

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

10-4206-I-32

State Center Community College District, Claimant

EXECUTIVE SUMMARY

Overview

This analysis addresses reductions of \$902,744 made by the State Controller's Office (Controller) to State Center Community College District's (claimant's) reimbursement claims for fiscal years 2002-2003 through 2006-2007 under the *Health Fee Elimination* program. The following issues are in dispute:

- The statutory deadlines applicable to the audit of the 2002-2003, 2003-2004, and 2004-2005 reimbursement claims.
- Reduction of costs claimed based on the claimant's development and application of indirect cost rates.
- The amount of offsetting revenue to be applied from health service fee authority.
- Whether the Controller has authority to provide reimbursement for allowable direct costs that could have been claimed, but were not.
- Whether the Commission has jurisdiction to hear and determine advisory findings by the Controller that did not result in any reduction or adjustment.

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session, to fund these services.² In 1984, the Legislature repealed the community colleges' fee authority for health services.³ However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, to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

Procedural History

Claimant signed and dated its reimbursement claim for the 2002-2003 fiscal year on January 8, 2004, and submitted the claim with a cover letter dated January 9, 2004.⁹ Claimant signed and dated its reimbursement claim for the 2003-2004 fiscal year on December 8, 2004,

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).

⁹ Exhibit A, IRC, pages 108, 109.

and submitted the claim with a cover letter dated December 13, 2004.¹⁰ Claimant signed and dated its reimbursement claim for fiscal year 2004-2005 on November 22, 2005, and submitted the claim with a cover letter dated December 5, 2005.¹¹ Claimant signed and dated its amended reimbursement claim for fiscal year 2005-2006 on December 17, 2007, and submitted the claim with a cover letter with the same date.¹² Claimant signed and dated its reimbursement claim for fiscal year 2006-2007 on December 17, 2007, and submitted the claim with a cover letter with the same date.¹³ On June 9, 2009, the Controller conducted an audit entrance conference for the claims for all five fiscal years.¹⁴ On June 11, 2010, the Controller issued its final audit report.¹⁵

The claimant filed this Incorrect Reduction Claim (IRC) on September 1, 2010.¹⁶ The Controller filed late comments on the IRC on December 2, 2014.¹⁷ Commission on State Mandates (Commission) staff issued the Draft Proposed Decision on May 19, 2017.¹⁸ The Controller filed comments supporting the Draft Proposed Decision on June 6, 2017.¹⁹ The claimant filed comments on the Draft Proposed Decision on June 19, 2017.²⁰

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

¹⁰ Exhibit A, IRC, pages 117, 118.

¹¹ Exhibit A, IRC, pages 127, 128.

¹² Exhibit A, IRC, pages 136, 137.

¹³ Exhibit A, IRC, pages 145, 146.

¹⁴ Exhibit A, IRC, page 25; Exhibit B, Controller's Late Comments on the IRC, pages 6, 29.

¹⁵ Exhibit A, IRC, page 64.

¹⁶ Exhibit A, IRC.

¹⁷ Exhibit B, Controller's Late Comments on the IRC.

¹⁸ Exhibit C, Draft Proposed Decision.

¹⁹ Exhibit D, Controller's Comments on the Draft Proposed Decision.

²⁰ Exhibit E, Claimant's Comments on the Draft Proposed Decision.

California Constitution.²¹ 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.”²²

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.²³

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.²⁴ In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission’s regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission’s ultimate findings of fact must be supported by substantial evidence in the record.²⁵

Claims

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

Issue	Description	Staff Recommendation
Whether the audit of the fiscal year 2002-2003, 2003-2004, 2004-2005 reimbursement claims was timely initiated 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, 2003-2004, and 2004-2005 reimbursement claims.</p> <p>The Controller alleges that the audit was timely.</p>	<i>The audit is timely initiated and timely completed</i> – The claimant contends the reimbursement claims for 2002-2003, 2003-2004, and 2004-2005 were filed January 9, 2004; December 13, 2004; and December 5, 2005, respectively. These are the dates on the cover letters to the claims. The audit

²¹ *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

²² *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.

²³ *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.

²⁴ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

²⁵ 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.

	<p>Government Code section 17558.5 requires a valid audit to be initiated no later than three years after the date the reimbursement claim is filed or last amended. However, the section also provides that <i>if no funds are appropriated or no payment is made</i> “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.”</p>	<p>conference took place on June 9, 2009. However, 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.</p> <p>In addition, the audit was timely completed. The final audit report was issued June 11, 2010, prior to the expiration of the two year deadline on June 9, 2011.</p>
Reduction of costs claimed based on the claimant’s development and application of indirect cost rates.	<p>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.</p> <p>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 for these years 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).</p> <p>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-</p>	<p><i>Partially Correct</i> – The reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 is correct as a matter of law. The claimant failed to obtain federal approval of its indirect cost rate for these fiscal years. Moreover, there is no evidence that the Controller’s recalculation of indirect costs using the FAM-29C in these years is arbitrary, capricious, or entirely lacking in evidentiary support.</p> <p>The reduction for fiscal years 2005-2006 and 2006-2007, however, is incorrect as a matter of law. The claiming instructions containing the Controller’s new indirect cost rate rule is included in the Controller’s annual Mandated Cost Manual. 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 <i>Health Fee Elimination</i> Program do not contain that language and, thus, the Controller’s change to the rule effectively prohibits the use of the</p>

	<p>2004, 2005-2006, and 2006-2007. The Controller's recalculation increased allowable indirect costs for fiscal year 2004-2005.</p>	<p>federal method for calculating indirect costs for this program. If a document that is incorporated by reference in the Parameters and Guidelines later changes without notice or opportunity for comment, then the new rule or standard of general application may become an invalid underground regulation.²⁶ 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, or was provided an opportunity to comment. 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, 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. Due process requires, at a minimum, that notice be reasonably calculated to afford affected claimants the realistic opportunity to protect their interests.²⁷ Under similar circumstances, when parameters and guidelines are amended, the Legislature has found that notice of</p>
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²⁶ *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 219-220.

²⁷ *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.

		<p>an extra 120 days after the revised claiming instructions are issued to local government is required before annual reimbursement claims are due.²⁸ Thus, in those cases, a full regulatory hearing is conducted to amend the parameters and guidelines <i>and</i> 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.</p> <p>Since the Controller's adjustment to indirect costs in 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.</p>
Reductions based on understated offsetting student health fee authority.	The claimant asserts that the Controller incorrectly reduced costs claimed based on fees authorized to be charged, rather than the fee revenue actually collected.	<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 full amount of fees authorized to be charged, and not only 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>
Whether the Commission has jurisdiction to hear and determine	In Finding 1, the Controller determined the claimant could have claimed salary, benefit, and related indirect costs for fiscal	<p><i>No Jurisdiction</i> – The Commission has no jurisdiction under Government Code section 17551(d) to hear and determine whether these</p>

²⁸ Government Code section 17560(c).

whether Findings 1, 4, and 5, are incorrect because these findings did not result in any reductions of costs claimed.	<p>year 2004-2005 for psychological interns and costs funded with Lottery revenue. The Controller applied some of these unclaimed costs to reduce the reductions made, but determined it did not have the authority to reimburse costs that exceeded what was claimed.</p> <p>Findings 4 and 5 address the claimant's reporting of base-year and current-year services and indicate that insufficient documentation of services provided. These findings were strictly advisory and did not result in any reductions. The claimant admits there is no fiscal effect from these findings, but argues that the Controller's interpretation of the Parameters and Guidelines is not legally correct.</p> <p>Government Code section 17551(d) provides that "the Commission . . . shall hear and decide upon a claim . . . that the Controller has <i>incorrectly reduced</i> payments to the local agency or school district."</p>	findings of the Controller are incorrect because they did not result in any reductions to costs claimed.
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Staff Analysis

A. The Audit of the 2002-2003, 2003-2004, and 2004-2005 Reimbursement Claims Was Timely Initiated and Timely Completed.

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."

The claimant contends the reimbursement claims for 2002-2003, 2003-2004, and 2004-2005 were filed January 9, 2004; December 13, 2004; and December 5, 2005, respectively. These are the dates on the cover letters to the claims. However, 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.

In addition, the audit was timely completed for all reimbursement claims before the two-year deadline. The final audit report was issued June 11, 2010, prior to the expiration of the two year deadline on June 9, 2011.

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.

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 reduced indirect costs claimed using a federally approved rate for these fiscal years based solely on the ground that the claiming instructions issued for these fiscal years 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.²⁹ The Controller's new indirect cost rate rule is included in the Controller's Mandated Cost Manual, 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.³⁰

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 incorporated document is adequately identified and available for comment.³¹ 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.³² There is no evidence in the record, such as a proof of service or certificate of

²⁹ Exhibit B, Controller's Late Comments on the IRC, page 7.

³⁰ Exhibit F, Mandated Cost Manuals for fiscal year 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.

³¹ *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.

³² *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 219-220.

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. In addition, due process requires, at a minimum, that notice be reasonably calculated to afford affected claimants the realistic opportunity to protect their interests.³³ 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.³⁴ 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, staff 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 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 hear and determine whether the Controller's audit adjustment for that fiscal year is incorrect.

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'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*,³⁵ 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. 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

³³ *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.

³⁴ Government Code section 17560(c).

³⁵ *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794.

health service fees using the authorized rates approved by the Chancellor's Office for the fiscal years at issue.³⁶

D. The Commission Has No Jurisdiction to Hear and Determine Whether Findings 1, 4, or 5 are Incorrect Since 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, the Controller found that 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 \$89,593.³⁷ Even though the audit did not result in a reduction of costs for fiscal year 2004-2005, 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 could have been claimed in fiscal year 2004-2005.

Similarly, Findings 4 and 5 address the claimant's reporting of base-year and current-year services and insufficient documentation of services provided, but made no reductions. These findings were advisory and the claimant admits there is no fiscal effect from these findings, but argues that the Controller's interpretation of the Parameters and Guidelines is not legally correct.³⁸

Staff finds that the Commission has no jurisdiction to make a determination on these findings.

Government Code section 17551(d) provides that "the Commission . . . shall hear and decide upon a claim ...that the Controller has *incorrectly reduced* payments to the local agency or

³⁶ Exhibit A, IRC, page 76.

³⁷ Exhibit A, IRC, pages 71-74.

³⁸ Exhibit A, IRC, pages 21-23.

school district.” This is the only provision of law granting authority to the Commission to review the Controller’s audit decisions and it is limited to alleged incorrect *reductions*.

With regard to Finding 1, the Government Code places the burden on the claimant to timely claim reimbursement for the increased costs mandated by the state. 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. In this case, the claimant signed the 2004-2005 reimbursement claim under penalty of perjury on November 22, 2005, and did not request reimbursement for the cost of the services provided by psychological interns or the costs of health services funded with California Lottery revenue.³⁹ Claimant did not file an amended claim to add these unclaimed costs. And, as stated with regard to Findings 4 and 5, these findings were strictly advisory and did not result in any reductions.

Thus, the Commission has no jurisdiction under Government Code section 17551(d) to hear and determine whether these findings of the Controller are incorrect because they did not result in any reductions to the costs claimed by claimant in its reimbursement claims.

Conclusion

Staff concludes that the Controller’s reduction of indirect costs of \$124,261 claimed using a federally approved indirect cost rate 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 should be reinstated to the claimant.

Staff further concludes that the remaining allegations in the IRC should be denied 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 regarding indirect costs for fiscal year 2004-2005 are incorrect because the findings and adjustments resulted in increased costs to the claimant.
- The reductions relating to understated offsetting health service authority, 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 these findings did not result in any reductions of costs claimed.

Staff Recommendation

Staff recommends that the Commission adopt the Proposed Decision to partially approve the IRC. Staff further recommends that the Commission authorize staff to make any technical, non-substantive changes following the hearing.

BEFORE THE
COMMISSION ON STATE MANDATES
STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM
ON:

Former Education Code Section 72246
(Renumbered as 76355)⁴⁰

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)

DECISION

The Commission on State Mandates (Commission) heard and decided this Incorrect Reduction Claim (IRC) during a regularly scheduled hearing on July 28, 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
Lee Adams, County Supervisor	
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	

⁴⁰ 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.⁴¹

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

⁴¹ 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.⁴² 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.⁴³ 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*,⁴⁴ 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.⁴⁵
- 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

⁴² *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.

⁴³ *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 219-220.

⁴⁴ *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794.

⁴⁵ 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, 2004.⁴⁶
- 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, 2004.⁴⁷
- 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, 2005.⁴⁸
- 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, 2007.⁴⁹
- 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, 2007.⁵⁰
- 10/25/2006 The Controller issued a payment of \$615,935 for fiscal year 2002-2003.⁵¹
- 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.⁵²
- 04/23/2010 The Controller issued the draft audit report.⁵³
- 05/12/2010 The claimant submitted comments on the draft audit report.⁵⁴

⁴⁶ Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2002-2003, pages 108, 109.

⁴⁷ Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2003-2004, pages 117, 118.

⁴⁸ Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2004-2005, pages 127, 128.

⁴⁹ Exhibit A, IRC, Claimant's Amended Reimbursement Claim for FY 2005-2006, pages 136, 137.

⁵⁰ Exhibit A, IRC, Claimant's Reimbursement Claim for FY 2006-2007, pages 145, 146.

⁵¹ Exhibit A, IRC, page 32; Exhibit B, Controller's Late Comments on the IRC, pages 6, 29.

⁵² Exhibit A, IRC, page 25; Exhibit B, Controller's Late Comments on the IRC, pages 6, 29.

⁵³ Exhibit A, IRC, page 69.

⁵⁴ Exhibit A, IRC, page 92-99.

06/11/2010 The Controller issued the final audit report.⁵⁵
09/01/2010 The claimant filed this IRC.⁵⁶
12/02/2014 The Controller filed late comments on the IRC.⁵⁷
05/19/2017 Commission staff issued the Draft Proposed Decision.⁵⁸
06/06/2017 The Controller filed comments supporting the Draft Proposed Decision.⁵⁹
06/19/2017 The claimant filed comments on the Draft Proposed Decision.⁶⁰

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.⁶¹ In 1984, the Legislature repealed the community colleges' fee authority for health services.⁶² 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).⁶³

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, 1988.⁶⁴ 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.

⁵⁵ Exhibit A, IRC, page 64.

⁵⁶ Exhibit A, IRC.

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

⁵⁸ Exhibit C, Draft Proposed Decision.

⁵⁹ Exhibit D, Controller's Comments on the Draft Proposed Decision.

⁶⁰ Exhibit E, Claimant's Comments on the Draft Proposed Decision.

⁶¹ 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.

⁶² Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4, repealing Education Code section 72246.

⁶³ Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4.5.

⁶⁴ Education Code section 72246.5 (Stats. 1984, 2d. Ex. Sess., ch. 1, § 4.7).

In 1987,⁶⁵ 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, 1988.⁶⁶ 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.⁶⁷ 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.⁶⁸ 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.⁶⁹

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

⁶⁵ Statutes 1987, chapter 1118.

⁶⁶ 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).

⁶⁷ Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

⁶⁸ 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).

⁶⁹ 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.⁷⁰

The Controller applied the understated costs that it found could have been claimed to offset the audit reductions.⁷¹ 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 \$89,593.⁷² 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.⁷³

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 2004-2005.⁷⁴

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.⁷⁵

⁷⁰ Exhibit A, IRC, pages 73-74.

⁷¹ Exhibit A, IRC, page 72.

⁷² Exhibit A, IRC, page 71.

⁷³ Exhibit A, IRC, page 29.

⁷⁴ Exhibit A, IRC, pages 74-76.

⁷⁵ 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.⁷⁶

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.⁷⁷

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.⁷⁸

The claimant also contends that it is only required to report as offsetting revenues, the health fee revenue actually collected.⁷⁹

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 2004-2005.⁸⁰

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.⁸¹

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

⁷⁶ Exhibit A, IRC, pages 83-87.

⁷⁷ Exhibit A, IRC, pages 25-28.

⁷⁸ Exhibit A, IRC, pages 11-15.

⁷⁹ Exhibit A, IRC, pages 15-23.

⁸⁰ Exhibit A, IRC, pages 23-24.

⁸¹ Exhibit A, IRC, pages 22, 23.

findings upholding the Controller's remaining reduction of costs, which are summarized in the Discussion below.⁸²

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.⁸³

The Controller filed comments supporting the Draft Proposed Decision.⁸⁴

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.⁸⁵ 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."⁸⁶

⁸² Exhibit E, Claimant's Comments on the Draft Proposed Decision.

⁸³ Exhibit B, Controller's Late Comments on the IRC.

⁸⁴ Exhibit D, Controller's Comments on the Draft Proposed Decision.

⁸⁵ *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

⁸⁶ *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.⁸⁷ 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.' " ⁸⁸

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.⁸⁹ 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.⁹⁰

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."⁹¹ "In any case," section 17558.5 requires the audit to be completed no later than two years after it is commenced.⁹²

⁸⁷ *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.

⁸⁸ *American Bd. of Cosmetic Surgery, Inc., v. Medical Bd. of California*, 162 Cal.App.4th 534, 547-548.

⁸⁹ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

⁹⁰ 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.

⁹¹ Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

⁹² 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.⁹³

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.”⁹⁴

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.⁹⁵

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...”⁹⁶ 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

⁹³ Exhibit A, IRC, pages 25-28; Exhibit B, Controller's Late Comments on the IRC, page 26.

⁹⁴ Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)).

⁹⁵ Exhibit A, IRC, page 28.

⁹⁶ California Constitution, article III, section 3.5 (added June 6, 1978, by Proposition 5).

claim was effective.⁹⁷ 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.”⁹⁸ 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.⁹⁹

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”¹⁰⁰ and “if the language of the statute is clear and unambiguous, there is no need for construction.”¹⁰¹ The Commission, like a court, may not substitute its judgement for that of the Legislature.¹⁰²

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, 2006,¹⁰³ 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, 2009.¹⁰⁴ 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.¹⁰⁵ 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.*”¹⁰⁶ Thus, the \$1,000 appropriation

⁹⁷ Government Code section 17561(d) (as amended, Stats. 2004, ch. 890).

⁹⁸ Government Code section 17567 (as added, Stats. 1986, ch. 879).

⁹⁹ Evidence Code section 664: “It is presumed that official duty has been regularly performed.”

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

¹⁰¹ *Maryland Cas. Co. v. Andreini & Co. of Southern California* (2000) 81 Cal.App.4th. 1413, 1420.

¹⁰² *County of San Diego v. State of California* (2008) 164 Cal.App.4th 580, 597.

¹⁰³ 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).

¹⁰⁴ 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).

¹⁰⁵ Statutes 2003, chapter 157, Item 6870-295-0001, schedule 1; Statutes 2004, chapter 208, Item 6870-295-0001, schedule 1.

¹⁰⁶ *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 791, emphasis added.

was 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.¹⁰⁷

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."¹⁰⁸ 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.¹⁰⁹ 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

¹⁰⁷ Exhibit E, Claimant's Comments on the Draft Proposed Decision, pages 1-2.

¹⁰⁸ *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 786-787, emphasis added.

¹⁰⁹ 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.¹¹⁰

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."¹¹¹

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."¹¹² 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.

¹¹⁰ *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 787, emphasis added.

¹¹¹ *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 790-791, emphasis added.

¹¹² 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 2004-2005.¹¹³

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.¹¹⁴

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

¹¹³ Exhibit A, IRC, pages 74-76.

¹¹⁴ Exhibit E, Claimant's Comments on the Draft Proposed Decision, page 2.

indirect costs of a state-mandated program.¹¹⁵ 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 17557.¹¹⁶ 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.

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."¹¹⁷ 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.¹¹⁸

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 2002-2003.¹¹⁹ 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

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.

¹¹⁷ Exhibit A, IRC, page 47.

¹¹⁸ Exhibit A, IRC, page 13.

¹¹⁹ 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. . . .¹²⁰

The OMB Circular A-21 establishes principles for determining costs applicable to grants, contracts, and other agreements between the federal government and educational institutions.

¹²⁰ 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.¹²¹ 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.¹²² 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.”¹²³

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.¹²⁴

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.¹²⁵ 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.

¹²¹ Exhibit F, OMB Circular A-21.

¹²² Exhibit F, OMB Circular A-21, pages 37-39.

¹²³ Exhibit F, OMB Circular A-21, page 6.

¹²⁴ Exhibit F, Mandated Cost Manual for fiscal year 2003-2004 reimbursement claims (Revised September 2004).

¹²⁵ 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."¹²⁶ 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.¹²⁷

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.¹²⁸ At that time, Government Code section 17560 required annual reimbursement claims to be filed by January 15 for 2005-2006 claims,¹²⁹ and February 15 for 2006-2007 claims.¹³⁰

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.¹³¹

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

¹²⁶ Exhibit A, IRC, page 47.

¹²⁷ Exhibit F, Mandated Cost Manual for fiscal year 2004-2005 reimbursement claims (Revised December 2005).

¹²⁸ 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.

¹²⁹ As amended by Statutes 1998, chapter 681.

¹³⁰ As amended by Statutes 2007, chapter 179 (eff. Aug. 24, 2007).

¹³¹ 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.”¹³²

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.¹³³ 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.¹³⁴ 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.¹³⁵ Thus, if the manual or document that is incorporated by reference later changes without notice or opportunity

¹³² Exhibit B, Controller’s Late Comments on the IRC, pages 14-15 (emphasis in original).

¹³³ *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.

¹³⁴ Government Code sections 11346, et seq.

¹³⁵ *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 570.

for comment, then the new rule or standard of general application in the incorporated document may become an invalid underground regulation.¹³⁶

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.¹³⁷ 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.”¹³⁸ 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.¹³⁹

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.¹⁴⁰ 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.”¹⁴¹ The court concluded that the documentation requirements in the manual were invalid underground regulations.¹⁴²

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.¹⁴³

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

¹³⁶ *Kings Rehabilitation Center Inc. v. Premo* (1999) 69 Cal.App.4th 215, 219-220.

¹³⁷ *Union of American Physicians & Dentists v. Kizer* (1990) 223 Cal.App.3d 490, 495.

¹³⁸ *Union of American Physicians & Dentists* (1990), 223 Cal.App.3d 490, 501.

¹³⁹ *Union of American Physicians & Dentists* (1990), 223 Cal.App.3d 490, 506.

¹⁴⁰ *California Assn. of Nursing Homes v. Williams* (1970) 4 Cal.App.3d 800, 808.

¹⁴¹ *California Assn. of Nursing Homes* (1970) 4 Cal.App.3d 800, 813-814.

¹⁴² *California Assn. of Nursing Homes* (1970) 4 Cal.App.3d 800, 816.

¹⁴³ *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.¹⁴⁴ 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.¹⁴⁵

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.¹⁴⁶ 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 2009-2010.¹⁴⁷ 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.¹⁴⁸ The claiming deadline for fiscal year 2005-2006 claims was January 15, 2007.¹⁴⁹ The claiming

¹⁴⁴ *Mullane v. Central Hanover B. & T. Co.* (1950) 339 U.S. 306, 313.

¹⁴⁵ Exhibit A, IRC, page 14 [“The Controller’s claiming instructions are unilaterally created and modified without public notice or comment.”].

¹⁴⁶ 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.”].

¹⁴⁷ 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.”].)

¹⁴⁸ California Code of Regulations, title 2, section 1184.1(m)(2).

¹⁴⁹ Government Code section 17560 (as amended by Stats. 1998, ch. 681).

deadline for 2006-2007 claims was February 15, 2008.¹⁵⁰ 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.¹⁵¹ 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.¹⁵² 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.¹⁵³ 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.¹⁵⁴

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.¹⁵⁵

¹⁵⁰ Government Code section 17560 (as amended by Stats. 2007, ch. 179, eff. Aug. 24, 2007).

¹⁵¹ 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."].)

¹⁵² *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.

¹⁵³ Government Code section 17560(c).

¹⁵⁴ 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.

¹⁵⁵ Exhibit A, IRC, page 76.

The claimant contends that it is only required to report as offsetting revenues, the fee revenue actually collected.¹⁵⁶

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.¹⁵⁷

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] 76355.¹⁵⁸ (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).¹⁵⁹

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.¹⁶⁰ The Chancellor of the California Community Colleges issues a notice to the

¹⁵⁶ Exhibit A, IRC, pages 15-21.

¹⁵⁷ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794.

¹⁵⁸ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 811.

¹⁵⁹ 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)].

¹⁶⁰ 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.¹⁶¹

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.’”¹⁶² 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,”¹⁶³ 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*.¹⁶⁴ (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.¹⁶⁵ In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.¹⁶⁶ 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.¹⁶⁷ 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

measuring national income and product, and is used to adjust government expenditure data for the effect of inflation.

¹⁶¹ *Clovis Unified School Dist. v. Chiang* (2010)188 Cal.App.4th 794, 812.

¹⁶² *Clovis Unified School Dist. v. Chiang* (2010)188 Cal.App.4th 794, 812.

¹⁶³ *Clovis Unified School Dist. v. Chiang* (2010)188 Cal.App.4th 794, 812 (italics in original).

¹⁶⁴ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

¹⁶⁵ *Fenske v. Board of Administration* (1980) 103 Cal.App.3d 590, 596.

¹⁶⁶ 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.

¹⁶⁷ *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.¹⁶⁸

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 \$89,593.¹⁶⁹ 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."¹⁷⁰ 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 2004-2005.¹⁷¹

¹⁶⁸ Exhibit A, IRC, page 76.

¹⁶⁹ Exhibit A, IRC, pages 71-74.

¹⁷⁰ Exhibit A, IRC, page 29; Exhibit E, Claimant's Comments on the Draft Proposed Decision.

¹⁷¹ 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.¹⁷²

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.¹⁷³

The Controller's Finding 5 states the following:

¹⁷³ 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.¹⁷⁴

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,¹⁷⁵ but argues that the Controller's interpretation of the Parameters and Guidelines is not legally correct.¹⁷⁶

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.

¹⁷⁴ Exhibit A, IRC, page 86.

¹⁷⁵ Exhibit A, IRC, pages 21, 23.

¹⁷⁶ Exhibit A, IRC, pages 22, 23.