscal Years 1999-2000, 2000-2001, 2003-2004, 2004-2005, 2005-2006, 2006-2007, 2007-2008, 2008-2009, 2009-2010 and 2010-2011

Gavilan Joint Community College District,  
Claimant

Case No.: 14-0007-I-04

*Integrated Waste Management*

DECISION PURSUANT TO  
GOVERNMENT CODE SECTION  
17500 ET SEQ.; CALIFORNIA CODE OF  
REGULATIONS, TITLE 2, DIVISION 2,  
CHAPTER 2.5, ARTICLE 7

*(Adopted September 22, 2017)*

*(Served September 26, 2017)*

**DECISION**

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on September 22, 2017. Claimant, Gavilan Joint Community College District, did not attend the hearing. Lisa Kurokawa appeared for the State Controller’s Office (Controller).

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

The Commission adopted the Proposed Decision to partially approve the IRC by a vote of 7-0 as follows:

<b>Member</b>	<b>Vote</b>
Lee Adams, County Supervisor	Yes
Richard Chivaro, Representative of the State Controller, Vice Chairperson	Yes
Mark Hariri, Representative of the State Treasurer	Yes
Scott Morgan, Representative of the Director of the Office of Planning and Research	Yes
Sarah Olsen, Public Member	Yes
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	Yes
Carmen Ramirez, City Council Member	Yes

## **Summary of the Findings**

This IRC addresses reductions made by the Controller to reimbursement claims of the Gavilan Joint Community College District (claimant) for fiscal years 1999-2000, 2000-2001, and 2003-2004 through 2010-2011, under the *Integrated Waste Management* program, 00-TC-07. The Controller made the audit reductions because the claimant did not identify and deduct from its reimbursement claims offsetting cost savings from its diversion of solid waste and the associated reduced or avoided landfill disposal costs.

The Commission finds that the Controller timely initiated the audit of the fiscal year 2000-2001 reimbursement claim and timely completed the audit for all claims pursuant to Government Code section 17558.5. Government Code section 17558.5(a) tolls the time to initiate the audit to three years from the date of initial payment on the claim, rather three years from the date the claim was filed, “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 record shows that payment on the 2000-2001 reimbursement claim was first made by the Controller on either January 18, 2011,<sup>1</sup> or January 28, 2011,<sup>2</sup> within three years of the date the audit was initiated on January 17, 2014. Thus, the audit was timely initiated. The audit was complete for all reimbursement claims when the final audit report was issued April 11, 2014,<sup>3</sup> well before the two-year deadline of January 17, 2016.

On the merits, the Commission finds that the audit reductions are partially correct. The Controller correctly presumed, consistent with the test claim statutes and the court’s interpretation of those statutes, and without any evidence to the contrary, that the claimant realized cost savings during the audit period equal to the avoided landfill disposal fee per ton of waste required to be diverted.

The Commission further finds, based on the evidence in the record, that the Controller’s calculation of offsetting cost savings for fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and fiscal years 2004-2005 through 2010-2011, is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support. Because the claimant exceeded the mandate and diverted more solid waste than required by law, the Controller’s cost savings formula “allocated” the diversion percentage by dividing the percentage of solid waste required to be diverted, either 25 or 50 percent, by the actual percentage of solid waste diverted, as reported by the claimant to the California Integrated Waste Management Board (CIWMB). The resulting quotient was then multiplied by the tons of solid waste diverted, as annually reported by the claimant to CIWMB, multiplied by the avoided landfill disposal fee (based on the statewide average fee).<sup>4</sup> The formula allocates cost savings based on the mandated rates of diversion, and was intended to prevent penalizing the claimant

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<sup>1</sup> Exhibit A, IRC, page 292.

<sup>2</sup> Exhibit B, Controller’s Late Comments on the IRC, page 36.

<sup>3</sup> Exhibit A, IRC, page 24 (Final Audit Report).

<sup>4</sup> Exhibit A, IRC, pages 33-35 (Final Audit Report); Exhibit B, Controller’s Late Comments on the IRC, page 21.

for diverting more solid waste than the amount mandated by law.<sup>5</sup> The claimant has not filed any evidence to rebut the statutory presumption of cost savings or to show that the statewide average disposal fee is incorrect or arbitrary. Thus, the Controller's reduction of costs claimed for these fiscal years is correct.

However, the Controller's reduction of costs claimed for the first half of fiscal year 2003-2004 is incorrect as a matter of law because the Controller calculated offsetting savings using an incorrect required diversion rate. During this period, the claimant achieved an actual diversion percentage of 75.43 percent.<sup>6</sup> The Controller allocated the diversion rate for the first half of fiscal year 2003-2004, as it had done for the other fiscal years, because the claimant exceeded the mandate. However, the Controller used a 50 percent rate to calculate the allocated diversion rate, although the test claim statutes required only 25 percent diversion in calendar year 2003. The requirement to divert 50 percent of solid waste did not become operative until January 1, 2004.<sup>7</sup> Applying the Controller's calculation of cost savings (using 25 percent to calculate the allocated diversion rate) to the first half of fiscal year 2003-2004, results in offsetting costs savings of \$3,822 (25 percent mandated diversion rate divided by 75.43 percent actual diversion rate equals a 33.14 percent allocated rate, multiplied by 313.1 tons diverted, multiplied by the avoided statewide average landfill disposal fee of \$36.83),<sup>8</sup> rather than the \$7,644 calculated by the Controller using a 50 percent diversion rate.

Accordingly, the Commission finds that the law and the record support offsetting cost savings for the first half of fiscal year 2003-2004 of \$3,822, rather than \$7,644, and that the difference of \$3,822 has been incorrectly reduced.

Therefore, the Commission partially approves this IRC, and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, that the Controller reinstate \$3,822 to the claimant.

## COMMISSION FINDINGS

### I. Chronology

- 10/06/2005 The claimant filed its 1999-2000, 2000-2001, 2003-2004, and 2004-2005 reimbursement claims.<sup>9</sup>
- 12/27/2006 The claimant filed its 2005-2006 reimbursement claim.<sup>10</sup>
- 01/22/2008 The claimant filed its 2006-2007 reimbursement claim.<sup>11</sup>

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<sup>5</sup> Exhibit B, Controller's Late Comments on the IRC, page 21.

<sup>6</sup> Exhibit B, Controller's Late Comments on the IRC, page 77.

<sup>7</sup> Public Resources Code sections 42921; Exhibit A, IRC, page 43 (Parameters and Guidelines, adopted March 30, 2005).

<sup>8</sup> Exhibit B, Controller's Late Comments on the IRC, page 77.

<sup>9</sup> Exhibit A, IRC, pages 224, 230, 237, and 244.

<sup>10</sup> Exhibit A, IRC, page 251.

<sup>11</sup> Exhibit A, IRC, page 258.

02/17/2009 The claimant filed its 2007-2008 reimbursement claim.<sup>12</sup>  
12/18/2009 The claimant filed its 2008-2009 reimbursement claim.<sup>13</sup>  
02/15/2011 The claimant filed its 2009-2010 reimbursement claim.<sup>14</sup>  
01/18/2011 The Controller issued a letter to the claimant for 2000-2001, indicating that payment was made for 2000-2001 on this date.<sup>15</sup>  
01/28/2011 Payment issue date for 2000-2001, according to Controller's remittance advice and apportionment report.<sup>16</sup>  
02/14/2012 The claimant filed its 2010-2011 reimbursement claim.<sup>17</sup>  
01/17/2014 The claimant was notified of the audit.<sup>18</sup>  
04/11/2014 The Controller issued the Final Audit Report.<sup>19</sup>  
07/14/2014 The claimant filed this IRC.<sup>20</sup>  
04/18/2016 The Controller filed late comments on the IRC.<sup>21</sup>  
07/14/2017 Commission staff issued the Draft Proposed Decision.<sup>22</sup>  
07/28/2017 The Controller filed comments agreeing with the Draft Proposed Decision.<sup>23</sup>

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<sup>12</sup> Exhibit A, IRC, page 264.

<sup>13</sup> Exhibit A, IRC, page 270.

<sup>14</sup> Exhibit A, IRC, page 277.

<sup>15</sup> Exhibit A, IRC, page 292 (Letter from the Controller to the claimant).

<sup>16</sup> Exhibit B, Controller's Late Comments on the IRC, pages 36 and 38 (Remittance Advice and Apportionment Report).

<sup>17</sup> Exhibit A, IRC, page 284.

<sup>18</sup> Exhibit B, Controller's Late Comments on the IRC, pages 12, 34; see also Exhibit A, IRC, page 33 (Final Audit Report).

<sup>19</sup> Exhibit A, IRC, page 24 (Final Audit Report).

<sup>20</sup> Exhibit A, IRC.

<sup>21</sup> Exhibit B, Controller's Late Comments on the IRC. Note that Government Code section 17553(d) states: "the Controller shall have no more than 90 days after the claim is delivered or mailed to file any rebuttal to an incorrect reduction claim. The failure of the Controller to file a rebuttal to an incorrect reduction claim shall not serve to delay the consideration of the claim by the Commission." However, in this instance, due to the backlog of IRCs, these late comments have not delayed consideration of this item and so have been included in the analysis and Proposed Decision.

<sup>22</sup> Exhibit C, Draft Proposed Decision.

<sup>23</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.

## II. Background

### A. The *Integrated Waste Management Program*

The test claim statutes require community college districts<sup>24</sup> to adopt and implement, in consultation with CIWMB (which is now the California Department of Resources Recycling and Recovery, or CalRecycle), integrated waste management (IWM) plans to reduce solid waste, reuse materials whenever possible, recycle recyclable materials, and procure products with recycled content in all agency offices and facilities.<sup>25</sup> To implement their plans, districts must divert from landfill disposal at least 25 percent of generated solid waste by January 1, 2002, and at least 50 percent by January 1, 2004. To divert means to “reduce or eliminate the amount of solid waste from solid waste disposal...”<sup>26</sup>

CIWMB developed and adopted a model IWM plan on February 15, 2000, and the test claim statutes provide that if a district does not adopt an IWM plan, the CIWMB model plan governs the community college.<sup>27</sup> Each district is also required to report annually to CIWMB on its progress in reducing solid waste; and the reports’ minimum contents are specified in statute.<sup>28</sup> The test claim statutes also require a community college, when entering into or renewing a lease, to ensure that adequate areas are provided for and adequate personnel are available to oversee collection, storage, and loading of recyclable materials in compliance with CIWMB’s requirements.<sup>29</sup> Additionally, the test claim statutes added Public Resources Code section 42925(a), which addressed cost savings from IWM plan implementation:

Any cost savings realized as a result of the state agency integrated waste management plan shall, to the extent feasible, be redirected to the agency’s integrated waste management plan to fund plan implementation and administration costs, in accordance with Sections 12167 and 12167.1 of the Public Contract Code.

The Public Contract Code sections referenced in section 42925(a) require that revenue received as a result of the community college’s IWM plan be deposited in CIWMB’s Integrated Waste Management Account. After July 1, 1994, CIWMB is authorized to spend the revenue upon appropriation by the Legislature to offset recycling program costs. Annual revenue under \$2,000 is to be continuously appropriated for expenditure by the community colleges, whereas annual revenue over \$2,000 is available for expenditures upon appropriation by the Legislature.<sup>30</sup>

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<sup>24</sup> The test claim statutes apply to “state agencies” and define them to include “the California Community Colleges” (Pub. Res. Code, § 40196.3).

<sup>25</sup> Public Resources Code section 42920(b).

<sup>26</sup> Public Resources Code section 40124.

<sup>27</sup> Public Resources Code section 42920(b)(3).

<sup>28</sup> Public Resources Code section 42926.

<sup>29</sup> Public Resources Code section 42924(b).

<sup>30</sup> Public Contract Code sections 12167 and 12167.1 are part of the State Assistance for Recycling Markets Act, which was originally enacted in 1989 to foster the procurement and use of recycled paper products and other recycled resources in daily state operations (See Pub.

On March 24, 2004, the Commission adopted the *Integrated Waste Management* Statement of Decision and determined that the test claim statutes impose a reimbursable state-mandated program on community college districts. The Commission also found that cost savings under Public Resources Code section 42925(a) did not preclude a reimbursable mandate under Government Code section 17556(e) because there was no evidence that offsetting savings would result in no net costs to a community college implementing an IWM plan, nor was there evidence that revenues received from plan implementation would be "in an amount sufficient to fund" the cost of the state-mandated program. The Commission found that any revenues received would be identified as offsetting revenue in the Parameters and Guidelines.

The Parameters and Guidelines were adopted on March 30, 2005, and authorize reimbursement for the increased costs to perform the following activities:

A. One-Time Activities (*Reimbursable starting January 1, 2000*)

1. Develop the necessary district policies and procedures for the implementation of the integrated waste management plan.
2. Train district staff on the requirements and implementation of the integrated waste management plan (one-time per employee). Training is limited to the staff working directly on the plan.

B. Ongoing Activities (*Reimbursable starting January 1, 2000*)

1. Complete and submit to the [Integrated Waste Management] Board the following as part of the State Agency Model Integrated Waste Management Plan (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.):
  - a. state agency or large state facility information form;
  - b. state agency list of facilities;
  - c. state agency waste reduction and recycling program worksheets that describe program activities, promotional programs, and procurement activities, and other questionnaires; and
  - d. state agency integrated waste management plan questions.

NOTE: Although reporting on promotional programs and procurement activities in the model plan is reimbursable, implementing promotional programs and procurement activities is not.

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Contract Code, §§ 12153, 12160; Stats. 1989, ch. 1094). The Act, including sections 12167 and 12167.1, applies to California community colleges only to the limited extent that these sections are referenced in Public Resources Code section 42925. Community colleges are not defined as state agencies or otherwise subject to the Act's provisions for the procurement and use of recycled products in daily state operations. See Exhibit B, Controller's Late Comments on the IRC, page 105 (*State of California, Department of Finance, California Integrated Waste Management Board v. Commission on State Mandates, et al.* (Sacramento County Superior Court, Case No. 07CS00355)).



2. Respond to any Board reporting requirements during the approval process. (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.)
3. Consult with the Board to revise the model plan, if necessary. (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.)
4. Designate one solid waste reduction and recycling coordinator for each college in the district to perform new duties imposed by chapter 18.5 (Pub. Resources Code, §§ 42920 – 42928). The coordinator shall implement the integrated waste management plan. The coordinator shall act as a liaison to other state agencies (as defined by section 40196.3) and coordinators. (Pub. Resources Code, § 42920, subd. (c).)
5. Divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004, through source reduction, recycling, and composting activities. Maintain the required level of reduction, as approved by the Board. (Pub. Resources Code, §§ 42921 & 42922, subd. (i).)

C. Alternative Compliance (*Reimbursable from January 1, 2000 – December 31, 2005*)

1. Seek either an alternative requirement or time extension if a community college is unable to comply with the January 1, 2002 deadline to divert 25 percent of its solid waste, by doing the following: (Pub. Resources Code, §§ 42927 & 42923 subds. (a) & (c).)
  - a. Notify the Board in writing, detailing the reasons for its inability to comply.
  - b. Request of the Board an alternative to the January 1, 2002 deadline.
  - c. Provide evidence to the Board that the college is making a good faith effort to implement the source reduction, recycling, and composting programs identified in its integrated waste management plan.
  - d. Provide information that describes the relevant circumstances that contributed to the request for extension, such as lack of markets for recycled materials, local efforts to implement source reduction, recycling and composting programs, facilities built or planned, waste disposal patterns, and the type of waste disposed of by the community college.
  - e. Submit a plan of correction that demonstrates that the college will meet the requirements of Section 42921 [the 25 and 50 percent diversion requirements] before the time extension expires, including the source reduction, recycling, or composting steps the community college will implement, a date prior to the expiration of the time extension when the requirements of Section 42921 will be met, the

existing programs that it will modify, any new programs that will be implemented to meet those requirements, and the means by which these programs will be funded.

2. Seek either an alternative requirement or time extension if a community college is unable to comply with the January 1, 2004 deadline to divert 50 percent of its solid waste, by doing the following: (Pub. Resources Code, §§ 42927 & 42922, subds. (a) & (b).)
  - a. Notify the Board in writing, detailing the reasons for its inability to comply.
  - b. Request of the Board an alternative to the 50-percent requirement.
  - c. Participate in a public hearing on its alternative requirement.
  - d. Provide the Board with information as to:
    - (i) the community college's good faith efforts to implement the source reduction, recycling, and composting measures described in its integrated waste management plan, and demonstration of its progress toward meeting the alternative requirement as described in its annual reports to the Board;
    - (ii) the community college's inability to meet the 50 percent diversion requirement despite implementing the measures in its plan;
    - (iii) how the alternative source reduction, recycling, and composting requirement represents the greatest diversion amount that the community college may reasonably and feasibly achieve; and,
    - (iv) the circumstances that support the request for an alternative requirement, such as waste disposal patterns and the types of waste disposed by the community college.<sup>31</sup>

D. Accounting System (*Reimbursable starting January 1, 2000*)

Developing, implementing, and maintaining an accounting system to enter and track the college's source reduction, recycling and composting activities, the cost of those activities, the proceeds from the sale of any recycled materials, and such other accounting systems which will allow it to make its annual reports to the state and determine waste reduction. Note: only the pro-rata portion of the costs incurred to implement the reimbursable activities can be claimed.

E. Annual Report (*Reimbursable starting January 1, 2000*)

Annually prepare and submit, by April 1, 2002, and by April 1 each subsequent year, a report to the Board summarizing its progress in reducing

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<sup>31</sup> These alternative compliance and time extension provisions in part C were sunset on January 1, 2006, but were included in the adopted Parameters and Guidelines.

solid waste. The information in the report must encompass the previous calendar year and shall contain, at a minimum, the following as outlined in section 42926, subdivision (b): (Pub. Resources Code, §§ 42926, subd. (a) & 42922, subd. (i).)

1. calculations of annual disposal reduction;
2. information on the changes in waste generated or disposed of due to increases or decreases in employees, economics, or other factors;
3. a summary of progress made in implementing the integrated waste management plan;
4. the extent to which the community college intends to use programs or facilities established by the local agency for handling, diversion, and disposal of solid waste (If the college does not intend to use those established programs or facilities, it must identify sufficient disposal capacity for solid waste that is not source reduced, recycled or composted.);
5. for a community college that has been granted a time extension by the Board, it shall include a summary of progress made in meeting the integrated waste management plan implementation schedule pursuant to section 42921, subdivision (b), and complying with the college's plan of correction, before the expiration of the time extension;
6. for a community college that has been granted an alternative source reduction, recycling, and composting requirement by the Board pursuant to section 42922, it shall include a summary of progress made towards meeting the alternative requirement as well as an explanation of current circumstances that support the continuation of the alternative requirement.

F. Annual Recycled Material Reports (*Reimbursable starting July 1, 1999*)

Annually report to the Board on quantities of recyclable materials collected for recycling. (Pub. Contract Code, § 12167.1.) (See Section VII. regarding offsetting revenues from recyclable materials.)

The Parameters and Guidelines further require that each claimed reimbursable cost be supported by contemporaneous source documentation.<sup>32</sup>

And as originally adopted, the Parameters and Guidelines required community college districts to identify and deduct from their reimbursement claims all of the offsetting revenues received from the sale of recyclable materials, limited by the provisions of Public Resources Code section 42925 and Public Contract Code section 12167.1. The original Parameters and Guidelines did not require community colleges to identify and deduct from their claims any offsetting cost savings resulting from the solid waste diversion activities required by the test claim statutes.<sup>33</sup>

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<sup>32</sup> Exhibit A, IRC, page 41 (Parameters and Guidelines, adopted March 30, 2005).

<sup>33</sup> Exhibit A, IRC, page 41-47 (Parameters and Guidelines, adopted March 30, 2005).

## B. Superior Court Decision on Cost Savings and Offsets Under the Program

After the Parameters and Guidelines were adopted, the Department of Finance (Finance) and CIWMB filed a petition for a writ of mandate requesting the court to direct the Commission to set aside the Test Claim Statement of Decision and Parameters and Guidelines and to issue a new Decision and Parameters and Guidelines that give full consideration to the cost savings and offsetting revenues community college districts will achieve by complying with the test claim statutes, including all cost savings realized from avoided landfill disposal fees and revenues received from the collection and sale of recyclable materials. The petitioners further argued that Public Contract Code sections 12167 and 12167.1 do not require community college districts to deposit revenues received from the collection and sale of recyclable materials into the Integrated Waste Management Account, as determined by the Commission, but instead allow community college districts to retain all revenues received. The petitioners argued that such revenues must be identified as offsetting revenues and applied to the costs of the program, without the community college district obtaining the approval of the Legislature or CIWMB.

On May 29, 2008, the Sacramento County Superior Court granted the petition for writ of mandate, finding that the Commission's treatment of cost savings and revenues in the Parameters and Guidelines was erroneous and required that the Parameters and Guidelines be amended. The court said:

There is no indication in the administrative record or in the legal authorities provided to the court that, as respondent [Commission] argues, a California Community College might not receive the full reimbursement of its actual increased costs required by section 6 if its claims for reimbursement of IWM plan costs were offset by realized cost savings and all revenues received from the plan activities.<sup>34</sup>

Instead, the court recognized that community colleges are "*likely* to experience costs savings in the form of reduced or avoided costs of landfill disposal" as a result of the mandated activities in Public Resources Code section 42921 because reduced or avoided costs "are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided."<sup>35</sup> The court noted that "diversion is defined in terms of landfill disposal for purposes of the IWM plan mandates" and cited the statutory definition of diversion: "activities which reduce or eliminate the amount of solid waste from solid waste disposal for purposes of this division [i.e., division 30, including § 42920 et seq.]" as well as the statutory definition of disposal: "the management of solid waste through landfill disposal or transformation at a permitted solid waste facility."<sup>36</sup> The court explained that:

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<sup>34</sup> Exhibit B, Controller's Late Comments on the IRC, page 63 (Ruling on Submitted Matter).

<sup>35</sup> Exhibit B, Controller's Late Comments on the IRC, page 63 (Ruling on Submitted Matter). Emphasis added.

<sup>36</sup> Exhibit B, Controller's Late Comments on the IRC, pages 63-64 (Ruling on Submitted Matter).

[R]eduction or avoidance of landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs of the IWM plan implementation . . . The amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(1) of Public Resources Code section 42926.<sup>37</sup>

The court harmonized section 42925(a) with Public Contract Code sections 12167 and 12167.1:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs “in accordance with Sections 12167 and 12167.1 of the Public Contract Code,” section 42925 assures that cost savings realized from state agencies’ IWM plans are handled in a manner consistent with the handling of revenues received from state agencies’ recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>38</sup>

The court issued a writ of mandate directing the Commission to amend the Parameters and Guidelines to require community college districts claiming reimbursable costs of an integrated waste management plan to:

1. Identify and offset from their claims, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1, cost savings realized as a result of implementing their plans; and

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<sup>37</sup> Exhibit B, Controller’s Late Comments on the IRC, page 64 (Ruling on Submitted Matter). Emphasis added.

<sup>38</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 65-66 (Ruling on Submitted Matter).

2. Identify and offset from their claims all of the revenue generated as a result of implementing their plans, without regard to the limitations or conditions described in sections 12167 and 12167.1 of the Public Contract Code.<sup>39</sup>

### C. Parameters and Guidelines Amendment Pursuant to the Writ

In compliance with the writ, the Commission amended the Parameters and Guidelines on September 26, 2008 to add section VIII. Offsetting Cost Savings, which states:

Reduced or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans shall be identified and offset from this claim as cost savings, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1. Pursuant to these statutes, community college districts are required to deposit cost savings resulting from their Integrated Waste Management plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the California Integrated Waste Management Board for the purpose of offsetting Integrated Waste Management plan costs. Subject to the approval of the California Integrated Waste Management Board, cost savings by a community college that do not exceed two thousand dollars (\$2,000) annually are continuously appropriated for expenditure by the community college for the purpose of offsetting Integrated Waste Management program costs. Cost savings exceeding two thousand dollars (\$2,000) annually may be available for expenditure by the community college only when appropriated by the Legislature. To the extent so approved or appropriated and applied to the college, these amounts shall be identified and offset from the costs claimed for implementing the Integrated Waste Management Plan.<sup>40</sup>

Section VII. of the Parameters and Guidelines, on Offsetting Revenues, was amended as follows (amendments in ~~strikeout~~ and underline):

Reimbursement for this mandate from any source, including but not limited to, services fees collected, federal funds, and other state funds allocated to any service provided under this program, shall be identified and ~~deducted~~ offset from this claim. Offsetting revenue shall include all revenues generated from implementing the Integrated Waste Management Plan. ~~the revenues cited in Public Resources Code section 42925 and Public Contract Code sections 12167 and 12167.1.~~

~~Subject to the approval of the California Integrated Waste Management Board, revenues derived from the sale of recyclable materials by a community college that do not exceed two thousand dollars (\$2,000) annually are continuously appropriated for expenditure by the community college for the purpose of~~

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<sup>39</sup> Exhibit B, Controller's Late Comments on the IRC, page 31 (Judgment Granting Petition for Writ of Administrative Mandamus).

<sup>40</sup> Exhibit A, IRC page 59 (Amended Parameters and Guidelines, adopted Sept. 26, 2008).

~~offsetting recycling program costs. Revenues exceeding two thousand dollars (\$2,000) annually may be available for expenditure by the community college only when appropriated by the Legislature. To the extent so approved or appropriated and applied to the college, these amounts are a reduction to the recycling costs mandated by the state to implement Statutes 1999, chapter 764.~~

In addition, revenue from a building-operating fee imposed pursuant to Education Code section 76375, subdivision (a) if received by a claimant and the revenue is applied to this program, shall be deducted from the costs claimed.<sup>41</sup>

All other requirements in the Parameters and Guidelines remained the same.

CIWMB requested additional amendments to the Parameters and Guidelines at this September 2008 hearing, including a request to alter the offsetting savings provision to require community college districts to provide offsetting savings information *whether or not* the offsetting savings generated in a fiscal year exceeded the \$2,000 continuous appropriation required by Public Contract Code sections 12167 and 12167.1. The Commission denied the request because the proposed language went beyond the scope of the court's judgment and writ.<sup>42</sup> As the court found:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs "in accordance with Sections 12167 and 12167.1 of the Public Contract Code," section 42925 assures that cost savings realized from state agencies' IWM plans are handled in a manner consistent with the handling of revenues received from state agencies' recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>43</sup>

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<sup>41</sup> Exhibit A, IRC, pages 58-59 (Amended Parameters and Guidelines, adopted Sept. 26, 2008).

<sup>42</sup> Exhibit E, Commission on State Mandates, Excerpt from the Minutes, September 26, 2008 Meeting.

<sup>43</sup> Exhibit B, Controller's Late Comments on the IRC, pages 65-66 (Ruling on Submitted Matter).

CIWMB also requested adding a requirement for community college districts to analyze specified categories of potential cost savings when filing their reimbursement claims. The Commission found that the court determined that the amount or value of cost savings is already available from the annual reports the community college districts provide to CIWMB pursuant to Public Resources Code section 42926(b). This report is required to include the district's "calculations of annual disposal reduction" and "information on the changes in waste generated or disposed of due to increases or decreases in employees, economics, or other factors." Thus, the Commission denied CIWMB's request and adopted the staff analysis finding that the request was beyond the scope of the court's writ and judgment. The Commission also noted that the request was the subject of separate pending request filed by CIWMB to amend the Parameters and Guidelines and would therefore be further analyzed for that matter.

**D. Subsequent Request by CIWMB to Amend the Parameters and Guidelines to Require Detailed Reports on Cost Savings and Revenues**

CIWMB filed a request to amend the Parameters and Guidelines to require community college districts to submit with their reimbursement claims a separate worksheet and report analyzing the costs incurred and avoided and any fees received relating to staffing, overhead, materials, storage, transportation, equipment, the sale of commodities, avoided disposal fees, and any other revenue received relating to the mandated program as specified by CIWMB. At its January 30, 2009 meeting, the Commission denied the request for the following reasons: there is no requirement in statute or regulation that community college districts perform the analysis specified by CIWMB; the Commission has no authority to impose additional requirements on community college districts regarding this program; the offsetting cost savings paragraph in the Parameters and Guidelines already identifies the offsetting savings consistent with the language of Public Resources Code section 42925(a), Public Contract Code sections 12167 and 12167.1, and the court's judgment and writ; and information on cost savings is already available in the community colleges' annual reports submitted to CIWMB, as required by Public Resources Code section 42926(b)(1).<sup>44</sup>

**E. The *Integrated Waste Management* Program Made Optional**

This program was made optional by statutes of 2010, chapter 724 (AB1610), section 34, effective October 19, 2010 and has remained so since that time.<sup>45</sup>

**F. The Controller's Audit**

The Controller issued the audit report for reimbursement claims for the fiscal years 1999-2000, 2000-2001, and 2003-2004 through 2010-2011 fiscal years (the audit period) dated April 11, 2014. Of the total of \$658,967 claimed for these fiscal years, the Controller found that \$458,791 is allowable and \$200,176 is unallowable because the claimant did not report offsetting

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<sup>44</sup> Exhibit E, Commission on State Mandates, Item 9, Final Staff Analysis of Proposed Amendments to the Parameters and Guidelines for *Integrated Waste Management*, 05-PGA-16, January 30, 2009, pages 2-3.

<sup>45</sup> See Government Code section 17581.5.



savings of \$306,596 related to implementation of its IWM plan.<sup>46</sup> The Controller did not audit the claims for fiscal years 2001-2002 and 2002-2003 because, according to the Controller, the statute of limitations to initiate the audit had expired before the Controller began the review.<sup>47</sup>

The Controller’s audit finding is based on the court’s ruling, which states that “the amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(1) of Public Resources Code section 42926,”<sup>48</sup> the resulting amendment to the Parameters and Guidelines, and the claimant’s annual reports to CIWMB.<sup>49</sup>

The Controller determined that for every year, the claimant diverted more solid waste than the amount mandated by the test claim statute.<sup>50</sup> Therefore, the Controller calculated offsetting cost savings by allocating the diversion rate based on the mandated rate:

$$\begin{array}{rcccl}
 & \text{Allocated Diversion \%} & & & \\
 & \text{Maximum} & & & \text{Avoided} \\
 & \text{Allowable} & & & \text{Landfill} \\
 \text{Offsetting} & = & \frac{\text{Diversion \%}}{\text{Actual}} & \times & \text{Disposal Fee} \\
 \text{Savings} & & \text{Diversion \%} & \times & \text{(per Ton)} \\
 \text{Realized} & & & \times & \\
 & & \text{Tonnage} & & \\
 & & \text{Diverted} & & 
 \end{array}$$

This allocated diversion rate is the percentage of solid waste required to be diverted (25 or 50 percent) divided by the actual percentage of solid waste diverted (as reported by the claimant to CIWMB).<sup>51</sup> The resulting quotient is then multiplied by the tons of solid waste diverted (as annually reported by the claimant), multiplied by the avoided landfill disposal fee (based on the statewide average fee).

The Controller provided an example of how this formula works. In calendar year 2007, the claimant reported that it diverted 261.8 tons of solid waste and disposed of 161.8 tons, which totals 423.6 tons of solid waste generated for that year. Diverting 261.8 tons out of the 423.6 tons generated results in a diversion rate of 61.8 percent (more than the 50 percent required).<sup>52</sup>

<sup>46</sup> Because the audit adjustment exceeded the amount claimed in two fiscal years (2005-2007) an excess of \$106,420 was subtracted from the offset amount, leaving a net audit adjustment of \$200,176. (Exhibit A, IRC, pages 17, 24, 29 (Final Audit Report); Exhibit B, Controller’s Late Comments on the IRC, page 28.)

<sup>47</sup> Exhibit A, IRC, page 24 (Final Audit Report); Exhibit B, Controller’s Late Comments on the IRC, page 79 (Email from the Controller to the claimant).

<sup>48</sup> Exhibit B, Controller’s Late Comments on the IRC, page 70 (Ruling on Submitted Matter).

<sup>49</sup> Exhibit A, IRC, page 35 (Final Audit Report).

<sup>50</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 21, 77.

<sup>51</sup> Exhibit B, Controller’s Late Comments on the IRC, page 77.

<sup>52</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 21, 77 (Controller’s calculations of offsetting savings for the audit period).

The Controller did not want to penalize the claimant for diverting more solid waste than the amount mandated<sup>53</sup> so instead of using 100 percent of the claimant's diversion, the Controller allocated the diversion by dividing the mandated diversion rate (50 percent) by the actual diversion rate (61.8 percent), which equals 80.91 percent. The 80.91 percent allocated diversion rate is then multiplied by the 261.8 tons diverted that year, which equals 211.8 tons of diverted solid waste, instead of the 261.8 tons actually diverted. The allocated 211.8 tons of diverted waste is then multiplied by the statewide average disposal fee per ton, which in calendar year 2007 was \$48, resulting in "offsetting cost savings" for calendar year 2007 of \$10,168.<sup>54</sup>

In 2008, CIWMB stopped requiring community college districts to report the actual amount of tonnage diverted, instead requiring a report based on "per-capita disposal." Consequently, the Controller used the claimant's reported 2007 percentage of tons diverted to calculate the offsetting savings for the last half of fiscal year 2007-2008, as well as for fiscal years 2008-2009, 2009-2010 and 2010-2011. The Controller pointed out in the audit report that the claimant did not provide documentation supporting different diversion rates or disposal fees.<sup>55</sup>

The Controller calculated offsetting savings for the audit period at \$306,596,<sup>56</sup> but because the adjustment exceeded the amount claimed for two fiscal years (2005-2006 and 2006-2007) an excess of \$106,420 was subtracted from the offset, leaving a net audit adjustment of \$200,176.<sup>57</sup>

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<sup>53</sup> Exhibit B, Controller's Late Comments on the IRC, page 21.

<sup>54</sup> Exhibit B, Controller's Late Comments on the IRC, pages 21, 77 (Controller's calculations of offsetting savings for the audit period). Page 21 of the Controller's Late Comments on the IRC describes the calculation differently than the formula identified in the audit report, but the result is the same. The Controller states that cost savings can be calculated by multiplying the total tonnage generated (solid waste diverted + disposed) by the mandated diversion percentage (25 or 50 percent), times the avoided landfill disposal fee:

For example, in calendar year 2007, the district reported to CalRecycle that it diverted 261.8 tons of solid waste and disposed of 161.8 tons, which results in an overall diversion percentage of 61.8% [Tab 6, page 13]. Because the district was required to divert 50% for that year to meet the mandated requirements and comply with the Public Resources Code, it needed to divert only 211.8 tons (423 total tonnage generated x 50%) in order to satisfy the 50% requirements. Therefore, we adjusted our calculation to compute offsetting savings based on 211.8 tons of diverted solid waste rather than a total of 261.8 tons diverted.

Using this formula results in cost savings for calendar year 2007 of \$10,166 (423.6 tons generated x 50 percent required = 211.8 tons x \$48 = 10,166).

<sup>55</sup> Exhibit A, IRC, pages 35-36 (Final Audit Report).

<sup>56</sup> Exhibit A, IRC, page 32, 33 (Final Audit Report).

<sup>57</sup> Exhibit A, IRC, pages 17, 24, 29 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 28.

### III. Positions of the Parties

#### A. Gavilan Joint Community College District

The claimant maintains that the audit reductions are incorrect and requests the reinstatement of the full amount reduced.

The claimant first argues that the three-year deadline to initiate the audit had expired for fiscal year 2000-2001 when the Controller commenced the audit. According to claimant, "Pursuant to Chapter 724, Statutes of 2010, an appropriation was made to the District by January 14, 2011, for FY 2000-01 for \$8,404. The exact date of payment is a matter of record not available to the District but that can be produced by the Controller."<sup>58</sup> Claimant cites the audit report that states that claimant was first contacted by the Controller on January 17, 2014 regarding the audit, which is more than three years after the January 14, 2011, appropriation for the fiscal year 2000-2001 annual claim, so the Controller did not have jurisdiction to audit fiscal year 2000-2001.<sup>59</sup>

The claimant next alleges that it did not realize any cost savings as a result of the mandate and quotes the Superior Court decision (discussed above) that cost savings will "most likely" occur as a result of reduced or avoided costs of landfill disposal. Claimant argues that:

The court presupposes a previous legal requirement for districts to incur landfill disposal fees to divert solid waste. Thus, potentially relieved of the need to incur new or additional landfill fees for increased waste diversion, a cost savings would occur. There is no finding of fact or law in the court decision or from the Commission Statement of Decision for the test claim for this assumed duty to use landfills.<sup>60</sup>

The claimant further argues that the offsetting savings provision in the Parameters and Guidelines does not assume that the cost savings occurred, but instead requires that the cost savings be *realized*. For the savings to be realized, the claimant contends that the following chain of events are required:

The cost savings must exist (avoided landfill costs); be converted to cash; amounts in excess of \$2,000 per year deposited in the state fund; and, these deposits by the districts appropriated by the Legislature to districts for purposes of mitigating the cost of implementing the plan. None of those prerequisite events occurred so no cost savings were "realized" by the District. Regardless, the adjustment cannot be applied to the District since no state appropriation of the cost savings was made to the District.<sup>61</sup>

The claimant also argues that the Parameters and Guidelines are silent as to how to calculate the avoided costs, but that the court provided two alternative methods, either disposal reduction or diversion reported by districts. The Controller used the diversion percentage, which assumes, without findings of fact, that all diversion tonnage is landfill disposal tonnage reduction. The

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<sup>58</sup> Exhibit A, IRC, pages 9-10.

<sup>59</sup> Exhibit A, IRC, pages 9-10.

<sup>60</sup> Exhibit A, IRC, page 12.

<sup>61</sup> Exhibit A, IRC, pages 13-14. Emphasis in original.

claimant contends that the Controller's calculation of cost savings is wrong because: (1) the formula is a standard of general application that was not adopted pursuant to the Administrative Procedure Act and is therefore an unenforceable underground regulation; (2) the Controller's formula assumes facts not in evidence, such as applying the same percentage of waste diverted in 2007 to all subsequent years without evidence in the record, and assumes that all tonnage diverted would have been disposed in a landfill, although some waste may have been composted or may not apply to the mandate (e.g. paint); and (3) the landfill disposal fee, a statewide average calculated by CIWMB, does not include the data used to generate the average fee amounts, so the average is unknown and unsupported by the audit findings.<sup>62</sup>

Claimant also asserts that application of the formula is incorrect. Since no landfill costs were claimed, none can be offset, so the offsets are not properly matched to relevant costs. Moreover, the Controller's calculation method prevents the claimant from receiving full reimbursement for its actual increased program costs. Claimant contends, using audit results for 23 other claimants under the *Integrated Waste Management* program, the application of the Controller's formula has arbitrary results because the percentages of allowed costs for those claimants ranges from zero to 83.4 percent.<sup>63</sup>

Finally, the claimant argues: (1) the Controller used the wrong standard of review in that the claimed costs were not found to be excessive or unreasonable, as required by Government Code section 17561(d)(2); and (2) the Controller has the burden of proof 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 evidence regarding its auditing methods and procedures, as well as the specific facts relied upon for its audit findings."<sup>64</sup>

The claimant did not file comments on the Draft Proposed Decision.

### **B. State Controller's Office**

The Controller maintains that the audit findings are correct. The Controller first argues that it complied with the three-year audit deadline in Government Code section 17558.5, in that it sent a remittance advice to the claimant for 2000-2001 on January 28, 2011, and initiated the audit on January 17, 2014, so the Controller had jurisdiction to audit the fiscal year 2000-2001 claim.<sup>65</sup>

The Controller also notes that the claimant does not indicate how undiverted solid waste would be disposed of if not at a landfill. In addition, the claimant does not state that it disposed of its solid waste at any location other than a landfill or used any other means to dispose of its waste rather than to contract with a commercial waste hauler.<sup>66</sup>

The Controller concludes that the claimant's comments relating to alternatives for the disposal of solid waste are irrelevant and cites the claimant's annual reports of tonnage disposed for each year of the audit period, arguing that the claimant "does not indicate in these annual reports that

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<sup>62</sup> Exhibit A, IRC, pages 14-16.

<sup>63</sup> Exhibit A, IRC, pages 16-18.

<sup>64</sup> Exhibit A, IRC, pages 20-21.

<sup>65</sup> Exhibit B, Controller's Late Comments on the IRC, pages 12-13.

<sup>66</sup> Exhibit B, Controller's Late Comments on the IRC, page 18.

it used any other methodology to dispose of solid waste other than in the landfill.”<sup>67</sup> The Controller also cites some of the claimant’s annual reports that indicates that the claimant disposed of waste in a landfill.<sup>68</sup> According to the Controller:

Unless the district had an arrangement with its waste hauler that it did not disclose to us or CalRecycle, the district did not dispose of its solid waste at a landfill for no cost. Gavilan Community College is located in Gilroy, California. An internet search for landfill fees revealed that the Buena Vista Sanitary Landfill in Watsonville, California, currently charges between \$59 and \$71 per ton to dispose of solid waste [citation omitted]. Thus, the higher rate of diversion results in less trash that is disposed at a landfill, which creates cost savings for the district.<sup>69</sup>

As to the claimant not remitting cost savings from the implementation of its IWM plan into the Integrated Waste Management Account in compliance with the Public Contract Code, the Controller asserts that the claimant is not precluded from the requirement to do so, as indicated in the Parameters and Guidelines and the court ruling. The Controller says the evidence supports that the claimant realized cost savings that should have been remitted to the state and that must be used to fund IWM plan costs.<sup>70</sup>

In response to the claimant’s argument that the Controller’s formula is a standard of general application that is an underground regulation, the Controller responds that the calculation is a “court approved methodology” to determine the “required offset.” The Controller also states that the claimant did not amend any of its reimbursement claims after the Parameters and Guidelines were amended in September 2008. According to the Controller: “We believe that this “court-identified” approach provides a reasonable methodology to identify the required offset.”<sup>71</sup>

The Controller also states that it “allocated” the offsetting savings to avoid penalizing the claimant for diverting more than the minimum percentage of diversion required. According to the Controller:

As there is no State mandate to exceed solid waste diversion for amounts in excess of 25% for calendar years 2000 through 2003 or greater than 50% for calendar year 2004 and beyond, there is no basis for calculating offsetting savings realized for actual diversion percentages that exceeded the levels set by statute.<sup>72</sup>

The Controller notes that after the passage of Statutes 2008, chapter 343, CIWMB no longer required districts to report their tonnage or percentage diverted, but they are still required to divert 50 percent of their solid waste.<sup>73</sup>

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<sup>67</sup> Exhibit B, Controller’s Late Comments on the IRC, page 18.

<sup>68</sup> Exhibit B, Controller’s Late Comments on the IRC, page 18.

<sup>69</sup> Exhibit B, Controller’s Late Comments on the IRC, page 18.

<sup>70</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 19.

<sup>71</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 19-20.

<sup>72</sup> Exhibit B, Controller’s Late Comments on the IRC, page 21.

<sup>73</sup> Exhibit B, Controller’s Late Comments on the IRC, page 21.

Defending its use of the claimant's 2007 reported diversion to calculate offsetting savings for 2007-2008 through 2010-2011, the Controller calls the 2007 report a "fair representation" of 2008 -2010 "because the district's recycling processes have already been established and committed to."<sup>74</sup> The Controller notes that the claimant's reported per-capita disposal rate is well below the target rate for 2008, 2009, and 2010, so "the district is meeting its requirement to divert 50% of its solid waste."<sup>75</sup> The Controller also cites the claimant's 2009 report that states: "The science club and the athletic association have been recycling aluminum and plastic bottles on campus. We have added 12 ea. new containers throughout the campus." In its 2010 report, the claimant states: "More recycling containers were placed on campus."<sup>76</sup> Based on these statements, the Controller states that its savings calculations for 2007-2008 through 2010-2011 may be understated.<sup>77</sup>

The Controller also responded to claimant's argument against the assumption that all tonnage diverted would have been disposed in a landfill, even though some waste may have been composted or may not apply to the mandate (e.g. paint). Noting that nearly \$100,000 was claimed for salaries and benefits for groundskeepers for diversion via composting, "it seems reasonable that the correlated landfill fees that the district did not incur for the composted materials translate into savings realized by the district . . . [that] should be recognized and appropriately offset against composting costs that the district claimed as part of implementing its IWM plan."<sup>78</sup> The Controller also states that claimant's reference to paint disposal is irrelevant because hazardous waste is not included in the diversion amounts that claimant reported, and therefore, are not included in the Controller's offsetting savings calculation.<sup>79</sup>

Regarding the data for the statewide disposal fee, the Controller states the information was provided by CIWMB, is included in the record, and is based on private surveys of a large percentage of landfills across California. In addition, the claimant "did not provide any information, such as its contract with or invoices received from its commercial waste hauler to support either the landfill fees actually incurred by the district or to confirm that the statewide average landfill fee was greater than the actual landfill fees incurred by the district."<sup>80</sup>

In response to the claimant's argument that it "did not claim landfill costs, so there are none to be offset," the Controller answers that the mandated program does not reimburse claimants for landfill costs incurred to dispose of solid waste, so none would be claimable. Rather, the program reimburses claimant's costs to divert solid waste from disposal, which according to the Controller, results in both a reduction of solid waste going to a landfill and the associated costs

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<sup>74</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>75</sup> Exhibit B, Controller's Late Comments on the IRC, page 21.

<sup>76</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>77</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>78</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>79</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>80</sup> Exhibit B, Controller's Late Comments on the IRC, page 23.

of having the waste hauled there, which creates offsetting savings that claimant is required to identify in its reimbursement claims.<sup>81</sup>

In response to the claimant's argument that "the adjustment method does not match or limit the landfill costs avoided to landfill costs, if any, actually claimed," the Controller quotes Public Resources Code section 42925 which provides that "cost savings realized as a result of the IWM plan are to "fund plan *implementation and administration costs*." The Controller argues that offsetting savings applies to the whole program and is not limited to solid waste diversion activities. The Controller also cites the reimbursable activities in the Parameters and Guidelines that refer to "implementation of the IWM plan," concluding that it is reasonable that offsetting savings from implementing the plan be offset against direct costs to implement the plan. The Controller also asserts that the claimant's reference to other IWM audits is irrelevant to the current issue.<sup>82</sup>

The Controller also disagrees with claimant's assertion that the Controller used the wrong standard of review because it did not conclude that the claims were excessive. The Controller cites the statute that authorizes it to audit the claimant's records to verify actual mandate-related costs *and* reduce any claim that is excessive or unreasonable. In this case, the claims were excessive because the amount claimed did not account for the cost savings required by the test claim statutes. As to the burden of proof, the Controller states that it used data from the claimant's annual reports to CIWMB from implementing its IWM program.<sup>83</sup>

On July 28, 2017, the Controller filed comments on the Draft Proposed Decision, agreeing with the conclusion and recommendation to support the audit reductions for fiscal years 1999-2000, 2000-2001, the second half of 2003-2004, and 2004-2005 through 2010-2011. The Controller also agreed to reinstate \$3,822 to the claimant for the first half of fiscal year 2003-2004.<sup>84</sup>

#### **IV. Discussion**

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

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

The Commission must review questions of law, including interpretation of the parameters and guidelines, *de novo*, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6 of

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<sup>81</sup> Exhibit B, Controller's Late Comments on the IRC, page 23.

<sup>82</sup> Exhibit B, Controller's Late Comments on the IRC, page 24.

<sup>83</sup> Exhibit B, Controller's Late Comments on the IRC, pages 26-27.

<sup>84</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.

the California Constitution.<sup>85</sup> The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 of the California Constitution and not apply it as an “equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities.”<sup>86</sup>

With regard to the Controller’s audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.<sup>87</sup> Under this standard, the courts have found that:

When reviewing the exercise of discretion, “[t]he scope of review is limited, out of deference to the agency’s authority and presumed expertise: ‘The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]’” ... “In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . .” [Citations.] When making that inquiry, the “ ‘ ‘court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute.’ ” [Citation.]”<sup>88</sup>

The Commission must review the Controller’s audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.<sup>89</sup> In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission’s regulations require that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission’s ultimate findings of fact must be supported by substantial evidence in the record.<sup>90</sup>

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<sup>85</sup> *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

<sup>86</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

<sup>87</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space Dist.* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

<sup>88</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>89</sup> *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

<sup>90</sup> Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission’s decision is not supported by substantial evidence in the record.



**A. The Controller Timely Initiated the Audit of the Fiscal Year 2000-2001 Reimbursement Claim, and Timely Completed the Audit of All Claims.**

Government Code section 17558.5 requires an audit to be initiated no later than three years after the date the reimbursement claim is filed or last amended. However, section 17558.5 also provides that *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.”<sup>91</sup> “In any case,” section 17558.5 requires the audit to be completed no later than two years after it is commenced.<sup>92</sup>

The claimant argues that the Controller did not timely initiate the audit of the 2000-2001 reimbursement claim. For the reasons below, the Commission finds that the Controller timely initiated and completed the audit.

1. The audit of the 2000-2001 reimbursement claim was timely initiated.

The claimant filed the 2000-2001 reimbursement claim on October 6, 2005.<sup>93</sup> However, payment was not made at that time. The claimant alleges that payment on the 2000-2001 claim was made on January 14, 2011, and that the Controller initiated the audit more than three years later on January 17, 2014, according to information in the final audit report. Therefore, the claimant asserts that the Controller did not timely initiate the audit.<sup>94</sup>

Government Code section 17558.5(a) tolls the time to initiate the audit to three years from the date of initial payment on the claim, rather three years from the date the claim was filed, “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,” as follows:

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*. In any case, an audit shall be completed not later than two years after the date that the audit is commenced.<sup>95</sup>

Although the parties agree that payment was first made on the 2000-2001 claim in January 2011, the parties dispute the date of payment. The claimant alleges:

Pursuant to Chapter 724, Statutes of 2010, an appropriation was made to the District by January 14, 2011, for FY 2000-01 for \$8,404. The exact date of

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<sup>91</sup> Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

<sup>92</sup> Government Code section 17558.5 (as amended, Stats. 2004, ch. 890 (AB 2856)).

<sup>93</sup> Exhibit A, IRC, page 230.

<sup>94</sup> Exhibit A, IRC, page 9.

<sup>95</sup> Emphasis added.

payment is a matter of record not available to the District but that can be produced by the Controller.<sup>96</sup>

There is no evidence in the record, however, to support the claimant's assertion that the Controller made payment on January 14, 2011. Rather, the record supports a finding that payment was first made on the 2000-2001 reimbursement claim on either January 18, 2011, or January 28, 2011.

The claimant filed, as part of its IRC, a copy of a notice from the Controller to the claimant dated April 18, 2014 (following the audit), showing the audit adjustments and identifying an \$8,406 payment on the 2000-2001 reimbursement claim on *January 18, 2011* by "Schedule No. AP00122A," that states:

WE HAVE REVIEWED YOUR 2000/2001 FISCAL YEAR REIMBURSEMENT CLAIM FOR THE MANDATED COST PROGRAM REFERENCED ABOVE. THE RESULTS OF OUR REVIEW ARE AS FOLLOWS:

AMOUNT CLAIMED	69,207.00
ADJUSTMENT TO CLAIM:	
FIELD AUDIT FINDINGS	- 2,739.00
TOTAL ADJUSTMENTS	2,739.00
<b>LESS PRIOR PAYMENT: SCHEDULE NO. AP00122A PAID 01-18-2011</b>	<b><u>8,406.00</u></b>
AMOUNT DUE CLAIMANT	\$ 58,062.00 <sup>97</sup>

The Controller asserts that payment was first made on the 2000-2001 reimbursement claim on *January 28, 2011*, pursuant to Statutes of 2010, chapter 724 (AB 1610, eff. October 19, 2010).<sup>98</sup> That statute appropriated funds to offset the outstanding balance of the state's minimum funding obligation under Proposition 98 to school districts and community college districts, and required that funds first be paid in satisfaction of any outstanding claims for reimbursement of state-mandated costs. The Controller filed a copy of a remittance advice showing payments to the claimant under AB 1610 for several state-mandated programs, including a payment of \$8,406 for the *Integrated Waste Management* program for fiscal year 2000-2001 by "Claim Schedule Number: 1000149A, Payment Issue Date: 01/28/2011."<sup>99</sup>

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<sup>96</sup> Exhibit A, IRC, page 9.

<sup>97</sup> Exhibit A, IRC, page 292. Emphasis added.

<sup>98</sup> Exhibit A, IRC, page 24 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 12 ("The SCO sent a remittance advice to the district dated January 28, 2011, notifying the district of payment made on that date pursuant to Chapter 724, Statutes 2010 (Assembly Bill No. 1610) totaling \$8,406 [Tab 5].").

<sup>99</sup> Exhibit B, Controller's Late Comments on the IRC, page 36.

The Controller has not explained the discrepancy between the notice indicating payment of \$8,406 for the 2000-2001 reimbursement claim on January 18, 2011 by “Schedule No. AP00122A,” and the remittance advice indicating payment of \$8,406 for the 2000-2001 reimbursement claim on January 28, 2011 by “Schedule Number: 1000149A.” Nevertheless, the Controller issued both documents that support a finding that payment was first made on the 2000-2001 reimbursement claim on either January 18, 2011, or January 28, 2011.

As indicated above, Government Codes section 17558.5(a) tolls the time to initiate the audit of a claim “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,” to three years from the date of initial payment on the claim. Therefore, using the earlier of the two dates showing payment on the 2000-2001 reimbursement claim on January 18, 2011, the Controller had until January 18, 2014 to initiate the audit of the 2000-2001 claim.

The Legislature has not specifically defined the event that initiates the audit and, unlike other auditing agencies,<sup>100</sup> the Controller has not adopted formal regulations (which can be viewed as the controlling interpretation of a statute) to clarify when an audit of a mandate reimbursement claim begins. Therefore, the Commission cannot, as a matter of law, state the event that initiates an audit in all cases, but must determine when the audit was initiated based on evidence in the record. Initiating an audit requires a unilateral act of the Controller. In this respect, Government Code section 17558.5(a) can be characterized as a statute of repose because it provides a period during which an audit has been commenced, and after which claimants may enjoy repose, dispose of evidence to support their claims, and assert a defense that the audit is not timely and therefore void.<sup>101</sup> Since the Controller’s authority to audit must be exercised within a specified time, it must be within the Controller’s exclusive control to meet or fail to meet the deadline imposed. The Controller has the burden of proof on this issue and must show with evidence in the record that the claimant was notified that an audit was being initiated by the statutory deadline to ensure that the claimant not dispose of any evidence or documentation to support its claim for reimbursement.

The Controller asserts that the audit began on January 17, 2014, the day before the January 18, 2014 deadline. In support, the Controller filed a declaration by Jim Spano (Chief, Mandated Cost Audits Bureau, Division of Audits), stating under penalty of perjury that “a review of the claims . . . commenced on January 17, 2014 (initial contact date).”<sup>102</sup> The Controller also filed a copy of an email dated January 17, 2014, from an audit manager at the Controller’s Office to the claimant, to evidence the Controller’s initial contact with the claimant about the audit. The email states in relevant part:

I am contacting you because the State Controller’s Office will be adjusting the district’s Integrated Waste Management claims for FY 2000-02, . . . because the

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<sup>100</sup> See, e.g., regulations adopted by the California Board of Equalization (title 18, section 1698.5, stating that an “audit engagement letter” is a letter “used by Board staff to confirm the start of an audit or establish contact with the taxpayer”).

<sup>101</sup> *Giest v. Sequoia Ventures, Inc.* (2000) 83 Cal.App.4th 300, 305.

<sup>102</sup> Exhibit B, Controller’s Late Comments on the IRC, page 5.

district did not offset any savings (e.g. avoided landfill disposal fees) received as a result of implementing the districts' IWM Plan.

I will notify you, via email, of the exact adjustment amount later this week. Also, included in this email, will be documentation to support the adjustment.<sup>103</sup>

The claimant concurs that the audit was initiated by the Controller's initial contact on January 17, 2014.<sup>104</sup>

Accordingly, the Commission finds that the Controller timely initiated the audit, pursuant to Government Code section 17558.5(a), on January 17, 2014.

2. The audit was timely completed.

Government Code section 17558.5 also prescribes the time in which an audit must be completed: "In any case, an audit shall be completed not later than two years after the date that the audit is commenced."<sup>105</sup> As indicated above, the audit was initiated on January 17, 2014, the date of initial contact with the claimant about the audit and thus, had to be completed no later than January 17, 2016. An audit is completed when the Controller issues the final audit report to the claimant. The final audit report constitutes the Controller's final determination on the subject claims and provides the claimant with written notice of the claim components adjusted, the amounts adjusted, and the reasons for the adjustment.<sup>106</sup> This notice enables the claimant to file an IRC. Here, the final audit report was issued April 11, 2014, well before the January 17, 2016 deadline.<sup>107</sup>

Based on the foregoing, the Commission finds that the Controller's audit was timely completed in accordance with Government Code section 17558.5.

**B. The Controller's Reduction of Costs Is Generally Correct as a Matter of Law; However, the Reduction of Costs for the First Half of Fiscal Year 2003-2004 Based on the Incorrect Mandated Diversion Rate, Is Incorrect as a Matter of Law.**

1. The test claim statutes presume that by complying with the mandate to divert solid waste through the IWM program, landfill fees are reduced or avoided and cost savings are realized.

The test claim statute added Public Resources Code section 42925(a), which provides that "Any cost savings realized as a result of the state agency integrated waste management plan shall, to the extent feasible, be redirected to the agency's integrated waste management plan to fund plan implementation and administration costs, in accordance with Sections 12167 and 12167.1 of the Public Contract Code."

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<sup>103</sup> Exhibit B, Controller's Late Comments on the IRC, page 34 (emphasis in original).

<sup>104</sup> Exhibit A, IRC, pages 9-10.

<sup>105</sup> Government Code section 17558.5 (Stats. 2004, ch. 890).

<sup>106</sup> Government Code section 17558.5(c).

<sup>107</sup> Exhibit A, IRC, page 24.

The court's Ruling on Submitted Matter states that community colleges are "likely to experience costs savings in the form of reduced or avoided costs of landfill disposal" as a result of the mandated activities in Public Resources Code section 42921 because reduced or avoided costs "are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided." The court noted that "diversion is defined in terms of landfill disposal for purposes of the IWM plan mandates." The statutory definition of diversion provides that "activities which reduce or eliminate the amount of solid waste from solid waste disposal for purposes of this division." And the statutory definition of disposal is "the management of solid waste through landfill disposal or transformation at a permitted solid waste facility."<sup>108</sup> The court explained that:

[R]eduction or avoidance of landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs of the IWM plan implementation . . . The amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(1) of Public Resources Code section 42926.<sup>109</sup>

As noted in the background, the court harmonized section 42925(a) with Public Contract Code sections 12167 and 12167.1:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs "in accordance with Sections 12167 and 12167.1 of the Public Contract Code," section 42925 assures that cost savings realized from state agencies' IWM plans are handled in a manner consistent with the handling of revenues received from state agencies' recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans

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<sup>108</sup> Exhibit B, Controller's Late Comments on the IRC, page 69 (Ruling on Submitted Matter).

<sup>109</sup> Exhibit B, Controller's Late Comments on the IRC, page 70 (Ruling on Submitted Matter). Emphasis added.

in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>110</sup>

Thus, the court found that offsetting savings are, by statutory definition, likely to occur as a result of implementing the mandated activities. Reduced or avoided costs “are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided.”<sup>111</sup> As the court held, “landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs. . . .”<sup>112</sup>

The statutes, therefore, presume that by complying with the mandate to divert solid waste through the IWM program, landfill fees are reduced or avoided and cost savings are realized. As indicated in the court’s ruling, the amount or value of the cost savings may be determined from the calculations of annual solid waste disposal reduction or diversion, which community colleges are required to annually report to CIWMB. The amount of cost savings realized must be identified by the claimant and used to offset the costs incurred to comply with IWM plan implementation and administration activities approved for reimbursement in the Parameters and Guidelines. Accordingly, the court’s ruling requires claimants to report in their reimbursement claims the costs incurred to comply with the reimbursable activities (which includes the activities and costs to divert at least 25 or 50 percent of all solid waste from landfill disposal) and the cost savings from the avoided landfill disposal fees, for a bottom line request for reimbursement of the net increased costs.

The Parameters and Guidelines are consistent with the court’s ruling and require in Section IV. that “[t]he claimant is only allowed to claim and be reimbursed for increased costs for reimbursable activities identified below. Increased cost is limited to the cost of an activity that the claimant is required to incur as a result of the mandate.”<sup>113</sup> Section VIII. requires that “[r]educed or avoided costs realized from implementation of the community college districts’ Integrated Waste Management plans shall be identified and offset from this claim as cost savings, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1.”<sup>114</sup> The court’s decision and the amended Parameters and Guidelines are binding.<sup>115</sup>

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<sup>110</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 71-72 (Ruling on Submitted Matter).

<sup>111</sup> Exhibit B, Controller’s Late Comments on the IRC, page 69 (Ruling on Submitted Matter).

<sup>112</sup> Exhibit B, Controller’s Late Comments on the IRC, page 70 (Ruling on Submitted Matter). Emphasis added.

<sup>113</sup> Exhibit A, IRC, page 55 (Parameters and Guidelines).

<sup>114</sup> Exhibit A, IRC, page 60 (Parameters and Guidelines).

<sup>115</sup> *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

2. During the audit period, the claimant exceeded the mandated diversion rate for solid waste, but has filed no evidence to rebut the presumption that cost savings were realized.

In this case, the claimant reported no cost savings in its reimbursement claims and asserts that no cost savings were realized, but does not explain why.<sup>116</sup>

The record shows that during the audit period the claimant complied with the mandate and diverted more solid waste than the state-mandated amount. The mandate requires community colleges to divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, through source reduction, recycling, and composting activities, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004.<sup>117</sup> The claimant's annual reports to CIWMB for calendar years 2000, 2001, and 2003 report diversion percentages from 36.21 percent to 75.43 percent of the total tonnage of waste generated, which exceeds the mandated diversion requirement of 25 percent.<sup>118</sup> The claimant's annual reports to CIWMB for calendar years 2004 through 2007 also report diversion percentages that exceed the mandated diversion requirement of 50 percent, and range from 61.8 percent to 98.23 percent of the total tonnage of waste generated.<sup>119</sup>

In 2008, CIWMB stopped requiring community college districts to report the amount and percentage of tonnage diverted, and instead required them to report the "per-capita disposal" of waste.<sup>120</sup> As amended, each community college now has a disposal target that is the equivalent to a 50 percent diversion, and is expressed on a per capita basis. So if the district's per-capita disposal rate is less than the target, it means that the district is meeting the requirement to divert 50 percent of its solid waste.<sup>121</sup>

In this case, the reports for 2008, 2009, and 2010 show that the claimant's annual per capita disposal rate for both the employee and student populations to be at or below the target rate, thereby satisfying the requirement to divert 50 percent of its solid waste during these years.<sup>122</sup> In

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<sup>116</sup> Exhibit A, IRC, page 10.

<sup>117</sup> Public Resources Code sections 42921; Exhibit A, IRC, pages 52 and 56 (Parameters and Guidelines, section IV.(B)(5)).

<sup>118</sup> Exhibit B, Controller's Late Comments on the IRC, pages 40-45 and 77.

<sup>119</sup> Exhibit B, Controller's Late Comments on the IRC, pages 46-53 and 77.

<sup>120</sup> The new requirement was a result of Statutes 2008, chapter 343 (SB 1016).

<sup>121</sup> Exhibit B, Controller's Late Comments on the IRC, pages 84-92 ["Understanding SB 1016 Solid Waste Per Capita Disposal Measurement Act", <http://www.calrecycle.ca.gov/lgcentral/goalmeasure/Tools/SimplePresen.pdf>].

<sup>122</sup> Exhibit B, Controller's Late Comments on the IRC, pages 54 (2008 report, showing an employee population target of 127.4, and 1.1 was achieved; and a student population target of 4.3, and 0.09 was achieved); 56 (2009 report, showing an employee population target of 127.4, and 1.3 was achieved; and a student population target of 4.3, and 0.1 was achieved); and 58 (2010 report, showing an employee population target of 127.4, and 1.0 was achieved; and a student population target of 4.3, and 0.09 was achieved).

addition, the claimant's 2008, 2009, and 2010 reports continue to show that the claimant had solid waste reduction programs in place. In its 2008 report, the claimant listed the following programs: "Business Source Reduction, Material Exchange, Beverage Containers, Cardboard, Office Paper (mixed), Xeriscaping, grasscycling, On-site composting/mulching, Tires, Scrap Metal, Concrete/asphalt/rubble (C&D), Rendering."<sup>123</sup> Also in its 2008 report, the claimant stated: "No changes were implemented in our Mission Statement. We are operating under our current Waste Management/Recycling program. . . . We still have recycle containers next to our general trash receptacles."<sup>124</sup> In its 2009 report, the claimant stated: "The science club and the athletic association have been recycling aluminum and plastic bottles on campus. We have added 12 ea new containers throughout the campus."<sup>125</sup> And in its 2010 report, the claimant stated: "Campus club from the sciences entitled 'Science Alliance' has propagated a massive push for recyclables as a fundraising method. More recycling containers were placed on campus."<sup>126</sup>

The record also shows that the tonnage of solid waste that was not diverted was disposed at a landfill. The annual reports filed by the claimant with CIWMB during the audit period identify the total tonnage of waste disposed and the use of a waste hauler.<sup>127</sup> Moreover, there are statements in the claimant's 2003, 2004, 2005, and 2006 annual reports pertaining to decreased landfill disposal, indicating that the claimant used a landfill to some extent.<sup>128</sup> The avoided landfill disposal fee was based on the statewide average disposal fee provided by CIWMB for each fiscal year in the audit period, since the claimant did not provide any information to the Controller regarding the landfill fees it was charged.<sup>129</sup>

Based on this documentation, the Controller correctly presumed, consistent with the presumption in the test claim statutes and the court's interpretation of those statutes and with no evidence to

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<sup>123</sup> Exhibit B, Controller's Late Comments on the IRC, page 55 (2008 report to CIWMB).

<sup>124</sup> Exhibit B, Controller's Late Comments on the IRC, page 55 (2008 report to CIWMB).

<sup>125</sup> Exhibit B, Controller's Late Comments on the IRC, page 57 (2009 report to CIWMB).

<sup>126</sup> Exhibit B, Controller's Late Comments on the IRC, page 58 (2010 report to CIWMB).

<sup>127</sup> For example, the 2001 report to CIWMB states: "On-site waste assessments and hauler/processor records review were conducted to obtain actual material weights, volumes, areas, and quantities wherever possible. . . . Hired a technical consultant to . . . research and analyze hauler and processor waste management records;" See Exhibit B, Controller's Late Comments on the IRC, page 43. The 2003 report states: "Actual hauler tonnages were obtained for disposal debris boxes. . . . Recycling Coordinator . . . Liaison to garbage and recycling hauling company." Similar statements were made in the 2003 report (p. 45) the 2004 report (p. 47). Statements that the recycling coordinator "Worked with garbage and recycling haulers to execute collection programs" is in the 2004 report (p. 47), the 2005 report (p. 49) and the 2006 report (p. 51). The 2008 report indicated that the claimant used "South Valley Disposal and Recycling" to haul its materials (p. 55). The 2009 report indicated that the claimant used "Recology Waste and Recycling Company" (p. 57).

<sup>128</sup> Exhibit B, Controller's Late Comments on the IRC, pages 45, 47, 49, 51.

<sup>129</sup> Exhibit B, Controller's Late Comments on the IRC, pages 23, 101-130.



the contrary, that the percentage of waste diverted results in offsetting savings in an amount equal to the avoided landfill fee per ton of waste required to be diverted.

The statutory presumption of cost savings controls unless the claimant files evidence to rebut the presumption and shows that cost savings were not realized.<sup>130</sup> The claimant has the burden of proof on this issue. Under the mandates statutes and regulations, the claimant is required to show that it has incurred increased costs mandated by the state when submitting a reimbursement claim to the Controller's Office, and the burden to show that any reduction made by the Controller is incorrect.<sup>131</sup> The Parameters and Guidelines, as amended pursuant to the court's writ, also require claimants to show the costs incurred to divert solid waste and to perform the administrative activities, and *to report and identify* the costs saved or avoided by diverting solid waste: "Reduced or avoided costs realized from implementation of the community college

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<sup>130</sup> Government Code section 17559, which requires that the Commission's decisions be supported by substantial evidence in the record. See also, *Coffy v. Shiomoto* (2015) 60 Cal.4th 1198, 1209, a case interpreting the rebuttable presumption in Vehicle Code section 23152 that if a person had 0.08 percent or more, by weight, of alcohol in the blood at the time of testing, then it is presumed by law that he or she had 0.08 percent or more, by weight, of alcohol in the blood at the time of driving, unless he or she files evidence to rebut the presumption. The court states that unless and until evidence is introduced that would support a finding that the presumption does not exist, the statutory presumption that the person was driving over the legal limit remains the finding of fact.

<sup>131</sup> Evidence Code section 500, which states: "Except as otherwise provided by law, a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting." See also, *Simpson Strong-Tie Co., Inc. v. Gore* (2010) 49 Cal.4th 12, 24, where the court recognized that "the general principle of Evidence Code 500 is that a party who seeks a court's action in his favor bears the burden of persuasion thereon." This burden of proof is recognized throughout the architecture of the mandates statutes and regulations. Government Code section 17551(a) requires the Commission to hear and decide a claim filed by a local agency or school district that it is entitled to reimbursement under article XIII B, section 6. Section 17551(d) requires the Commission to hear and decide a claim by a local agency or school district that the Controller has incorrectly reduced payments to the local agency or school district. In these claims, the claimant must show that it has incurred increased costs mandated by the state. (Gov. Code, §§ 17514 [defining "costs mandated by the state"], 17560(a) ["A local agency or school district may . . . file an annual reimbursement claim that details the costs actually incurred for that fiscal year."]; 17561 [providing that the issuance of the Controller's claiming instructions constitutes a notice of the right of local agencies and school districts to file reimbursement claims based upon the parameters and guidelines, and authorizing the Controller to audit the records of any local agency or school district to "verify the actual amount of the mandated costs."]; 17558.7(a) ["If the Controller reduces a claim approved by the commission, the claimant may file with the commission an incorrect reduction claim pursuant to regulations adopted by the commission."]). By statute, only the local agency or school district may bring these claims, and the local entity must present and prove its claim that it is entitled to reimbursement. (See also, Cal. Code Regs., tit. 2, §§ 1185.1, et seq., which requires that the IRC contain a narrative that describes the alleged incorrect reductions, and be signed under penalty of perjury.)

districts' Integrated Waste Management plans *shall be* identified and offset from this claim as cost savings.”<sup>132</sup> Thus, the claimant has the burden to rebut the statutory presumption and to show, with substantial evidence in the record, that the costs of complying with the mandate exceed any cost savings realized by diverting solid waste.

Accordingly, the Commission finds that the claimant has not filed any evidence to rebut the statutory presumption of cost savings. Therefore, the Controller’s finding of cost savings is correct as a matter of law.

3. For fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and 2004-2005 through 2010-2011, the Controller’s calculation of cost savings is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

The Controller correctly determined that for every year during the audit period, the claimant diverted more solid waste than the amount mandated by the test claim statute. Therefore, the Controller allocated the actual diversion rate based on the mandated diversion rate to calculate offsetting savings. Instead of using 100 percent of the diverted amount, the Controller divided the percentage of solid waste required to be diverted (either 25 percent or 50 percent) by the actual percentage of solid waste diverted (as reported by the claimant to CIWMB). The resulting quotient is then multiplied by the tons of solid waste diverted (as annually reported to CIWMB), multiplied by the avoided landfill disposal fee (based on the statewide average fee).<sup>133</sup>

$$\begin{array}{rcc}
 & \text{Allocated Diversion \%} & \\
 & \text{Maximum Allowable} & \\
 \text{Offsetting Savings Realized} & = \frac{\text{Diversion \%}}{\text{Actual Diversion \%}} & \times \text{Tonnage Diverted} \times \text{Avoided Landfill Disposal Fee (per Ton)}
 \end{array}$$

The formula allocates or reduces cost savings based on the mandated rate, and is intended to prevent penalizing the claimant for diverting more solid waste than the amount mandated by law.<sup>134</sup>

The claimant raises several arguments to assert that the Controller’s calculation of cost savings is incorrect. These arguments are not supported by the law or evidence in the record.

The claimant first alleges that cost savings cannot be realized because the chain of events required by Public Contract Code sections 12167 and 12167.1 did not occur: that savings have to be converted to cash, and amounts in excess of \$2000 per year must be deposited in the state fund and appropriated back by the Legislature to mitigate the costs.<sup>135</sup> It is undisputed that the claimant did not remit to the state any savings realized from the implementation of the IWM

<sup>132</sup> Exhibit A, IRC, page 96 (Parameters and Guidelines). Emphasis added.

<sup>133</sup> Exhibit A, IRC, pages 33-35; Exhibit B, Controller’s Late Comments on the IRC, page 21.

<sup>134</sup> Exhibit B, Controller’s Late Comments on the IRC, page 21.

<sup>135</sup> Exhibit A, IRC, page 13.

plan.<sup>136</sup> However, as indicated above, cost savings are presumed by the statutes and the claimant has not filed evidence to rebut that presumption. Thus the claimant should have deposited the cost savings into the state's account as required by the test claim statutes, and the claimant's failure to comply with the law does not make the Controller's calculations of cost savings incorrect as a matter of law, or arbitrary or capricious. Since cost savings are presumed by the statutes, the claimant has the burden to show increased costs mandated by the state. As the court stated: "[r]eimbursement is not available under section 6 and section 17514 to the extent that a local government or school district is able to provide the mandated program or increased level of service without actually incurring increased costs."<sup>137</sup>

The claimant next asserts that the Controller's formula is an underground regulation.<sup>138</sup> The Commission disagrees. Government Code section 11340.5 provides that no state agency shall enforce or attempt to enforce a rule or criterion which is a regulation, as defined in section 11342.600, unless it has been adopted pursuant to the Administrative Procedures Act. As indicated above, however, the formula is consistent with the statutory presumption of cost savings, as interpreted by the court for this program. Interpretations that arise in the course of case-specific adjudication are not regulations.<sup>139</sup>

The claimant also argues that using landfill fees in the calculation of offsetting savings is not relevant because "[t]he District did not claim landfill costs, so there are none to be offset."<sup>140</sup> The claimant's interpretation of the cost savings requirement is not correct. The cost of disposing waste at a landfill is not eligible for reimbursement. Reimbursement is authorized to *divert* solid waste from the landfill through source reduction, recycling, and composting activities.<sup>141</sup> As explained by the court:

In complying with the mandated solid waste diversion requirements of Public Resources Code section 42921, California Community Colleges are likely to experience cost savings in the form of reduced or avoided costs of landfill disposal. The reduced or avoided costs are a direct result and an integral part of the mandated IWM plan ....

Such reduction or avoidance of landfill fees and costs resulting from solid waste diversion activities under § 42920 et seq. represent savings which must be offset against the costs of the diversion activities to determine the reimbursable costs of IWM plan implementation -- i.e., the actual increased costs of diversion -- under section 6 and section 17514.<sup>142</sup>

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<sup>136</sup> Exhibit B, Controller's Late Comments on the IRC, page 19.

<sup>137</sup> Exhibit B, Controller's Late Comments on the IRC, page 69 (Ruling on Submitted Matter).

<sup>138</sup> Exhibit A, IRC, page 14.

<sup>139</sup> *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 571.

<sup>140</sup> Exhibit A, IRC, page 17.

<sup>141</sup> Exhibit A, IRC, page 56 (Parameters and Guidelines).

<sup>142</sup> Public Resources Code section 40124. Exhibit B, Controller's Late Comments on the IRC, pages 69-70 (Ruling on Submitted Matter).

The court also noted that diversion is defined as “activities which reduce or eliminate the amount of solid waste from solid waste disposal.”<sup>143</sup>

In addition, the claimant argues that the formula assumes facts without evidence in the record. For example, the claimant questions the Controller’s assumption that the diversion percentage achieved in 2007 applies equally to subsequent years, that all diverted waste would have been disposed in a landfill, and that the statewide average cost to dispose of waste at a landfill actually applied to the claimant.<sup>144</sup>

The Controller’s assumptions, however, are supported by evidence in the record and the claimant has filed no evidence to rebut them. The Controller applied the diversion percentage achieved in 2007 to subsequent years because the CIWMB stopped requiring community college districts to report the actual amount and percent of tonnage diverted in 2008. As the Controller notes, the claimant’s diversion program was well-established by 2007, and the claimant’s reports of subsequent years reflect continued diversion. In its 2008 report, the claimant stated: “We are operating under the current Waste Management/Recycling program. . . . We still have recycle containers next to our general trash receptacles”<sup>145</sup> In its 2009 report, the claimant stated: “The science club and the athletic association have been recycling aluminum and plastic bottles on campus. We have added 12 ea new containers throughout the campus.”<sup>146</sup> And in its 2010 report, the claimant stated: “Campus club from the sciences entitled ‘Science Alliance’ has propagated a massive push for recyclables as a fundraising method. More recycling containers were placed on campus”<sup>147</sup> Moreover, the claimant’s reported per-capita disposal rate is well below the target rate for 2008, 2009, and 2010, so the 50-percent target diversion rate is being met.<sup>148</sup>

Thus, there is evidence in the record that for 2008 through 2010, the claimant met or exceeded the diversion rates recorded in 2007.

The Controller obtained the statewide average cost for landfill disposal fees from the CIWMB, which was based on private surveys of a large percentage of landfills across California.<sup>149</sup> The

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<sup>143</sup> Exhibit B, Controller’s Late Comments on the IRC, page 69 (Ruling on Submitted Matter).

<sup>144</sup> Exhibit A, IRC, pages 15-16.

<sup>145</sup> Exhibit B, Controller’s Late Comments on the IRC, page 55 (2008 Annual Report).

<sup>146</sup> Exhibit B, Controller’s Late Comments on the IRC, page 57 (claimant’s 2009 report to CIWMB).

<sup>147</sup> Exhibit B, Controller’s Late Comments on the IRC, page 58 (claimant’s 2010 report to CIWMB).

<sup>148</sup> Exhibit B, Controller’s Late Comments on the IRC, page 21, and pages 54 (2008 report, showing an employee population target of 127.4, and 1.1 was achieved; and a student population target of 4.3, and 0.09 was achieved); 56 (2009 report, showing an employee population target of 127.4, and 1.3 was achieved; and a student population target of 4.3, and 0.1 was achieved); and 58 (2010 report, showing an employee population target of 127.4, and 1.0 was achieved; and a student population target of 4.3, and 0.09 was achieved).

<sup>149</sup> Exhibit B, Controller’s Late Comments on the IRC, page 23.

Controller's audit report indicates that the claimant did not provide documentation to support a different disposal fee.<sup>150</sup> In addition, the Controller states:

The district did not provide any information, such as its contract with or invoices received from its commercial waste hauler to support either the landfill fees actually incurred by the district or to confirm that the statewide average landfill fee was greater than the actual landfill fees incurred by the district.<sup>151</sup>

On these audit issues, the Commission may not reweigh the evidence or substitute its judgment for that of the Controller. The Commission must only ensure that the Controller's decision is not arbitrary, capricious, or entirely lacking in evidentiary support, and that it adequately considered all relevant factors.<sup>152</sup> There is no evidence that the Controller's assumptions are wrong or arbitrary or capricious with regard to the statewide average landfill fee.

The claimant also points to the Controller's audits of other community college districts, arguing that the costs allowed by the Controller in those cases vary and are arbitrary.<sup>153</sup> The Controller's audits of other community college district reimbursement claims are not relevant to the Controller's audit here. Each audit depends on the documentation and evidence provided by the claimant to show increased costs mandated by the state.

Accordingly, the Controller's calculations of cost savings for fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and fiscal years 2004-2005 through 2010-2011, are correct as a matter of law, and are not arbitrary, capricious, or entirely lacking in evidentiary support.

4. The Controller's calculation of the allocated diversion rate for the first half of fiscal year 2003-2004 using 50 percent required diversion rate, rather than the 25 percent rate actually required, is incorrect as a matter of law.

For the first half of fiscal year 2003-2004, the claimant achieved an actual diversion percentage of 75.43 percent.<sup>154</sup> The Controller allocated the diversion rate for the first half of fiscal year 2003-2004, as it had done for the other fiscal years, because the claimant exceeded the mandate. However, the Controller used a 50 percent rate to calculate the allocated diversion rate, when the test claim statutes required only 25 percent diversion in calendar year 2003. The requirement to divert 50 percent of all solid waste did not become operative until January 1, 2004.<sup>155</sup> Therefore, using the 50 percent rate, the Controller's allocated diversion rate was calculated at 66.29 percent, which resulted in a reduction of \$7,644 for this time period (313.1 tons of diverted waste

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<sup>150</sup> Exhibit A, IRC, page 36.

<sup>151</sup> Exhibit B, Controller's Late Comments on the IRC, page 23.

<sup>152</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>153</sup> Exhibit A, IRC, pages 18-19.

<sup>154</sup> Exhibit B, Controller's Late Comments on the IRC, page 77.

<sup>155</sup> Public Resources Code sections 42921; Exhibit A, IRC, page 43 (Parameters and Guidelines, adopted March 30, 2005).

multiplied by the allocated diversion rate of 66.29 percent -50 percent divided by 75.43 percent - multiplied by the avoided statewide average landfill disposal fee of \$36.83).<sup>156</sup>

As indicated in the Parameters and Guidelines, the mandate is to divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004, through source reduction, recycling, and composting activities.<sup>157</sup> Thus, from July 1, 2003, through December 31, 2003, community college districts were mandated to achieve only 25 percent diversion. The Controller admits that: “as there is no state mandate to exceed solid waste diversion for amounts in excess of 25% for calendar years 2000 through 2003 or 50% for calendar year 2004 and later, there is no basis for calculating offsetting savings realized for actual diversion percentages that exceed the levels set by statute.”<sup>158</sup>

However, the Controller’s calculation of cost savings incorrectly applied a 50 percent diversion rate to calculate the allocated diversion rate for the period of July 1, 2003, through December 31, 2003, instead of the mandated 25 percent diversion rate.<sup>159</sup> Because the Controller used the incorrect percentage to calculate the allocated rate, the calculation of offsetting savings for this time period is incorrect as a matter of law.

As indicated above, the Controller’s formula for offsetting cost savings for years when the claimant exceeded the diversion mandate, which allocates the diversion percentage achieved based on the mandated diversion percentage, is consistent with the test claim statutes and the court’s decision on this program. That allocated rate is the percentage of solid waste required to be diverted (either 25 percent or 50 percent) divided by the actual percentage of solid waste diverted (as reported by the claimant to CIWMB). The resulting quotient is then multiplied by the tons of solid waste diverted (as annually reported by the claimant to the CIWMB), multiplied by the avoided landfill disposal fee (based on the statewide average fee).<sup>160</sup>

Applying the formula to the first half of fiscal year 2003-2004, using the 25 percent diversion requirement, results in a finding of offsetting costs savings of \$3,822 (25 percent mandated diversion rate divided by the 75.43 percent diversion actually achieved equals an allocated diversion rate of 33.14 percent, multiplied by 313.1 tons diverted, multiplied by the avoided

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<sup>156</sup> Exhibit A, IRC, page 30 (Final Audit Report); Exhibit B, Controller’s Late Comments on the IRC, page 77.

<sup>157</sup> Public Resources Code sections 42921; Exhibit A, IRC, page 92 (Parameters and Guidelines).

<sup>158</sup> Exhibit B, Controller’s Late Comments on the IRC, page 21; see also the Final Audit Report, which states: “Public Resource Code 42921 requires districts to achieve a solid waste diversion percentage of 25% beginning January 1, 2002, and a 50% diversion percentage by January 1, 2004.” (Exhibit A, IRC, page 35).

<sup>159</sup> Exhibit B, Controller’s Late Comments on the IRC, page 77.

<sup>160</sup> Exhibit A, IRC, pages 34 - 35 (Final Audit Report). Exhibit B, Controller’s Late Comments on the IRC, page 77.

statewide average landfill disposal fee of \$36.83), rather than the \$7,644 the Controller calculated.<sup>161</sup>

In comments on the Draft Proposed Decision, the Controller agreed to reinstate \$3,822 for the first half of fiscal year 2003-2004.<sup>162</sup>

Accordingly, the Commission finds that the reduction of \$7,644 in the first half of fiscal year 2004-2004, based on the incorrect diversion rate used to calculate offsetting cost savings, is incorrect as a matter of law. The law and the record support offsetting cost savings for the first half of fiscal year 2003-2004 of \$3,822, rather than \$7,644, and that the difference of \$3,822 has been incorrectly reduced.

## **V. Conclusion**

Based on the foregoing, the Commission concludes that the Controller's reduction of costs claimed for fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and fiscal years 2004-2005 through 2010-2011 is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

However, the reduction of costs claimed for the first half of fiscal year 2003-2004 is incorrect as a matter of law.

Accordingly, the Commission partially approves this IRC and requests that the Controller reinstate \$3,822 to the claimant pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations.

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<sup>161</sup> Exhibit B, Controller's Late Comments on the IRC, pages 37 and 71.

<sup>162</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.



RE: **Decision**

*Integrated Waste Management*, 14-0007-I-04  
Public Resources Code Sections 40418, 40196.3, 42920-42928;  
Public Contract Code Sections 12167 and 12167.1  
Statutes 1992, Chapter 1116 (AB 3521); Statutes 1999, Chapter 764 (AB 75)  
State Agency Model Integrated Waste Management Plan (February 2000)  
Fiscal Years: 1999-2000, 2000-2001, 2003-2004, 2004-2005, 2005-2006, 2006-2007,  
2007-2008, 2008-2009, 2009-2010, and 2010-2011  
Gavilan Joint Community College District, Claimant

On September 22, 2017, the foregoing Decision of the Commission on State Mandates was adopted on the above-entitled matter.

Heather Halsey, Executive Director

Dated: September 26, 2017



BEFORE THE  
 COMMISSION ON STATE MANDATES  
 STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM  
 ON:**

Public Resources Code Sections 40148, 40196.3, 42920-42928; Public Contract Code Sections 12167 and 12167.1; Statutes 1992, Chapter 1116 (AB 3521); Statutes 1999, Chapter 764 (AB 75); State Agency Model Integrated Waste Management Plan (February 2000)

Fiscal Years 1999-2000, 2000-2001, 2003-2004, 2004-2005, 2005-2006, 2006-2007, 2007-2008, 2008-2009, 2009-2010 and 2010-2011

State Center Community College District,  
 Claimant

Case No.: 14-0007-I-05

*Integrated Waste Management*

DECISION PURSUANT TO  
 GOVERNMENT CODE SECTION  
 17500 ET SEQ.; CALIFORNIA CODE OF  
 REGULATIONS, TITLE 2, DIVISION 2,  
 CHAPTER 2.5, ARTICLE 7

*(Adopted December 1, 2017)*

*(Served December 6, 2017)*

**DECISION**

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on December 1, 2017. Claimant, State Center Community College District, did not attend the hearing. Lisa Kurokawa appeared for the State Controller’s Office (Controller).

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

The Commission adopted the Proposed Decision to partially approve the IRC by a vote of 6-0 as follows:

<b>Member</b>	<b>Vote</b>
Lee Adams, County Supervisor	Yes
Ken Alex, Director of the Office of Planning and Research	Yes
Richard Chivaro, Representative of the State Controller, Vice Chairperson	Absent
Mark Hariri, Representative of the State Treasurer	Yes
Sarah Olsen, Public Member	Yes
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	Yes
Carmen Ramirez, City Council Member	Yes

## **Summary of the Findings**

This IRC addresses reductions made by the Controller to reimbursement claims of the State Center Community College District (claimant) for fiscal years 1999-2000, 2000-2001, and 2003-2004 through 2010-2011 under the *Integrated Waste Management* program, 00-TC-07. The Controller made the audit reductions because the claimant (in the two colleges within the district: Reedley College and Fresno City College (FCC)) did not identify and deduct from its reimbursement claims offsetting cost savings from its diversion of solid waste and the associated reduced or avoided costs of landfill disposal fees.

The Commission finds that the audit reductions are partially correct.

During the audit period, the claimant diverted solid waste, as required by the test claim statutes, and exceeded the mandated diversion rate in all years except calendar year 2000. The Controller correctly presumed, consistent with the test claim statutes and the court's interpretation of those statutes, and without any evidence to the contrary, that the claimant realized cost savings during the audit period equal to the avoided landfill disposal fee per ton of waste required to be diverted.

The Commission further finds, based on the evidence in the record, that the Controller's calculation of offsetting cost savings for fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and fiscal years 2004-2005 through 2010-2011 is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support. During the audit period, the claimant exceeded the mandated diversion rate in all years except calendar year 2000.<sup>1</sup> Instead of using 100 percent of the diversion percentage achieved in years when the claimant diverted more solid waste than the amount mandated by the test claim statutes, the Controller's cost savings formula "allocated" the diversion by dividing the percentage of solid waste required to be diverted, either 25 or 50 percent, by the actual percentage of solid waste diverted, as reported by the claimant to California Integrated Waste Management Board (CIWMB). The resulting quotient was then multiplied by the tons of solid waste diverted, as annually reported by the claimant to CIWMB, multiplied by the avoided landfill disposal fee (based on the statewide average fee).<sup>2</sup> The formula allocates cost savings based on the mandated levels of diversion, and is intended to prevent penalizing the claimant for diverting more solid waste than the amount mandated by law.<sup>3</sup> The claimant has not filed any evidence to rebut the statutory presumption of cost savings or to show that the statewide average disposal fee is incorrect or arbitrary. Thus, the Controller's reduction of costs claimed for these fiscal years is correct.

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<sup>1</sup> The Controller found that Fresno City College exceeded the mandate in all years in the audit period, but that Reedley College did not exceed the mandate in calendar years 2000 and 2003. In years that Reedley College did not exceed the mandated (25 or 50 percent) diversion level, the Controller did not allocate the diversion rate, but used 100 percent of the tonnage diverted to calculate offsetting savings. See Exhibit B, Controller's Late Comments on the IRC, pages 92-93.

<sup>2</sup> Exhibit A, IRC, pages 33-35 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 21.

<sup>3</sup> Exhibit B, Controller's Late Comments on the IRC, pages 20-21.

In calendar year 2000, the claimant's Reedley College achieved a 24.57 diversion rate, which was less than the 25 percent required, so the Controller did not allocate the diversion rate, but multiplied 100 percent of the solid waste diverted by the claimant by the avoided landfill disposal fee (based on the statewide average fee).

These formulas are consistent with the statutory presumption of cost savings and correctly presume, without any evidence to the contrary, that the percentage of waste diverted results in offsetting cost savings in an amount equal to the avoided landfill fee per ton of waste required to be diverted. In years when the claimant exceeded the mandated diversion rates, the Controller's formula limits the offset to the mandated levels.<sup>4</sup>

However, the Controller's reduction of costs claimed for the first half of fiscal year 2003-2004 for both colleges is incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support. For the first half of fiscal year 2003-2004, Reedley College achieved an actual diversion rate of 26.11 percent. The Controller found that Reedley College did not achieve the mandated "50 percent" diversion rate, although only 25 percent diversion was mandated in the first half of fiscal year 2003-2004. Thus, for this period at Reedley College, the Controller did not allocate the diversion percentage to calculate cost savings, but used 100 percent of the reported diversion to calculate offsetting savings.<sup>5</sup> In addition, FCC achieved an actual diversion rate of 53.59 percent in the first half of fiscal year 2003-2004.<sup>6</sup> The Controller allocated the diversion rate for FCC, as it had done for the other fiscal years because the claimant exceeded the mandate, but used a 50 percent rate to calculate the allocated diversion rate, when the test claim statutes mandated only 25 percent diversion in calendar year 2003.<sup>7</sup> The requirement to divert 50 percent of all solid waste did not become operative until January 1, 2004.<sup>8</sup> Therefore, the Controller's calculation of cost savings, which applied a 50 percent diversion rate to the period from July 1, 2003, through December 31, 2003, for both colleges, instead of the mandated 25 percent diversion rate, is incorrect as a matter of law. In addition, the Controller's calculation, which did not reduce cost savings by allocating the diversion percentage to the 25 percent mandated diversion rate as it did for other years when the claimant exceeded the mandate, is arbitrary, capricious, and entirely lacking in evidentiary support. Applying the Controller's formula to the first half of fiscal year 2003-2004 for both colleges within the claimant's district, using the 25 percent diversion requirement, results in offsetting costs savings of:

- \$7,166 for Reedley College (25 percent divided by 26.11 percent, multiplied by 203.2 tons diverted multiplied by the statewide average landfill disposal fee of \$36.83) rather than

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<sup>4</sup> Exhibit A, IRC, page 35, footnote 2 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 93.

<sup>5</sup> Exhibit A, IRC, page 35, footnote 2 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 93.

<sup>6</sup> Exhibit B, Controller's Late Comments on the IRC, pages 92-93.

<sup>7</sup> Exhibit B, Controller's Late Comments on the IRC, pages 92-93.

<sup>8</sup> Public Resources Code sections 42921; Exhibit A, IRC, page 95 (Parameters and Guidelines).

\$7,484 calculated by the Controller using a 100 percent diversion rate of the solid waste diverted; and

- \$3,039 for FCC (25 percent divided by 53.59 percent, multiplied by 176.9 tons diverted multiplied by the statewide average landfill disposal fee of \$36.83) rather than \$6,079 calculated by the Controller using a 50 percent diversion rate.

Thus, the Commission finds that the law and the record support offsetting savings for the first half of fiscal year 2003-2004 of \$10,205 rather than \$13,563, and the difference of \$3,358 has been incorrectly reduced.<sup>9</sup>

Therefore, the Commission partially approves this IRC, and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, that the Controller reinstate \$3,358 to the claimant.

## COMMISSION FINDINGS

### I. Chronology

- 10/06/2005 The claimant filed its 1999-2000, 2000-2001, and 2003-2004 reimbursement claims.<sup>10</sup>
- 03/30/2009 The claimant filed its 2004-2005, 2005-2006, 2006-2007, and 2007-2008 reimbursement claims.<sup>11</sup>
- 12/14/2009 The claimant filed its 2008-2009 reimbursement claim.<sup>12</sup>
- 12/13/2010 The claimant filed its 2009-2010 reimbursement claim.<sup>13</sup>
- 02/07/2012 The claimant filed its reimbursement claim for July 1, 2010 to October 7, 2010.<sup>14</sup>
- 08/01/2013 The claimant was notified of the audit.<sup>15</sup>
- 08/30/2013 The Controller issued the Final Audit Report.<sup>16</sup>

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<sup>9</sup> Exhibit B, Controller's Late Comments on the IRC, pages 37 (FCC 2003 Annual Report), 60 (Reedley 2003 Annual Report) and 92-93.

<sup>10</sup> Exhibit A, IRC, pages 209, 215 and 220. Although these reimbursement claims were filed in 2005, the final audit report states that the state made no payment to the claimant (Exhibit A, IRC, p. 25), which the claimant admits (Exhibit A, IRC, p. 5). Thus, the audit was timely initiated on August 1, 2013 when the claimant was notified of the audit (Exhibit B, Controller's Late Comments on the IRC, pp. 95-97).

<sup>11</sup> Exhibit A, IRC, pages 227, 234, 239 and 246.

<sup>12</sup> Exhibit A, IRC, page 252.

<sup>13</sup> Exhibit A, IRC, page 258.

<sup>14</sup> Exhibit A, IRC, page 265. This claim states it is for "7/1/10 to 10/7/10."

<sup>15</sup> Exhibit B, Controller's Late Comments on the IRC, pages 95-97.

<sup>16</sup> Exhibit A, IRC, page 25.

- 07/14/2014 The claimant filed this IRC.<sup>17</sup>
- 11/25/2015 The Controller filed late comments on the IRC.<sup>18</sup>
- 08/25/2017 Commission staff issued the Draft Proposed Decision.<sup>19</sup>
- 09/01/2017 The Controller filed comments on the Draft Proposed Decision.<sup>20</sup>

## II. Background

### A. The *Integrated Waste Management Program*

The test claim statutes require community college districts<sup>21</sup> to adopt and implement, in consultation with CIWMB (which is now the California Department of Resources Recycling and Recovery, or CalRecycle), integrated waste management (IWM) plans to reduce solid waste, reuse materials whenever possible, recycle recyclable materials, and procure products with recycled content in all agency offices and facilities.<sup>22</sup> To implement their plans, districts must divert from landfill disposal at least 25 percent of generated solid waste by January 1, 2002, and at least 50 percent by January 1, 2004. To divert means to “reduce or eliminate the amount of solid waste from solid waste disposal...”<sup>23</sup>

CIWMB developed and adopted a model IWM plan on February 15, 2000, and the test claim statutes provide that if a district does not adopt an IWM plan, the CIWMB model plan governs the community college.<sup>24</sup> Each district is also required to report annually to CIWMB on its progress in reducing solid waste; and the reports’ minimum contents are specified in statute.<sup>25</sup> The test claim statutes also require a community college, when entering into or renewing a lease, to ensure that adequate areas are provided for and adequate personnel are available to oversee collection, storage, and loading of recyclable materials in compliance with CIWMB’s

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<sup>17</sup> Exhibit A, IRC.

<sup>18</sup> Exhibit B, Controller’s Late Comments on the IRC. Note that Government Code section 17553(d) states: “the Controller shall have no more than 90 days after the claim is delivered or mailed to file any rebuttal to an incorrect reduction claim. The failure of the Controller to file a rebuttal to an incorrect reduction claim shall not serve to delay the consideration of the claim by the Commission.” However, in this instance, due to the backlog of IRCs, these late comments have not delayed consideration of this item and so have been included in the analysis and Proposed Decision.

<sup>19</sup> Exhibit C, Draft Proposed Decision.

<sup>20</sup> Exhibit D, Controller’s Comments on the Draft Proposed Decision.

<sup>21</sup> The test claim statutes apply to “state agencies” and define them to include “the California Community Colleges” (Pub. Res. Code, § 40196.3).

<sup>22</sup> Public Resources Code section 42920(b).

<sup>23</sup> Public Resources Code section 40124.

<sup>24</sup> Public Resources Code section 42920(b)(3).

<sup>25</sup> Public Resources Code section 42926.

requirements.<sup>26</sup> Additionally, the test claim statutes added Public Resources Code section 42925(a), which addressed cost savings from IWM plan implementation:

Any cost savings realized as a result of the state agency integrated waste management plan shall, to the extent feasible, be redirected to the agency's integrated waste management plan to fund plan implementation and administration costs, in accordance with Sections 12167 and 12167.1 of the Public Contract Code.

The Public Contract Code sections referenced in section 42925(a) require that revenue received as a result of the community college's IWM plan be deposited in CIWMB's Integrated Waste Management Account. After July 1, 1994, CIWMB is authorized to spend the revenue upon appropriation by the Legislature to offset recycling program costs. Annual revenue under \$2,000 is to be continuously appropriated for expenditure by the community colleges, whereas annual revenue over \$2,000 is available for expenditures upon appropriation by the Legislature.<sup>27</sup>

On March 24, 2004, the Commission adopted the *Integrated Waste Management* Statement of Decision and determined that the test claim statutes impose a reimbursable state-mandated program on community college districts. The Commission also found that cost savings under Public Resources Code section 42925(a) did not preclude a reimbursable mandate under Government Code section 17556(e) because there was no evidence that offsetting savings would result in no net costs to a community college implementing an IWM plan, nor was there evidence that revenues received from plan implementation would be "in an amount sufficient to fund" the cost of the state-mandated program. The Commission found that any revenues received would be identified as offsetting revenue in the Parameters and Guidelines.

The Parameters and Guidelines were adopted on March 30, 2005, and authorize reimbursement for the increased costs to perform the following activities:

A. One-Time Activities (*Reimbursable starting January 1, 2000*)

1. Develop the necessary district policies and procedures for the implementation of the integrated waste management plan.
2. Train district staff on the requirements and implementation of the integrated waste management plan (one-time per employee). Training is

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<sup>26</sup> Public Resources Code section 42924(b).

<sup>27</sup> Public Contract Code sections 12167 and 12167.1 are part of the State Assistance for Recycling Markets Act, which was originally enacted in 1989 to foster the procurement and use of recycled paper products and other recycled resources in daily state operations (See Pub. Contract Code, §§ 12153, 12160; Stats. 1989, ch. 1094). The Act, including sections 12167 and 12167.1, applies to California community colleges only to the limited extent that these sections are referenced in Public Resources Code section 42925. Community colleges are not defined as state agencies or otherwise subject to the Act's provisions for the procurement and use of recycled products in daily state operations. See Exhibit B, Controller's Late Comments on the IRC, page 105 (*State of California, Department of Finance, California Integrated Waste Management Board v. Commission on State Mandates, et al.* (Sacramento County Superior Court, Case No. 07CS00355)).

limited to the staff working directly on the plan.

B. Ongoing Activities (*Reimbursable starting January 1, 2000*)

1. Complete and submit to the [Integrated Waste Management] Board the following as part of the State Agency Model Integrated Waste Management Plan (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.):
  - a. state agency or large state facility information form;
  - b. state agency list of facilities;
  - c. state agency waste reduction and recycling program worksheets that describe program activities, promotional programs, and procurement activities, and other questionnaires; and
  - d. state agency integrated waste management plan questions.

NOTE: Although reporting on promotional programs and procurement activities in the model plan is reimbursable, implementing promotional programs and procurement activities is not.

2. Respond to any Board reporting requirements during the approval process. (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.)
3. Consult with the Board to revise the model plan, if necessary. (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.)
4. Designate one solid waste reduction and recycling coordinator for each college in the district to perform new duties imposed by chapter 18.5 (Pub. Resources Code, §§ 42920 – 42928). The coordinator shall implement the integrated waste management plan. The coordinator shall act as a liaison to other state agencies (as defined by section 40196.3) and coordinators. (Pub. Resources Code, § 42920, subd. (c).)
5. Divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004, through source reduction, recycling, and composting activities. Maintain the required level of reduction, as approved by the Board. (Pub. Resources Code, §§ 42921 & 42922, subd. (i).)

C. Alternative Compliance (*Reimbursable from January 1, 2000 – December 31, 2005*)

1. Seek either an alternative requirement or time extension if a community college is unable to comply with the January 1, 2002 deadline to divert 25 percent of its solid waste, by doing the following: (Pub. Resources Code, §§ 42927 & 42923 subds. (a) & (c).)

- a. Notify the Board in writing, detailing the reasons for its inability to comply.
  - b. Request of the Board an alternative to the January 1, 2002 deadline.
  - c. Provide evidence to the Board that the college is making a good faith effort to implement the source reduction, recycling, and composting programs identified in its integrated waste management plan.
  - d. Provide information that describes the relevant circumstances that contributed to the request for extension, such as lack of markets for recycled materials, local efforts to implement source reduction, recycling and composting programs, facilities built or planned, waste disposal patterns, and the type of waste disposed of by the community college.
  - e. Submit a plan of correction that demonstrates that the college will meet the requirements of Section 42921 [the 25 and 50 percent diversion requirements] before the time extension expires, including the source reduction, recycling, or composting steps the community college will implement, a date prior to the expiration of the time extension when the requirements of Section 42921 will be met, the existing programs that it will modify, any new programs that will be implemented to meet those requirements, and the means by which these programs will be funded.
2. Seek either an alternative requirement or time extension if a community college is unable to comply with the January 1, 2004 deadline to divert 50 percent of its solid waste, by doing the following: (Pub. Resources Code, §§ 42927 & 42922, subs. (a) & (b).)
- a. Notify the Board in writing, detailing the reasons for its inability to comply.
  - b. Request of the Board an alternative to the 50-percent requirement.
  - c. Participate in a public hearing on its alternative requirement.
  - d. Provide the Board with information as to:
    - (i) the community college's good faith efforts to implement the source reduction, recycling, and composting measures described in its integrated waste management plan, and demonstration of its progress toward meeting the alternative requirement as described in its annual reports to the Board;
    - (ii) the community college's inability to meet the 50 percent diversion requirement despite implementing the measures in its plan;
    - (iii) how the alternative source reduction, recycling, and composting requirement represents the greatest diversion amount that the community college may reasonably and feasibly achieve; and,



- (iv) the circumstances that support the request for an alternative requirement, such as waste disposal patterns and the types of waste disposed by the community college.<sup>28</sup>

D. Accounting System (*Reimbursable starting January 1, 2000*)

Developing, implementing, and maintaining an accounting system to enter and track the college's source reduction, recycling and composting activities, the cost of those activities, the proceeds from the sale of any recycled materials, and such other accounting systems which will allow it to make its annual reports to the state and determine waste reduction. Note: only the pro-rata portion of the costs incurred to implement the reimbursable activities can be claimed.

E. Annual Report (*Reimbursable starting January 1, 2000*)

Annually prepare and submit, by April 1, 2002, and by April 1 each subsequent year, a report to the Board summarizing its progress in reducing solid waste. The information in the report must encompass the previous calendar year and shall contain, at a minimum, the following as outlined in section 42926, subdivision (b): (Pub. Resources Code, §§ 42926, subd. (a) & 42922, subd. (i).)

1. calculations of annual disposal reduction;
2. information on the changes in waste generated or disposed of due to increases or decreases in employees, economics, or other factors;
3. a summary of progress made in implementing the integrated waste management plan;
4. the extent to which the community college intends to use programs or facilities established by the local agency for handling, diversion, and disposal of solid waste (If the college does not intend to use those established programs or facilities, it must identify sufficient disposal capacity for solid waste that is not source reduced, recycled or composted.);
5. for a community college that has been granted a time extension by the Board, it shall include a summary of progress made in meeting the integrated waste management plan implementation schedule pursuant to section 42921, subdivision (b), and complying with the college's plan of correction, before the expiration of the time extension;
6. for a community college that has been granted an alternative source reduction, recycling, and composting requirement by the Board pursuant to section 42922, it shall include a summary of progress made towards meeting the alternative requirement as well as an explanation of current

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<sup>28</sup> These alternative compliance and time extension provisions in part C were sunset on January 1, 2006, but were included in the adopted Parameters and Guidelines.

circumstances that support the continuation of the alternative requirement.

F. Annual Recycled Material Reports (*Reimbursable starting July 1, 1999*)

Annually report to the Board on quantities of recyclable materials collected for recycling. (Pub. Contract Code, § 12167.1.) (See Section VII. regarding offsetting revenues from recyclable materials.)

The Parameters and Guidelines further require that each claimed reimbursable cost be supported by contemporaneous source documentation.<sup>29</sup>

And as originally adopted, the Parameters and Guidelines required community college districts to identify and deduct from their reimbursement claims all of the offsetting revenues received from the sale of recyclable materials, limited by the provisions of Public Resources Code section 42925 and Public Contract Code section 12167.1. The original Parameters and Guidelines did not require community colleges to identify and deduct from their claims any offsetting cost savings resulting from the solid waste diversion activities required by the test claim statutes.<sup>30</sup>

**B. Superior Court Decision Regarding Cost Savings and Offsets Under the Program**

After the Parameters and Guidelines were adopted, the Department of Finance (Finance) and CIWMB filed a petition for writ of mandate requesting the court to direct the Commission to set aside the Test Claim Statement of Decision and Parameters and Guidelines and to issue a new Decision and Parameters and Guidelines that give full consideration to the cost savings and offsetting revenues community college districts will achieve by complying with the test claim statutes, including all cost savings realized from avoided landfill disposal fees and revenues received from the collection and sale of recyclable materials. The petitioners further argued that Public Contract Code sections 12167 and 12167.1 do not require community college districts to deposit revenues received from the collection and sale of recyclable materials into the Integrated Waste Management Account, as determined by the Commission, but instead allow community college districts to retain all revenues received. The petitioners argued that such revenues must be identified as offsetting revenues and applied to the costs of the program, without the community college district obtaining the approval of the Legislature or CIWMB.

On May 29, 2008, the Sacramento County Superior Court granted the petition for writ of mandate, finding that the Commission's treatment of cost savings and revenues in the Parameters and Guidelines was erroneous and required that the Parameters and Guidelines be amended. The court said:

There is no indication in the administrative record or in the legal authorities provided to the court that, as respondent [Commission] argues, a California Community College might not receive the full reimbursement of its actual increased costs required by section 6 if its claims for reimbursement of IWM plan costs were offset by realized cost savings and all revenues received from the plan activities.<sup>31</sup>

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<sup>29</sup> Exhibit A, IRC, page 45 (Parameters and Guidelines, adopted March 30, 2005).

<sup>30</sup> Exhibit A, IRC, page 41-51 (Parameters and Guidelines, adopted March 30, 2005).

<sup>31</sup> Exhibit B, Controller's Late Comments on the IRC, page 84 (Ruling on Submitted Matter).

Instead, the court recognized that community colleges are “likely to experience costs savings in the form of reduced or avoided costs of landfill disposal” as a result of the mandated activities in Public Resources Code section 42921 because reduced or avoided costs “are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided.”<sup>32</sup> The court noted that “diversion is defined in terms of landfill disposal for purposes of the IWM plan mandates” and cited the statutory definition of diversion: “activities which reduce or eliminate the amount of solid waste from solid waste disposal for purposes of this division [i.e., division 30, including § 42920 et seq.]” as well as the statutory definition of disposal: “the management of solid waste through landfill disposal or transformation at a permitted solid waste facility.”<sup>33</sup> The court explained that:

[R]eduction or avoidance of landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs of the IWM plan implementation . . . The amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(1) of Public Resources Code section 42926.<sup>34</sup>

The court harmonized section 42925(a) with Public Contract Code sections 12167 and 12167.1:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs “in accordance with Sections 12167 and 12167.1 of the Public Contract Code,” section 42925 assures that cost savings realized from state agencies’ IWM plans are handled in a manner consistent with the handling of revenues received from state agencies’ recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan

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<sup>32</sup> Exhibit B, Controller’s Late Comments on the IRC, page 84 (Ruling on Submitted Matter). Emphasis added.

<sup>33</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 84-85 (Ruling on Submitted Matter).

<sup>34</sup> Exhibit B, Controller’s Late Comments on the IRC, page 85 (Ruling on Submitted Matter). Emphasis added.

implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>35</sup>

The court issued a writ of mandate directing the Commission to amend the Parameters and Guidelines to require community college districts claiming reimbursable costs of an integrated waste management plan to:

1. Identify and offset from their claims, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1, cost savings realized as a result of implementing their plans; and
2. Identify and offset from their claims all of the revenue generated as a result of implementing their plans, without regard to the limitations or conditions described in sections 12167 and 12167.1 of the Public Contract Code.<sup>36</sup>

### **C. Parameters and Guidelines Amendment Pursuant to the Writ**

In compliance with the writ, the Commission amended the Parameters and Guidelines on September 26, 2008 to add section VIII. Offsetting Cost Savings, which states:

Reduced or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans shall be identified and offset from this claim as cost savings, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1. Pursuant to these statutes, community college districts are required to deposit cost savings resulting from their Integrated Waste Management plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the California Integrated Waste Management Board for the purpose of offsetting Integrated Waste Management plan costs. Subject to the approval of the California Integrated Waste Management Board, cost savings by a community college that do not exceed two thousand dollars (\$2,000) annually are continuously appropriated for expenditure by the community college for the purpose of offsetting Integrated Waste Management program costs. Cost savings exceeding two thousand dollars (\$2,000) annually may be available for expenditure by the community college only when appropriated by the Legislature. To the extent so approved or appropriated and applied to the college, these amounts shall be identified and offset from the costs claimed for implementing the Integrated Waste Management Plan.<sup>37</sup>

Section VII. of the Parameters and Guidelines, on Offsetting Revenues, was amended as follows (amendments in ~~strikeout~~ and underline):

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<sup>35</sup> Exhibit B, Controller's Late Comments on the IRC, pages 86-87 (Ruling on Submitted Matter).

<sup>36</sup> Exhibit B, Controller's Late Comments on the IRC, page 31 (Judgment Granting Petition for Writ of Administrative Mandamus).

<sup>37</sup> Exhibit A, IRC, page 63 (Amended Parameters and Guidelines, adopted Sept. 26, 2008).

Reimbursement for this mandate from any source, including but not limited to, services fees collected, federal funds, and other state funds allocated to any service provided under this program, shall be identified and ~~deducted~~ offset from this claim. Offsetting revenue shall include all revenues generated from implementing the Integrated Waste Management Plan. ~~the revenues cited in Public Resources Code section 42925 and Public Contract Code sections 12167 and 12167.1.~~

~~Subject to the approval of the California Integrated Waste Management Board, revenues derived from the sale of recyclable materials by a community college that do not exceed two thousand dollars (\$2,000) annually are continuously appropriated for expenditure by the community college for the purpose of offsetting recycling program costs. Revenues exceeding two thousand dollars (\$2,000) annually may be available for expenditure by the community college only when appropriated by the Legislature. To the extent so approved or appropriated and applied to the college, these amounts are a reduction to the recycling costs mandated by the state to implement Statutes 1999, chapter 764.~~

In addition, revenue from a building-operating fee imposed pursuant to Education Code section 76375, subdivision (a) if received by a claimant and the revenue is applied to this program, shall be deducted from the costs claimed.<sup>38</sup>

All other requirements in the Parameters and Guidelines remained the same.

CIWMB requested additional amendments to the Parameters and Guidelines at this September 2008 hearing, including a request to alter the offsetting savings provision to require community college districts to provide offsetting savings information *whether or not* the offsetting savings generated in a fiscal year exceeded the \$2,000 continuous appropriation required by Public Contract Code sections 12167 and 12167.1. The Commission denied the request because the proposed language went beyond the scope of the court's judgment and writ.<sup>39</sup> As the court found:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs "in accordance with Sections 12167 and 12167.1 of the Public Contract Code," section 42925 assures that cost savings realized from state agencies' IWM plans are handled in a manner consistent with the handling of revenues received from state agencies' recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature,

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<sup>38</sup> Exhibit A, IRC, pages 62-63 (Amended Parameters and Guidelines, adopted Sept. 26, 2008).

<sup>39</sup> Exhibit E, Commission on State Mandates, Excerpt from the Minutes for the September 26, 2008 Meeting.

may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>40</sup>

CIWMB also requested adding a requirement for community college districts to analyze specified categories of potential cost savings when filing their reimbursement claims. The Commission found that the court determined that the amount or value of cost savings is already available from the annual reports the community college districts provide to CIWMB pursuant to Public Resources Code section 42926(b). This report is required to include the district's "calculations of annual disposal reduction" and "information on the changes in waste generated or disposed of due to increases or decreases in employees, economics, or other factors." Thus, the Commission denied CIWMB's request and adopted the staff analysis finding that the request was beyond the scope of the court's writ and judgment. The Commission also noted that the request was the subject of separate pending request filed by CIWMB to amend the Parameters and Guidelines and would therefore be further analyzed for that matter.

#### **D. Subsequent Request by CIWMB to Amend the Parameters and Guidelines to Require Detailed Reports on Cost Savings and Revenues**

CIWMB filed a request to amend the Parameters and Guidelines to require community college districts to submit with their reimbursement claims a separate worksheet and report analyzing the costs incurred and avoided and any fees received relating to staffing, overhead, materials, storage, transportation, equipment, the sale of commodities, avoided disposal fees, and any other revenue received relating to the mandated program as specified by CIWMB. At its January 30, 2009 meeting, the Commission denied the request for the following reasons: there is no requirement in statute or regulation that community college districts perform the analysis specified by CIWMB; the Commission has no authority to impose additional requirements on community college districts regarding this program; the offsetting cost savings paragraph in the Parameters and Guidelines already identifies the offsetting savings consistent with the language of Public Resources Code section 42925(a), Public Contract Code sections 12167 and 12167.1, and the court's judgment and writ; and information on cost savings is already available in the community colleges' annual reports submitted to CIWMB, as required by Public Resources Code section 42926(b)(1).<sup>41</sup>

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<sup>40</sup> Exhibit B, Controller's Late Comments on the IRC, pages 86-87 (Ruling on Submitted Matter).

<sup>41</sup> Exhibit E, Commission on State Mandates, Item 9, Final Staff Analysis of Proposed Amendments to the Parameters and Guidelines for *Integrated Waste Management*, 05-PGA-16, January 30, 2009, pages 2-3.

### **E. *Integrated Waste Management Program Made Optional***

This program was made optional by Statutes 2010, chapter 724 (AB 1610), section 34, effective October 19, 2010, and has remained so since that time.<sup>42</sup>

### **F. *The Controller's Audit***

The Controller audited the reimbursement claims for the 1999-2000, 2000-2001, and 2003-2004 through 2010-2011 fiscal years (the audit period). Of the total of \$436,519 claimed for these fiscal years, the Controller found that \$140,311 is allowable and \$296,208 is unallowable because the claimant did not report offsetting savings from implementation of its IWM plan.<sup>43</sup> The Controller did not audit the claims for 2001-2002 and 2002-2003 because, according to the Controller, the statute of limitations to initiate the audit had expired before the Controller began the review.<sup>44</sup>

The Controller's audit finding is based on the court's ruling, which states that "the amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California community colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(1) of Public Resources Code section 42926,"<sup>45</sup> the resulting amendment to the Parameters and Guidelines, and the claimant's annual reports to CIWMB.<sup>46</sup>

During the audit period, the claimant operated two campuses: FCC and Reedley College, each of which submitted annual reports to CIWMB.<sup>47</sup> The Controller determined, based on the annual reports, that FCC diverted more solid waste than the amount mandated by the test claim statute each year of the audit period.<sup>48</sup> The Controller also found that Reedley College diverted more solid waste than the mandated amount in all years except 2000 and 2003, when the tons of solid waste diverted did not reach the mandated levels.<sup>49</sup> Thus, the Controller found that the claimant realized cost savings in each year of the audit period.

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<sup>42</sup> See Government Code section 17581.5.

<sup>43</sup> Exhibit A, IRC, pages 25, 35 (Final Audit Report). Exhibit B, Controller's Late Comments on the IRC, pages 7 and 28.

<sup>44</sup> Exhibit A, IRC, page 25 (Final Audit Report).

<sup>45</sup> Exhibit B, Controller's Late Comments on the IRC, page 85 (Ruling on Submitted Matter).

<sup>46</sup> Exhibit B, Controller's Late Comments on the IRC, pages 35-77.

<sup>47</sup> Exhibit B, Controller's Late Comments on the IRC, pages 35-55 (FCC Annual Reports) 56-77 (Reedley College Annual Reports).

<sup>48</sup> Exhibit B, Controller's Late Comments on the IRC, page 92.

<sup>49</sup> Exhibit A, IRC, page 35, fn. 2 (final audit report); Exhibit B, Controller's Late Comments on the IRC, page 93.

For the years the claimant *exceeded* the diversion mandate of 25 or 50 percent, the Controller calculated cost savings by allocating the diversion achieved to reflect the state mandate and used the following formula:<sup>50</sup>

$$\text{Offsetting Savings Realized} = \frac{\text{Allocated Diversion \%}}{\text{Actual Diversion \%}} \times \text{Tonnage Diverted} \times \text{Avoided Landfill Disposal Fee (per Ton)}$$

Maximum Allowable Diversion %
Avoided Landfill Disposal Fee (per Ton)

This allocated diversion rate is the percentage of solid waste required to be diverted (25 or 50 percent) divided by the actual percentage of solid waste diverted (as annually reported by the claimant to CIWMB). The resulting quotient is then multiplied by the tons of solid waste diverted, multiplied by the avoided landfill disposal fee (based on the statewide average fee).<sup>51</sup>

The Controller provided an example of how this formula works. For calendar year 2007, FCC reported that it diverted 346.2 tons of solid waste and disposed of 326.8 tons, which totals 673 tons of solid waste generated for that year. Diverting 346.2 tons out of the 673 tons of waste generated results in a diversion rate of 51.44 percent (more than the 50 percent required).<sup>52</sup> The Controller did not want to penalize the claimant for diverting more solid waste than the amount mandated,<sup>53</sup> so the Controller allocated the diversion by dividing the diversion rate mandated by the test claim statute (50 percent) by the actual diversion rate (51.44 percent), which equals 97.2 percent. The allocated diversion rate of 97.2 percent is then multiplied by the 346.2 tons diverted that year, which equals 336.5 tons of diverted solid waste, instead of the 346.2 tons actually diverted. The allocated 336.5 tons of diverted waste is then multiplied by the statewide average disposal fee per ton, which in calendar year 2007 was \$48, resulting in “offsetting cost savings” for calendar year 2007 of \$16,152.<sup>54</sup>

<sup>50</sup> Exhibit A, IRC, pages 37-38 (final audit report); Exhibit B, Controller’s Late Comments on the IRC, page 21.

<sup>51</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 92-93.

<sup>52</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 21, 92 (Controller’s calculations of offsetting savings for Fresno City College).

<sup>53</sup> Exhibit B, Controller’s Late Comments on the IRC, page 20.

<sup>54</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 21, 93 (Controller’s calculations of offsetting savings). Page 21 of the Controller’s Late Comments on the IRC describe the calculation differently than the formula in the audit report, but the result is the same. The Controller states that cost savings can be calculated by multiplying the total tonnage generated (solid waste diverted + disposed) by the mandated diversion percentage (25 or 50 percent), times the avoided landfill disposal fee:

For example, in calendar year 2007, the Fresno City College reported to CalRecycle that it diverted 346.1 tons of solid waste and disposed of 326.8 tons, which results in an overall diversion percentage of 51.4% [Tab 4, page 12]. Because the district was required to divert 50% for that year to meet the mandated



To calculate cost savings when the claimant did *not* reach the mandated diversion rate, the Controller multiplied 100 percent of the solid waste diverted by the avoided landfill disposal fee (based on the statewide average fee). For example, from January 1, 2000, until June 30, 2000, Reedley College generated 793.90 tons of waste, and diverted 195.10 tons, achieving 24.57 percent diversion. The state mandated a 25 percent diversion rate during this time period. The Controller calculated offsetting cost savings by multiplying *all* of the solid waste diverted (195.10 tons) times the avoided landfill disposal fee (\$36.39), for a total offset of \$7,100.<sup>55</sup> In 2000, FCC reported that its annual report had not been finalized, yet costs were claimed for diversion activities for both 1999-2000 and 2000-2001.<sup>56</sup> Since the Controller did not have the 2000 annual report data, the 2001 diversion percentage was used to calculate the offsetting savings for 1999-2000 and 2000-2001.<sup>57</sup>

In 2008, CIWMB stopped requiring community college districts to report the actual tonnage diverted, instead requiring a report based on "per-capita disposal." Consequently, the Controller used the claimant's reported 2007 percentage of tons diverted to calculate the offsetting savings for the last half of fiscal year 2007-2008, as well as for fiscal years 2008-2009, 2009-2010 and 2010-2011.<sup>58</sup>

According to the Controller, the claimant did not provide any documentation to support the use of different diversion rates or different disposal fees to calculate offsetting cost savings.<sup>59</sup>

### **III. Positions of the Parties**

#### **A. State Center Community College District**

The claimant maintains that the audit reductions are incorrect and requests the reinstatement of the full amount reduced. The claimant alleges that it did not realize any cost savings as a result of the mandate and quotes the Superior Court decision (discussed above) that cost savings will "most likely" occur as a result of reduced or avoided costs of landfill disposal. The claimant argues that:

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requirements and comply with the Public Resources Code, it needed to divert only 336.5 tons (673.0 total tonnage generated x 50%) in order to satisfy the 50% requirement. Therefore, we adjusted our calculation to compute offsetting savings based on 336.5 tons of diverted solid waste rather than a total of 346.2 tons diverted.

Using this formula also results in cost savings for calendar year 2007 of \$16,152 (673.0 tons generated x 50 percent = 336.5 tons x \$48 = \$16,152).

<sup>55</sup> Exhibit B, Controller's Late Comments on the IRC, page 93.

<sup>56</sup> Exhibit B, Controller's Late Comments on the IRC, page 34 (FCC 2000 Report). Exhibit A, IRC, pages 209-218 (1999-2000 and 2000-2001 Claims for Payment).

<sup>57</sup> Exhibit A, IRC, page 38 (Final Audit Report).

<sup>58</sup> Exhibit A, IRC, page 38 (Final Audit Report).

<sup>59</sup> Exhibit A, IRC, pages 38, 39 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 23.

The court presupposes a previous legal requirement for districts to incur landfill disposal fees to divert solid waste. Thus, potentially relieved of the need to incur new or additional landfill fees for increased waste diversion, a cost savings would occur. There is no finding of fact or law in the court decision or from the Commission Statement of Decision for the test claim for this assumed duty to use landfills.<sup>60</sup>

The claimant further argues that the offsetting savings provision in the Parameters and Guidelines does not assume that the cost savings occurred, but instead requires that the cost savings be *realized*. For the savings to be realized, the claimant contends that the following chain of events are required:

The cost savings must exist (avoided landfill costs); be converted to cash; amounts in excess of \$2,000 per year deposited in the state fund; and, these deposits by the districts appropriated by the Legislature to districts for purposes of mitigating the cost of implementing the plan. None of those prerequisite events occurred so no cost savings were "realized" by the District. Regardless, the adjustment cannot be applied to the District since no state appropriation of the cost savings was made to the District.<sup>61</sup>

The claimant also argues that the Parameters and Guidelines are silent as to how to calculate the avoided costs, but that the court provided two alternative methods, either disposal reduction or diversion reported by districts. The Controller used the diversion percentage, which assumes, without findings of fact, that all diversion tonnage is landfill disposal tonnage reduction. According to the claimant, the Controller's calculation of cost savings is wrong because: (1) the formula is a standard of general application that was not adopted pursuant to the Administrative Procedure Act and is therefore an unenforceable underground regulation; (2) the Controller's formula assumes facts not in evidence, such as applying the same percentage of waste diverted in 2007 to all subsequent years without evidence in the record, and applying the reported 2001 diversion percentage at FCC to calculate offsetting savings for 1999-2000 and 2000-2001 because the school's annual report had not been finalized, and assumes that all tonnage diverted would have been disposed in a landfill, although some waste may have been composted or may not apply to the mandate (e.g. paint); and (3) the landfill disposal fee, a statewide average calculated by CIWMB, does not include the data used to generate the average fee amounts, so the average is unknown and unsupported by the audit findings.<sup>62</sup>

The claimant also asserts that application of the formula is incorrect. Since no landfill costs were claimed, none can be offset, so the offsets are not properly matched to relevant costs. Moreover, the Controller's calculation method prevents the claimant from receiving full reimbursement for its actual increased program costs. The claimant contends, using audit results for 23 other claimants under the *Integrated Waste Management* program, the application of the Controller's

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<sup>60</sup> Exhibit A, IRC, page 11.

<sup>61</sup> Exhibit A, IRC, page 13. Emphasis in original.

<sup>62</sup> Exhibit A, IRC, pages 14-16.

formula has arbitrary results because the percentages of allowed costs for those claimants ranges from zero to 83.4 percent.<sup>63</sup>

Finally, the claimant argues: (1) the Controller used the wrong standard of review in that the claimed costs were not found to be excessive or unreasonable, as required by Government Code section 17561(d)(2); and (2) the Controller has the burden of proof 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 evidence regarding its auditing methods and procedures, as well as the specific facts relied upon for its audit findings.”<sup>64</sup>

The claimant did not file comments on the Draft Proposed Decision.

### **B. State Controller’s Office**

The Controller maintains that the audit findings are correct. The Controller notes that the claimant does not indicate how solid waste that is not diverted would be disposed of if not at a landfill. In addition, the claimant does not state that it disposed of its solid waste at any location other than a landfill or used any other means to dispose of its waste rather than to contract with a commercial waste hauler.<sup>65</sup>

The Controller concludes that the claimant’s comments relating to alternatives for the disposal of solid waste are irrelevant and cites the claimant’s reports of tonnage disposed, stating that the claimant “does not indicate in these annual reports that it used any other methodology to dispose of solid waste.”<sup>66</sup> The Controller also cites the narrative in some of the claimant’s annual reports that indicates that the claimant disposed of waste in a landfill.<sup>67</sup> According to the Controller: “Unless the district had an arrangement with its waste hauler that it did not disclose to us or CalRecycle, the district did not dispose of its solid waste at a landfill for no cost.”<sup>68</sup>

As to the claimant not remitting cost savings from the implementation of its IWM plan into the Integrated Waste Management Account in compliance with the Public Contract Code, the Controller asserts that the claimant is not precluded from the requirement to do so, as indicated in the Parameters and Guidelines and the court ruling, and that the evidence supports the claimant’s realization of cost savings that should have been remitted to the State and that must be used to fund IWM plan costs.<sup>69</sup>

In response to the claimant’s argument that the Controller’s formula is a standard of general application that is an underground regulation, the Controller asserts that the calculation is a “court approved methodology” to determine the “required offset.” The Controller also states that the claimant did not amend any of its reimbursement claims after the Parameters and Guidelines

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<sup>63</sup> Exhibit A, IRC, pages 16-18.

<sup>64</sup> Exhibit A, IRC, page 21.

<sup>65</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 16-17.

<sup>66</sup> Exhibit B, Controller’s Late Comments on the IRC, page 17.

<sup>67</sup> Exhibit B, Controller’s Late Comments on the IRC, page 17.

<sup>68</sup> Exhibit B, Controller’s Late Comments on the IRC, page 17.

<sup>69</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 18-19.

were amended in September 2008. According to the Controller: “We believe that this “court-identified” approach provides a reasonable methodology to identify the required offset.”<sup>70</sup>

The Controller further explains that for years in which the claimant exceeded the mandated levels (25 or 50 percent) of diversion, the Controller “allocated” the offsetting savings to avoid penalizing the claimant for diverting more than the minimum percentage. According to the Controller:

As there is no State mandate to exceed solid waste diversion for amounts in excess of 25% for calendar years 2002 through 2003 or 50% for calendar year 2004 and later, there is no basis for calculating offsetting savings realized for actual diversion percentages that exceeded the levels set by statute.<sup>71</sup>

The Controller defended its use of the 2001 data to calculate FCC’s diversion rates for fiscal years 1999-2000 and 2000-2001, stating that the Controller confirmed that FCC performed diversion activities in 2000, but the 2000 diversion information was not available because FCC’s annual report had not been finalized.<sup>72</sup>

The Controller notes that after the passage of Statutes 2008, chapter 343, CIWMB no longer required community college districts to report their tonnage or percentage diverted, but they are still required to divert 50 percent of their solid waste. Thus, the Controller asserts that the 2007 annual report is a “fair representation” of 2008 -2011 “because the district’s recycling processes have already been established and committed to.”<sup>73</sup> The Controller notes that the claimant’s reported per-capita disposal rate is well below the target rate for 2008, 2009, and 2010, so “the district met its requirement to divert 50% of its solid waste.”<sup>74</sup> The Controller also cites Reedley College’s 2008 report that states: “In the source reduction area the use of electronic media also shows growth, this was identified in the addition of forms and catalogs now available on our website,” and “One of our Industrial Trades Programs now reports their recycling of tractor and farm equipment metals.”<sup>75</sup> Based on these claimant statements, the Controller states that its savings calculations for 2007-2008 through 2010-2011, could be understated.<sup>76</sup>

The Controller also responds to the claimant’s argument against the assumption that all tonnage diverted would have been disposed in a landfill, and observes that none of the claimant’s annual reports during the audit period mention that any of its waste was composted. The Controller also states that the claimant’s reference to paint or hazardous waste disposal is irrelevant because

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<sup>70</sup> Exhibit B, Controller’s Late Comments on the IRC, page 19.

<sup>71</sup> Exhibit B, Controller’s Late Comments on the IRC, page 21.

<sup>72</sup> Exhibit B, Controller’s Late Comments on the IRC, page 20.

<sup>73</sup> Exhibit B, Controller’s Late Comments on the IRC, page 21.

<sup>74</sup> Exhibit B, Controller’s Late Comments on the IRC, page 21.

<sup>75</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 22 and 71 (2008 Annual Report).

<sup>76</sup> Exhibit B, Controller’s Late Comments on the IRC, page 22.

hazardous waste is not included in the diversion amounts the claimant reported, and are not included in the Controller's offsetting savings calculation.<sup>77</sup>

Regarding the data for the statewide disposal fee, the Controller states the information was provided by CIWMB, is included in the record, and is based on private surveys of a large percentage of landfills across California. In addition, the claimant "did not provide any information, such as its contract with or invoices received from its commercial waste hauler to support either the landfill fees actually incurred by the district or to confirm that the statewide average landfill fee was greater than the actual landfill fees incurred by the district."<sup>78</sup>

In response to the claimant's argument that it "did not claim landfill costs, so there are none to be offset," the Controller answers that the mandated program does not reimburse claimants for landfill costs incurred to dispose of solid waste, so none would be claimable. Rather, the claimant's costs to divert solid waste from disposal are reimbursable, which according to the Controller, results in both a reduction of solid waste going to a landfill in compliance with its IWM plan, and the associated costs of having the waste hauled there, which are required to offset reimbursement claims.<sup>79</sup>

In response to the claimant's argument that "the adjustment method does not match or limit the landfill costs avoided to landfill costs, if any, actually claimed," the Controller quotes Public Resources Code section 42925 which provides that "cost savings realized as a result of the IWM plan are to "fund plan *implementation and administration costs*."<sup>80</sup> The Controller argues that offsetting savings apply to the whole program and is not limited to solid waste diversion activities. The Controller also cites the reimbursable activities in the Parameters and Guidelines that refer to "implementation of the IWM plan," concluding that it is reasonable that offsetting savings from implementing the plan be offset against direct costs to implement the plan. The Controller also asserts that the claimant's reference to other IWM audits is irrelevant to the current issue.<sup>81</sup>

The Controller also disagrees with the claimant's assertion that the Controller used the wrong standard of review. The Controller states that Government Code section 17561(d)(2) authorizes the Controller to audit the district's records to verify actual mandate-related costs, *and* reduce any claim that is excessive or unreasonable. In this case, the claims were excessive because the amount claimed did not take into account any cost savings as required by the test claim statutes. As to the burden of proof, the Controller states that it used data from the claimant's annual reports from implementing its IWM program.<sup>82</sup>

In comments on the Draft Proposed Decision, the Controller agreed with the conclusion that the audit reductions for fiscal years 1999-2000, 2000-2001, the second half of 2003-2004, and 2004-2005 through 2010-2011 are correct as a matter of law. The Controller also agreed to reinstate to

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<sup>77</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>78</sup> Exhibit B, Controller's Late Comments on the IRC, page 23.

<sup>79</sup> Exhibit B, Controller's Late Comments on the IRC, page 23.

<sup>80</sup> Public Resources Code section 42925. Emphasis added.

<sup>81</sup> Exhibit B, Controller's Late Comments on the IRC, pages 23-24.

<sup>82</sup> Exhibit B, Controller's Late Comments on the IRC, pages 26-28.

the claimant \$3,358 for the first half of fiscal year 2003-2004, which the Draft Proposed Decision concluded was incorrectly reduced as a matter of law.<sup>83</sup>

#### **IV. Discussion**

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

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

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6 of the California Constitution.<sup>84</sup> The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 of the California Constitution and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."<sup>85</sup>

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.<sup>86</sup> Under this standard, the courts have found that:

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

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<sup>83</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision, page 1.

<sup>84</sup> *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

<sup>85</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

<sup>86</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space Dist.* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

connection between those factors, the choice made, and the purposes of the enabling statute.” [Citation.]’ ”<sup>87</sup>

The Commission must review the Controller’s audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant. <sup>88</sup> In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission’s regulations require that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission’s ultimate findings of fact must be supported by substantial evidence in the record. <sup>89</sup>

**The Controller’s Reduction of Costs Is Generally Correct as a Matter of Law; However, the Reduction of Costs for the First Half of Fiscal Year 2003-2004 Based on the Incorrect Mandated Diversion Rate, Is Incorrect as a Matter of Law and Is Arbitrary, Capricious, and Entirely Lacking in Evidentiary Support.**

- A. The test claim statutes presume that by complying with the mandate to divert solid waste through the IWM program, landfill fees are reduced or avoided and cost savings are realized.

The test claim statute added Public Resources Code section 42925(a), which provides that “Any cost savings realized as a result of the state agency integrated waste management plan shall, to the extent feasible, be redirected to the agency’s integrated waste management plan to fund plan implementation and administration costs, in accordance with Sections 12167 and 12167.1 of the Public Contract Code.”

The court’s Ruling on Submitted Matter states that community colleges are “likely to experience costs savings in the form of reduced or avoided costs of landfill disposal” as a result of the mandated activities in Public Resources Code section 42921 because reduced or avoided costs “are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided.” The court noted that “diversion is defined in terms of landfill disposal for purposes of the IWM plan mandates.” The statutory definition of diversion is “activities which reduce or eliminate the amount of solid waste from solid waste disposal for purposes of this division.” And the statutory definition of disposal is “the management of solid waste through landfill disposal or transformation at a permitted solid waste facility.”<sup>90</sup> The court explained that:

[R]eduction or avoidance of landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the

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<sup>87</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>88</sup> *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

<sup>89</sup> Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission’s decision is not supported by substantial evidence in the record.

<sup>90</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 84-85 (Ruling on Submitted Matter).

costs of the diversion activities to determine the reimbursable costs of the IWM plan implementation . . . The amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(l) of Public Resources Code section 42926.<sup>91</sup>

The court harmonized section 42925(a) with Public Contract Code sections 12167 and 12167.1:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs “in accordance with Sections 12167 and 12167.1 of the Public Contract Code,” section 42925 assures that cost savings realized from state agencies’ IWM plans are handled in a manner consistent with the handling of revenues received from state agencies’ recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>92</sup>

Thus, the court found that offsetting savings are, by statutory definition, likely to occur as a result of implementing the mandated activities. Reduced or avoided costs “are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided.”<sup>93</sup> As the court held, “landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs. . . .”<sup>94</sup>

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<sup>91</sup> Exhibit B, Controller’s Late Comments on the IRC, page 85 (Ruling on Submitted Matter). Emphasis added.

<sup>92</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 86-87 (Ruling on Submitted Matter).

<sup>93</sup> Exhibit B, Controller’s Late Comments on the IRC, page 84 (Ruling on Submitted Matter).

<sup>94</sup> Exhibit B, Controller’s Late Comments on the IRC, page 85 (Ruling on Submitted Matter). Emphasis added.



The statutes, therefore, presume that by complying with the mandate to divert solid waste through the IWM program, landfill fees are reduced or avoided and cost savings are realized. As indicated in the court's ruling, the amount or value of the cost savings may be determined from the calculations of annual solid waste disposal reduction or diversion, which community colleges are required to annually report to CIWMB. The amount of cost savings realized must be identified by the claimant and used to offset the costs incurred to comply with IWM plan implementation and administration activities approved for reimbursement in the Parameters and Guidelines. Accordingly, the court's ruling requires claimants to report in their reimbursement claims the costs incurred to comply with the reimbursable activities (which includes the activities and costs to divert at least 25 or 50 percent of all solid waste from landfill disposal) and the cost savings from the avoided landfill disposal fees, for a bottom line request for reimbursement of the net increased costs.

The Parameters and Guidelines are consistent with the court's ruling and require in Section IV. that "[t]he claimant is only allowed to claim and be reimbursed for increased costs for reimbursable activities identified below. Increased cost is limited to the cost of an activity that the claimant is required to incur as a result of the mandate."<sup>95</sup> Section VIII. requires that "[r]educed or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans shall be identified and offset from this claim as cost savings, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1."<sup>96</sup> The court's decision and the amended Parameters and Guidelines are binding.<sup>97</sup>

B. During the audit period, the claimant diverted solid waste as required by the test claim statutes, but has filed no evidence to rebut the presumption that cost savings were realized. Thus, the Controller's finding that the claimant realized cost savings is correct as a matter of law.

In this case, the claimant reported no cost savings in its reimbursement claims and asserts that no cost savings were realized, but does not explain why.<sup>98</sup>

The record shows that the claimant diverted more solid waste than required by the test claim statutes except in calendar year 2000 at Reedley College.<sup>99</sup> The test claim statute requires community colleges to divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, through source reduction, recycling, and composting activities, and divert at least 50 percent of all solid waste from landfill disposal or

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<sup>95</sup> Exhibit A, IRC, page 58 (Parameters and Guidelines).

<sup>96</sup> Exhibit A, IRC, page 63 (Parameters and Guidelines).

<sup>97</sup> *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

<sup>98</sup> Exhibit A, IRC, page 9.

<sup>99</sup> Reedley College diverted 24.57 percent of its waste in 2000, just under the state requirement was 25 percent. Exhibit B, Controller's Late Comments on the IRC, pages 56 (Reedley College 2000 Annual Report) and 93.

transformation facilities by January 1, 2004.<sup>100</sup> The claimant's annual reports to CIWMB for calendar years 2000, 2001, and 2003 report diversion of 53.39 percent of the total tonnage of waste generated by FCC, which exceeds the mandated diversion requirement of 25 percent.<sup>101</sup> Reedley College achieved a diversion rate of 24.57 percent in calendar year 2000, just below the 25 percent required by the test claim statute.<sup>102</sup> Reedley College reported diversion of 25.02 to 26.11 percent for calendar years 2001 and 2003.<sup>103</sup> FCC's annual reports to CIWMB for calendar years 2004 through 2007 also report diversion percentages that exceed the mandated diversion requirement of 50 percent, and range from 50.7 to 55.23 percent of the total tonnage of waste generated.<sup>104</sup> Similarly, the claimant's Reedley College annual reports to CIWMB for calendar years 2004 through 2007 range from 67.69 to 69.65 percent of waste diverted.<sup>105</sup>

In 2008, CIWMB stopped requiring community college districts to report the actual amount and percentage of tonnage diverted, and instead required them to report the "per-capita disposal" of waste.<sup>106</sup> As a result, each community college now has a disposal target that is the equivalent to a 50 percent diversion, and is expressed on a per capita basis. So if the district's per-capita disposal rate is less than the target, it means that the district is meeting the requirement to divert 50 percent of its solid waste.<sup>107</sup>

In this case, the reports for 2008, 2009, and 2010 show that the claimant's annual per capita disposal rate for both the employee and student populations to be equal to or less than the target rate (except the FCC 2009 report, showing a student population target of 0.10, and 0.14 was achieved; however the employee population target was 1.8, and 1.3 was achieved). Thus, the claimant satisfied the requirement to divert 50 percent of its solid waste during these years.<sup>108</sup>

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<sup>100</sup> Public Resources Code section 42921; Exhibit A, IRC, pages 55 and 59 (Parameters and Guidelines, section IV.(B)(5)).

<sup>101</sup> Exhibit B, Controller's Late Comments on the IRC, pages 34-38 and 92. FCC did not report diversion for 2000 because it had not finalized its 2000 report.

<sup>102</sup> Exhibit B, Controller's Late Comments on the IRC, page 93.

<sup>103</sup> Exhibit B, Controller's Late Comments on the IRC, pages 58-61 and 92.

<sup>104</sup> Exhibit B, Controller's Late Comments on the IRC, pages 39-46 and 92.

<sup>105</sup> Exhibit B, Controller's Late Comments on the IRC, pages 62-69 and 92.

<sup>106</sup> The new requirement was a result of Statutes 2008, chapter 343 (SB 1016).

<sup>107</sup> Exhibit B, Controller's Late Comments on the IRC, pages 101-109 ("Understanding SB 1016 Solid Waste Per Capita Disposal Measurement Act", <http://www.calrecycle.ca.gov/lgcentral/goalmeasure/Tools/SimplePresen.pdf>.)

<sup>108</sup> Exhibit B, Controller's Late Comments on the IRC, pages 47 (FCC 2008 report, showing an employee population target of 1.8, and 1.8 was achieved; and a student population target of 0.10, and 0.08 was achieved); 50 (FCC 2009 report, showing an employee population target of 1.8, and 1.3 was achieved; and a student population target of 0.10, and 0.14 was achieved); and 53 (FCC 2010 report, showing an employee population target of 1.8, and 0.80 was achieved; and a student population target of 0.10, and 0.09 was achieved), 70 (Reedley College 2008 report, showing an employee population target of 14.2, and 8.8 was achieved; and a student population target of 0.4, and 0.26 was achieved); 72 (Reedley College 2009 report, showing an employee

In addition, the claimant's 2008, 2009, and 2010 reports continue to show that the claimant had solid waste reduction programs in place. In its 2008 report, FCC listed the following programs: Business Source Reduction, Material Exchange, Salvage Yards, Beverage Containers, Cardboard, Office Paper (white), Office Paper (mixed), Scrap Metal, Xeriscaping/grasscycling, White/brown Goods, Scrap Metal, Wood Waste, and as "planned for expansion" Food Waste Composting.<sup>109</sup> In its 2009 report, FCC stated "There are no major types of waste material that we are not diverting"<sup>110</sup> and "The amount of tonnage may be up this year due to the increase of construction and clean-up we have to do."<sup>111</sup> The 2009 report also listed Food Waste Composting as an existing program, whereas in 2008 it was listed as a program that FCC planned or was expanding.<sup>112</sup> The FCC 2010 report also states that "We do not have any major types of waste materials that we are not diverting."<sup>113</sup>

Similarly, the Reedley College 2008 report states, "We now utilize a secure area that allows this processing [for recyclables] to take place without disruption. One of our Industrial Trades Programs now reports their recycling of tractor and farm equipments [sic] metals." It also states, "In the source reduction area the use of electronic media also shows growth, this was identified in the addition of forms and catalogs available on our website" and "Recycling, the participation of the campus student body in our program continues to increased [sic] by the number and type of containers used."<sup>114</sup> Also, "Salvage Yards" was listed as a program that is planned or expanding.<sup>115</sup> The Reedley College 2009 report states:

Our Food Services Department is currently eliminating plastic and paper plates and replacing them with reusable plates. • Though out [sic] our campus we have started a program that all food containers will be disposed in designated receptacles. This will greatly decrease the cross contamination of recyclable trash in the same areas.<sup>116</sup>

According to the Reedley College 2010 report, "The current program has increased its effectiveness by allowing the combining of all office and classroom recyclables in to one

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population target of 14.2, and 8.8 was achieved; and a student population target of 0.40, and 0.26 was achieved); 75 (Reedley College 2010 report, showing an employee population target of 14.2, and 9.7 was achieved; and a student population target of 0.40, and 0.27 was achieved).

<sup>109</sup> Exhibit B, Controller's Late Comments on the IRC, page 49.

<sup>110</sup> Exhibit B, Controller's Late Comments on the IRC, page 51.

<sup>111</sup> Exhibit B, Controller's Late Comments on the IRC, page 52.

<sup>112</sup> Exhibit B, Controller's Late Comments on the IRC, pages 52 and 49.

<sup>113</sup> Exhibit B, Controller's Late Comments on the IRC, page 54.

<sup>114</sup> Exhibit B, Controller's Late Comments on the IRC, page 71.

<sup>115</sup> Exhibit B, Controller's Late Comments on the IRC, page 71.

<sup>116</sup> Exhibit B, Controller's Late Comments on the IRC, page 73.

collection container. . . . Along with this we have greatly decreased the use of plastic trash bags and labor involved in the removing and reinstalling them.”<sup>117</sup>

The record also shows that the tonnage of solid waste that was not diverted was disposed at a landfill. The annual reports filed by the claimant with CIWMB during the audit period identify the total tonnage of waste disposed and the use of a waste hauler.<sup>118</sup> Moreover, there are statements in the Reedley College<sup>119</sup> and FCC annual reports<sup>120</sup> pertaining to decreased landfill disposal, indicating that the claimant used a landfill to some extent. The avoided landfill disposal fee was based on the statewide average disposal fee provided by CIWMB for each fiscal year in the audit period, since the claimant did not provide any information to the Controller regarding the landfill fees it was charged.<sup>121</sup>

Based on this documentation, the Controller correctly presumed, consistent with the presumption in the test claim statutes and the court’s interpretation of those statutes and with no evidence to the contrary, that the percentage of waste diverted results in offsetting savings in an amount equal to the avoided landfill fee per ton of waste required to be diverted.

The statutory presumption of cost savings controls unless the claimant files evidence to rebut the presumption and shows that cost savings were not realized.<sup>122</sup> The claimant has the burden of proof on this issue. Under the mandates statutes and regulations, the claimant is required to show that it has incurred increased costs mandated by the state when submitting a reimbursement claim to the Controller’s Office, and the burden to show that any reduction made by the Controller is incorrect.<sup>123</sup> The Parameters and Guidelines, as amended pursuant to the court’s

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<sup>117</sup> Exhibit B, Controller’s Late Comments on the IRC, page 76.

<sup>118</sup> For example, the FCC 2001 report states, “Our refuge [sic] hauler provides us with data for our Annual Report” See Exhibit B, Controller’s Late Comments on the IRC, page 36. Similar statements were made in the FCC 2003 report (p. 38) the FCC 2004 report (p. 40), the FCC 2005 report (p. 42), the FCC 2006 report (p. 44), the FCC 2007 report (p. 46), the FCC 2008 report (p. 49), the FCC 2009 report (p. 51) and the FCC 2010 report (p. 54).

<sup>119</sup> Exhibit B, Controller’s Late Comments on the IRC, page 65 (Reedley College 2005 report).

<sup>120</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 40 (FCC 2004 report), 44 (FCC 2006 report).

<sup>121</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 23, 116-138.

<sup>122</sup> Government Code section 17559, which requires that the Commission’s decisions be supported by substantial evidence in the record. See also, *Coffy v. Shiimoto* (2015) 60 Cal.4th 1198, 1209, a case interpreting the rebuttable presumption in Vehicle Code section 23152 that if a person had 0.08 percent or more, by weight, of alcohol in the blood at the time of testing, then it is presumed by law that he or she had 0.08 percent or more, by weight, of alcohol in the blood at the time of driving, unless he or she files evidence to rebut the presumption. The court states that unless and until evidence is introduced that would support a finding that the presumption does not exist, the statutory presumption that the person was driving over the legal limit remains the finding of fact.

<sup>123</sup> Evidence Code section 500, which states: “Except as otherwise provided by law, a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the

writ, also require claimants to show the costs incurred to divert solid waste and to perform the administrative activities, and *to report and identify* the costs saved or avoided by diverting solid waste: “Reduced or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans *shall be* identified and offset from this claim as cost savings.”<sup>124</sup> Thus, the claimant has the burden to rebut the statutory presumption and to show, with substantial evidence in the record, that the costs of complying with the mandate exceed any cost savings realized by diverting solid waste.

Accordingly, the Commission finds that the claimant has not filed any evidence to rebut the statutory presumption of cost savings. Therefore, the Controller’s finding that cost savings have been realized is correct as a matter of law.

C. For fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and 2004-2005 through 2010-2011, the Controller’s calculation of cost savings is correct as a matter of law, and is not arbitrary, capricious or entirely lacking in evidentiary support.

The Controller correctly determined that FCC, in all fiscal years of the audit period, diverted more solid waste than the amount mandated by the test claim statute. The Controller also correctly determined that Reedley College diverted more solid waste than mandated by the state in the second half of fiscal years 2000-2001 and 2003-2004, and in fiscal years 2004-2005 through 2010-2011.<sup>125</sup>

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claim for relief or defense that he is asserting.” See also, *Simpson Strong-Tie Co., Inc. v. Gore* (2010) 49 Cal.4th 12, 24, where the court recognized that “the general principle of Evidence Code 500 is that a party who seeks a court's action in his favor bears the burden of persuasion thereon.” This burden of proof is recognized throughout the architecture of the mandates statutes and regulations. Government Code section 17551(a) requires the Commission to hear and decide a claim filed by a local agency or school district that it is entitled to reimbursement under article XIII B, section 6. Section 17551(d) requires the Commission to hear and decide a claim by a local agency or school district that the Controller has incorrectly reduced payments to the local agency or school district. In these claims, the claimant must show that it has incurred increased costs mandated by the state. (Gov. Code, §§ 17514 [defining “costs mandated by the state”], 17560(a) [“A local agency or school district may . . . file an annual reimbursement claim that details the costs actually incurred for that fiscal year.”]; 17561 [providing that the issuance of the Controller’s claiming instructions constitutes a notice of the right of local agencies and school districts to file reimbursement claims based upon the parameters and guidelines, and authorizing the Controller to audit the records of any local agency or school district to “verify the actual amount of the mandated costs.”]; 17558.7(a) [“If the Controller reduces a claim approved by the commission, the claimant may file with the commission an incorrect reduction claim pursuant to regulations adopted by the commission.”]. By statute, only the local agency or school district may bring these claims, and the local entity must present and prove its claim that it is entitled to reimbursement. (See also, Cal. Code Regs., tit. 2, §§ 1185.1, et seq., which requires that the IRC contain a narrative that describes the alleged incorrect reductions, and be signed under penalty of perjury.)

<sup>124</sup> Exhibit A, IRC, page 99 (Parameters and Guidelines). Emphasis added.

<sup>125</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 92-93.

For those years when the claimant exceeded the mandate, the Controller calculated offsetting cost savings by allocating the diversion to reflect the mandate. The Controller allocated the diversion by dividing the percentage of solid waste required to be diverted by the test claim statute (either 25 or 50 percent) by the actual percentage of solid waste diverted (as reported by the claimant to CIWMB). The allocated diversion was then multiplied by the avoided landfill disposal fee (based on the statewide average fee) to calculate the offsetting savings realized for those years.<sup>126</sup>

$$\begin{array}{rcc}
 & \text{Allocated Diversion \%} & \\
 & \text{---} & \\
 & \text{Maximum} & \\
 & \text{Allowable} & \\
 \text{Offsetting} & = \frac{\text{Diversion \%}}{\text{Actual}} & \times \text{Tonnage} \times \text{Avoided} \\
 \text{Savings} & & \text{Diverted} & \times \text{Disposal Fee} \\
 \text{Realized} & & & \text{(per Ton)} \\
 & \text{Diversion \%} & & 
 \end{array}$$

This formula works to allocate or *reduce* cost savings to reflect the mandated rate of diversion, and is intended to prevent penalizing the claimant for diverting more solid waste than the amount mandated by law.<sup>127</sup>

For calendar year 2000, Reedley College achieved a 24.7 percent diversion rate, which the Controller correctly determined did *not* reach the 25 percent diversion rate mandated by the state. To calculate cost savings for that year, the Controller multiplied 100 percent of the solid waste diverted by the claimant for the year (390.2 tons) by the avoided landfill disposal fee (based on the statewide average fee of \$36.39), for a total offset of \$14,200.<sup>128</sup>

These formulas are consistent with the statutory presumption of cost savings, as interpreted by the court for this program, and the requirements in the Parameters and Guidelines. The court found that the test claim statutes require that reduced or avoided landfill fees represent savings that must be offset against the cost of diversion. The court stated: “The amount or value of the [offsetting cost] savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report” to CIWMB.<sup>129</sup> The Parameters and Guidelines state: “Reduced or avoided costs realized from implementation of the community college districts’ Integrated Waste Management plans shall be identified and offset from this claim as cost savings . . . .”<sup>130</sup> Thus, the Controller’s formula correctly presumes, based on the record and without any evidence to the contrary, that the percentage of waste diverted results in offsetting cost savings in an amount equal to the avoided landfill fee per ton of waste required to be diverted. In years when the claimant exceeded the mandated diversion rates, the Controller’s formula limits the offset to reflect the mandated rate.

<sup>126</sup> Exhibit A, IRC, pages 37-38; Exhibit B, Controller’s Late Comments on the IRC, page 21.

<sup>127</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 20-21.

<sup>128</sup> Exhibit B, Controller’s Late Comments on the IRC, page 93.

<sup>129</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 84-85 (Ruling on Submitted Matter). Emphasis added.

<sup>130</sup> Exhibit A, IRC, page 63 (Parameters and Guidelines).

The claimant raises several arguments to assert that the Controller's calculation of cost savings is incorrect. These arguments are not supported by the law or evidence in the record.

The claimant first alleges that cost savings cannot be realized because the chain of events required by Public Contract Code sections 12167 and 12167.1 did not occur: that savings have to be converted to cash, and amounts in excess of \$2000 per year must be deposited in the state fund and appropriated back by the Legislature to mitigate the costs.<sup>131</sup> It is undisputed that the claimant did not remit to the state any savings realized from the implementation of the IWM plan.<sup>132</sup> However, as indicated above, cost savings are presumed by the statutes and the claimant has not filed evidence to rebut that presumption. Thus, the claimant should have deposited the cost savings into the state's account as required by the test claim statutes, and the claimant's failure to comply with the law does not make the Controller's calculations of cost savings incorrect as a matter of law, or arbitrary or capricious. Since cost savings are presumed by the statutes, the claimant has the burden to show increased costs mandated by the state. As the court stated: "[r]eimbursement is not available under section 6 and section 17514 to the extent that a local government or school district is able to provide the mandated program or increased level of service without actually incurring increased costs."<sup>133</sup>

The claimant next asserts that the Controller's formula is an underground regulation.<sup>134</sup> The Commission disagrees. Government Code section 11340.5 provides that no state agency shall enforce or attempt to enforce a rule or criterion which is a regulation, as defined in section 11342.600, unless it has been adopted pursuant to the Administrative Procedures Act. As indicated above, however, the formula is consistent with the statutory presumption of cost savings, as interpreted by the court for this program. Interpretations that arise in the course of case-specific adjudication are not regulations.<sup>135</sup>

The claimant also argues that using landfill fees in the calculation of offsetting savings is not relevant because "[t]he District did not claim landfill costs, so there are none to be offset."<sup>136</sup> The claimant's interpretation of the cost savings requirement is not correct. The cost of disposing waste at a landfill is not eligible for reimbursement. Reimbursement is authorized to *divert* solid waste from the landfill through source reduction, recycling, and composting activities.<sup>137</sup> As explained by the court:

In complying with the mandated solid waste diversion requirements of Public Resources Code section 42921, California Community Colleges are likely to experience cost savings in the form of reduced or avoided costs of landfill

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<sup>131</sup> Exhibit A, IRC, page 13.

<sup>132</sup> Exhibit B, Controller's Late Comments on the IRC, page 18.

<sup>133</sup> Exhibit B, Controller's Late Comments on the IRC, page 84 (Ruling on Submitted Matter).

<sup>134</sup> Exhibit A, IRC, page 14.

<sup>135</sup> *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 571.

<sup>136</sup> Exhibit A, IRC, page 17.

<sup>137</sup> Exhibit A, IRC, page 59 (Parameters and Guidelines).

disposal. The reduced or avoided costs are a direct result and an integral part of the mandated IWM plan ....

Such reduction or avoidance of landfill fees and costs resulting from solid waste diversion activities under § 42920 et seq. represent savings which must be offset against the costs of the diversion activities to determine the reimbursable costs of IWM plan implementation -- i.e., the actual increased costs of diversion -- under section 6 and section 17514.<sup>138</sup>

The court also noted that diversion is defined as “activities which reduce or eliminate the amount of solid waste from solid waste disposal.”<sup>139</sup>

In addition, the claimant argues that the formula assumes facts without evidence in the record. For example, the claimant questions the Controller’s assumption that the diversion percentage achieved in 2007 applies equally to subsequent years; the Controller’s use of the 2001 annual report of tonnage diverted at FCC to calculate offsetting savings for fiscal years 1999-2000 and 2000-2001; the assumption that all diverted waste would have been disposed in a landfill; and the assumption that the statewide average cost to dispose of waste at a landfill actually applied to the claimant.<sup>140</sup>

The Controller’s assumptions, however, are supported by evidence in the record, and the claimant has filed no evidence to rebut them. The Controller applied the diversion percentage achieved in 2007 to subsequent years because CIWMB stopped requiring community college districts to report the actual amount and percent of tonnage diverted in 2008. As the Controller notes, the claimant’s diversion program was well-established by 2007, and the claimant’s reports of subsequent years reflect continued diversion. The claimant’s reports for 2008, 2009, and 2010 show that the claimant’s annual per capita disposal rate for both the employee and student populations was below or near the target rate (the only higher disposal rate was in the FCC 2009 report, showing a student population target of 0.10, and 0.14 was achieved; however the employee population target was 1.8, and 1.3 was achieved). Overall, the evidence indicates that the claimant satisfied the requirement to divert 50 percent of its solid waste during these years.<sup>141</sup>

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<sup>138</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 84-85 (Ruling on Submitted Matter).

<sup>139</sup> Public Resources Code section 40124. Exhibit B, Controller’s Late Comments on the IRC, page 84 (Ruling on Submitted Matter).

<sup>140</sup> Exhibit A, IRC, pages 15-16.

<sup>141</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 47 (FCC 2008 report, showing an employee population target of 1.8, and 1.8 was achieved; and a student population target of 0.10, and 0.08 was achieved); 50 (FCC 2009 report, showing an employee population target of 1.8, and 1.3 was achieved; and a student population target of 0.10, and 0.14 was achieved); and 53 (FCC 2010 report, showing an employee population target of 1.8, and 0.80 was achieved; and a student population target of 0.10, and 0.09 was achieved), 70 (Reedley College 2008 report, showing an employee population target of 14.2, and 8.8 was achieved; and a student population target of 0.4, and 0.26 was achieved); 72 (Reedley College 2009 report, showing an employee population target of 14.2, and 8.8 was achieved; and a student population target of 0.40, and 0.26



In addition, the claimant's 2008, 2009, and 2010 reports continue to show that the claimant had solid waste reduction programs in place. In its 2008 report, FCC listed the following programs: Business Source Reduction, Material Exchange, Salvage Yards, Beverage Containers, Cardboard, Office Paper (white), Office Paper (mixed), Scrap Metal, Xeriscaping/grasscycling, White/brown Goods, Scrap Metal, Wood Waste, and as "planned for expansion" Food Waste Composting.<sup>142</sup> In its 2009 report, FCC stated "There are no major types of waste material that we are not diverting"<sup>143</sup> and "The amount of tonnage may be up this year due to the increase of construction and clean-up we have to do."<sup>144</sup> The 2009 report also listed Food Waste Composting as an existing program, whereas in 2008 it was listed as a program FCC planned to begin or expand.<sup>145</sup> The FCC 2010 report also states that "We do not have any major types of waste materials that we are not diverting."<sup>146</sup>

Similarly, the Reedley College 2008 report states, "One of our Industrial Trades Programs now reports their recycling of tractor and farm equipments [sic] metals." It also states, "In the source reduction area the use of electronic media also shows growth, this was identified in the addition of forms and catalogs available on our website" and "Recycling, the participation of the campus student body in our program continues to increased [sic] by the number and type of containers used."<sup>147</sup> Also, "Salvage Yards" was listed as a program that is planned or expanding.<sup>148</sup> The Reedley College 2009 report states, "Our Food Services Department is currently eliminating plastic and paper plates and replacing them with reusable plates. Though out [sic] our campus we have started a program that all food containers will be disposed in designated receptacles. This will greatly decrease the cross contamination of recyclable trash in the same areas."<sup>149</sup> According to the Reedley College 2010 report, "The current program has increased its effectiveness by allowing the combining of all office and classroom recyclables in to one collection container. . . . Along with this we have greatly decreased the use of plastic trash bags and labor involved in the removing and reinstalling them."<sup>150</sup> Thus, there is evidence in the record that for 2008 through 2010, the claimant met or exceeded the diversion rates reported in 2007.

Evidence in the record also supports the Controller's use of FCC's 2001 annual report of tonnage diverted to calculate offsetting savings for FCC for fiscal years 1999-2000 and 2000-2001. The

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was achieved); 75 (Reedley College 2010 report, showing an employee population target of 14.2, and 9.7 was achieved; and a student population target of 0.40, and 0.27 was achieved).

<sup>142</sup> Exhibit B, Controller's Late Comments on the IRC, page 49.

<sup>143</sup> Exhibit B, Controller's Late Comments on the IRC, page 51.

<sup>144</sup> Exhibit B, Controller's Late Comments on the IRC, page 52.

<sup>145</sup> Exhibit B, Controller's Late Comments on the IRC, pages 52 and 49.

<sup>146</sup> Exhibit B, Controller's Late Comments on the IRC, page 54.

<sup>147</sup> Exhibit B, Controller's Late Comments on the IRC, page 71.

<sup>148</sup> Exhibit B, Controller's Late Comments on the IRC, page 71.

<sup>149</sup> Exhibit B, Controller's Late Comments on the IRC, page 73.

<sup>150</sup> Exhibit B, Controller's Late Comments on the IRC, page 76.

Controller used the 2001 data because FCC's 2000 report stated "Annual Report has not been finalized."<sup>151</sup> However, the record shows that the claimant diverted solid waste in fiscal years 1999-2000 and 2000-2001. Salary and benefit costs were claimed for custodians and gardeners to perform diversion activities in fiscal years 1999-2000 and FY 2000-01.<sup>152</sup> Moreover, FCC's 2001 annual report states "we have increased recycling of beverage containers and the expansion of recycling of paper in the classrooms,"<sup>153</sup> indicating that FCC had been diverting waste prior to the 2001 annual report. And as the Controller stated in the audit report, the claimant did not provide documentation supporting a different "diversion percentage."<sup>154</sup>

The Controller obtained the statewide average cost for landfill disposal fees from CIWMB, which was based on private surveys of a large percentage of landfills across California.<sup>155</sup> The Controller's audit report indicates that the claimant did not provide documentation to support a different disposal fee.<sup>156</sup> In addition, the Controller states:

The district did not provide any information, such as its contract with or invoices received from its commercial waste hauler to support either the landfill fees actually incurred by the district or to confirm that the statewide average landfill fee was greater than the actual landfill fees incurred by the district.<sup>157</sup>

On these audit issues, the Commission may not reweigh the evidence or substitute its judgment for that of the Controller. The Commission must only ensure that the Controller's decision is not arbitrary, capricious, or entirely lacking in evidentiary support, and adequately considered all relevant factors.<sup>158</sup> There is no evidence that the Controller's assumptions are wrong or arbitrary or capricious.

The claimant also points to the Controller's audits of other community college districts, arguing that the costs allowed by the Controller in those cases vary and are arbitrary.<sup>159</sup> The Controller's audits of other community college district reimbursement claims are not relevant to the Controller's audit here. Each audit depends on the documentation and evidence provided by the claimant to show increased costs mandated by the state.

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<sup>151</sup> Exhibit B, Controller's Late Comments on the IRC, page 34 (FCC 2000 Annual Report).

<sup>152</sup> Exhibit A, IRC, pages 210-213 (1999-2000 Reimbursement Claim, \$28,356 claimed), 215-218 (2000-2001 Reimbursement Claim, \$25,358 claimed). Exhibit B, Controller's Late Comments on the IRC, page 20.

<sup>153</sup> Exhibit B, Controller's Late Comments on the IRC, page 36 (FCC 2001 Annual Report).

<sup>154</sup> Exhibit A, IRC, page 38 (Audit Report).

<sup>155</sup> Exhibit B, Controller's Late Comments on the IRC, page 23.

<sup>156</sup> Exhibit A, IRC, page 39.

<sup>157</sup> Exhibit B, Controller's Late Comments on the IRC, page 23.

<sup>158</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>159</sup> Exhibit A, IRC, pages 17-18.

Accordingly, the Controller's calculations of cost savings for fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and fiscal years 2004-2005 through 2010-2011, are correct as a matter of law, and are not arbitrary, capricious, or entirely lacking in evidentiary support.

D. The Controller's calculation of cost savings for the first half of fiscal year 2003-2004 for both colleges is incorrect as a matter of law and is arbitrary, capricious, and entirely lacking in evidentiary support.

For the first half of fiscal year 2003-2004, Reedley College achieved an actual diversion rate of 26.11 percent. The Controller found that Reedley College did not achieve the mandated "50 percent" diversion rate in the first half of fiscal year 2003-2004, even though only 25 percent was required during calendar year 2003. Thus, the Controller did not allocate the diversion to calculate cost savings, but used 100 percent of the solid waste diverted to calculate offsetting savings.<sup>160</sup> In addition, FCC achieved an actual diversion rate of 53.59 percent in the first half of fiscal year 2003-2004.<sup>161</sup> The Controller allocated the diversion rate for FCC, as it did for the other fiscal years, because the claimant exceeded the mandate, but used a 50 percent rate to calculate the allocated diversion rate, when the test claim statutes required only 25 percent diversion in calendar year 2003.<sup>162</sup> The requirement to divert 50 percent of all solid waste did not become operative until January 1, 2004.<sup>163</sup>

As indicated in the Parameters and Guidelines, the mandate is to divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004, through source reduction, recycling, and composting activities.<sup>164</sup> Thus, from July 1, 2003, through December 31, 2003, community college districts were mandated to achieve diversion levels of only 25 percent. The Controller's comments admit that, "as there is no state mandate to exceed solid waste diversion for amounts in excess of 25% for calendar years 2000 through 2003 or 50% for calendar year 2004 and later, there is no basis for calculating offsetting savings realized for actual diversion percentages that exceed the levels set by statute."<sup>165</sup>

However, the Controller's calculation of cost savings, which applied a 50 percent diversion rate to the period from July 1, 2003, through December 31, 2003, instead of the mandated 25 percent diversion rate, is incorrect as a matter of law.<sup>166</sup> In this respect, the Controller's finding, that Reedley College's 26.11 percent diversion of solid waste for the first half of fiscal year 2003-2004 did not achieve the mandated diversion rate, is incorrect as a matter of law. And the

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<sup>160</sup> Exhibit A, IRC, page 35, footnote 2 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 93.

<sup>161</sup> Exhibit B, Controller's Late Comments on the IRC, pages 92-93.

<sup>162</sup> Exhibit B, Controller's Late Comments on the IRC, pages 92-93.

<sup>163</sup> Public Resources Code sections 42921; Exhibit A, IRC, page 95 (Parameters and Guidelines).

<sup>164</sup> Exhibit A, IRC, page 95 (Parameters and Guidelines). This is based on Public Resources Code sections 42921.

<sup>165</sup> Exhibit B, Controller's Late Comments on the IRC, page 21.

<sup>166</sup> Exhibit B, Controller's Late Comments on the IRC, pages 92-93.

Controller's calculation of cost savings for FCC incorrectly applied a 50 percent diversion level to calculate the allocated diversion rate, instead of the mandated 25 percent diversion level.

Moreover, the Controller's calculation of offsetting savings for both colleges, which did not reduce cost savings by allocating the diversion rate to reflect the 25 percent mandated diversion rate as it did for other years when the claimant exceeded the mandate, is arbitrary, capricious, and entirely lacking in evidentiary support. As indicated above, the Controller's formula for offsetting cost savings for years in which the claimant exceeded the diversion mandate, which allocates the diversion based on the mandated rate, is consistent with the test claim statutes and the court's decision on this program. That allocated rate is the percentage of solid waste required to be diverted (25 percent in the first half of fiscal year 2003-2004) divided by the actual percentage of solid waste diverted (as reported by the claimant to CIWMB). The resulting quotient is then multiplied by the tons of solid waste diverted (as annually reported by the claimant to CIWMB), multiplied by the avoided landfill disposal fee (based on the statewide average fee).<sup>167</sup>

Applying the Controller's formula (for years when the claimant exceeded the diversion mandate) to the first half of fiscal year 2003-2004, using the 25 percent diversion requirement to allocate the tons of waste diverted, results in offsetting costs savings of:

- \$7,166 for Reedley College (25 percent divided by 26.11 percent, multiplied by 203.2 tons diverted multiplied by the statewide average landfill disposal fee of \$36.83) rather than \$7,484 as calculated by the Controller using a 100 percent of the solid waste diverted; and
- \$3,039 for FCC (25 percent divided by 53.59 percent, multiplied by 176.9 tons diverted multiplied by the statewide average landfill disposal fee of \$36.83) rather than the \$6,079 calculated by the Controller using a 50 percent diversion rate.

Thus, the difference between the Controller's calculated reduction (\$13,563) and the amount that should have been reduced (\$10,205) is \$3,358, which has been incorrectly reduced.<sup>168</sup>

In comments on the Draft Proposed Decision, the Controller agreed with the conclusion and agreed to reinstate to the claimant \$3,358 for the first half of fiscal year 2003-2004.<sup>169</sup>

Accordingly, the Commission finds that the reduction of costs for the first half of fiscal year 2004-2004 is incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support.

## **V. Conclusion**

Based on the foregoing, the Commission concludes that the Controller's reduction of costs claimed for fiscal years 1999-2000, 2000-2001, the second half of fiscal year 2003-2004, and

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<sup>167</sup> Exhibit A, IRC, pages 34 - 35 (Final Audit Report). Exhibit B, Controller's Late Comments on the IRC, page 77.

<sup>168</sup> Exhibit B, Controller's Late Comments on the IRC, pages 37 (FCC 2003 Annual Report), 60 (Reedley 2003 Annual Report) and 92-93.

<sup>169</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision, page 1.

fiscal years 2004-2005 through 2010-2011 is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

The Commission further concludes that the Controller's reduction of costs claimed for the first half of fiscal year 2003-2004 is partially incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support. The law and the record support offsetting cost savings for the first half of fiscal year 2003-2004 of \$10,205, rather than \$13,563. Therefore, the difference of \$3,358 has been incorrectly reduced and should be reinstated to the claimant.

Accordingly, the Commission partially approves this IRC and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, that the Controller reinstate \$3,358 to the claimant.



RE: **Decision**

*Integrated Waste Management*, 14-0007-I-05

Public Resources Code Sections 40418, 40196.3, 42920-42928;

Public Contract Code Sections 12167 and 12167.1

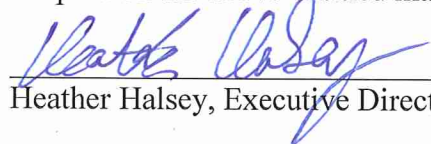
Statutes 1992, Chapter 1116 (AB 3521); Statutes 1999, Chapter 764 (AB 75)

State Agency Model Integrated Waste Management Plan (February 2000)

Fiscal Years: 1999-2000, 2000-2001, 2003-2004, 2004-2005, 2005-2006, 2006-2007,  
2007-2008, 2008-2009, 2009-2010, and 2010-2011

State Center Community College District, Claimant

On December 1, 2017, the foregoing Decision of the Commission on State Mandates was adopted on the above-entitled matter.

  
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Heather Halsey, Executive Director

Dated: December 6, 2017

BEFORE THE  
 COMMISSION ON STATE MANDATES  
 STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM  
 ON:**

Public Resources Code Sections 40148, 40196.3, 42920-42928; Public Contract Code Sections 12167 and 12167.1; Statutes 1992, Chapter 1116 (AB 3521); Statutes 1999, Chapter 764 (AB 75); State Agency Model Integrated Waste Management Plan (February 2000)

Fiscal Years 1999-2000, 2000-2001, 2001-2002, 2002-2003, 2003-2004, 2004-2005, 2005-2006, 2006-2007, 2007-2008, 2008-2009, and 2009-2010

Victor Valley Community College District,  
 Claimant

Case No.: 14-0007-I-06

*Integrated Waste Management*

DECISION PURSUANT TO  
 GOVERNMENT CODE SECTION  
 17500 ET SEQ.; CALIFORNIA CODE OF  
 REGULATIONS, TITLE 2, DIVISION 2,  
 CHAPTER 2.5, ARTICLE 7

*(Adopted December 1, 2017)*

*(Served December 6, 2017)*

**DECISION**

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on December 1, 2017. Yoon-Woo Nam appeared on behalf of the claimant. Lisa Kurokawa appeared for the State Controller’s Office (Controller).

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

The Commission adopted the Proposed Decision to partially approve the IRC by a vote of 6-0 as follows:

<b>Member</b>	<b>Vote</b>
Lee Adams, County Supervisor	Yes
Ken Alex, Director of the Office of Planning and Research	Yes
Richard Chivaro, Representative of the State Controller, Vice Chairperson	Absent
Mark Hariri, Representative of the State Treasurer	Yes
Sarah Olsen, Public Member	Yes
Eraina Ortega, Representative of the Director of the Department of Finance, Chairperson	Yes
Carmen Ramirez, City Council Member	Yes

## **Summary of the Findings**

This IRC addresses reductions made by the Controller to reimbursement claims of the Victor Valley Community College District (claimant) for fiscal years 1999-2000 through 2009-2010, under the *Integrated Waste Management* program, 00-TC-07. The Controller made the audit reductions because the claimant did not identify and deduct from its reimbursement claims offsetting cost savings from its diversion of solid waste and the associated reduced or avoided landfill disposal costs.

The Commission finds that the Controller timely initiated the audit of the fiscal year 1999-2000, 2003-2004, and 2005-2006 reimbursement claims and timely completed the audit for all of the reimbursement claims at issue in this matter pursuant to Government Code section 17558.5. Government Code section 17558.5(a) tolls the time to initiate the audit to three years from the date of initial payment on the claim, rather than three years from the date the claim was filed, “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 record shows that the Controller first made payment on the 1999-2000, 2003-2004, and 2005-2006 reimbursement claims on either January 18, 2011,<sup>1</sup> or January 28, 2011,<sup>2</sup> within three years of the date the audit was initiated on January 17, 2014,<sup>3</sup> so the audit was timely initiated. The audit was complete for all reimbursement claims when the final audit report was issued on April 9, 2014,<sup>4</sup> well before the two-year deadline of January 17, 2016.

On the merits, the Commission finds that the audit reductions are partially correct.

During the audit period, the claimant diverted solid waste, as required by the test claim statutes, and exceeded the mandated diversion rate (25 or 50 percent) in all years of the audit period. Thus, the Controller correctly presumed, consistent with the test claim statutes and the court’s interpretation of those statutes, and without any evidence to the contrary, that the claimant realized cost savings during the audit period equal to the avoided landfill disposal fee per ton of waste required to be diverted.

The Commission further finds, based on the evidence in the record, that the Controller’s calculation of offsetting cost savings for all calendar years in the audit period, except 2002 and 2003, is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support. Because the claimant exceeded the mandate and diverted more solid waste than required by law, the Controller’s cost savings formula “allocated” the diversion by dividing the percentage of solid waste required to be diverted, either 25 or 50 percent, by the actual percentage of solid waste diverted, as reported by the claimant to the California Integrated Waste Management Board (CIWMB). The resulting quotient was then multiplied by the tons of solid waste diverted, as annually reported by the claimant to CIWMB, multiplied by the avoided landfill disposal fee (based on the statewide average fee).<sup>5</sup> The formula allocates cost savings

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<sup>1</sup> Exhibit A, IRC, page 275.

<sup>2</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 38-40.

<sup>3</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 5, 36. Exhibit A, IRC, page 10.

<sup>4</sup> Exhibit A, IRC, page 26 (Final Audit Report).

<sup>5</sup> Exhibit A, IRC, pages 37-38; Exhibit B, Controller’s Late Comments on the IRC, page 22.



based on the mandated rates of diversion, and was intended to prevent penalizing the claimant for diverting more solid waste than the amount mandated by law.<sup>6</sup> The claimant has not filed any evidence to rebut the statutory presumption of cost savings or to show that the statewide average disposal fee is incorrect or arbitrary. Thus, the Controller's reduction of costs claimed for these fiscal years is correct.

However, the Controller's reduction of costs claimed for calendar years 2002 and 2003 (the second half of fiscal year 2001-2002, all of fiscal year 2002-2003, and the first half of fiscal year 2003-2004) is incorrect as a matter of law and arbitrary, capricious, and entirely lacking in evidentiary support. During 2002, the claimant achieved a 46.97 percent diversion rate, and in 2003, a 46.3 percent diversion rate.<sup>7</sup> The Controller found that the claimant did not achieve the mandated "50 percent" diversion rate in calendar years 2002 and 2003, although the mandate is to divert at least 25 percent of all solid waste by January 1, 2002, and at least 50 percent of all solid waste by January 1, 2004.<sup>8</sup> Thus, in calendar years 2002 and 2003, community college districts were required to divert only 25 percent, which the claimant exceeded. Therefore, the Controller's finding, that the claimant did not divert the required rate in calendar years 2002 and 2003 is incorrect as a matter of law. Moreover, the Controller's calculation of offsetting savings for this time period, which used 100 percent of the reported diversion and did not reduce cost savings by allocating the diversion to reflect the mandate as it did for other years when the claimant exceeded the mandate, is arbitrary, capricious, or entirely lacking in evidentiary support. Applying the Controller's calculation of cost savings (using 25 percent to calculate the allocated diversion) to calendar years 2002 and 2003, results in offsetting savings of:

- \$6,746 for 2002 (25 percent divided by 46.97 percent, multiplied by 350.4 tons diverted multiplied by the statewide average landfill disposal fee of \$36.17) rather than \$12,674; and
- \$7,105 for 2003 (25 percent divided by 46.3 percent, multiplied by 357.3 tons diverted multiplied by the statewide average landfill disposal fee of \$36.83) rather than \$13,160.

The Commission finds that the law and the record support offsetting cost savings for calendar years 2002 and 2003 of \$13,851, and the difference of \$11,983 has been incorrectly reduced.

Therefore, the Commission partially approves this IRC, and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, that the Controller reinstate \$11,983 to the claimant.

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<sup>6</sup> Exhibit B, Controller's Late Comments on the IRC, page 22.

<sup>7</sup> Exhibit B, Controller's Late Comments on the IRC, pages 48-53, 94.

<sup>8</sup> Exhibit A, IRC, page 58 (Parameters and Guidelines). This is based on Public Resources Code sections 42921.

## COMMISSION FINDINGS

### I. Chronology

- 09/25/2006 The claimant signed its 1999-2000, 2000-2001, 2001-2002, 2002-2003, 2003-2004, 2004-2005, 2005-2006 reimbursement claims.<sup>9</sup>
- 01/24/2008 The claimant signed its 2006-2007 reimbursement claim.<sup>10</sup>
- 12/19/2008 The claimant signed its 2007-2008 reimbursement claim.<sup>11</sup>
- 01/21/2010 The claimant signed its 2008-2009 reimbursement claim.<sup>12</sup>
- 12/16/2010 The claimant signed its 2009-2010 reimbursement claim.<sup>13</sup>
- 01/17/2014 The Controller notified the claimant of the audit.<sup>14</sup>
- 04/09/2014 The Controller issued the Final Audit Report.<sup>15</sup>
- 07/14/2014 The claimant filed this IRC.<sup>16</sup>
- 07/03/2015 The Controller filed late comments on the IRC.<sup>17</sup>
- 08/25/2017 Commission staff issued the Draft Proposed Decision.<sup>18</sup>
- 09/01/2017 The Controller filed comments on the Draft Proposed Decision.<sup>19</sup>

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<sup>9</sup> Exhibit A, IRC, pages 208, 212, 218, 224, 230, 236, 242.

<sup>10</sup> Exhibit A, IRC, page 247.

<sup>11</sup> Exhibit A, IRC, page 253.

<sup>12</sup> Exhibit A, IRC, page 260.

<sup>13</sup> Exhibit A, IRC, page 266.

<sup>14</sup> Exhibit B, Controller's Late Comments on the IRC, pages 13, 36.

<sup>15</sup> Exhibit A, IRC, page 26 (Final Audit Report).

<sup>16</sup> Exhibit A, IRC.

<sup>17</sup> Exhibit B, Controller's Late Comments on the IRC. Note that Government Code section 17553(d) states: "the Controller shall have no more than 90 days after the claim is delivered or mailed to file any rebuttal to an incorrect reduction claim. The failure of the Controller to file a rebuttal to an incorrect reduction claim shall not serve to delay the consideration of the claim by the Commission." However, in this instance, due to the backlog of IRCs, these late comments have not delayed consideration of this item and so have been included in the analysis and Proposed Decision.

<sup>18</sup> Exhibit C, Draft Proposed Decision.

<sup>19</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision.

## II. Background

### A. The *Integrated Waste Management Program*

The test claim statutes require community college districts<sup>20</sup> to adopt and implement, in consultation with CIWMB (which is now the California Department of Resources Recycling and Recovery, or CalRecycle), integrated waste management (IWM) plans to reduce solid waste, reuse materials whenever possible, recycle recyclable materials, and procure products with recycled content in all agency offices and facilities.<sup>21</sup> To implement their plans, districts must divert from landfill disposal at least 25 percent of generated solid waste by January 1, 2002, and at least 50 percent by January 1, 2004. To divert means to “reduce or eliminate the amount of solid waste from solid waste disposal...”<sup>22</sup>

CIWMB developed and adopted a model IWM plan on February 15, 2000, and the test claim statutes provide that if a district does not adopt an IWM plan, the CIWMB model plan governs the community college.<sup>23</sup> Each district is also required to report annually to CIWMB on its progress in reducing solid waste; and the reports’ minimum contents are specified in statute.<sup>24</sup> The test claim statutes also require a community college, when entering into or renewing a lease, to ensure that adequate areas are provided for and adequate personnel are available to oversee collection, storage, and loading of recyclable materials in compliance with CIWMB’s requirements.<sup>25</sup> Additionally, the test claim statutes added Public Resources Code section 42925(a), which addressed cost savings from IWM plan implementation:

Any cost savings realized as a result of the state agency integrated waste management plan shall, to the extent feasible, be redirected to the agency’s integrated waste management plan to fund plan implementation and administration costs, in accordance with Sections 12167 and 12167.1 of the Public Contract Code.

The Public Contract Code sections referenced in section 42925(a) require that revenue received as a result of the community college’s IWM plan be deposited in CIWMB’s Integrated Waste Management Account. After July 1, 1994, CIWMB is authorized to spend the revenue upon appropriation by the Legislature to offset recycling program costs. Annual revenue under \$2,000 is to be continuously appropriated for expenditure by the community colleges, whereas annual revenue over \$2,000 is available for expenditures upon appropriation by the Legislature.<sup>26</sup>

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<sup>20</sup> The test claim statutes apply to “state agencies” and define them to include “the California Community Colleges” (Pub. Res. Code, § 40196.3).

<sup>21</sup> Public Resources Code section 42920(b).

<sup>22</sup> Public Resources Code section 40124.

<sup>23</sup> Public Resources Code section 42920(b)(3).

<sup>24</sup> Public Resources Code section 42926.

<sup>25</sup> Public Resources Code section 42924(b).

<sup>26</sup> Public Contract Code sections 12167 and 12167.1 are part of the State Assistance for Recycling Markets Act, which was originally enacted in 1989 to foster the procurement and use of recycled paper products and other recycled resources in daily state operations (See Pub.

On March 24, 2004, the Commission adopted the *Integrated Waste Management* Statement of Decision and determined that the test claim statutes impose a reimbursable state-mandated program on community college districts. The Commission also found that cost savings under Public Resources Code section 42925(a) did not preclude a reimbursable mandate under Government Code section 17556(e) because there was no evidence that offsetting savings would result in no net costs to a community college implementing an IWM plan, nor was there evidence that revenues received from plan implementation would be "in an amount sufficient to fund" the cost of the state-mandated program. The Commission found that any revenues received would be identified as offsetting revenue in the Parameters and Guidelines.

The Parameters and Guidelines were adopted on March 30, 2005, and authorize reimbursement for the increased costs to perform the following activities:

A. One-Time Activities (*Reimbursable starting January 1, 2000*)

1. Develop the necessary district policies and procedures for the implementation of the integrated waste management plan.
2. Train district staff on the requirements and implementation of the integrated waste management plan (one-time per employee). Training is limited to the staff working directly on the plan.

B. Ongoing Activities (*Reimbursable starting January 1, 2000*)

1. Complete and submit to the [Integrated Waste Management] Board the following as part of the State Agency Model Integrated Waste Management Plan (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.):
  - a. state agency or large state facility information form;
  - b. state agency list of facilities;
  - c. state agency waste reduction and recycling program worksheets that describe program activities, promotional programs, and procurement activities, and other questionnaires; and
  - d. state agency integrated waste management plan questions.

NOTE: Although reporting on promotional programs and procurement activities in the model plan is reimbursable, implementing promotional programs and procurement activities is not.

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Contract Code, §§ 12153, 12160; Stats. 1989, ch. 1094). The Act, including sections 12167 and 12167.1, applies to California community colleges only to the limited extent that these sections are referenced in Public Resources Code section 42925. Community colleges are not defined as state agencies or otherwise subject to the Act's provisions for the procurement and use of recycled products in daily state operations. See Exhibit B, Controller's Late Comments on the IRC, pages 88-89 (*State of California, Department of Finance, California Integrated Waste Management Board v. Commission on State Mandates, et al.* (Sacramento County Superior Court, Case No. 07CS00355)).

2. Respond to any Board reporting requirements during the approval process. (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.)
3. Consult with the Board to revise the model plan, if necessary. (Pub. Resources Code, § 42920, subd. (b)(3) & State Agency Model Integrated Waste Management Plan, February 2000.)
4. Designate one solid waste reduction and recycling coordinator for each college in the district to perform new duties imposed by chapter 18.5 (Pub. Resources Code, §§ 42920 – 42928). The coordinator shall implement the integrated waste management plan. The coordinator shall act as a liaison to other state agencies (as defined by section 40196.3) and coordinators. (Pub. Resources Code, § 42920, subd. (c).)
5. Divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004, through source reduction, recycling, and composting activities. Maintain the required level of reduction, as approved by the Board. (Pub. Resources Code, §§ 42921 & 42922, subd. (i).)

C. Alternative Compliance (*Reimbursable from January 1, 2000 – December 31, 2005*)

1. Seek either an alternative requirement or time extension if a community college is unable to comply with the January 1, 2002 deadline to divert 25 percent of its solid waste, by doing the following: (Pub. Resources Code, §§ 42927 & 42923 subds. (a) & (c).)
  - a. Notify the Board in writing, detailing the reasons for its inability to comply.
  - b. Request of the Board an alternative to the January 1, 2002 deadline.
  - c. Provide evidence to the Board that the college is making a good faith effort to implement the source reduction, recycling, and composting programs identified in its integrated waste management plan.
  - d. Provide information that describes the relevant circumstances that contributed to the request for extension, such as lack of markets for recycled materials, local efforts to implement source reduction, recycling and composting programs, facilities built or planned, waste disposal patterns, and the type of waste disposed of by the community college.
  - e. Submit a plan of correction that demonstrates that the college will meet the requirements of Section 42921 [the 25 and 50 percent diversion requirements] before the time extension expires, including the source reduction, recycling, or composting steps the community college will implement, a date prior to the expiration of the time extension when the requirements of Section 42921 will be met, the

existing programs that it will modify, any new programs that will be implemented to meet those requirements, and the means by which these programs will be funded.

2. Seek either an alternative requirement or time extension if a community college is unable to comply with the January 1, 2004 deadline to divert 50 percent of its solid waste, by doing the following: (Pub. Resources Code, §§ 42927 & 42922, subds. (a) & (b).)
  - a. Notify the Board in writing, detailing the reasons for its inability to comply.
  - b. Request of the Board an alternative to the 50-percent requirement.
  - c. Participate in a public hearing on its alternative requirement.
  - d. Provide the Board with information as to:
    - (i) the community college's good faith efforts to implement the source reduction, recycling, and composting measures described in its integrated waste management plan, and demonstration of its progress toward meeting the alternative requirement as described in its annual reports to the Board;
    - (ii) the community college's inability to meet the 50 percent diversion requirement despite implementing the measures in its plan;
    - (iii) how the alternative source reduction, recycling, and composting requirement represents the greatest diversion amount that the community college may reasonably and feasibly achieve; and,
    - (iv) the circumstances that support the request for an alternative requirement, such as waste disposal patterns and the types of waste disposed by the community college.<sup>27</sup>

D. Accounting System (*Reimbursable starting January 1, 2000*)

Developing, implementing, and maintaining an accounting system to enter and track the college's source reduction, recycling and composting activities, the cost of those activities, the proceeds from the sale of any recycled materials, and such other accounting systems which will allow it to make its annual reports to the state and determine waste reduction. Note: only the pro-rata portion of the costs incurred to implement the reimbursable activities can be claimed.

E. Annual Report (*Reimbursable starting January 1, 2000*)

Annually prepare and submit, by April 1, 2002, and by April 1 each subsequent year, a report to the Board summarizing its progress in reducing

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<sup>27</sup> These alternative compliance and time extension provisions in part C were sunset on January 1, 2006, but were included in the adopted Parameters and Guidelines.

solid waste. The information in the report must encompass the previous calendar year and shall contain, at a minimum, the following as outlined in section 42926, subdivision (b): (Pub. Resources Code, §§ 42926, subd. (a) & 42922, subd. (i).)

1. calculations of annual disposal reduction;
2. information on the changes in waste generated or disposed of due to increases or decreases in employees, economics, or other factors;
3. a summary of progress made in implementing the integrated waste management plan;
4. the extent to which the community college intends to use programs or facilities established by the local agency for handling, diversion, and disposal of solid waste (If the college does not intend to use those established programs or facilities, it must identify sufficient disposal capacity for solid waste that is not source reduced, recycled or composted.);
5. for a community college that has been granted a time extension by the Board, it shall include a summary of progress made in meeting the integrated waste management plan implementation schedule pursuant to section 42921, subdivision (b), and complying with the college's plan of correction, before the expiration of the time extension;
6. for a community college that has been granted an alternative source reduction, recycling, and composting requirement by the Board pursuant to section 42922, it shall include a summary of progress made towards meeting the alternative requirement as well as an explanation of current circumstances that support the continuation of the alternative requirement.

F. Annual Recycled Material Reports (*Reimbursable starting July 1, 1999*)

Annually report to the Board on quantities of recyclable materials collected for recycling. (Pub. Contract Code, § 12167.1.) (See Section VII. regarding offsetting revenues from recyclable materials.)

The Parameters and Guidelines further require that each claimed reimbursable cost be supported by contemporaneous source documentation.<sup>28</sup>

And as originally adopted, the Parameters and Guidelines required community college districts to identify and deduct from their reimbursement claims all of the offsetting revenues received from the sale of recyclable materials, limited by the provisions of Public Resources Code section 42925 and Public Contract Code section 12167.1. The original Parameters and Guidelines did not require community colleges to identify and deduct from their claims any offsetting cost savings resulting from the solid waste diversion activities required by the test claim statutes.<sup>29</sup>

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<sup>28</sup> Exhibit A, IRC, page 44 (Parameters and Guidelines, adopted March 30, 2005).

<sup>29</sup> Exhibit A, IRC, pages 44-47 (Parameters and Guidelines, adopted March 30, 2005).

## **B. Superior Court Decision on Cost Savings and Offsets Under the Program**

After the Parameters and Guidelines were adopted, the Department of Finance (Finance) and CIWMB filed a petition for writ of mandate requesting the court to direct the Commission to set aside the Test Claim Statement of Decision and Parameters and Guidelines and to issue a new Decision and Parameters and Guidelines that give full consideration to the cost savings and offsetting revenues community college districts will achieve by complying with the test claim statutes, including all cost savings realized from avoided landfill disposal fees and revenues received from the collection and sale of recyclable materials. The petitioners further argued that Public Contract Code sections 12167 and 12167.1 do not require community college districts to deposit revenues received from the collection and sale of recyclable materials into the Integrated Waste Management Account, as determined by the Commission, but instead allow community college districts to retain all revenues received. The petitioners argued that such revenues must be identified as offsetting revenues and applied to the costs of the program, without the community college district obtaining the approval of the Legislature or CIWMB.

On May 29, 2008, the Sacramento County Superior Court granted the petition for writ of mandate, finding that the Commission's treatment of cost savings and revenues in the Parameters and Guidelines was erroneous and required that the Parameters and Guidelines be amended. The court said:

There is no indication in the administrative record or in the legal authorities provided to the court that, as respondent [Commission] argues, a California Community College might not receive the full reimbursement of its actual increased costs required by section 6 if its claims for reimbursement of IWM plan costs were offset by realized cost savings and all revenues received from the plan activities.<sup>30</sup>

Instead, the court recognized that community colleges are “*likely* to experience costs savings in the form of reduced or avoided costs of landfill disposal” as a result of the mandated activities in Public Resources Code section 42921 because reduced or avoided costs “are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided.”<sup>31</sup> The court noted that “diversion is defined in terms of landfill disposal for purposes of the IWM plan mandates” and cited the statutory definition of diversion: “activities which reduce or eliminate the amount of solid waste from solid waste disposal for purposes of this division [i.e., division 30, including § 42920 et seq.]” as well as the statutory definition of disposal: “the management of solid waste through landfill disposal or transformation at a permitted solid waste facility.”<sup>32</sup> The court explained that:

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<sup>30</sup> Exhibit B, Controller's Late Comments on the IRC, page 86 (Ruling on Submitted Matter, Footnote 1).

<sup>31</sup> Exhibit B, Controller's Late Comments on the IRC, page 86 (Ruling on Submitted Matter). Emphasis added.

<sup>32</sup> Exhibit B, Controller's Late Comments on the IRC, pages 86-87 (Ruling on Submitted Matter).



[R]eduction or avoidance of landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs of the IWM plan implementation . . . The amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(1) of Public Resources Code section 42926.<sup>33</sup>

The court harmonized section 42925(a) with Public Contract Code sections 12167 and 12167.1:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs “in accordance with Sections 12167 and 12167.1 of the Public Contract Code,” section 42925 assures that cost savings realized from state agencies’ IWM plans are handled in a manner consistent with the handling of revenues received from state agencies’ recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>34</sup>

The court issued a writ of mandate directing the Commission to amend the Parameters and Guidelines to require community college districts claiming reimbursable costs of an integrated waste management plan to:

1. Identify and offset from their claims, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1, cost savings realized as a result of implementing their plans; and

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<sup>33</sup> Exhibit B, Controller’s Late Comments on the IRC, page 87 (Ruling on Submitted Matter). Emphasis added.

<sup>34</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 88-89 (Ruling on Submitted Matter).

2. Identify and offset from their claims all of the revenue generated as a result of implementing their plans, without regard to the limitations or conditions described in sections 12167 and 12167.1 of the Public Contract Code.<sup>35</sup>

### C. Parameters and Guidelines Amendment Pursuant to the Writ

In compliance with the writ, the Commission amended the Parameters and Guidelines on September 26, 2008 to add section VIII. Offsetting Cost Savings, which states:

Reduced or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans shall be identified and offset from this claim as cost savings, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1. Pursuant to these statutes, community college districts are required to deposit cost savings resulting from their Integrated Waste Management plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the California Integrated Waste Management Board for the purpose of offsetting Integrated Waste Management plan costs. Subject to the approval of the California Integrated Waste Management Board, cost savings by a community college that do not exceed two thousand dollars (\$2,000) annually are continuously appropriated for expenditure by the community college for the purpose of offsetting Integrated Waste Management program costs. Cost savings exceeding two thousand dollars (\$2,000) annually may be available for expenditure by the community college only when appropriated by the Legislature. To the extent so approved or appropriated and applied to the college, these amounts shall be identified and offset from the costs claimed for implementing the Integrated Waste Management Plan.<sup>36</sup>

Section VII. of the Parameters and Guidelines, on Offsetting Revenues, was amended as follows (amendments in ~~strikeout~~ and underline):

Reimbursement for this mandate from any source, including but not limited to, services fees collected, federal funds, and other state funds allocated to any service provided under this program, shall be identified and ~~deducted~~ offset from this claim. Offsetting revenue shall include all revenues generated from implementing the Integrated Waste Management Plan. ~~the revenues cited in Public Resources Code section 42925 and Public Contract Code sections 12167 and 12167.1.~~

~~Subject to the approval of the California Integrated Waste Management Board, revenues derived from the sale of recyclable materials by a community college that do not exceed two thousand dollars (\$2,000) annually are continuously appropriated for expenditure by the community college for the purpose of~~

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<sup>35</sup> Exhibit B, Controller's Late Comments on the IRC, page 33 (Judgment Granting Petition for Writ of Administrative Mandamus).

<sup>36</sup> Exhibit A, IRC page 62 (Amended Parameters and Guidelines, adopted Sept. 26, 2008).

~~offsetting recycling program costs. Revenues exceeding two thousand dollars (\$2,000) annually may be available for expenditure by the community college only when appropriated by the Legislature. To the extent so approved or appropriated and applied to the college, these amounts are a reduction to the recycling costs mandated by the state to implement Statutes 1999, chapter 764.~~

In addition, revenue from a building-operating fee imposed pursuant to Education Code section 76375, subdivision (a) if received by a claimant and the revenue is applied to this program, shall be deducted from the costs claimed.<sup>37</sup>

All other requirements in the Parameters and Guidelines remained the same.

CIWMB requested additional amendments to the Parameters and Guidelines at this September 2008 hearing, including a request to alter the offsetting savings provision to require community college districts to provide offsetting savings information *whether or not* the offsetting savings generated in a fiscal year exceeded the \$2,000 continuous appropriation required by Public Contract Code sections 12167 and 12167.1. The Commission denied the request because the proposed language went beyond the scope of the court's judgment and writ.<sup>38</sup> As the court found:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs "in accordance with Sections 12167 and 12167.1 of the Public Contract Code," section 42925 assures that cost savings realized from state agencies' IWM plans are handled in a manner consistent with the handling of revenues received from state agencies' recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans

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<sup>37</sup> Exhibit A, IRC, pages 49, 61-62 (Amended Parameters and Guidelines, adopted Sept. 26, 2008).

<sup>38</sup> Exhibit E, Commission on State Mandates, Excerpt from the Minutes for the September 26, 2008 Meeting.

in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>39</sup>

CIWMB also requested adding a requirement for community college districts to analyze specified categories of potential cost savings when filing their reimbursement claims. The Commission found that the court determined that the amount or value of cost savings is already available from the annual reports the community college districts provide to CIWMB pursuant to Public Resources Code section 42926(b). This report is required to include the district's "calculations of annual disposal reduction" and "information on the changes in waste generated or disposed of due to increases or decreases in employees, economics, or other factors." Thus, the Commission denied CIWMB's request and adopted the staff analysis finding that the request was beyond the scope of the court's writ and judgment. The Commission also noted that the request was the subject of separate pending request filed by CIWMB to amend the Parameters and Guidelines and would therefore be further analyzed for that matter.

#### **D. Subsequent Request by CIWMB to Amend the Parameters and Guidelines to Require Detailed Reports on Cost Savings and Revenues**

CIWMB filed a request to amend the Parameters and Guidelines to require community college districts to submit with their reimbursement claims a separate worksheet and report analyzing the costs incurred and avoided and any fees received relating to staffing, overhead, materials, storage, transportation, equipment, the sale of commodities, avoided disposal fees, and any other revenue received relating to the mandated program as specified by CIWMB. At its January 30, 2009 meeting, the Commission denied the request for the following reasons: there is no requirement in statute or regulation that community college districts perform the analysis specified by CIWMB; the Commission has no authority to impose additional requirements on community college districts regarding this program; the offsetting cost savings paragraph in the Parameters and Guidelines already identifies the offsetting savings consistent with the language of Public Resources Code section 42925(a), Public Contract Code sections 12167 and 12167.1, and the court's judgment and writ; and information on cost savings is already available in the community colleges' annual reports submitted to CIWMB, as required by Public Resources Code section 42926(b)(1).<sup>40</sup>

#### **E. The *Integrated Waste Management Program* Made Optional**

This program was made optional by Statutes 2010, chapter 724 (AB 1610), section 34, effective October 19, 2010 and has remained so since that time.<sup>41</sup>

#### **F. The Controller's Audit**

The Controller audited the reimbursement claims for the 1999-2000 through 2009-2010 fiscal years (the audit period). Of the \$908,792 claimed for these years, the Controller found that

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<sup>39</sup> Exhibit B, Controller's Late Comments on the IRC, pages 88-89 (Ruling on Submitted Matter).

<sup>40</sup> Exhibit E, Commission on State Mandates, Item 9, Final Staff Analysis of Proposed Amendments to the Parameters and Guidelines for *Integrated Waste Management*, 05-PGA-16, January 30, 2009, pages 2-3.

<sup>41</sup> See Government Code section 17581.5.

\$667,182 is allowable (\$704,860 less a \$37,678 penalty for filing late claims) and \$241,610 is unallowable because the claimant did not report offsetting savings from implementation of its IWM plan.<sup>42</sup>

The Controller’s audit finding is based on the court’s ruling, which states that “the amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California community colleges must annually report to petitioner Integrated Waste Management Board pursuant to subdivision (b)(1) of Public Resources Code section 42926,”<sup>43</sup> the resulting amendment to the Parameters and Guidelines, and the claimant’s annual reports to CIWMB.

The Controller determined that the claimant diverted more solid waste than the amount mandated by the test claim statute each year of the audit period, except for calendar years 2002 and 2003 when the Controller found that the claimant diverted solid waste, but not to the mandated rate of diversion.<sup>44</sup> Thus, the Controller found that the claimant realized cost savings in each year of the audit period.

For the years the claimant exceeded the diversion mandate, the Controller calculated offsetting cost savings by allocating the diversion to reflect the mandate. Thus, instead of using 100 percent of the tons of waste diverted to calculate offsetting savings, the Controller allocated the diversion by dividing the percentage of solid waste required to be diverted (either 25 or 50 percent) by the actual percentage of solid waste diverted (as reported by the claimant to CIWMB). The allocated diversion was then multiplied by the avoided landfill disposal fee (based on the statewide average fee) to calculate the offsetting savings realized in those years.<sup>45</sup>

$$\begin{array}{rcccl}
 & \text{Allocated Diversion \%} & & & \\
 & \text{Maximum} & & & \text{Avoided} \\
 & \text{Allowable} & & & \text{Landfill} \\
 \text{Offsetting} & = & \frac{\text{Diversion \%}}{\text{Actual}} & \times & \text{Disposal Fee} \\
 \text{Savings} & & \text{Diversion \%} & \times & \text{(per Ton)} \\
 \text{Realized} & & & \times & \\
 & & & \text{Tonnage} & \\
 & & & \text{Diverted} & 
 \end{array}$$

The Controller provided an example of how the formula works. For calendar year 2007, the claimant reported diversion of 447.5 tons of solid waste and disposed of 440.0 tons, which totals 887.5 tons of solid waste generated for that year. Diverting 447.5 tons out of the 887.5 tons of waste generated results in a diversion rate of 50.42 percent (more than the 50 percent required).<sup>46</sup> The Controller did not want to penalize the claimant for diverting more solid waste than the

<sup>42</sup> Exhibit A, IRC, page 26 (Final Audit Report). Exhibit B, Controller’s Late Comments on the IRC, pages 7 and 30.

<sup>43</sup> Exhibit B, Controller’s Late Comments on the IRC, page 87 (Ruling on Submitted Matter).

<sup>44</sup> Exhibit A, IRC, page 35, fn. 2 (Final Audit Report); Exhibit B, Controller’s Late Comments on the IRC, page 94.

<sup>45</sup> Exhibit A, IRC, pages 37 (Final Audit Report).

<sup>46</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 22, 94 (Controller’s calculation of offsetting savings).

amount mandated,<sup>47</sup> so the Controller allocated the diversion by dividing the diversion rate mandated by the test claim statute (50 percent) by the actual diversion rate (50.42 percent), which equals 99.17 percent. The 99.17 allocated diversion rate is then multiplied by the 447.5 tons diverted that year, which equals 443.78 tons of diverted solid waste, instead of the 447.5 tons actually diverted. The allocated 443.78 tons of diverted waste is then multiplied by the statewide average disposal fee per ton, which in calendar year 2007 was \$48, resulting in “offsetting cost savings” for calendar year 2007 of \$21,301.<sup>48</sup>

For calendar years 2002 and 2003, the Controller found that the claimant did not achieve the mandated diversion rate (which the Controller found to be 50 percent) so the Controller did not allocate the diversion of solid waste to the mandated rates. Instead, the Controller multiplied 100 percent of the solid waste diverted by the claimant by the avoided landfill disposal fee (based on the statewide average fee) to calculate offsetting savings.<sup>49</sup>

In 2008, CIWMB stopped requiring community college districts to report the actual tonnage diverted, instead requiring a report based on "per-capita disposal." Consequently, the Controller used the claimant’s reported 2007 percentage of tons diverted to calculate the offsetting savings for the last half of fiscal year 2007-2008, as well as for fiscal years 2008-2009 and 2009-2010.

The Controller pointed out in the audit report that the claimant did not provide documentation supporting different diversion rates or disposal fees to calculate offsetting cost savings.<sup>50</sup>

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<sup>47</sup> Exhibit B, Controller’s Late Comments on the IRC, page 22.

<sup>48</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 22, 94 (Controller’s calculations of offsetting savings). Page 22 of the Controller’s Late Comments on the IRC describe the calculation differently than the formula identified in the audit report, but the result is the same. The Controller states that cost savings can be calculated by multiplying the total tonnage generated (solid waste diverted + disposed) by the mandated diversion percentage (25 or 50 percent), times the avoided landfill disposal fee:

For example, in calendar year 2007, the district reported to CalRecycle that it diverted 447.5 tons of solid waste and disposed of 440.0 tons, which results in an overall diversion percentage of 50.4% [**Tab 6, page 23**]. Because the district was required to divert 50% for that year to meet the mandated requirements and comply with the Public Resources Code, it needed to divert only 443.75 tons (887.50 total tonnage generated x 50%) in order to satisfy the 50% requirement. Therefore, we adjusted our calculation to compute offsetting savings based on 443.75 tons of diverted solid waste rather than a total of 447.5 tons diverted.

Using this formula also results in cost savings for calendar year 2007 of \$21,300 (887.5 tons generated x 50 percent = 443.75 tons x \$48 = \$21,300).

<sup>49</sup> Exhibit A, IRC, page 35, fn. 2 (Final Audit Report); Exhibit B, Controller’s Late Comments on the IRC, page 94.

<sup>50</sup> Exhibit A, IRC, page 38 (Final Audit Report).

### III. Positions of the Parties

#### A. Victor Valley Community College District

The claimant maintains that the audit reductions are incorrect and requests the reinstatement of the full amount reduced.

The claimant first argues that the three-year deadline to initiate the audit had expired for fiscal years 1999-2000, 2003-2004 and 2005-2006, when the Controller commenced the audit. According to the claimant:

Pursuant to Chapter 724, Statutes of 2010, appropriations were made to the District by January 14, 2011, for the following fiscal years: FY 1999-00 (\$20,479); FY 2003-04 (\$22,748); and FY 2005-06 (\$103,900). See Exhibit D. The exact date of payment is a matter of record not available to the District but that can be produced by the Controller.<sup>51</sup>

The claimant cites the audit report that states that the claimant was first contacted by the Controller on January 17, 2014 regarding the audit, which is more than three years after the January 14, 2011, appropriation for the three referenced annual claims, so the Controller did not have jurisdiction to audit fiscal years 1999-2000, 2003-2004 and 2005-2006.<sup>52</sup>

The claimant next alleges that it did not realize any cost savings as a result of the mandate and quotes the Superior Court decision (discussed above) that cost savings will “most likely” occur as a result of reduced or avoided costs of landfill disposal. The claimant argues:

The court presupposes a previous legal requirement for districts to incur landfill disposal fees to divert solid waste. Thus, potentially relieved of the need to incur new or additional landfill fees for increased waste diversion, a cost savings would occur. There is no finding of fact or law in the court decision or from the Commission Statement of Decision for the test claim for this assumed duty to use landfills.<sup>53</sup>

The claimant further argues that the offsetting savings provision in the Parameters and Guidelines does not assume that the cost savings occurred, but instead requires that the cost savings be *realized*. For the savings to be realized, the claimant contends that the following chain of events are required:

[T]he cost savings must exist (avoided landfill costs); be converted to cash; amounts in excess of \$2,000 per year deposited in the state fund; and, these deposits by the districts appropriated by the Legislature to districts for purposes of mitigating the cost of implementing the plan. None of those prerequisite events occurred so no cost savings were "realized" by the District. Regardless, the

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<sup>51</sup> Exhibit A, IRC, page 9.

<sup>52</sup> Exhibit A, IRC, page 10.

<sup>53</sup> Exhibit A, IRC, page 12.

adjustment cannot be applied to the District since no state appropriation of the cost savings was made to the District.<sup>54</sup>

The claimant also argues that the Parameters and Guidelines are silent as to how to calculate the avoided costs, but that the court provided two alternative methods, either disposal reduction or diversion reported by districts. The Controller used the diversion percentage, which assumes, without findings of fact, that all diversion tonnage is landfill disposal tonnage reduction. The claimant contends that the Controller's calculation of cost savings is wrong because: (1) the formula is a standard of general application that was not adopted pursuant to the Administrative Procedure Act and is therefore an unenforceable underground regulation; (2) the Controller's formula assumes facts not in evidence, such as applying the same percentage of waste diverted in 2007 to all subsequent years without evidence in the record, and assumes that all tonnage diverted would have been disposed in a landfill, although some waste may have been composted or may not apply to the mandate (e.g. paint); and (3) the landfill disposal fee, a statewide average calculated by CIWMB, does not include the data used to generate the average fee amounts, so the average is unknown and unsupported by the audit findings.<sup>55</sup>

The claimant also asserts that application of the formula is incorrect. The claimant alleges that it "claimed \$50,347 in landfill costs, which is the maximum that can potentially be offset, if it was realized. The adjustment method does not match or limit the landfill costs avoided to landfill costs, actually claimed by year."<sup>56</sup> Moreover, the Controller's calculation method prevents the claimant from receiving full reimbursement for its actual increased program costs. The claimant contends, using audit results for 23 other claimants under the *Integrated Waste Management* program, the application of the Controller's formula has arbitrary results because the percentages of allowed costs for those claimants ranges from zero to 83.4 percent.<sup>57</sup>

Finally, the claimant argues: (1) the Controller used the wrong standard of review in that the claimed costs were not found to be excessive or unreasonable, as required by Government Code section 17561(d)(2); and (2) the Controller has the burden of proof 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 evidence regarding its auditing methods and procedures, as well as the specific facts relied upon for its audit findings."<sup>58</sup>

The claimant did not file comments on the Draft Proposed Decision.

## **B. State Controller's Office**

The Controller maintains that the audit findings are correct. The Controller first argues that it complied with the three-year audit deadline in Government Code section 17558.5, in that it made payment to the claimant for 1999-2000, 2003-2004, and 2005-2006 on January 28, 2011, and notified the district of payments made pursuant to Chapter 724, Statutes 2010, totaling \$147,127.

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<sup>54</sup> Exhibit A, IRC, pages 14. Emphasis in original.

<sup>55</sup> Exhibit A, IRC, pages 14-17.

<sup>56</sup> Exhibit A, IRC, page 17.

<sup>57</sup> Exhibit A, IRC, pages 17-19.

<sup>58</sup> Exhibit A, IRC, pages 21-22.



Because it initiated the audit on January 17, 2014, within the three-year deadline, the Controller had jurisdiction to audit the claims for fiscal years 1999-2000, 2003-2004 and 2005-2006.<sup>59</sup>

The Controller also notes that the claimant does not indicate how solid waste that is not diverted would be disposed of if not at a landfill. In addition, the claimant does not state that it disposed of its solid waste at any location other than a landfill or used any other means to dispose of its waste rather than to contract with a commercial waste hauler.<sup>60</sup>

The Controller concludes that the claimant's comments relating to alternatives for the disposal of solid waste are irrelevant. The Controller cites the claimant's annual reports of tonnage disposed for each year of the audit period, arguing that the claimant "does not indicate in these annual reports that it used any other methodology to dispose of solid waste other than the landfill."<sup>61</sup> The Controller also cites some of the claimant's annual reports that indicates that the claimant disposed of waste in a landfill.<sup>62</sup> According to the Controller:

Unless the district had an arrangement with its waste hauler that it did not disclose to us or CalRecycle, the district did not dispose of its solid waste at a landfill for no cost. Victor Valley Community College is located in Victorville, California. An internet search for landfill fees revealed that the Victorville Landfill in Victorville, California (12 miles from Victor Valley College), currently charges \$59.94 per ton to dispose of solid waste [citation omitted]. Therefore, the higher rate of diversion results in less trash that is disposed at a landfill, which creates cost savings to the district.<sup>63</sup>

As to the claimant not remitting cost savings from the implementation of its IWM plan into the Integrated Waste Management Account in compliance with the Public Contract Code, the Controller asserts that the claimant is not precluded from the requirement to do so, as indicated in the Parameters and Guidelines and the court ruling. The Controller says the evidence supports that the claimant realized cost savings that should have been remitted to the State and that must be used to fund IWM plan costs.<sup>64</sup>

In response to the claimant's argument that the Controller's formula is a standard of general application that is an underground regulation, the Controller responds that the calculation is a "court approved methodology" to determine the "required offset." The Controller also states that the claimant did not amend any of its reimbursement claims after the Parameters and Guidelines were amended in September 2008. According to the Controller: "We believe that this "court-identified" approach provides a reasonable methodology to identify the required offset."<sup>65</sup>

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<sup>59</sup> Exhibit B, Controller's Late Comments on the IRC, pages 12-13.

<sup>60</sup> Exhibit B, Controller's Late Comments on the IRC, pages 19.

<sup>61</sup> Exhibit B, Controller's Late Comments on the IRC, page 19.

<sup>62</sup> Exhibit B, Controller's Late Comments on the IRC, page 19.

<sup>63</sup> Exhibit B, Controller's Late Comments on the IRC, page 19.

<sup>64</sup> Exhibit B, Controller's Late Comments on the IRC, page 20.

<sup>65</sup> Exhibit B, Controller's Late Comments on the IRC, page 21.

The Controller also states that it “allocated” the offsetting savings to avoid penalizing the claimant for diverting more than the minimum percentage of diversion required in calendar years 2000, 2001, and 2004 through 2007. According to the Controller:

As there is no State mandate to exceed solid waste diversion for amounts in excess of 25% for calendar years 2000 and 2003 or greater than 50% for calendar year 2004 and beyond, there is no basis for calculating offsetting savings realized for actual diversion percentages that exceeded the levels set by statute.<sup>66</sup>

The Controller notes that after the passage of Statutes 2008, chapter 343, CIWMB no longer required districts to report their tonnage or percentage diverted, but they are still required to divert 50 percent of their solid waste.<sup>67</sup>

Defending its use of the claimant’s 2007 reported diversion rate to calculate offsetting savings for 2007-2008 through 2009-2010, the Controller calls the 2007 report a “fair representation” of 2008 -2010 because the claimant’s Director of Maintenance and Operations told the auditors that his information was “pretty much inline” with the Controller’s data, and “because the district’s recycling processes have already been established and committed to”<sup>68</sup> The Controller notes that the claimant’s reported per-capita disposal rate is well below the target rate for 2008, 2009, and 2010, so “the district far surpassed its requirement to divert more than 50% of its solid waste.”<sup>69</sup> The Controller also cites the claimant’s 2009 and 2010 annual reports, in which the claimant did not respond to the question regarding changes to waste diversion programs, indicating that no changes were implemented either year.<sup>70</sup>

The Controller also responded to the claimant’s argument against the assumption that all tonnage diverted would have been disposed in a landfill, even though some waste may have been composted or may not apply to the mandate (e.g. paint). The Controller points out a statement in the claimant’s 2001 annual report that it began composting that year, and also notes that nearly \$100,000 was claimed for salaries and benefits for groundskeepers for diversion via composting. According to the Controller, “it seems reasonable that the correlated landfill fees that the district did not incur for the composted materials translate into savings realized by the district . . . [that] should be recognized and appropriately offset against composting costs that the district incurred and claimed as part of implementing its IWM plan.”<sup>71</sup> The Controller also states that the claimant’s reference to paint disposal is irrelevant because hazardous waste is not included in the diversion amounts that the claimant reported, and therefore, are not included in the Controller’s offsetting savings calculation.<sup>72</sup>

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<sup>66</sup> Exhibit B, Controller’s Late Comments on the IRC, page 22.

<sup>67</sup> Exhibit B, Controller’s Late Comments on the IRC, page 22.

<sup>68</sup> Exhibit B, Controller’s Late Comments on the IRC, page 23.

<sup>69</sup> Exhibit B, Controller’s Late Comments on the IRC, page 22.

<sup>70</sup> Exhibit B, Controller’s Late Comments on the IRC, page 23.

<sup>71</sup> Exhibit B, Controller’s Late Comments on the IRC, page 23.

<sup>72</sup> Exhibit B, Controller’s Late Comments on the IRC, page 23.

Regarding the data for the statewide disposal fee, the Controller states the information was provided by CIWMB, is included in the record, and is based on private surveys of a large percentage of landfills across California. The Controller also cites its internet search for landfill fees revealed that the Victorville Landfill, in Victorville, California, currently charges \$59.94 per ton to dispose of solid waste, so the \$36 to \$56 "statewide average disposal fee" used to calculate the offsetting savings realized by the district is reasonable. In addition, the claimant "did not provide any information, such as its contract with or invoices received from its commercial waste hauler to support either the landfill fees actually incurred by the district or to confirm that the statewide average landfill fee was greater than the actual landfill fees incurred by the district."<sup>73</sup>

In response to the claimant's argument that it claimed "\$50,347 in landfill costs, which is the maximum that can potentially be offset, if it was realized" the Controller answers that the mandated program does not reimburse claimants for landfill costs incurred to dispose of solid waste, so none would be claimable. Rather, the program reimburses claimants' costs to divert solid waste from disposal, which according to the Controller, results in both a reduction of solid waste going to a landfill and the associated costs of having the waste hauled there, which creates offsetting savings that the claimant is required to identify in its reimbursement claims.<sup>74</sup>

In response to the claimant's argument that "the adjustment method does not match or limit the landfill costs avoided to landfill costs, if any, actually claimed," the Controller quotes Public Resources Code section 42925 which provides that "cost savings realized as a result of the IWM plan are to "fund plan *implementation and administration costs.*"<sup>75</sup> The Controller argues that offsetting savings applies to the whole program and is not limited to solid waste diversion activities. The Controller also cites the reimbursable activities in the Parameters and Guidelines that refer to "implementation of the IWM plan," concluding that it is reasonable that offsetting savings from implementing the plan be offset against direct costs to implement the plan. The Controller also asserts that the claimant's reference to other IWM audits is irrelevant to the current issue.<sup>76</sup>

The Controller also disagrees with claimant's argument that the Controller used the wrong standard of review. The Controller cites the statute that authorizes it to audit the claimant's records to verify actual mandate-related costs *and* reduce any claim that is excessive or unreasonable. In this case, the claims were excessive because the amount claimed did not account for the cost savings required by the test claim statutes. As to the burden of proof, the Controller states that it used data from the claimant's annual reports to CIWMB from implementing its IWM program.<sup>77</sup>

In comments on the Draft Proposed Decision, the Controller agreed with the conclusion that the audit reductions for all years in the audit period except calendar years 2002 and 2003 were

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<sup>73</sup> Exhibit B, Controller's Late Comments on the IRC, page 24.

<sup>74</sup> Exhibit B, Controller's Late Comments on the IRC, page 25.

<sup>75</sup> Public Resources Code section 42925. Emphasis added.

<sup>76</sup> Exhibit B, Controller's Late Comments on the IRC, pages 25-26.

<sup>77</sup> Exhibit B, Controller's Late Comments on the IRC, pages 28-29.

correct. The Controller also agreed to reinstate to the claimant \$11,983 for calendar years 2002 and 2003 because the Draft Proposed Decision concluded the reduction was incorrect as a matter of law.<sup>78</sup>

#### IV. Discussion

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

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

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6 of the California Constitution.<sup>79</sup> The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 of the California Constitution and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."<sup>80</sup>

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.<sup>81</sup> Under this standard, the courts have found that:

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

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<sup>78</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision, page 1.

<sup>79</sup> *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

<sup>80</sup> *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

<sup>81</sup> *Johnston v. Sonoma County Agricultural Preservation and Open Space Dist.* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

connection between those factors, the choice made, and the purposes of the enabling statute.” [Citation.]’ ”<sup>82</sup>

The Commission must review the Controller’s audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant. <sup>83</sup> In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission’s regulations require that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission’s ultimate findings of fact must be supported by substantial evidence in the record. <sup>84</sup>

**A. The Controller Timely Initiated the Audit for Fiscal Years 1999-2000, 2003-2004, and 2005-2006, and Timely Completed the Audit of All Claims.**

Government Code section 17558.5 requires an audit to be initiated no later than three years after the date the reimbursement claim is filed or last amended. However, section 17558.5 also provides that *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.”<sup>85</sup> “In any case,” section 17558.5 requires the audit to be completed no later than two years after it is commenced.<sup>86</sup>

1. The audit of the 1999-2000, 2003-2004, and 2005-2006 reimbursement claim was timely initiated.

The claimant signed its 1999-2000, 2003-2004, and 2005-2006 reimbursement claims on September 25, 2006,<sup>87</sup> but the State did not pay them until January 2011. The claimant alleges that appropriations were made to the claimant by January 14, 2011 for these years, and that the Controller initiated the audit more than three years later on January 17, 2014, according to the final audit report. Therefore, the claimant asserts that the Controller did not timely initiate the audit.<sup>88</sup>

Government Code section 17558.5(a) tolls the time to initiate the audit to three years from the date of initial payment on the claim, rather than three years from the date the claim was filed, “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,” as follows:

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<sup>82</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>83</sup> *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

<sup>84</sup> Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission’s decision is not supported by substantial evidence in the record.

<sup>85</sup> Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

<sup>86</sup> Government Code section 17558.5 (as amended, Stats. 2004, ch. 890 (AB 2856)).

<sup>87</sup> Exhibit A, IRC, pages 208, 230, 242.

<sup>88</sup> Exhibit A, IRC, pages 9-10.

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*. In any case, an audit shall be completed not later than two years after the date that the audit is commenced.<sup>89</sup>

Although the Controller agrees that payment was first made on these 1999-2000, 2003-2004, and 2005-2006 claims in January 2011, the parties dispute the date of payment. The claimant alleges:

Pursuant to Chapter 724, Statutes of 2010, appropriations were made to the District by January 14, 2011, for the following fiscal years: FY 1999-00 (\$20,479); FY 2003-04 (\$22,748); and, FY 2005-06 (\$103,900). See Exhibit D. The exact date of payment is a matter of record not available to the District but that can be produced by the Controller.<sup>90</sup>

There is no evidence in the record, however, to support the claimant’s assertion that payment was made by January 14, 2011. Rather, the record supports a finding that payment was first made on the 1999-2000, 2003-2004, and 2005-2006 reimbursement claims on either January 18, 2011, or January 28, 2011.

The claimant filed, as part of its IRC, a copy of a notice from the Controller to the claimant dated April 18, 2014 (following the audit), showing the audit adjustments to the 2003-2004 reimbursement claim, and noting a payment on this reimbursement claim on *January 18, 2011* by “Schedule No. AP00123A” of \$22,748. The letter states in pertinent part:

FIELD AUDIT FINDINGS	-	16,219.00
LATE CLAIM PENALTY	-	7.725.00
TOTAL ADJUSTMENTS		- 23,944.00
PRIOR PAYMENTS:		
SCHEDULE NO. AP00123A		
<b>PAID 01-18-2011</b>	-	22,748.00
TOTAL PRIOR PAYMENTS		- 22,748.00 <sup>91</sup>

The claimant’s IRC does not include documentation that identifies the payment dates for fiscal years 1999-2000 or 2005-2006.<sup>92</sup>

<sup>89</sup> Emphasis added. This is the current version of section 17558.5, and the version in effect when these reimbursement claim was signed in September 2006 (Exhibit A, IRC, pp. 208, 230, 242).

<sup>90</sup> Exhibit A, IRC, page 9.

<sup>91</sup> Exhibit A, IRC, page 275. Emphasis added.

<sup>92</sup> For 1999-2000 and 2005-2006, claimant attached a “Claim Adjustment Detail List” which does not include the payment dates. (Exhibit A, pages 271, 277.)

The Controller asserts that payment was first made on the reimbursement claims on *January 28, 2011*, pursuant to Statutes of 2010, chapter 724 (AB 1610, eff. October 19, 2010).<sup>93</sup> That statute appropriated funds to offset the outstanding balance of the State’s minimum funding obligation under Proposition 98 to school districts and community college districts, and required that funds first be paid in satisfaction of any outstanding claims for reimbursement of state-mandated costs. The Controller filed a copy of a remittance advice showing payments to the claimant under AB 1610 for several state-mandated programs, including \$154,746 for the *Integrated Waste Management* program for fiscal years 1999-2000, 2003-2004, and 2005-2006 in “CLAIM SCHEDULE NUMBER: 1000149A, PAYMENT ISSUE DATE: 01/28/2011.”<sup>94</sup>

The Controller has not explained the discrepancy between the notice indicating payment of \$22,748 for the 2003-2004 reimbursement claim on January 18, 2011 by “Schedule No. AP00123A,” and the remittance advice indicating payment for the 1999-2000, 2003-2004 and 2005-2006 reimbursement claims on January 28, 2011 by “Schedule Number: 1000149A.” Nevertheless, the Controller issued both documents that support a finding that payment was first made on the 2003-2004 reimbursement claim on either January 18, 2011, or January 28, 2011. And the remittance advice filed by the Controller supports a finding that the State made payment on the fiscal year 1999-2000 and 2005-2006 reimbursement claims on January 28, 2011.

As indicated above, Government Codes section 17558.5(a) tolls the time to initiate the audit of a claim “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,” to three years from the date of initial payment on the claim. Therefore, using the earlier of the two dates in documents showing payment on the 2003-2004 reimbursement claim on January 18, 2011, the Controller had until January 18, 2014 to initiate the audit of the 2003-2004 reimbursement claim. And using the only date in the record showing payment on the 1999-2000 and 2005-2006 reimbursement claims on January 28, 2011, the Controller had until January 28, 2014 to initiate the audit of the claims for those years.

The Legislature has not specifically defined the event that initiates the audit and, unlike other auditing agencies,<sup>95</sup> the Controller has not adopted formal regulations (which can be viewed as the controlling interpretation of a statute), to clarify when the audit of a mandate reimbursement claim begins. Therefore, the Commission cannot, as a matter of law, state the event that initiates an audit in all cases, but must determine when the audit was initiated based on evidence in the record. Initiating an audit requires a unilateral act of the Controller. In this respect, Government

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<sup>93</sup> Exhibit A, IRC, pages 26 (Final Audit Report – “For fiscal year (FY) 1999-2000 and FY 2005-06 claims, the State paid the district \$124,379 from funds appropriated under Chapter 724, Statutes of 2010. . . . For the FY 2003-04 claim, the State paid the district \$22,748 from funds appropriated under Chapter 724, Statutes of 2010”); Exhibit B, Controller’s Late Comments on the IRC, page 12 (“The SCO sent a remittance advice to the district dated January 28, 2011 [Tab 5], notifying the district of payments made on that date pursuant to Chapter 724, Statutes 2010 (Assembly Bill No. 1610) totaling \$147,127.”).

<sup>94</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 38-40.

<sup>95</sup> See, e.g., regulations adopted by the California Board of Equalization (title 18, section 1698.5, stating that an “audit engagement letter” is a letter “used by Board staff to confirm the start of an audit or establish contact with the taxpayer”).

Code section 17558.5(a) can be characterized as a statute of repose because it provides a period during which an audit has been commenced, and after which claimants may enjoy repose, dispose of evidence to support their claims, and assert a defense that the audit is not timely and therefore void.<sup>96</sup> Since the Controller's authority to audit must be exercised within a specified time, it must be within the Controller's exclusive control to meet or fail to meet the deadline imposed. The Controller has the burden of proof on this issue and must show with evidence in the record that the claimant was notified that an audit was being initiated by the statutory deadline to ensure that the claimant not dispose of any evidence or documentation to support its claim for reimbursement.

The Controller asserts that the audit began on January 17, 2014, before the January 18, 2014 or January 28, 2014 deadline. In support, the Controller filed a declaration by Jim Spano (Chief, Mandated Cost Audits Bureau, Division of Audits), stating under penalty of perjury that "a review of the claims . . . commenced on January 17, 2014 (initial contact date)."<sup>97</sup> The Controller also filed a copy of an email dated January 17, 2014, from an audit manager at the Controller's Office to the claimant, as evidence of the Controller's initial contact with the claimant about the audit. The email states in relevant part:

I am contacting you because the State Controller's Office will be adjusting the district's Integrated Waste Management claims for FY 1999-2000 through FY 2009-10 because the district did not offset any savings (e.g. avoided landfill disposal fees) received as a result of implementing the districts' IWM Plan.

I will notify you, via email, of the exact adjustment amount later this week. Also, included in this email, will be documentation to support the adjustment.<sup>98</sup>

The claimant concurs that the audit was initiated by the Controller's initial contact on January 17, 2014.<sup>99</sup>

Accordingly, the Commission finds that the Controller timely initiated the audit, pursuant to Government Code section 17558.5(a), on January 17, 2014.

## 2. The audit was timely completed.

Government Code section 17558.5 provides that an audit must be completed: "In any case, an audit shall be completed not later than two years after the date that the audit is commenced."<sup>100</sup> As indicated above, the audit was initiated on January 17, 2014, the date of the Controller's initial contact with the claimant about the audit and thus, had to be completed no later than January 17, 2016. An audit is completed when the Controller issues the final audit report to the claimant. The final audit report constitutes the Controller's final determination on the subject claims and provides the claimant with written notice of the claim components adjusted, the

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<sup>96</sup> *Giest v. Sequoia Ventures, Inc.* (2000) 83 Cal.App.4th 300, 305.

<sup>97</sup> Exhibit B, Controller's Late Comments on the IRC, page 5.

<sup>98</sup> Exhibit B, Controller's Late Comments on the IRC, page 36. Emphasis in original.

<sup>99</sup> Exhibit A, IRC, page 10.

<sup>100</sup> Government Code section 17558.5 (Stats. 2004, ch. 890).



amounts adjusted, and the reasons for the adjustment.<sup>101</sup> This notice enables the claimant to file an IRC. Here, the final audit report was issued April 9, 2014, well before the January 17, 2016 deadline.<sup>102</sup>

Therefore, the Commission finds that the Controller's audit of all years in the audit period was timely completed in accordance with Government Code section 17558.5.

**B. The Controller's Reduction of Costs Claimed Is Generally Correct as a Matter of Law; However, the Reduction for Calendar Years 2002 and 2003, Based on a 100 percent Diversion Rate, Is Incorrect as a Matter of Law and Arbitrary, Capricious, and Entirely Lacking in Evidentiary Support.**

1. The test claim statutes presume that by complying with the mandate to divert solid waste through the IWM program, landfill fees are reduced or avoided and cost savings are realized.

The test claim statute added Public Resources Code section 42925(a), which provides that "Any cost savings realized as a result of the state agency integrated waste management plan shall, to the extent feasible, be redirected to the agency's integrated waste management plan to fund plan implementation and administration costs, in accordance with Sections 12167 and 12167.1 of the Public Contract Code."

The court's Ruling on Submitted Matter states that community colleges are "likely to experience costs savings in the form of reduced or avoided costs of landfill disposal" as a result of the mandated activities in Public Resources Code section 42921 because reduced or avoided costs "are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided." The court noted that "diversion is defined in terms of landfill disposal for purposes of the IWM plan mandates." The statutory definition of diversion provides that "activities which reduce or eliminate the amount of solid waste from solid waste disposal for purposes of this division." And the statutory definition of disposal is "the management of solid waste through landfill disposal or transformation at a permitted solid waste facility."<sup>103</sup> The court explained that:

[R]eduction or avoidance of landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs of the IWM plan implementation . . . The amount or value of the savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report to petitioner Integrated

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<sup>101</sup> Government Code section 17558(c).

<sup>102</sup> Exhibit A, IRC, page 26 (Final Audit Report).

<sup>103</sup> Exhibit B, Controller's Late Comments on the IRC, pages 86-87 (Ruling on Submitted Matter).

Waste Management Board pursuant to subdivision (b)(1) of Public Resources Code section 42926.<sup>104</sup>

The court harmonized section 42925(a) with Public Contract Code sections 12167 and 12167.1:

By requiring the redirection of cost savings from state agency IWM plans to fund plan implementation and administration costs “in accordance with Sections 12167 and 12167.1 of the Public Contract Code,” section 42925 assures that cost savings realized from state agencies’ IWM plans are handled in a manner consistent with the handling of revenues received from state agencies’ recycling plans under the State Assistance for Recycling Markets Act. Thus, in accordance with section 12167, state agencies, along with California Community Colleges which are defined as state agencies for purposes of IWM plan requirements in Public Resources Code section 42920 et seq. [citations omitted], must deposit cost savings resulting from IWM plans in the Integrated Waste Management Account in the Integrated Waste Management Fund; the funds deposited in the Integrated Waste Management Account, upon appropriation by the Legislature, may be expended by the Integrated Waste Management Board for the purpose of offsetting IWM plan costs. In accordance with section 12167.1 and notwithstanding section 12167, cost savings from the IWM plans of the agencies and colleges that do not exceed \$2000 annually are continuously appropriated for expenditure by the agencies and colleges for the purpose of offsetting IWM plan implementation and administration costs; cost savings resulting from IWM plans in excess of \$2000 annually are available for such expenditure by the agencies and colleges when appropriated by the Legislature.<sup>105</sup>

Thus, the court found that offsetting savings are, by statutory definition, likely to occur as a result of implementing the mandated activities. Reduced or avoided costs “are a direct result and an integral part of the IWM plan mandated under Public Resources Code section 42920 et seq.: as solid waste diversion occurs, landfill disposal of the solid waste and associated landfill disposal costs are reduced or avoided.”<sup>106</sup> As the court held, “landfill fees resulting from solid waste diversion activities under § 42920 et seq. represent savings *which must be offset* against the costs of the diversion activities to determine the reimbursable costs. . . .”<sup>107</sup>

The statutes, therefore, presume that by complying with the mandate to divert solid waste through the IWM program, landfill fees are reduced or avoided and cost savings are realized. As indicated in the court’s ruling, the amount or value of the cost savings may be determined from the calculations of annual solid waste disposal reduction or diversion, which community colleges

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<sup>104</sup> Exhibit B, Controller’s Late Comments on the IRC, page 87 (Ruling on Submitted Matter). Emphasis added.

<sup>105</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 88-89 (Ruling on Submitted Matter).

<sup>106</sup> Exhibit B, Controller’s Late Comments on the IRC, page 86 (Ruling on Submitted Matter).

<sup>107</sup> Exhibit B, Controller’s Late Comments on the IRC, page 87 (Ruling on Submitted Matter). Emphasis added.

are required to annually report to CIWMB. The amount of cost savings realized must be identified by the claimant and used to offset the costs incurred to comply with IWM plan implementation and administration activities approved for reimbursement in the Parameters and Guidelines. Accordingly, the court's ruling requires claimants to report in their reimbursement claims the costs incurred to comply with the reimbursable activities (which includes the activities and costs to divert at least 25 or 50 percent of all solid waste from landfill disposal) and the cost savings from the avoided landfill disposal fees, for a reimbursement claim of the net increased costs.

The Parameters and Guidelines are consistent with the court's ruling and require in Section IV. that "[t]he claimant is only allowed to claim and be reimbursed for increased costs for reimbursable activities identified below. Increased cost is limited to the cost of an activity that the claimant is required to incur as a result of the mandate."<sup>108</sup> Section VIII. requires that "[r]educed or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans shall be identified and offset from this claim as cost savings, consistent with the directions for revenue in Public Contract Code sections 12167 and 12167.1."<sup>109</sup> The court's decision and the amended Parameters and Guidelines are binding.<sup>110</sup>

2. During the audit period, the claimant exceeded the mandated solid waste diversion rate, but has filed no evidence to rebut the presumption that cost savings were realized. Thus, the Controller's finding that the claimant realized cost savings is correct as a matter of law.

In this case, the claimant reported no cost savings in its reimbursement claims and asserts that no cost savings were realized, but does not explain why.<sup>111</sup>

The record shows that during the audit period, the claimant complied with the mandate and diverted more solid waste than the state-mandated amount.<sup>112</sup> The mandate requires community colleges to divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, through source reduction, recycling, and composting activities, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004.<sup>113</sup> The claimant's annual reports to CIWMB for calendar years 2000 through 2003 report diversion percentages from 32.27 percent to 46.97 percent of the total waste generated, which exceed the mandated diversion requirement of 25 percent.<sup>114</sup> The claimant's

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<sup>108</sup> Exhibit A, IRC, page 57 (Parameters and Guidelines).

<sup>109</sup> Exhibit A, IRC, page 62 (Parameters and Guidelines).

<sup>110</sup> *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

<sup>111</sup> Exhibit A, IRC, page 10.

<sup>112</sup> The Controller found that the claimant did not divert the mandated percentage in calendar years 2002 and 2003, but as discussed below, that finding is incorrect.

<sup>113</sup> Public Resources Code sections 42921. Exhibit A, IRC, pages 54 and 58 (Parameters and Guidelines, section IV.(B)(5)).

<sup>114</sup> Exhibit B, Controller's Late Comments on the IRC, pages 42-53 and 94.

annual reports to CIWMB for calendar years 2004 through 2007 also report diversion percentages that exceed the mandated diversion requirement of 50 percent, and range from 50.09 percent to 80.10 percent of the total waste generated.<sup>115</sup>

In 2008, CIWMB stopped requiring community college districts to report the amount and percentage of tonnage diverted, and instead required them to report the "per-capita disposal" of waste.<sup>116</sup> As amended, each community college now has a disposal target that is the equivalent to a 50 percent diversion, and is expressed on a per capita basis. So if the district's per-capita disposal rate is less than the target, it means that the district is meeting the requirement to divert 50 percent of its solid waste.<sup>117</sup>

In this case, the reports for 2008, 2009, and 2010 show that the claimant's annual per capita disposal rate for both the employee and student populations to be at or below the target rate, thereby satisfying the requirement to divert 50 percent of its solid waste during these years.<sup>118</sup> In addition, the claimant's 2008, 2009, and 2010 reports continue to show that the claimant had solid waste reduction programs in place. In its 2008 report, the claimant listed the following programs: "Business source reduction, Beverage containers, Cardboard, Glass, Newspaper, Office paper (white), Office paper (mixed), Plastics, Scrap Metal, Other Materials, Xeriscaping, grasscycling, Tires, Concrete/asphalt/rubble, and MRF."<sup>119</sup> Also, the 2008 report asked about waste diversion programs continued or newly implemented during the reporting year, to which the claimant responded: "Campus wide recycling program, xeriscaping [sic] practices including mulching mowers."<sup>120</sup> In its 2009 and 2010 reports, the claimant left blank the question regarding any significant changes to its waste diversion programs.<sup>121</sup> In the claimant's 2009 report states, in response to the question on per capita disposal (pounds per person per day, or

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<sup>115</sup> Exhibit B, Controller's Late Comments on the IRC, pages 54-77 and 94.

<sup>116</sup> The new requirement was a result of Statutes 2008, chapter 343 (SB 1016).

<sup>117</sup> Exhibit B, Controller's Late Comments on the IRC, pages 104-112 ["Understanding SB 1016 Solid Waste Per Capita Disposal Measurement Act", <http://www.calrecycle.ca.gov/lgcentral/goalmeasure/Tools/SimplePresen.pdf>.]

<sup>118</sup> Exhibit B, Controller's Late Comments on the IRC, pages 68 (2008 report, showing an employee population target of 14.9, and 2.6 was achieved; and a student population target of 0.5, and 0.08 was achieved); 71 (2009 report, showing an employee population target of 14.9, and 2.4 was achieved; and a student population target of 0.50, and 0.09 was achieved); and 75 (2010 report, showing an employee population target of 14.9, and 1.5 was achieved; and a student population target of 0.50, and 0.08 was achieved).

<sup>119</sup> Exhibit B, Controller's Late Comments on the IRC, page 69 (2008 report to CIWMB).

<sup>120</sup> Exhibit B, Controller's Late Comments on the IRC, page 68 (2008 report to CIWMB).

<sup>121</sup> Exhibit B, Controller's Late Comments on the IRC, pages 72 and 75 (2009 & 2010 reports to CIWMB).

PPPD): “There was a reduction of .2 pounds PPPD.”<sup>122</sup> Similarly, the claimant’s 2010 report states: “Our PPD went from 2.4 to 2.1”<sup>123</sup>

The record also shows that the tonnage of solid waste that was not diverted was disposed at a landfill. The annual reports filed by the claimant with CIWMB during the audit period identify the total tonnage of waste disposed (or per capita disposal) and the use of a waste hauler.<sup>124</sup> Moreover, there are statements in the claimant’s reports indicating that it used a landfill. In its 2001 annual report, the claimant stated “The plan has made us accountable for the materials that we once sent to the landfills.”<sup>125</sup> In the 2006 annual report, the claimant stated that hiring a Recycling/Hazardous Waste Technician will “help us capture more material before it’s diverted to the landfill.”<sup>126</sup> In its 2007 annual report, the claimant indicated that due to its recycling program, it is “sending a substantially smaller amount of cardboard and CRV containers to the landfill.”<sup>127</sup>

The avoided landfill disposal fee was based on the statewide average disposal fee provided by CIWMB for each fiscal year in the audit period, since the claimant did not provide any information to the Controller regarding the landfill fees it was charged.<sup>128</sup>

Based on this documentation, the Controller correctly presumed, consistent with the presumption in the test claim statutes and the court’s interpretation of those statutes and with no evidence to the contrary, that the claimant realized cost savings during the audit period equal to the avoided landfill fee per ton of waste required to be diverted.

The statutory presumption of cost savings controls unless the claimant files evidence to rebut the presumption and shows that cost savings were not realized.<sup>129</sup> The claimant has the burden of

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<sup>122</sup> Exhibit B, Controller’s Late Comments on the IRC, page 73 (2009 report to CIWMB).

<sup>123</sup> Exhibit B, Controller’s Late Comments on the IRC, page 75 (2010 report to CIWMB).

<sup>124</sup> For example, the 2001 report to CIWMB states: “All generated waste is disposed of via a contracted waste disposal contractor.” See Exhibit B, Controller’s Late Comments on the IRC, page 47. The 2002 report states: “All generated waste is disposed of via a contracted waste contractor.” Exhibit B, Controller’s Late Comments on the IRC, page 49. A similar statement was made in the 2003 report (p. 52). The 2004 report (p. 55) states “The major portion of our determined tonnages are calculated and reported back to us by the waste contractor for the city of Victorville.” The 2009 report (p. 72) states: “The actual weight for a 40 yard roll off was provided by the waste hauler.” The 2010 report (p. 76) states: “For the 40 YD3 roll off, the actual disposal weight was obtained from the waste hauler.

<sup>125</sup> Exhibit B, Controller’s Late Comments on the IRC, page 46 (2001 report to CIWMB).

<sup>126</sup> Exhibit B, Controller’s Late Comments on the IRC, page 63 (2006 report to CIWMB).

<sup>127</sup> Exhibit B, Controller’s Late Comments on the IRC, page 65 (2007 report to CIWMB).

<sup>128</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 24, 121-144.

<sup>129</sup> Government Code section 17559, which requires that the Commission’s decisions be supported by substantial evidence in the record. See also, *Coffy v. Shiimoto* (2015) 60 Cal.4th 1198, 1209, a case interpreting the rebuttable presumption in Vehicle Code section 23152 that if a person had 0.08 percent or more, by weight, of alcohol in the blood at the time of testing, then

proof on this issue. Under the mandates statutes and regulations, the claimant is required to show that it has incurred increased costs mandated by the state when submitting a reimbursement claim to the Controller's Office, and the burden to show that any reduction made by the Controller is incorrect.<sup>130</sup> The Parameters and Guidelines, as amended pursuant to the court's writ, also require claimants to show the costs incurred to divert solid waste and to perform the administrative activities, and *to report and identify* the costs saved or avoided by diverting solid waste: "Reduced or avoided costs realized from implementation of the community college districts' Integrated Waste Management plans *shall be* identified and offset from this claim as cost savings."<sup>131</sup> Thus, the claimant has the burden to rebut the statutory presumption and to show, with substantial evidence in the record, that the costs of complying with the mandate exceed any cost savings realized by diverting solid waste.

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it is presumed by law that he or she had 0.08 percent or more, by weight, of alcohol in the blood at the time of driving, unless he or she files evidence to rebut the presumption. The court states that unless and until evidence is introduced that would support a finding that the presumption does not exist, the statutory presumption that the person was driving over the legal limit remains the finding of fact.

<sup>130</sup> Evidence Code section 500, which states: "Except as otherwise provided by law, a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting." See also, *Simpson Strong-Tie Co., Inc. v. Gore* (2010) 49 Cal.4th 12, 24, where the court recognized that "the general principle of Evidence Code 500 is that a party who seeks a court's action in his favor bears the burden of persuasion thereon." This burden of proof is recognized throughout the architecture of the mandates statutes and regulations. Government Code section 17551(a) requires the Commission to hear and decide a claim filed by a local agency or school district that it is entitled to reimbursement under article XIII B, section 6. Section 17551(d) requires the Commission to hear and decide a claim by a local agency or school district that the Controller has incorrectly reduced payments to the local agency or school district. In these claims, the claimant must show that it has incurred increased costs mandated by the state. (Gov. Code, §§ 17514 [defining "costs mandated by the state"], 17560(a) ["A local agency or school district may . . . file an annual reimbursement claim that details the costs actually incurred for that fiscal year."]; 17561 [providing that the issuance of the Controller's claiming instructions constitutes a notice of the right of local agencies and school districts to file reimbursement claims based upon the parameters and guidelines, and authorizing the Controller to audit the records of any local agency or school district to "verify the actual amount of the mandated costs."]; 17558.7(a) ["If the Controller reduces a claim approved by the commission, the claimant may file with the commission an incorrect reduction claim pursuant to regulations adopted by the commission."]). By statute, only the local agency or school district may bring these claims, and the local entity must present and prove its claim that it is entitled to reimbursement. (See also, Cal. Code Regs., tit. 2, §§ 1185.1, et seq., which requires that the IRC contain a narrative that describes the alleged incorrect reductions, and be signed under penalty of perjury.)

<sup>131</sup> Exhibit A, IRC, page 62 (Amended Parameters and Guidelines). Emphasis added.

Accordingly, the Commission finds that the claimant has not filed any evidence to rebut the statutory presumption of cost savings. Therefore, the Controller’s finding that cost savings have been realized is correct as a matter of law.

3. For all years of the audit period except calendar years 2002 and 2003, the Controller’s calculation of cost savings is correct as a matter of law, and not arbitrary, capricious or entirely lacking in evidentiary support.

The Controller correctly determined that for every year during the audit period (except for calendar years 2002 and 2003 as discussed below), the claimant diverted more solid waste than the amount mandated by the test claim statute. For those years the claimant exceeded the mandate, the Controller calculated offsetting savings by allocating the diversion to reflect the mandate. The Controller allocated the diversion by dividing the percentage of solid waste required to be diverted by the test claim statute (either 25 percent or 50 percent) by the actual percentage of solid waste diverted (as annually reported by the claimant to CIWMB). The allocated diversion was then multiplied by the avoided landfill disposal fee (based on the statewide average fee) to calculate the offsetting savings realized for those years.<sup>132</sup>

$$\begin{array}{rcccl}
 & \text{Allocated Diversion \%} & & & \\
 & \text{-----} & & & \\
 & \text{Maximum} & & & \text{Avoided} \\
 & \text{Allowable} & & & \text{Landfill} \\
 \text{Offsetting} & = & \frac{\text{Diversion \%}}{\text{Actual}} & \times & \text{Disposal Fee} \\
 \text{Savings} & & & \times & \text{(per Ton)} \\
 \text{Realized} & & & \text{Tonnage} & \\
 & & & \text{Diverted} & \\
 & & & & \text{Actual} \\
 & & & & \text{Diversion \%}
 \end{array}$$

The formula allocates or reduces cost savings based on the mandated rate, and is intended to prevent penalizing the claimant for diverting more solid waste than the amount mandated by law.<sup>133</sup>

This formula is consistent with the statutory presumption of cost savings, as interpreted by the court for this program, and the requirements in the Parameters and Guidelines. The court found that the test claim statutes require that reduced or avoided landfill fees represent savings that must be offset against the cost of diversion. The court stated: “The amount or value of the [offsetting cost] savings may be determined from the calculations of annual solid waste disposal reduction or diversion which California Community Colleges must annually report” to CIWMB.<sup>134</sup> The Parameters and Guidelines state: “Reduced or avoided costs realized from implementation of the community college districts’ Integrated Waste Management plans shall be identified and offset from this claim as cost savings . . . .”<sup>135</sup> Thus, the Controller’s formula correctly presumes, based on the record and without any evidence to the contrary, that the claimant realized cost savings during the audit period equal to the avoided landfill fee per ton of

<sup>132</sup> Exhibit A, IRC, pages 37-38; Exhibit B, Controller’s Late Comments on the IRC, page 22.

<sup>133</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 22.

<sup>134</sup> Exhibit B, Controller’s Late Comments on the IRC, pages -- (Ruling on Submitted Matter). Emphasis added.

<sup>135</sup> Exhibit A, IRC page 62 (Amended Parameters and Guidelines, adopted Sept. 26, 2008).

waste required to be diverted. And when the claimant exceeded the mandated diversion rates, the Controller's formula limits the offset to reflect the mandated rate.

The claimant raises several arguments, unsupported by the law or evidence in the record, that the Controller's calculation of cost savings is incorrect.

The claimant first alleges that cost savings cannot be realized because the chain of events required by Public Contract Code sections 12167 and 12167.1 did not occur: that savings have to be converted to cash, and amounts in excess of \$2000 per year must be deposited in the state fund and appropriated back by the Legislature to mitigate the costs.<sup>136</sup> It is undisputed that the claimant did not remit to the state any savings realized from the implementation of the IWM plan.<sup>137</sup> However, as indicated above, cost savings are presumed by the statutes and the claimant has not filed evidence to rebut that presumption. Thus, the claimant should have deposited the cost savings into the state's account as required by the test claim statutes, and the claimant's failure to comply with the law does not make the Controller's calculations of cost savings incorrect as a matter of law, or arbitrary or capricious. Since cost savings are presumed by the statutes, the claimant has the burden to show increased costs mandated by the state. As the court stated: "[r]eimbursement is not available under section 6 and section 17514 to the extent that a local government or school district is able to provide the mandated program or increased level of service without actually incurring increased costs."<sup>138</sup>

The claimant next asserts that the Controller's formula is an underground regulation.<sup>139</sup> The Commission disagrees. Government Code section 11340.5 provides that no state agency shall enforce or attempt to enforce a rule or criterion which is a regulation, as defined in section 11342.600, unless it has been adopted pursuant to the Administrative Procedures Act. As indicated above, however, the formula is consistent with the statutory presumption of cost savings, as interpreted by the court for this program. Interpretations that arise in the course of case-specific adjudication are not regulations.<sup>140</sup>

The claimant also argues that using landfill fees in the calculation of offsetting savings is not relevant because the District "claimed \$50,347 in landfill costs, which is the maximum that can potentially be offset, if it was realized. The adjustment method does not match or limit the landfill costs avoided to landfill costs, actually claimed by year."<sup>141</sup> The claimant's interpretation of the cost savings requirement is not correct. The cost of disposing waste at a landfill is not eligible for reimbursement. Reimbursement is authorized to *divert* solid waste

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<sup>136</sup> Exhibit A, IRC, page 14.

<sup>137</sup> Exhibit B, Controller's Late Comments on the IRC, pages 14, 20.

<sup>138</sup> Exhibit B, Controller's Late Comments on the IRC, page 86 (Ruling on Submitted Matter).

<sup>139</sup> Exhibit A, IRC, page 14-15.

<sup>140</sup> *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 571.

<sup>141</sup> Exhibit A, IRC, page 17.



from the landfill through source reduction, recycling, and composting activities.<sup>142</sup> As explained by the court:

In complying with the mandated solid waste diversion requirements of Public Resources Code section 42921, California Community Colleges are likely to experience cost savings in the form of reduced or avoided costs of landfill disposal. The reduced or avoided costs are a direct result and an integral part of the mandated IWM plan ....

Such reduction or avoidance of landfill fees and costs resulting from solid waste diversion activities under § 42920 et seq. represent savings which must be offset against the costs of the diversion activities to determine the reimbursable costs of IWM plan implementation -- i.e., the actual increased costs of diversion -- under section 6 and section 17514.<sup>143</sup>

The court also noted that diversion is defined as “activities which reduce or eliminate the amount of solid waste from solid waste disposal.”<sup>144</sup>

In addition, the claimant argues that the formula assumes facts without evidence in the record. For example, the claimant questions the Controller’s assumption that the diversion percentage achieved in 2007 applies equally to subsequent years, the assumption that all diverted waste would have been disposed in a landfill, and that the statewide average cost to dispose of waste at a landfill actually applied to the claimant.<sup>145</sup>

The Controller’s assumptions, however, are supported by evidence in the record and the claimant has filed no evidence to rebut them. The Controller applied the diversion percentage achieved in 2007 to subsequent years because CIWMB stopped requiring community college districts to report the actual amount and percent of tonnage diverted in 2008. As the Controller notes, the claimant’s diversion program was well-established by 2007, and the claimant’s reports of subsequent years show continued diversion. The claimant’s reports for 2008, 2009, and 2010 reveal that the claimant’s annual per capita disposal rate for both the employee and student populations were below or near the target rate. Overall, the evidence indicates that the claimant satisfied the requirement to divert 50 percent of its solid waste during these years.<sup>146</sup>

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<sup>142</sup> Exhibit A, IRC, page 59 (Parameters and Guidelines).

<sup>143</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 86-87 (Ruling on Submitted Matter).

<sup>144</sup> Public Resources Code section 40124. Exhibit B, Controller’s Late Comments on the IRC, page 86 (Ruling on Submitted Matter).

<sup>145</sup> Exhibit A, IRC, pages 15-17.

<sup>146</sup> Exhibit B, Controller’s Late Comments on the IRC, pages 68 (2008 report, showing an employee population target of 14.9, and 2.6 was achieved; and a student population target of 0.50, and 0.08 was achieved); 71 (2009 report, showing an employee population target of 14.9, and 2.4 was achieved; and a student population target of 0.50, and 0.09 was achieved); and 75 (2010 report, showing an employee population target of 14.9, and 1.5 was achieved; and a student population target of 0.50, and 0.08 was achieved).

In addition, the claimant's 2008, 2009, and 2010 reports continue to show that the claimant had solid waste reduction programs in place. In its 2008 report, the claimant listed the following programs: "Business Source reduction, Beverage Containers, Cardboard, Glass, Newspaper, Office Paper (white), Office Paper (mixed), Plastics, Scrap Metal, Other Materials, Xeriscaping, grasscycling, Tires, Concrete/asphalt/rubble (C&D), MRF."<sup>147</sup> The claimant also stated, "no changes were made to waste diversion programs."<sup>148</sup> In its 2009 report, the claimant left blank the question about significant changes to its waste diversion program, indicating that no significant changes were made.<sup>149</sup> The claimant also stated that it accomplished a reduction of .2 pounds PPPD (pounds per person per day) in its 2009 report.<sup>150</sup> In its 2010 report, the claimant again left blank the question about significant changes to its waste diversion programs, and stated that that its PPD went down from 2.4 to 2.1.<sup>151</sup> Thus, there is evidence in the record that for 2008 through 2010, the claimant met or exceeded the diversion rates reported in 2007.

The Controller obtained the statewide average cost for landfill disposal fees from CIWMB, which was based on private surveys of a large percentage of landfills across California.<sup>152</sup> The Controller's audit report indicates that the claimant did not provide documentation to support a different disposal fee.<sup>153</sup> In addition, the Controller states:

The district did not provide any information, such as its contract with or invoices received from its commercial waste hauler to support either the landfill fees actually incurred by the district or to confirm that the statewide average landfill fee was greater than the actual landfill fees incurred by the district.<sup>154</sup>

On these audit issues, the Commission may not reweigh the evidence or substitute its judgment for that of the Controller. The Commission must only ensure that the Controller's decision is not arbitrary, capricious, or entirely lacking in evidentiary support, and adequately considered all relevant factors.<sup>155</sup> There is no evidence that the Controller's assumptions are wrong or arbitrary or capricious with regard to the statewide average landfill fee.

The claimant also points to the Controller's audits of other community college districts, arguing that the costs allowed by the Controller in those cases vary and are arbitrary.<sup>156</sup> The Controller's audits of other community college district reimbursement claims are not relevant to the

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<sup>147</sup> Exhibit B, Controller's Late Comments on the IRC, pages 69 (2008 report).

<sup>148</sup> Exhibit B, Controller's Late Comments on the IRC, pages 68 (2008 report).

<sup>149</sup> Exhibit B, Controller's Late Comments on the IRC, pages 72 (2009 report).

<sup>150</sup> Exhibit B, Controller's Late Comments on the IRC, pages 73 (2009 report).

<sup>151</sup> Exhibit B, Controller's Late Comments on the IRC, pages 75 (2010 report).

<sup>152</sup> Exhibit B, Controller's Late Comments on the IRC, page 24.

<sup>153</sup> Exhibit A, IRC, page 38.

<sup>154</sup> Exhibit B, Controller's Late Comments on the IRC, page 24.

<sup>155</sup> *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

<sup>156</sup> Exhibit A, IRC, pages 18-19.

Controller's audit here. Each audit depends on the documentation and evidence provided by the claimant to show increased costs mandated by the state.

Accordingly, the Controller's calculation of cost savings for all years in the audit except calendar years 2002 and 2003, is correct as a matter of law, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

4. The Controller's finding that the claimant's diversion of solid waste for calendar years 2002 and 2003 (the second half of fiscal year 2001-2002, all of fiscal year 2002-2003, and the first half of fiscal year 2003-2004) did not achieve the mandated diversion rate, and its recalculation of cost savings for those years using 100 percent of the diversion reported by the claimant, rather than the allocated diversion rate used for all other fiscal years in the audit period, is incorrect as a matter of law and is arbitrary, capricious, and entirely lacking in evidentiary support.

The Controller found that the claimant did not achieve the mandated "50 percent" diversion in calendar years 2002 and 2003 (the second half of fiscal year 2001-2002, all of fiscal year 2002-2003, and the first half of fiscal year 2003-2004), although only 25 percent diversion was required at that time. For these years, the Controller did not allocate the diversion to reflect the mandate, but used 100 percent of the reported diversion to calculate offsetting savings. This resulted in an audit reduction of \$25,833 for these years (350.4 tons of waste diverted in 2002, multiplied by the avoided statewide average disposal fee of \$36.17, and 357.3 tons of waste diverted in 2003, multiplied by the avoided statewide average disposal fee of \$36.83).<sup>157</sup>

As indicated in the Parameters and Guidelines, the mandate is to divert at least 25 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2002, and at least 50 percent of all solid waste from landfill disposal or transformation facilities by January 1, 2004, through source reduction, recycling, and composting activities.<sup>158</sup> Thus, in calendar years 2002 and 2003, community college districts were mandated to achieve diversion rates of only 25 percent. The Controller admits that "as there is no state mandate to exceed solid waste diversion for amounts in excess of 25% for calendar years 2000 through 2003 or 50% for calendar year 2004 and later, there is no basis for calculating offsetting savings realized for actual diversion percentages that exceed the levels set by statute."<sup>159</sup>

However, the Controller's calculation of cost savings incorrectly applied a 50 percent diversion rate to calendar years 2002 and 2003 instead of the mandated 25 percent diversion rate.<sup>160</sup> The claimant's 2002 report to CIWMB shows it achieved 46.97 percent diversion, and its 2003 report shows it achieved 46.3 percent diversion,<sup>161</sup> thereby exceeding the mandated diversion rate of 25 percent. Therefore, the Controller's finding, that the claimant's diversion of solid waste did not

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<sup>157</sup> Exhibit A, IRC, page 35, footnote 2 (Final Audit Report); Exhibit B, Controller's Late Comments on the IRC, page 94.

<sup>158</sup> Exhibit A, IRC, page 58 (Parameters and Guidelines). This is based on Public Resources Code sections 42921.

<sup>159</sup> Exhibit B, Controller's Late Comments on the IRC, page 21.

<sup>160</sup> Exhibit B, Controller's Late Comments on the IRC, page 94.

<sup>161</sup> Exhibit B, Controller's Late Comments on the IRC, pages 48-53, 94.

achieve the mandated diversion rate in calendar years 2002 and 2003, is incorrect as a matter of law.

Moreover, the Controller's calculation of offsetting savings, which did not reduce cost savings by allocating the diversion to reflect the mandate as it did for other years when the claimant exceeded the mandate, is arbitrary, capricious, or entirely lacking in evidentiary support. As indicated above, the Controller's formula for offsetting cost savings for years in which the claimant exceeded the diversion mandate, which allocates the diversion based on the mandated rate, is consistent with the test claim statutes and the court's decision on this program.

Therefore, applying the Controller's calculation of cost savings (for years when the claimant exceeded the mandate) to the second half of fiscal year 2001-2002, all of fiscal year 2002-2003, and the first half of fiscal year 2003-2004, results in offsetting savings of:

- \$6,746 for 2002 (25 percent divided by 46.97 percent, multiplied by 350.4 tons diverted multiplied by the statewide average landfill disposal fee of \$36.17) rather than \$12,674; and
- \$7,105 for 2003 (25 percent divided by 46.3 percent, multiplied by 357.3 tons diverted multiplied by the statewide average landfill disposal fee of \$36.83) rather than \$13,160.

Thus, the difference of \$11,983 (\$25,834 - \$13,851) has been incorrectly reduced.

In comments on the Draft Proposed Decision, the Controller agreed to reinstate to the claimant \$11,983 for calendar years 2002 and 2003.<sup>162</sup>

Accordingly, the Commission finds that the reduction of costs for calendar years 2002 and 2003 is incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support.

## **V. Conclusion**

Based on the foregoing, the Commission concludes that the Controller's reduction of costs claimed for all years in the audit period except calendar years 2002 and 2003 is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

The Commission further concludes that the Controller's reduction of costs claimed for calendar years 2002 and 2003 (the second half of fiscal year 2001-2002, all of fiscal year 2002-2003, and the first half of fiscal year 2003-2004), is partially incorrect as a matter of law, and is arbitrary, capricious, and entirely lacking in evidentiary support. The law and the record support offsetting cost savings for this time period of \$13,851 rather than \$25,834. Therefore, the difference of \$11,983 has been incorrectly reduced and should be reinstated to claimant.

Accordingly, the Commission partially approves this IRC and requests, pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, that the Controller reinstate \$11,983 to the claimant.

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<sup>162</sup> Exhibit D, Controller's Comments on the Draft Proposed Decision, page 1.



RE: **Decision**

*Integrated Waste Management*, 14-0007-I-06  
Public Resources Code Sections 40418, 40196.3, 42920-42928;  
Public Contract Code Sections 12167 and 12167.1  
Statutes 1992, Chapter 1116 (AB 3521); Statutes 1999, Chapter 764 (AB 75)  
State Agency Model Integrated Waste Management Plan (February 2000)  
Fiscal Years: 1999-2000, 2000-2001, 2001-2002, 2002-2003, 2003-2004, 2004-2005,  
2005-2006, 2006-2007, 2007-2008, 2008-2009, and 2009-2010  
Victor Valley Community College District, Claimant

On December 1, 2017, the foregoing Decision of the Commission on State Mandates was adopted on the above-entitled matter.

Heather Halsey, Executive Director

Dated: December 6, 2017