

ITEM 3
INCORRECT REDUCTION CLAIM
PROPOSED DECISION

Former Education Code Section 72246 (Renumbered as §76355)¹
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1); and
Statutes 1987, Chapter 1118 (AB 2336)

Health Fee Elimination

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

09-4206-I-25

Yosemite Community College District, Claimant

EXECUTIVE SUMMARY

Overview

This analysis addresses the Incorrect Reduction Claim (IRC) filed by 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.

The following issues are in dispute:

- Whether the Controller timely commenced the audit of the fiscal year 2002-2003 and 2003-2004 within the deadline required by Government Code section 17558.5;
- 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.

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

¹ Statutes 1993, chapter 8.

session, to fund these services.² In 1984, the Legislature repealed the community colleges' fee authority for health services.³ However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, to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).⁴

In addition to temporarily repealing community college districts' authority to levy a health services fee, the 1984 enactment required any district that provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.⁵ As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987, 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, 1988.⁶ 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.⁷ 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 limited fee authority to offset the costs of those services. In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.⁸

² Former Education Code section 72246 (Stats. 1981, ch. 763). Low-income students, students that depend upon prayer for healing, and students attending a college under an approved apprenticeship training program, were exempt from the fee.

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

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

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

⁶ 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).

⁷ Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

⁸ 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).

Procedural History

The claimant signed the reimbursement claim for fiscal year 2002-2003 on January 8, 2004,⁹ the reimbursement claim for 2003-2004 on January 3, 2005,¹⁰ the reimbursement claim for 2004-2005 on November 21, 2005,¹¹ the reimbursement claim for 2005-2006 on January 2, 2007,¹² and the reimbursement claim for 2006-2007 on February 2, 2009.¹³ The Controller asserts that the audit was initiated on March 5, 2008,¹⁴ while the claimant asserts the audit was initiated on March 24, 2008.¹⁵ The Controller issued the draft audit report on March 12, 2009,¹⁶ to which the claimant submitted comments on March 24, 2009.¹⁷ The Controller issued the final audit report on April 30, 2009.¹⁸ The claimant filed this IRC on October 5, 2009.¹⁹ The Controller filed late comments on the IRC on December 2, 2014.²⁰ The claimant did not file rebuttal comments.

On January 25, 2017, Commission on State Mandates (Commission) staff issued the Draft Proposed Decision.²¹ On February 1, 2017, the Controller filed comments agreeing with the Draft Proposed Decision.²² The claimant did not file comments on the Draft Proposed Decision.

⁹ Exhibit A, IRC, page 136. The claimant asserts this reimbursement claim was filed on January 12, 2004. (Exhibit A, page 24.)

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

¹¹ Exhibit A, IRC, page 158.

¹² Exhibit A, IRC, page 170.

¹³ Exhibit A, IRC, page 178.

¹⁴ Exhibit B, Controller's Late Comments on the IRC, page 26.

¹⁵ Exhibit A, IRC, page 27.

¹⁶ Exhibit A, IRC, page 64.

¹⁷ Exhibit A, IRC, pages 64, 86-93.

¹⁸ Exhibit A, IRC, page 59.

¹⁹ Exhibit A, IRC, page 1.

²⁰ 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.

²¹ Exhibit C, Draft Proposed Decision.

²² Exhibit D, Controller's Comments on the Draft Proposed Decision.

Commission Responsibilities

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 parameters and guidelines, *de novo*, without consideration of conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6 of the California Constitution.²³ 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."²⁴

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.²⁵

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.²⁶ 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.²⁷

²³ *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

²⁴ *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.

²⁵ *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.

²⁶ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

²⁷ Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission's decision is not supported by substantial evidence in the record.

Claims

Issue	Description	Staff Recommendation
Whether the audit of the fiscal year 2002-2003 and 2003-2004 reimbursement claims was timely commenced and completed within the deadlines required by Government Code section 17558.5.	<p>The claimant alleges that the Controller failed to timely commence the audit of the fiscal year 2002-2003 and 2003-2004 reimbursement claims. Both parties agree that the Controller commenced the audit sometime in March 2008.</p> <p>The claimant argues that the Controller was required to commence the audit three years from the dates the claims were filed, or by January 12, 2007 (for the 2002-2003, which was filed January 12, 2004), and January 10, 2008 (for the 2003-2004 claim, which was filed January 10, 2005).</p>	<p><i>The audit is timely commenced and timely completed –</i></p> <p>According to Government Code section 17558.5, “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.” The district received its initial payment for 2002-2003 claim on October 25, 2006 (making the deadline to commence Oct. 25, 2009) and did not receive any payment for 2003-2004, so the time to initiate an audit had not yet begun to run.²⁸ Therefore, the audit of the fiscal year 2002-2003 and 2003-2004 reimbursement claims was timely commenced.</p> <p>The audit was also timely completed on April 30, 2009, within the two-year deadline required by Government Code section 17558.5.</p>
Reduction in Finding 2 based on asserted flaws in the development of indirect cost rates.	The Controller reduced the claimant’s indirect costs for 2005-2006 and 2006-2007 because the claimant used the prior year’s expenses as reported in the CCFS-311 rather than the current year’s expenses, 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	<p><i>Correct –</i> To the extent the Controller’s reduction is based in part on the claimant’s use of the prior year’s CCFS-311 financial reporting, rather than the current year data, which the claimant was required to provide to the Chancellor’s Office, and did provide in each claim year prior to the deadline for filing annual reimbursement claims, the reduction is correct as a matter of</p>

²⁸ Exhibit A, IRC, pages 92-93.

	<p>two fiscal years using the FAM-29C methodology in accordance with the claiming instructions.</p> <p>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.</p>	<p>law. The prior year financial reporting does not reflect actual costs incurred in the claim year, as required by Government Code sections 17560 and 17564. The Controller's subsequent recalculation of indirect costs using its preferred FAM-29C methodology is not arbitrary, capricious, or entirely lacking in evidentiary support.</p>
<p>Reduction in Finding 4 for student health fees authorized to be charged but not offset from costs claimed.</p>	<p>The claimant asserts that the Controller incorrectly reduced costs claimed for the audit period based on revenue authorized to be charged, rather than the fee revenue actually collected.</p>	<p><i>Correct</i> – This issue has been conclusively decided by <i>Clovis Unified School District v. Chiang</i> (2010) 188 Cal.App.4th 794, in which the court held that local government is required to identify and deduct the fee revenue authorized to be charged as offsetting revenue, and not the fee revenue actually collected. Therefore, this reduction is correct as a matter of law. In addition, the Controller's calculation of authorized health service fees, based on student enrollment and BOGG recipient data from the Chancellor's Office is not arbitrary, capricious, or entirely lacking in evidentiary support.</p>
<p>Reduction in Finding 5 for understated offsetting savings or reimbursements from earned interest from the health service fee revenue.</p>	<p>The Controller found that the claimant did not identify and deduct as offsetting savings or reimbursements, as required by Section VIII. of the Parameters and Guidelines, earned interest income on the health service fee revenue.</p>	<p><i>Correct</i> – 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</p>

		and deducted from the costs claimed.
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Staff Analysis

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),²⁹ 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.

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.*³⁰

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 2003-2004,³¹ 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.³² The Fourth District Court of Appeal in *California School Boards Assoc. v. State of California*, 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.*”³³ 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

²⁹ Exhibit A, IRC, pages 92-93 (claimant asserts that these are the dates the reimbursement 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). (Exhibit A, IRC, pages 136 and 149.)

³⁰ Statutes 2002, chapter 1128, effective January 1, 2003, emphasis added.

³¹ Exhibit B, Controller’s Late Comments on the IRC, page 26.

³² Statutes 2003, chapter 157, Item 6870-295-0001, schedule 1.

³³ *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 791, emphasis added.

report states that the allowable amount to be reimbursed for the 2003-2004 claim will be paid “contingent upon available appropriations.”³⁴ Therefore, staff finds that the audit, initiated in March 2008, was timely.

Staff 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.”³⁵ 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.

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 \$63,675.³⁶ The claimant used the FAM-29C methodology to calculate indirect costs, but used the expenditures from the prior year’s CCFS-311 reports instead of the expenditures for the claim year.³⁷ The claimant also included capital costs rather than depreciation in calculating indirect costs, and did not allocate direct and indirect costs as specified in the claiming instructions.³⁸ The Controller recalculated the indirect costs for the two fiscal years using the FAM-29C methodology in accordance with the claiming instructions.³⁹

Staff finds that 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.

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.⁴⁰ After a public hearing, the district is required to adopt a final budget on or before September 15, and complete and adopt the annual financial and budget report (CCFS-311) by September 30 of

³⁴ Exhibit A, IRC, page 64.

³⁵ Statutes 2004, chapter 890.

³⁶ 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), emphasis added), not over increases in allowable costs.

³⁷ Exhibit A, IRC, page 13.

³⁸ Exhibit A, IRC, page 69 and Exhibit B, Controller’s Late Comments on the IRC, page 11.

³⁹ Exhibit A, IRC, page 69; Exhibit B, Controller’s Late Comments on the IRC, page 17.

⁴⁰ California Code of Regulations, title 5, section 58300.

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.⁴¹ 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, 2007.⁴² 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, 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.”⁴³ 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.

Finally, there is no evidence in the record that the Controller's recalculation of indirect costs is arbitrary, capricious, or totally 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.

C. The Controller's Reduction in Finding 4 for Underreported Offsetting Fee Authority 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 health service fees that claimant had authority to charge was not reported for the audit period and that the claimant reported only fees collected. The

⁴¹ California Code of Regulations, title 5, section 58305; California Community Colleges, Budget and Accounting Manual (2012), page 1-8.

⁴² Former Government Code section 17560 (as amended, Stats. 1998, ch. 681 (AB 1963)).

⁴³ Exhibit A, IRC, page 38.

Controller also found that the claimant did not charge students the fully authorized fee in 2005-2006 and 2006-2007.⁴⁴

Staff 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. This issue has been conclusively decided in *Clovis Unified School District*⁴⁵, in which the court held that local government is required to identify and deduct the fee revenue authorized to be charged as offsetting revenue, 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.

Staff 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.⁴⁶

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 its health service fee revenue as offsetting savings or reimbursements and, thus, reduced the claims by this amount.⁴⁷ The claimant disputes the reduction and contends that the interest income should not be offset against this program. Staff 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."⁴⁸

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

⁴⁴ Exhibit A, IRC, page 74.

⁴⁵ *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794.

⁴⁶ Exhibit A, IRC, page 74.

⁴⁷ Exhibit A, IRC, page 81.

⁴⁸ Exhibit A, IRC, page 43 (emphasis added).

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 providing the service.⁴⁹ And, here, the claimant contends that the program operates at a loss, which required it to file a reimbursement claim.⁵⁰ 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.⁵¹ Thus, the earned interest income from on health service fees authorized by 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.

Conclusion

Staff 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.

Staff Recommendation

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

⁴⁹ *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.

⁵⁰ Exhibit A, IRC, pages 91-92.

⁵¹ Exhibit A, IRC, page 59.

BEFORE THE
COMMISSION ON STATE MANDATES
STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM
ON:

Former Education Code Section 72246
(Renumbered as § 76355)⁵²

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)

DECISION

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on March 24, 2017. [Witness list will be included in the adopted Decision.]

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

The Commission [adopted/modified] the Proposed Decision to [approve/partially approve/deny] the IRC by a vote of [vote count will be included in the adopted Decision].

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

⁵² 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."⁵³ 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 2002-2003.⁵⁴

01/03/2005 Claimant signed the reimbursement claim for fiscal year 2003-2004.⁵⁵

⁵³ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

⁵⁴ Exhibit A, IRC page 136. The claimant asserts this reimbursement claim was filed on January 12, 2004. (Exhibit A, page 24.)

⁵⁵ 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. ⁵⁶
10/25/2006	Claimant received its initial payment for 2002-2003. ⁵⁷
01/02/2007	Claimant signed the reimbursement claim for fiscal year 2005-2006. ⁵⁸
March 2008	Controller initiated the audit. ⁵⁹
02/02/2009	Claimant signed the reimbursement claim for fiscal year 2006-2007. ⁶⁰
03/12/2009	Controller issued the draft audit report. ⁶¹
03/24/2009	Claimant submitted comments on the draft audit report. ⁶²
04/30/2009	Controller issued the final audit report. ⁶³
10/05/2009	Claimant filed this IRC. ⁶⁴
12/02/2014	Controller filed late comments on the IRC. ⁶⁵
01/25/2017	Commission staff issued the Draft Proposed Decision. ⁶⁶
02/01/2017	Controller filed comments on the Draft Proposed Decision. ⁶⁷

⁵⁶ Exhibit A, IRC, page 158.

⁵⁷ Exhibit B, Controller's Late Comments on the IRC, page 26.

⁵⁸ Exhibit A, IRC, page 170.

⁵⁹ 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.)

⁶⁰ Exhibit A, IRC, page 178.

⁶¹ Exhibit A, IRC, page 64.

⁶² Exhibit A, IRC, pages 64, 86-93.

⁶³ Exhibit A, IRC, page 59.

⁶⁴ Exhibit A, IRC, page 1.

⁶⁵ 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.

⁶⁶ Exhibit C, Draft Proposed Decision.

⁶⁷ 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.⁶⁸ In 1984, the Legislature repealed the community colleges' fee authority for health services.⁶⁹ 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).⁷⁰

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, 1988.⁷¹ 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 1987,⁷² 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, 1988.⁷³ 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.⁷⁴ 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.⁷⁵ In 1992,

⁶⁸ 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.

⁶⁹ Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4, repealing Education Code section 72246.

⁷⁰ Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4.5.

⁷¹ Education Code section 72246.5 (Stats. 1984, 2d. Ex. Sess., ch. 1, § 4.7).

⁷² Statutes 1987, chapter 1118.

⁷³ 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).

⁷⁴ Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

⁷⁵ 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.⁷⁶

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

1993, former Education Code section 72246, was renumbered as Education Code section 76355 (Stats. 1993, ch. 8).

⁷⁶ 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.⁷⁷

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 12410.⁷⁸

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.⁷⁹

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.⁸⁰

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.⁸¹

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

⁷⁷ Exhibit A, IRC, pages 11-14.

⁷⁸ Exhibit A, IRC, pages 15-17.

⁷⁹ Exhibit A, IRC, pages 17-21.

⁸⁰ Exhibit A, IRC, pages 22-23.

⁸¹ Exhibit A, IRC, page 24.

comment during the review.⁸² 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.⁸³

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

⁸² Exhibit B, Controller's Late Comments on the IRC, page 15.

⁸³ 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.⁸⁴ 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."⁸⁵

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.⁸⁶ 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.]' "⁸⁷

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.⁸⁸ In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertions

⁸⁴ *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

⁸⁵ *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.

⁸⁶ *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.

⁸⁷ *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California*, 162 Cal.App.4th 534, 547-548.

⁸⁸ *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.⁸⁹

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),⁹⁰ 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,⁹¹ 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.*⁹²

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

⁸⁹ 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.

⁹⁰ 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.

⁹¹ 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.

⁹² 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.⁹³

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, 2008.⁹⁴

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.⁹⁵ 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.”⁹⁶ The legal presumption is that the Controller performs these duties.⁹⁷

The claimant’s argument also focuses on how long it must keep documentation,⁹⁸ but a statute “cannot be held void for uncertainty if any reasonable and practical construction can be given to

⁹³ Exhibit A, IRC, page 84 (final audit report).

⁹⁴ Exhibit A, IRC, pages 26-27.

⁹⁵ Government Code section 17561(d).

⁹⁶ Government Code section 17567.

⁹⁷ Evidence Code section 664: “It is presumed that official duty has been regularly performed.”

⁹⁸ Exhibit A, IRC, pages 27-28.

its language”⁹⁹ and “if the language of the statute is clear and unambiguous, there is no need for construction.”¹⁰⁰ The Commission, like a court, may not substitute its judgement for that of the Legislature.¹⁰¹ 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 2003-2004,¹⁰² 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.¹⁰³ 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.*”¹⁰⁴ 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.”¹⁰⁵ 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.”¹⁰⁶ 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-

⁹⁹ *Personal Watercraft Coalition v. Board of Supervisors* (2002) 100 Cal.App.4th 129, 137.

¹⁰⁰ *Maryland Cas. Co. v. Andreini & Co. of Southern California* (2000) 81 Cal.App.4th. 1413, 1420.

¹⁰¹ *County of San Diego v. State of California* (2008) 164 Cal.App.4th 580, 597.

¹⁰² Exhibit B, Controller’s Late Comments on the IRC, page 26.

¹⁰³ Statutes 2003, chapter 157, Item 6870-295-0001, schedule 1.

¹⁰⁴ *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 791, emphasis added.

¹⁰⁵ Exhibit A, IRC, page 64.

¹⁰⁶ Statutes 2004, chapter 890.

2004, and there was no reduction for 2004-2005).¹⁰⁷ 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.¹⁰⁸ Second, the claimant did not comply with the claiming instructions.¹⁰⁹ 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.¹¹⁰

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."¹¹¹ 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.¹¹²

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.¹¹³ 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

¹⁰⁷ 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.

¹⁰⁸ Exhibit A, IRC, pages 13-14.

¹⁰⁹ Exhibit A, IRC, page 69 and Exhibit B, Controller's Late Comments on the IRC, page 11.

¹¹⁰ Exhibit A, IRC, page 69; Exhibit B, Controller's Late Comments on the IRC, page 17.

¹¹¹ Exhibit A, IRC, page 10.

¹¹² Exhibit A, IRC, page 15.

¹¹³ *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.]’ ”¹¹⁴

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.”¹¹⁵ 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 17557.¹¹⁶ 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

¹¹⁴ *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

¹¹⁵ Government Code section 17557; California Code of Regulations, title 2, section 1183.7.

¹¹⁶ *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-21.¹¹⁷

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.¹¹⁸

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.¹¹⁹ 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.¹²⁰ After a public hearing, the district is required to adopt a final budget on or before September 15,

¹¹⁷ Exhibit E, Community Colleges Mandated Cost Manual excerpt, issued December 2006.

¹¹⁸ Exhibit E, Community Colleges Mandated Cost Manual excerpt, issued October 2007.

¹¹⁹ Exhibit A, IRC, page 13.

¹²⁰ 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.¹²¹ 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, 2007.¹²² 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.”¹²³ 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.¹²⁴ 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.¹²⁵

¹²¹ California Code of Regulations, title 5, section 58305; California Community Colleges, Budget and Accounting Manual (2012), page 1-8.

¹²² Former Government Code section 17560 (as amended, Stats. 1998, ch. 681 (AB 1963)).

¹²³ Exhibit A, IRC, page 38.

¹²⁴ Exhibit A, IRC, page 69; Exhibit B, Controller's Late Comments on the IRC, page 17.

¹²⁵ Exhibit A, IRC, page 69.

The claimant disputes the recalculation, which excludes capital costs from the calculation and replaces capital costs with depreciation expenses.¹²⁶ 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."¹²⁷

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 2006-2007.¹²⁸

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."¹²⁹

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.*,¹³⁰ 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:

¹²⁶ Exhibit A, IRC, page 69; Exhibit B, Controller's Late Comments on the IRC, page 17.

¹²⁷ *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

¹²⁸ Exhibit A, IRC, page 74.

¹²⁹ Exhibit A, IRC, pages 19.

¹³⁰ *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] 76355.¹³¹ (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).¹³²

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.¹³³ The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered.¹³⁴ 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.¹³⁵ 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

¹³¹ *Clovis Unified School Dist. v. Chiang*, *supra*, 188 Cal.App.4th 794, 811.

¹³² 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)].

¹³³ 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.

¹³⁴ Exhibit A, IRC, California Community Colleges Chancellor's Office, Student Health Fee Increase, March 5, 2001, pages 148-149.

¹³⁵ 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.¹³⁶

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.’”¹³⁷ 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,”¹³⁸ 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*.¹³⁹ (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.¹⁴⁰ In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.¹⁴¹ 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.¹⁴² 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.”¹⁴³

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

¹³⁶ *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 812.

¹³⁷ *Ibid.*

¹³⁸ *Ibid.* Italics in original.

¹³⁹ *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 812.

¹⁴⁰ *Fenske v. Board of Administration* (1980) 103 Cal.App.3d 590, 596.

¹⁴¹ 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.

¹⁴² *Roos v. Red* (2006) 130 Cal.App.4th 870, 879-880.

¹⁴³ *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.¹⁴⁴

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.¹⁴⁵

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.¹⁴⁶

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."¹⁴⁷

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

¹⁴⁴ Exhibit A, IRC, page 74.

¹⁴⁵ Exhibit A, IRC, page 81.

¹⁴⁶ Exhibit A, IRC, pages 91-92.

¹⁴⁷ 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.)¹⁴⁸

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.¹⁴⁹

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."¹⁵⁰

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

¹⁴⁸ Exhibit B, Controller's Late Comments on the IRC, page 22.

¹⁴⁹ Exhibit A, IRC, page 23, referring to California Code of Regulations, title 2, 1183.1.

¹⁵⁰ Exhibit A, IRC, page 43 (emphasis added).

providing the service.¹⁵¹ And, here, the claimant contends that the program operates at a loss, which required it to file a reimbursement claim.¹⁵² 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.¹⁵³ 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.

¹⁵¹ *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.

¹⁵² Exhibit A, IRC, pages 91-92.

¹⁵³ Exhibit A, IRC, page 59.