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COMMISSION ON STATE MANDATES
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August 1, 2014

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

Ms. Jill Kanemasu
State Controller's Office
Accounting and Reporting
3301 C Street, Suite 700
Sacramento, CA 95816

And Parties, Interested Parties, and Interested Persons (See Mailing List)

Re: **Draft Proposed Decision, Schedule for Comments, and Notice of Hearing**
Health Fee Elimination, 05-4206-I-03
Education Code Section 76355
Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118
Fiscal Years 2001-2002 and 2002-2003
Long Beach Community College District, Claimant

Dear Mr. Petersen and Ms. Kanemasu:

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

Written Comments

Written comments may be filed on the draft proposed decision by **August 22, 2014**. You are advised that comments filed with the Commission are required to be simultaneously served on the other interested parties on the mailing list, and to be accompanied by a proof of service. However, this requirement may also be satisfied by electronically filing your documents. Please see http://www.csm.ca.gov/dropbox.shtml on the Commission's website for instructions on electronic filing. (Cal. Code Regs., tit. 2, § 1181.3.)

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

Hearing

This matter is set for hearing on **Friday, September 26, 2014**, at 10:00 a.m., State Capitol, Room 447, Sacramento, California. The proposed decision will be issued on or about September 12, 2014. Please let us know in advance if you or a representative of your agency will testify at the hearing, and if other witnesses will appear. If you would like to request postponement of the hearing, please refer to section 1187.9(b) of the Commission's regulations.

Please contact Tyler Asmundson at (916) 323-3562 if you have any questions.

Sincerely,

Heather Halsey
Executive Director

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ITEM __

INCORRECT REDUCTION CLAIM

DRAFT PROPOSED DECISION

Former Education Code Section 72246 (Renumbered as 76355)[1]
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.); Statutes 1987, Chapter 1118

Health Fee Elimination

Fiscal Years 2001-2002 and 2002-2003

05-4206-I-03

Long Beach Community College District, Claimant

EXECUTIVE SUMMARY

Overview

This analysis addresses an incorrect reduction claim (IRC) filed by Long Beach Community College District (claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during fiscal years 2001-2002 and 2002-2003 under the *Health Fee Elimination* program.

The following issues are in dispute:

- The statute of limitations applicable to audits of reimbursement claims by the Controller;
- Reduction of costs for athletic insurance premiums based on the scope of the reimbursable activities under the parameters and guidelines;
- Reduction of indirect costs based on asserted faults in the development and application of indirect cost rates; and
- The amount of offsetting revenue to be applied from health service fee authority.

Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts to charge almost all students a general fee (health service fee) for the purpose of voluntarily providing health supervision and services, direct and indirect medical and hospitalization services, and operation of student health centers.[2] In 1984, the Legislature repealed the community colleges' fee authority for health services.[3] However, the Legislature also reenacted

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[1] Statutes 1993, chapter 8.

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

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

section 72246, to become operative on January 1, 1988, in order to reauthorize the fee, at $7.50 for each semester (or $5 for quarter or summer semester).[4]

In addition to temporarily repealing community college districts' authority to levy a health services fee, the 1984 enactment required any district that provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.[5] As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987,[6] the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.[7] In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than $7.50 for each semester, or $5 for each quarter or summer semester.[8] As a result, beginning January 1, 1988 all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services. In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.[9]

Procedural History

On December 2, 2002, the claimant submitted its reimbursement claim for fiscal year 2001-2002.[10] On January 9, 2004, claimant signed and dated its 2002-2003 claim form. On August 18, 2004, an entrance conference for the audit was held. The Controller issued the final audit report on April 27, 2005.

On September 6, 2005, claimant filed this IRC.[11] On December 16, 2008, the Controller filed comments on the IRC.[12] On August 11, 2009, claimant filed rebuttal comments.[13]

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

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

[6] Statutes 1987, chapter 1118.

[7] Education Code section 72246 (as amended, Stats. 1987, ch. 1118). See also former Education Code section 72246.5 (Stats. 1984, 2d Ex. Sess., ch. 1, § 4.7).

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

[9] Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355. (Stats. 1993, ch. 8).

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

[11] Exhibit A, Incorrect Reduction Claim, at p. 1.

[12] Exhibit B, Controller's Comments on IRC.

[13] Exhibit C, Claimant's Rebuttal Comments.

Commission staff issued a draft proposed decision on the IRC on August 1, 2014.

Commission Responsibilities

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

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to the local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9 of the Commission's regulations requires the Commission to send the decision to the Controller and request that the costs in the claim be reinstated.

The Commission must review questions of law, including interpretation of parameters and guidelines, de novo, without consideration of conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[14] 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."[15]

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.[16] 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.[17] In addition, section 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[18]

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

[15] *County of Sonoma*, supra, 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

[16] *Johnston v. Sonoma County Agricultural* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

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

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

Claims

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

Issue	Description	Staff Recommendation
Statute of limitations applicable to the audit of claimant's 2000-2001 reimbursement claim.	At the time the underlying reimbursement claims were filed, Government Code section 17558.5 stated: A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim. Claimant asserts that the claim was no longer *subject to audit* at the time the final audit report was issued.	Deny – The audit for the 2001-2002 reimbursement claim was timely initiated within two calendar years after the end of the calendar year in which they were filed. Staff finds that the plain language of the statute of limitations pursuant to section 17558.5 in effect at the time the reimbursement claim was filed does not require the Controller to complete an audit within any specified period of time, and that a subsequent amendment to the statute demonstrates that "subject to audit" means "subject to the initiation of an audit."
Reductions based on interpretation of parameters and guidelines finding athletic health insurance premiums non-reimbursable.	Claimant asserts that the Controller incorrectly reduced costs claimed for student health insurance premiums, on the theory that student athletes were inappropriately included in the general student health insurance premiums.	Deny – Staff finds that athletic insurance premiums are not included among the reimbursable services authorized in the parameters and guidelines and therefore such premiums are not reimbursable. Therefore this reduction is correct as a matter of law.
Reductions based on asserted flaws in the development of indirect cost rates.	The claimant asserts that the Controller incorrectly reduced indirect costs claimed, because claimant did not obtain federal approval for its indirect cost rate proposals. Claimant argues that there is no requirement that an indirect cost rate proposal be federally approved. Claimant further argues that the use of the alternative state method, the FAM-29C was arbitrary and capricious.	Deny – Staff finds that claimant did not comply with the requirements in the parameters and guidelines and claiming instructions in developing and applying its indirect cost rate. Claimant used the OMB A-21 method, but did not obtain federal approval for its indirect costs,

		as required by the OMB Circular A-21 method. Thus, the reduction is correct as a matter of law. Staff further finds that the Controller's recalculation of indirect costs using the Form FAM-29C was consistent with the parameters and guidelines and the claiming instructions and, thus, the Controller's recalculation of indirect costs was not arbitrary, capricious, or entirely lacking in evidentiary support.
Reductions based on understated offsetting revenues from student health fees.	Claimant asserts that the Controller incorrectly reduced costs claimed based on the Controller's application of health service fees that the claimant was authorized to collect, but did not, as offsetting revenue.	Deny – Staff finds that the reduction is correct as a matter of law. This issue has been conclusively decided by *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, in which the court held that local government could choose not to exercise statutory fee authority to its maximum extent, but not at the state's expense.

Staff Analysis

A. The Statute of Limitations Found in Government Code Section 17558.5 does not Bar the Controller's Audit of the Claimant's 2001-2002 Reimbursement Claim.

Government Code section 17558.5, as added by Statutes 1995, chapter 945 (operative July 1, 1996), provides that a reimbursement claim "is *subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended*."[19] Claimant asserts that the fiscal year 2001-2002 claim was no longer subject to audit at the time the final audit report was completed and issued on April 27, 2005, based on filing date of December 2, 2002.

The Controller argues that section 17558.5 does not require an audit to be *completed* within two years; "subject to audit," according to the Controller, means subject to *initiation* of an audit.

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

Staff agrees with this interpretation. A 2002 amendment to the relevant code section clarifies that reimbursement claims are subject to "the initiation of an audit" within a specified time.[20]

Furthermore, the 2002 and 2004 amendments to section 17558.5 must be analyzed with respect to the subject claims and the audit because the audit was still pending on the effective dates of these amendments. The 2002 amendment expanded the statute of limitations to conduct an audit to "three years after the date that the actual reimbursement claim is filed or last amended." [21] The 2004 amendment established, for the first time, the requirement to "complete" an audit two years after the audit is commenced. [22]

Generally, an expansion or contraction of a statute of limitations applies to pending claims unless a party's rights would be unconstitutionally impaired. An expansion of a period of limitation will always apply to claims not yet barred, because no party has a vested right in the running of the statute prior to its expiration. A contraction of a period of limitation will apply to pending claims if to do so would not effectively deprive the affected party of the right to pursue its claim; in other words, there must be a reasonable time remaining under the new statute to satisfy due process considerations.[23] However, in the event that the *State* is the affected party, the courts have said that the Legislature may limit or extinguish the state's right irrespective of any due process concerns.[24]

Pursuant to the 2002 and 2004 amendments to section 17558.5, the audit of the claimant's 2001-2002 reimbursement claim was required to be initiated within three years of the date the claim was filed or last amended, and required to be completed within two years after it was commenced.[25] The claim was filed on December 2, 2002, the audit was initiated on August 18, 2004, and the audit was completed April 27, 2005, well within the two year requirement.

Based on the plain language of the statute, beginning in 1995 and as amended, staff finds that the statute of limitations found in section 17558.5 does not bar the audit of the 2001-2002 reimbursement claim.

B. The Controller's Reduction for Insurance Premiums is Consistent with the Parameters and Guidelines and Therefore Correct as a Matter of Law.

The Controller reduced amounts claimed for "services and supplies" by $9,257 for fiscal year 2001-2002, and $8,637 for fiscal year 2002-2003, on the ground that athletic insurance costs are beyond the scope of the mandate, and certain costs were "claimed twice."[26] The total reduction

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

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

[22] Statutes 2004, ch. 313 (AB 2224) (effective January 1, 2005).

[23] *Mudd v. McColgan* (1947) 30 Cal.2d 463, at p. 468; *Liptak v. Diane Apartments, Inc.* 109 Cal.App.3d 762, at p. 773 [citing *Rosefield Packing Co. v. Superior Court* (1935) 4 Cal.2d 120, 122].

[24] *California Employment Stabilization Commission v. Payne*, (1948) 1931 Cal.2d 210, 215-216.

[25] Government Code section 17558.5 (Stats. 2002, ch. 1128 (AB 2834); Stats. 2004, ch. 313 (AB 2224)).

[26] Exhibit A, Incorrect Reduction Claim, at p. 50 [Controller's Final Audit Report].

for direct costs for services and supplies for both fiscal years is $17,894.[27] The claimant does not dispute the "duplicated charges of $6,025 for services and supplied for both fiscal years."[28]

However, the claimant does dispute the reduction for health insurance premiums. What was originally unclear from the record was whether the parties were talking about the student athlete portion of the general student health insurance premiums for "(1) on campus accident, (2) voluntary, and (3) insurance inquiry/claim administration" which are reimbursable activities under the parameters and guidelines, or "athletic insurance," which is not listed as a reimbursable activity. If the former, then under Education Code section 76355, this is a reimbursable cost, because the law provides that "no student shall be denied a service supported by student health fees on account of participation in athletic programs."[29] Student athletes are not exempt from the requirement to pay the student health fee and are entitled to the services made available to the student body generally. However, athletic insurance premiums are not a reimbursable type of insurance based on the plain language of the parameters and guidelines, and if the claimed costs are for athletic insurance specifically, the disputed reduction would be consistent with the scope of reimbursable activities in the parameters and guidelines.[30]

Based on admissions of the claimant in rebuttal comments, these costs were for athletic insurance. Therefore, staff finds that the reductions for insurance premiums are consistent with the parameters and guidelines and correct as a matter of law.

C. The Controller's Reduction and Recalculation of Claimed Indirect Costs is Correct as a Matter of Law and is not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced indirect costs claimed by the claimant, by $70,710 for fiscal year 2001-2002, and $68,383 for fiscal year 2002-2003, on the ground that claimant did not utilize a federally approved indirect cost rate.[31] Claimant argues that "[c]ontrary to the Controller's ministerial preferences, there is no requirement in law that the district's indirect cost rate must be 'federally' approved, and further the Controller has never specified the federal agencies which have the authority to approve indirect cost rates."[32]

However, the parameters and guidelines state "[i]ndirect costs may be claimed in the manner described by the State Controller in his claiming instructions." The claiming instructions applicable to all community college district reimbursement claims in effect at the time this reimbursement claim was filed (*i.e.*, the general provisions of the School Mandated Cost Manual) specified as follows:

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[27] *Ibid.*

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

[29] Education Code section 76355(d)(2) (Stats. 1993, ch. 8 (AB 46). See also former Education Code section 72246(e) (Stats. 1987, ch. 1118).

[30] Exhibit A, Incorrect Reduction Claim [Parameters and Guidelines, at pp. 30-33].

[31] Exhibit A, Incorrect Reduction Claim, at p. 51.

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

> A college has the option of using a federally approved rate, utilizing the cost accounting principles from Office of Management and Budget Circular A-21 "Cost Principals for Educational Institutions," or the Controller's methodology outlined in the following paragraphs.[33] If a federal rate is used, it must be from the same fiscal year in which the costs were incurred.[34]

The reference in the parameters and guidelines to the Controller's claiming instructions necessarily includes the general provisions of the Mandated Cost Manual applicable at the time a reimbursement claim is filed. The manual provides general claiming instructions for a number of programs, including instructions for indirect cost rates. Therefore, claimant's assertion that "[n]either State law or the parameters and guidelines made compliance with the Controller's claiming instructions a condition of reimbursement" is clearly in error.

Staff finds that claimant did not comply with the requirements in the parameters and guidelines and claiming instructions in developing and applying its indirect cost rate. Claimant used the OMB A-21 method, but did not obtain federal approval for its indirect costs, as required by the OMB Circular A-21 method. Thus, the reduction is correct as a matter of law.

In addition, due to the claimant's failure to calculate its indirect cost rates in accordance with the claiming instructions, the Controller's audit staff utilized the alternative state method, the FAM-29C, to recalculate indirect costs, and adjusted the claim accordingly. Controller's recalculation of indirect costs using the Form FAM-29C was consistent with the parameters and guidelines and the claiming instructions and, thus, the Controller's recalculation of indirect costs was not arbitrary, capricious, or entirely lacking in evidentiary support. Staff finds the Controller's use of the Form FAM-29C was consistent with the parameters and guidelines and the claiming instructions. Therefore, the Controller's reduction and recalculation of claimant's indirect costs is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

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

The Controller reduced the reimbursement claims by $217,409 for the two years at issue.[35] These reductions were made on the basis of the fee authority available to claimant, multiplied by the number of students subject to the fee, less any amount of offsetting revenue claimed.

Claimant disputed the Controller's finding that offsetting revenues from student health fees had been understated in the relevant claim years. Claimant argued that the parameters and guidelines only require a claimant to declare offsetting revenues that the claimant "experiences," and that while the fee amount that community college districts were authorized to impose may have increased during the applicable audit period, nothing in the Education Code made the increase of those fees mandatory. Claimant argues that the issue is the difference between fees collected and fees collectible.

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

[34] Exhibit X, Mandated Cost Manual for Schools updated September 28, 2001.

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

After the claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge students, whether or not a district chooses to charge its students those fees. As cited by the court, the Health Fee Rule states in pertinent part:

> Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.[36]

The court in *Clovis Unified* upheld the Controller's use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. In making its decision the court notes that the concept underlying the state mandates process that Government Code sections 17514 and 17556(d) embody is:

> 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.[37]

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.'"[38] 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.[39]

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

<u>Conclusion</u>

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

- Reduction for both fiscal years of $11,869 for athletic insurance costs that are beyond the scope of the mandate.
- Reductions of indirect costs claimed of $70,710 for fiscal year 2001-2002, and $68,383 for fiscal year 2002-2003, based on the claimant's failure to comply with the claiming instructions in the development of its indirect cost rate, and the Controller's use of an alternative method to calculate indirect costs authorized by the parameters and guidelines and claiming instructions.

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

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

[38] *Ibid.*

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

- Reduction for both fiscal years of $217,409 based on understated offsetting health fee revenues.

Staff Recommendation

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

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 2001-2002 and 2002-2003 Long Beach Community College District, Claimant.	Case No.: 05-4206-I-03 *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 September 26, 2014*)

DECISION

The Commission on State Mandates (Commission) heard and decided this incorrect reduction claim (IRC) during a regularly scheduled hearing on September 26, 2014. [Witness list will be included in the adopted decision.]

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

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

Summary of the Findings

This analysis addresses an IRC filed by Long Beach Community College District (claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during fiscal years 2001-2002 and 2002-2003 under the *Health Fee Elimination* program. Over the two fiscal years in question, reductions totaling $217,409 were made based on alleged understated offsetting health fees authorized to be collected, and additional reductions totaling $156,987 were made based on disallowed indirect cost rates and unallowable services and supplies.

The Commission denies this IRC, finding that the statute of limitations pursuant to Government Code section 17558.5 does not bar the subject audit; and that the Controller's reduction of costs for services and supplies beyond the scope of the mandate, the reduction of indirect costs based on the claimant's failure to obtain federal approval for its indirect cost rate proposals, and the reduction in reimbursement based on the claimant's underreporting of health service fee revenue

[40] Statutes 1993, chapter 8.

authorized by statute, are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support.

COMMISSION FINDINGS

I. Chronology

12/02/2002	Claimant filed its fiscal year 2001-2002 reimbursement claim. [41]
01/09/2004	Claimant signed and dated its 2002-2003 claim form.
08/18/2004	An entrance conference for the audit was held.
04/27/2005	Controller issued its final audit report.
09/06/2005	Claimant filed this IRC.
12/16/2008	Controller submitted comments on the IRC.
08/10/2009	Claimant submitted rebuttal comments.
08/01/2014	Commission staff issued the draft proposed decision.

II. Background

Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts to charge almost all students a general fee (health service fee) for the purpose of voluntarily providing health supervision and services, direct and indirect medical and hospitalization services, and operation of student health centers.[42] In 1984, the Legislature repealed the community colleges' fee authority for health services.[43] However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, in order to reauthorize the fee, at $7.50 for each semester (or $5 for quarter or summer semester).[44]

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.[45] 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.

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

[42] 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.].

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

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

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

In 1987,[46] 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.[47] In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than $7.50 for each semester, or $5 for each quarter or summer semester.[48] 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.[49] 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.[50]

On November 20, 1986, the Commission determined that Statutes 1984, chapter 1 imposed a reimbursable state-mandated new program upon community college districts. On August 27, 1987, the Commission adopted parameters and guidelines for the *Health Fee Elimination* program. On May 25, 1989, the Commission adopted amendments to the parameters and guidelines for the *Health Fee Elimination* program to reflect amendments made by Statutes1987, chapter 1118.

The parameters and guidelines generally provide that eligible community college districts shall be reimbursed for the costs of providing a health services program, and that only services specified in the parameters and guidelines and provided by the community college in the 1986-1987 fiscal year may be claimed.

<u>Controller's Audit and Summary of the Issues</u>

The Controller reduced the reimbursement claims for costs allegedly incurred during fiscal years 2001-2002 and 2002-2003 under the *Health Fee Elimination* program, totaling $466,629. The following issues are in dispute:

- The statute of limitations applicable to audits of reimbursement claims by the Controller;
- Reduction of costs for student health insurance based on the scope of reimbursement excluding student athletic costs.
- Reduction of indirect costs based on asserted faults in the development and application of indirect cost rates; and

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[46] Statutes 1987, chapter 1118.

[47] 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).

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

[49] 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).

[50] 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).

- The amount of offsetting revenue to be applied from health service fee authority.

III. Positions of the Parties

Long Beach Community College District

The claimant asserts that the Controller incorrectly reduced costs claimed for fiscal years 2001-2002 and 2002-2003, totaling $368,371. Specifically, claimant asserts that reduction of $11,869 in athletic insurance costs was inappropriate, because the amounts claimed represented the district's basic and catastrophic coverage for the general student population, some of whom are also student athletes, but student athletes are also a part of the general student population for purposes of the general student population premium.[51] In addition, claimant asserts that the reduction of $139,093 in overstated indirect costs on the basis that "the district did not obtain federal approval for its [indirect cost rates,]" was incorrect. The claimant argues that "[c]ontrary to the Controller's ministerial preferences, there is no requirement in law that the district's indirect cost rate must be 'federally' approved," and the Controller did not make findings that the claimant's rate was excessive or unreasonable.[52] And, claimant asserts that a reduction of its total claim in the amount of $217,409, based on understated authorized health service fees, was incorrect, because the parameters and guidelines require claimants to state offsetting savings "experienced," and claimant did not experience offsetting savings for fees that it did not charge to students.[53] In addition, claimant asserts that the statute of limitations applicable to the Controller's audits of reimbursement claims barred auditing its fiscal year 2001-2002 reimbursement claim.

State Controller's Office

The Controller asserts that "athletic insurance is not an authorized expenditure" within the scope of the *Health Fee Elimination* mandate, and that "[t]he district did not provide any additional information supporting the allowability of insurance costs claimed."[54]

The Controller further asserts that the claimant overstated its indirect costs, because claimant did not obtain federal approval for its indirect cost rate proposals, as required by the Controller's claiming instructions.[55] The Controller asserts that "[s]ince the Claimant did not have a current approved ICRP (via the OMB Circular A-21 method), the auditors utilized the FAM-29C and determined that the allowable rate was much less than claimed."[56]

In addition, the Controller found that the claimant understated its authorized health service fees for the audit period in the amount of $217,409. Using enrollment and exemption data, the Controller recalculated the health fees that the claimant was authorized to collect, and reduced the claim by the amount not stated as offsetting revenues.[57] The Controller argues that "[t]he

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

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

[53] Exhibit A, Incorrect Reduction Claim, at pp. 14-18.

[54] Exhibit A, Incorrect Reduction Claim, at p. 50 [Controller's Audit Report, at p. 6].

[55] Exhibit A, Incorrect Reduction Claim, at p. 51 [Controller's Audit Report, at p. 7].

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

[57] Exhibit A, Incorrect Reduction Claim, at p. 52 [Controller's Audit Report, at p. 8].

relevant amount [of offsetting savings] is not the amount charged, nor the amount collected, rather it is the amount authorized."[58]

Finally, the Controller argues that the claimant "incorrectly applies the 1996 version of [the statute of limitations.]" The Controller explains that the prior version of section 17558.5 provided that a reimbursement claim is "subject to audit" for two years after the end of the calendar year in which the claim is filed, meaning that the claimant's 2001-2002 claim, filed December 2, 2002, would be "subject to audit" through December 31, 2004. The Controller asserts that the audit in dispute in this IRC was initiated no later than August 18, 2004, "when the entrance conference was held," and therefore the audit was proper. In addition, the Controller argues that the amendments to section 17558.5, which took effect January 1, 2003, expanded the statute of limitations, and that "[u]nless a statute expressly provides to the contrary, any enlargement of a statute of limitations provision applies to matters pending but not already barred." The amended statute provides that an audit must be initiated no later than *three* years after the claim is filed or last amended. The Controller argues that the expansion of the statute of limitations pursuant to section 17558.5, as amended by Statutes 2002, chapter 1128 (AB 2834) applies to the audit in dispute in this IRC, and therefore the audit was proper.[59]

IV. Discussion

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

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the 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 statement of 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.[60] 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."[61]

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

[59] Exhibit B, Controller's Comments on IRC, at pp. 2-3.

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

[61] *County of Sonoma, supra,* 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

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

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

The Commission must review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant. [64] In addition, section 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[65]

A. The Statute of Limitations Found in Government Code Section 17558.5 does not Bar the Controller's Audit of the Claimant's 2001-2002 Reimbursement Claim.

The statute of limitations applicable to mandate reimbursement claims is provided in Government Code 17558.5. Section 17558.5 was amended twice between the time the subject claims were filed and the final audit report was issued, and the parties take opposing views on what version of the statute to apply and the meaning given to the statutory language.

At the time claimant incurred the mandated costs in fiscal year 2001-2002 and filed its reimbursement claim on December 2, 2002, Government Code section 17558.5, as added in 1995, stated the following:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the

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[62] *Johnston v. Sonoma County Agricultural* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

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

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

[65] 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.

> fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[66]

Claimant asserts that "the first year of the two claims audited, FY 2001-02, is beyond the statute of limitations for audit when the Controller completed its audit on April 27, 2005."[67] The claimant reasons that its fiscal year 2001-2002 reimbursement claim, submitted on December 2, 2002, was "subject to audit" until December 31, 2004. The claimant interprets "subject to audit" to require the *completion* of an audit within the two year period, and therefore concludes that pursuant to "the unmistakable language of Section 17558.5," the Controller's issuance of a final audit report on April 27, 2005 was beyond the statute of limitations.[68]

The Controller argues that the claimant inappropriately relies on "the 1996 version of this statute," but that "[e]ven under this inappropriate version, [the claimant's] conclusion is based on an erroneous interpretation that attempts to rewrite that section, adding a deadline for completion of the audit where none exists." The Controller argues that "[a]lthough there may be a dispute as to what constitutes the initiation of an audit, it is clear that the audit was initiated no later than August 18, 2004, when the entrance conference was held," and that "[t]herefore, the audit of the fiscal year 2000-01 [reimbursement claim] was proper, even under the 1996 version of Section 17558.5."[69] Alternatively, the Controller argues that a 2002 amendment to section 17558.5, which became effective on January 1, 2003, enlarges the statute of limitations to initiate an audit to three years, and that the later enacted statute applies here to grant the Controller additional time to initiate the audit, because the audit period for the 2001-2002 claim was still open. In addition, a 2004 amendment to section 17558.5 also applies, requiring that an audit be completed within two years of the date commenced.[70]

The Commission finds that the audit of the 2001-2002 reimbursement claim was timely under Government Code section 17558.5, as added by Statutes 1995, chapter 945. In addition, when applying the 2002 and 2004 amendments to section 17558.5 the audit is also timely.

The plain language of Government Code section 17558.5, as added in 1995, provides that reimbursement claims are "subject to audit" no later than two years after the end of the calendar year that the reimbursement claim was filed. The phrase "subject to audit" does not require the completion of the audit, but sets a time during which a claimant is on notice that an audit of a claim may occur. This reading is consistent with the plain language of the second sentence, when no funds are appropriated for the program, "the time for the Controller *to initiate an audit* shall commence to run from the date of initial payment of the claim."[71]

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[66] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)). Former Government Code section 17558.5 was originally added by the Legislature by Statutes 1993, chapter 906, effective January 1, 1994. The 1993 statute became inoperative on July 1, 1996, and was repealed on January 1, 1997 by its own terms.

[67] Exhibit A, Incorrect Reduction Claim, at pp. 18-19.

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

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

[70] Government Code section 17558.5, (Stats. 2004, ch. 313 (AB 2224)).

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

This interpretation is also consistent with the Legislature's 2002 amendment to Government Code section 17558.5, clarifying that "subject to audit" means "subject to the initiation of an audit," as follows in underline and strikeout:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than ~~two~~ three years after the ~~end of the calendar year in which the~~ date that the actual reimbursement claim is filed or last amended, whichever is later. However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the claim is ~~made~~ filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[72]

And finally, section 17558.5 was amended again in 2004 to establish, for the first time, the requirement to "complete" an audit two years after the audit is commenced. As amended and effective beginning January 1, 2005, the section provides as follows in underline and strikeout:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than three years after the date that the actual reimbursement claim is filed or last amended, whichever is later. However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the claim is filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim. In any case, an audit shall be completed not later than two years after the date that the audit is commenced.[73]

Each of these amendments must be analyzed, with respect to the subject claims and the audit because an expansion or contraction of a statute of limitations generally applies to pending claims unless a party's rights would be unconstitutionally impaired.

In *Douglas Aircraft*,[74] cited in the Controller's comments, the Court stated the general rule as follows:

> The extension of the statutory period within which an action must be brought is generally held to be valid if made before the cause of action is barred. (*Weldon v. Rogers*, 151 Cal. 432.) The party claiming to be adversely affected is deemed to suffer no injury where he was under an obligation to pay before the period was lengthened. This is on the theory that the legislation affects only the remedy and not a right. (*Mudd v. McColgan*, 30 Cal.2d 463; *Davis & McMillan v. Industrial Acc. Com.*, 198 Cal. 631; 31 Cal.Jur.2d 434.) An enlargement of the limitation period by the Legislature has been held to be proper in cases where the period had not run against a corporation for additional franchise taxes (*Edison Calif. Stores, Inc. v. McColgan*, 30 Cal.2d 472), against an individual for personal income taxes (*Mudd v. McColgan, supra*, 30 Cal.2d 463), and against a judgment debtor

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[72] Statutes 2002, chapter 1128 (AB 2834).

[73] Statutes 2004, chapter 313 (AB 2224).

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

> (*Weldon v. Rogers*, *supra*, 151 Cal. 432). It has been held that unless the statute expressly provides to the contrary any such enlargement applies to matters pending but not already barred. (*Mudd v. McColgan*, *supra*, 30 Cal.2d 463.)[75]

In *Mudd v. McColgan*, relied upon in *Douglas Aircraft*, the Court explained:

> It is settled law of this state that an amendment which enlarges a period of limitation applies to pending matters where not otherwise expressly excepted. Such legislation affects the remedy and is applicable to matters not already barred, without retroactive effect. Because the operation is prospective rather than retrospective, there is no impairment of vested rights. [Citations.] Moreover, a party has *no vested right in the running of a statute of limitation prior to its expiration*. He is deemed to suffer no injury if, at the time of an amendment extending the period of limitation for recovery, he is under obligation to pay. In *Campbell v. Holt*, 115 U.S. 620, at page 628, it was said that statutes shortening the period or making it longer have always been held to be within the legislative power until the bar was complete.[76]

And in *Liptak v. Diane Apartments, Inc.*,[77] the Second District Court of Appeal, relying in part on *Mudd*, *supra*, reasoned:

> A party does not have a vested right in the time for the commencement of an action. (*Mill and Lumber Co. v. Olmstead* (1890) 85 Cal. 80, 84-85.) Nor does he have a vested right in the running of the statute of limitations prior to its expiration. (*Mudd v. McColgan* (1947) 30 Cal.2d 463, 468; *Weldon v. Rogers* (1907) 151 Cal. 432, 434.) *A change in the statute of limitations merely effects a change in procedure and the Legislature may shorten the period, however, a reasonable time must be permitted for a party affected to avail himself of the remedy before the statute takes effect.* (*Rosefield Packing Co. v. Superior Court* (1935) 4 Cal.2d 120, 122; *Davis & McMillan v. Industrial Acc. Com.* (1926) 198 Cal. 631, 637; *Mill and Lumber Co. v. Olmstead*, *supra*, 85 Cal. at p. 84.)[78]

Therefore, an expansion of a statute of limitations applies to matters pending but not already barred, based in part on the theory that a party has no vested right in the running of a statutory period prior to its expiration.[79] In addition, a contraction of a statute of limitations will generally apply to pending claims or matters as long as the party affected has a reasonable time to assert the claim.[80] However, the courts have also found that where an amended statute of limitations relinquishes a right previously held *by the state or one of its agencies,* a reasonable time to avail

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[75] *Id*, at p. 465.

[76] *Mudd v. McColgan* (1947) 30 Cal.2d 463, at p. 468 [emphasis added].

[77] 109 Cal.App.3d 762.

[78] *Id*, at p. 773.

[79] *Mudd v. McColgan* (1947) 30 Cal.2d 463, at p. 468

[80] *Liptak v. Diane Apartments, Inc.* 109 Cal.App.3d 762, at p. 773 [citing *Rosefield Packing Co. v. Superior Court* (1935) 4 Cal.2d 120, 122].

itself of the right is not required. In *California Employment Stabilization Commission v. Payne*, the Court stated the following:

> Accordingly, the power of the Legislature to lessen a statute of limitations is subject to the restriction that an existing right cannot be cut off summarily without giving a reasonable time after the act becomes effective to exercise such right. (See *Davis & McMillan v. Ind. Acc. Comm.*, 198 Cal. 631, 637.) This principle, however, does not apply where the state gives up a right previously possessed by it or by one of its agencies. Except where such an agency is given powers by the Constitution, it derives its authority from the Legislature, which may add to or take away from those powers and therefore a statute which adversely affects only the right of the state is not invalid merely because it operates to cut off an existing remedy of an agency of the state.[81]

Therefore the amendments to section 17558.5 discussed above, first expanding the time to initiate an audit (and clarifying the meaning of "subject to audit"),[82] and then imposing a two year deadline for completion of an audit,[83] must be applied and analyzed as of their effective dates. As explained above, the claimant has no "vested right in the running of the statute of limitations prior to its expiration,"[84] and the Controller's authority to audit can be impaired by the Legislature, as it was by the 2004 amendment to section 17558.5, without consideration of whether the agency has a reasonable time in which to avail itself of the "right."[85]

Here, the reimbursement claim filed for fiscal year 2001-2002 was subject to audit "no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended;"[86] in this case, before December 31, 2004. Based on the interpretation urged by the Controller, which is consistent with the clarifying change made in the 2002 amendment, effective January 1, 2003, an audit initiated before December 31, 2004 would be timely. Here, an entrance conference was held on August 18, 2004, and while "there may be a dispute as to what constitutes the initiation of an audit,"[87] the Commission has previously found that an entrance conference is sufficient. Moreover, applying the expanded statute of limitations, effective January 1, 2003 (*i.e.*, effective before the time the audit would have been barred) the period during which the claim is "subject to the initiation of an audit" extends to December 2, 2005, based on the filing date of the claim.[88] Finally, the audit was commenced on August 18,

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[81] (1948) 31 Cal.2d 210, 215-216.

[82] Statutes 2002, chapter 1128 (AB 2834).

[83] Statutes 2004, ch. 313 (AB 2224).

[84] *Liptak*, *supra*, 109 Cal.App.3d 762, at p. 773 [citing *Mudd*, *supra*, 30 Cal.2d 463, at p. 468].

[85] *California Employment Stabilization Commission v. Payne*, (1948) 1931 Cal.2d 210, 215-216.

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

[87] Exhibit B, Controller's Comments, at p. 2.

[88] See Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)) [Audit must be initiated no later than *three years after reimbursement claim filed or last amended*].

2004, and completed April 27, 2005, well within the two-year time period required by Statutes 2004, ch. 313.[89]

Based on the foregoing, the Commission finds that the audit of the claimant's reimbursement claims is not barred by the statute of limitations in Government Code section 17558.5.

B. The Controller's Reduction for Insurance Premiums is Consistent with the Parameters and Guidelines and Correct as a Matter of Law.

The Controller reduced amounts claimed for "services and supplies" by $9,257 for fiscal year 2001-2002, and $8,637 for fiscal year 2002-2003, on the grounds that athletic insurance costs are beyond the scope of the mandate, and certain costs were "claimed twice."[90] The total reduction for services and supplies for both fiscal years is $17,894.[91] The claimant does not dispute the "duplicated charges of $6,025 for services and supplies for both fiscal years."[92]

However, in its IRC filing, claimant asserts that the total amount includes "$11,869 in "overclaimed athletic insurance costs," for both fiscal years,[93] which claimant disputes, arguing:

> The District pays two types of student insurance premiums. The basic and catastrophic coverage for the general student population, and a separate premium amount for intercollegiate athletics. The Controller's adjustment improperly disallows a portion of the general population premium as somehow being related to intercollegiate athletics. The audit report does not describe how the disallowance was calculated. Regardless the reduction is inappropriate since student athletes are part of the student population for purpose of the general student population insurance premium. The insurance premiums for athletes pertains to coverage while participating in intercollegiate sports, not while they are attending class or on campus in their capacity [sic] as a member of the general student population.[94]

The Controller asserts that claimant "overclaimed insurance premiums for student basic and catastrophic coverage by $11,869, because it included unallowable premiums paid for athletic insurance." The Controller explains that the parameters and guidelines provide for reimbursement for the cost of insurance for "(1) on campus accident, (2) voluntary, and (3) insurance inquiry/claim administration." However, the Controller notes that "Education Code

[89] See, *California Employment Stabilization Commission v. Payne* (1948) 1931 Cal.2d 210, 215-216, where the court found that when state gives up a right previously possessed by it or one of its agencies, the restriction in the new law becomes effective immediately upon the operative date of the change in law for all pending claims.

[90] Exhibit A, Incorrect Reduction Claim, at p. 50.

[91] *Ibid*.

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

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

[94] Exhibit A, Incorrect Reduction Claim, at p. 11-12.

Section 76355(d) (formerly Section 72246(2)) states that athletic insurance is not an authorized expenditure for health services."[95]

What was initially unclear from the record was whether the parties were talking about health insurance premiums for "(1) on campus accident, (2) voluntary, and (3) insurance inquiry/claim administration" which premiums include coverage of student athletes as members of the student body, or whether the costs claimed were in fact for "athletic insurance." If the former, then the costs are reimbursable because Education Code section 76355 provides that "no student shall be denied a service supported by student health fees on account of participation in athletic programs"[96] and student athletes are not exempt from the requirement to pay the student health fee. Student athletes are entitled to the same services as other students. However, if the latter, the cost is not a reimbursable type of insurance based on the plain language of the parameters and guidelines, and the disputed adjustment would therefore be a proper reduction.[97]

Adding to the confusion is claimant's statement in a letter to the Controller's Audit Bureau that it "is still investigating the athletic insurance costs to determine if the amounts reported in the claim related to basic insurance costs for students who also were covered by athletic insurance."[98] And later, in rebuttal comments, claimant asserted that the reductions were based on "the erroneous conclusion...that premiums for athletic insurance are not reimbursable." Claimant states: "the athletic insurance premiums claimed are part of the excess costs that make up the District's claims, and as such, were not paid for with the student [health] fees from the fund."[99] It appears from these comments that claimant is arguing a mandate issue that was already decided in the test claim and parameters and guidelines: *i.e.*, that athletic insurance should be reimbursable.

However, that is not what the adopted parameters and guidelines provide. The only insurance premiums authorized for reimbursement under this program are "(1) on campus accident, (2) voluntary, and (3) insurance inquiry/claim administration."[100] The test claim decision and parameters and guidelines are final decisions of the Commission and they bind the parties. The Controller is required to follow the parameters and guidelines.[101]

The Commission finds that the rebuttal contains an admission from claimant that the costs were in fact for "athletic insurance" and not for the "(1) on campus accident, (2) voluntary, and (3) insurance inquiry/claim administration" insurance premiums which are included as reimbursable costs in the parameters and guidelines.[102] Therefore, the Controller's reduction of costs for

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[95] Exhibit B, Controller's Comments, at p. 13.

[96] 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)].

[97] Exhibit A, Incorrect Reduction Claim [Parameters and Guidelines, at pp. 30-33].

[98] Exhibit A, Incorrect Reduction Claim [Controller's audit report, at p. 50].

[99] Exhibit C, Claimant's Rebuttal Comments, at p. 5.

[100] Exhibit A, Incorrect Reduction Claim [Parameters and Guidelines, at p. 32].

[101] Government Code 17558.

[102] Exhibit C, Claimant's Rebuttal Comments.

athletic insurance is correct based on the plain language of the parameters and guidelines. Based on the evidence in the record, the claimant has not demonstrated that the reduction was based on insurance costs for the general student population, rather than athletic insurance.

Based on the foregoing, the Commission finds that the reductions for insurance premiums are consistent with the parameters and guidelines and correct as a matter of law.

C. The Controller's Recalculation and Reduction of Claimed Indirect Costs is Correct as a Matter of Law and is not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced indirect costs claimed by claimant, by $70,710 for fiscal year 2001-2002, and $68,383 for fiscal year 2002-2003, on the ground that claimant did not utilize a federally approved indirect cost rate.[103] Claimant argues that "[c]ontrary to the Controller's ministerial preferences, there is no requirement in law that the district's indirect cost rate must be 'federally' approved, and further the Controller has never specified the federal agencies which have the authority to approve indirect cost rates."

The Commission finds that the parameters and guidelines require claimants to adhere to the claiming instructions when claiming indirect costs, and that the claimant here did not do so. Therefore, the reduction was correct as a matter of law. The Commission further finds that the Controller's use of the alternative state method to calculate indirect costs was not arbitrary, capricious, or entirely lacking in evidentiary support.

1. *The parameters and guidelines expressly require claimants to claim indirect costs in the manner described in the Controller's claiming instructions, which in turn provide that an indirect cost rate may be developed in accordance with federal OMB guidelines or by using the state Form FAM-29C.*

The claimant argues that "[n]o particular indirect cost rate calculation is required by law," and that the parameters and guidelines "do not require that indirect costs be claimed in the manner described by the Controller."[104] The claimant argues that the word "may" is permissive, and that therefore the parameters and guidelines do not require that indirect costs be claimed in the manner described by the Controller.[105]

The 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*."[106] The interpretation that is consistent with the plain language of the parameters and guidelines is that "indirect costs may be claimed," or may not, but if a claimant chooses to claim indirect costs, the claimant must adhere to the Controller's claiming instructions.

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[103] Exhibit A, Incorrect Reduction Claim, at p. 51.

[104] Exhibit A, Incorrect Reduction Claim, at pp. 12-13.

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

[106] Exhibit A, Incorrect Reduction Claim, at p. 34.

The claiming instructions specific to the *Health Fee Elimination* mandate, included in the submissions of both claimant and of the Controller,[107] do not discuss specific rules or guidelines for claiming indirect costs with respect to this mandate. However, the School Mandated Cost Manual contains *general instructions* for school districts and community college districts seeking to claim indirect costs, and those instructions provide guidance to claimants for *all mandates*, absent specific provisions to the contrary.[108] The Controller submitted an excerpt of the School Mandated Cost Manual addressing indirect cost rates, revised September 2002, in response to the IRC.[109] The Controller also submitted an excerpt of the School Mandated Cost Manual revised September 1997, which contained the program-specific instructions for the *Health Fee Elimination* mandate.[110]

More recently the manuals for school districts and community college districts have been printed separately.[111] The Mandated Cost Manual for Community Colleges now contains general instructions for claiming under all mandates, with the suggestion that claimants refer to the parameters and guidelines and specific claiming instructions, as follows:

> This manual is issued to assist claimants in preparing mandated cost claims for submission to the State Controller's Office (SCO). The information contained in this manual is based on the State of California's statutes, regulations, and the parameters and guidelines (P's & G's) adopted by the Commission on State Mandates (CSM). Since each mandate is unique, it is imperative that claimants refer to the claiming instructions and P's & G's of each program for updated data on established policies, procedures, eligible reimbursable activities, and revised forms.[112]

Therefore, the reference in the parameters and guidelines to the Controller's claiming instructions necessarily includes the general provisions of the School Mandated Cost Manual (and later the Mandated Cost Manual for Community Colleges), and the manual provides ample notice to claimants as to how they may properly claim indirect costs. Claimant's assertion that "[n]either applicable law nor the Parameters and Guidelines made compliance with the Controller's claiming instructions a condition of reimbursement"[113] is therefore in error. The parameters and guidelines, which were duly adopted at a Commission hearing, require compliance with the claiming instructions.

Claimant also argues that "the Controller's claiming instructions were never adopted as law, or regulations pursuant to the Administrative Procedure Act," and therefore, claimant argues, "the

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[107] Exhibit A, Incorrect Reduction Claim, at pp. 37-40; Exhibit B, Controller's Comments, at pp. 29-40.

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

[109] Exhibit B, Controller's Comments, at pp. 24-27.

[110] Exhibit B, Controller's Comments, at pp. 29-40.

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

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

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

claiming instructions are merely a statement of the ministerial interests of the Controller and not law."[114] In *Clovis Unified*, the Controller's contemporaneous source document rule, or CSDR, was held to be an unenforceable underground regulation because it was applied generally against school districts and had never been adopted as a regulation under the APA.[115] Here, claimant alleges, somewhat indirectly, the same fault in the claiming instructions with respect to indirect cost rates. But the distinction is that here the parameters and guidelines, which *were* duly adopted at a Commission hearing, require compliance with the claiming instructions on indirect cost rates.

The parameters and guidelines expressly require claimants to claim indirect costs in the manner described in the Controller's claiming instructions, which in turn provide that an indirect cost rate may be developed in accordance with federal OMB guidelines or by using the state Form FAM-29C.

2. *Claimant did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rates. Therefore, the Controller's reduction and recalculation of costs based on applying the Form FAM-29C calculation to provide an indirect cost rate is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.*

In the audit of the reimbursement claims for the period of July 1, 2001 through June 30, 2003, the Controller concluded that the claimed indirect costs were based on a rate not federally approved, and that the Controller's calculated rates did not support the indirect cost rates claimed.[116] Indirect costs in the amount of $149,291 were claimed for fiscal year 2001-2002, against direct costs of $417,010; and $148,836 for fiscal year 2002-2003, against direct costs of $437,679. Those indirect costs amount to rates of approximately 35.8 percent and 34 percent, respectively.

The claiming instructions provide two options for claiming indirect costs, one of which is using the OMB Circular A-21. However, to use this option, a claimant must obtain federal approval, which the claimant here did not do. The claiming instructions applicable at the time the subject reimbursement claims were filed stated:

> A college has the option of using a federally approved rate, utilizing the cost accounting principles from Office of Management and Budget Circular A-21 "Cost Principles for Educational Institutions," or the Controller's methodology outlined in the following paragraphs. If the federal rate is used, it must be from the same fiscal year in which the costs were incurred.[117]

Thus, the claimant did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rate to the direct costs claimed, and the Commission finds that the reduction is correct as a matter of law.

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

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

[116] Exhibit A, Incorrect Reduction Claim, at p. 51.

[117] Exhibit X, School Mandated Cost Manual Excerpt, Revised 09/01; Mandated Cost Manual for Community Colleges, Revised 09/03.

The Controller, concluding that the rate was not approved, and therefore not supported consistently with the parameters and guidelines and the claiming instructions, recalculated the indirect cost rate using the alternative state procedure, the "FAM-29C method," outlined in the School Mandated Cost Manual.[118]. Applying the FAM-29C methodology, the Controller reduced the claimed indirect costs to $75,424 (an 18.23% rate) for fiscal year 2001-2002 and $77,522 (a 17.96% rate) for fiscal year 2002-2003.[119]

Claimant argues that the Controller "made no determination as to whether the method used by the District was reasonable, but, merely substituted its FAM-29C method for the method reported by the District [*sic*]."[120]

However, the Commission finds that because claimant failed to obtain federal approval of its OMB Circular A-21 indirect cost rate, the Controller acted reasonably in recalculating the rate using one of the options provided for in the claiming instructions. The Controller asserts that the parameters and guidelines require a claimant choosing to claim indirect costs to use one of the two options provided in the claiming instructions: "if the district chooses to claim indirect costs, then the district must comply with the [Controller]'s claiming instructions."[121] The Controller's assertion is consistent with the plain language of the parameters and guidelines which state: "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions."[122] Moreover, as claimant points out, "both the District's method and the Controller's method utilized the same source document, the CCFS-311 annual financial and budget report required by the state."[123] Therefore, the Controller's selection of the alternative state method was effectively the only valid alternative available, given that claimant failed to obtain federal approval in accordance with the other (OMB) option.

Accordingly, the Commission finds that the Controller's reduction and recalculation of costs based on applying the Form FAM-29C calculation to provide an indirect cost rate is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

D. The Controller's Reduction for Understated Offsetting Revenues Pursuant to the Health Fee Rule is Correct as a Matter of Law.

The Controller reduced the reimbursement claims by $217,409 for the two years at issue.[124] These reductions were made on the basis of the fee authority available to claimant, multiplied by the number of students subject to the fee, less the amount of offsetting revenue claimed.

Claimant disputes the reduction, arguing that the relevant Education Code provisions permit, but do not require, a community college district to levy a health services fee, and that the parameters and guidelines require a community college district to deduct from its reimbursement claims

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[118] See Exhibit B, Controller's Comments, at p. 16.

[119] Exhibit A, Incorrect Reduction Claim, at pp. 48; 51.

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

[121] Exhibit B, Controller Response to District IRC, Tab 2 at p. 15.

[122] Exhibit B, Controller's Comments on IRC [Parameters and Guidelines], at p. 110].

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

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

"[a]ny offsetting savings that the claimant experiences as a direct result of this statute…" Claimant argues that "[i]n order for the district to 'experience' these 'offsetting savings' the district must actually have collected these fees." Claimant concludes that "[s]tudent fees actually collected must be used to offset costs, but not student fees that could have been collected and were not."[125]

The Commission finds that the correct calculation and application of offsetting revenue from student health fees has been resolved by the *Clovis Unified* decision, and that the reduction is correct as a matter of law.

After the claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge students, whether or not a district chooses to charge its students those fees. As cited by the court, the Health Fee Rule states in pertinent part:

> Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.[126] (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).[127]

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.[128] The Chancellor of the California Community Colleges issues a notice to the

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[125] Exhibit A, Incorrect Reduction Claim, at pp. 14-15.

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

[127] 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)].

[128] 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

governing boards of all community colleges when a fee increase is triggered.[129] Here, the Controller asserts that claimant should have collected an additional fee amount in accordance with the notices periodically issued by the Chancellor, stating that the Implicit Price Deflator Index had increased enough to support a one dollar increase in student health fees.[130] Claimant argues that "the Controller cannot rely on the Chancellor's notice as a basis to adjust the claim for 'collectible' student health services fees,"[131] because the fees levied on students are raised by action of the governing board of the community college district. But the *authority* to impose the health service fees increases automatically with the Implicit Price Deflator, as noticed by the Chancellor. Accordingly, the court in *Clovis Unified* upheld the Controller's use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. In making its decision the court notes that the concept underlying the state mandates process that Government Code sections 17514 and 17556(d) embody is:

> 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.[132]

The court also notes that, "this basic principle flows from common sense as well. As the Controller succinctly puts it, 'Claimants can choose not to require these fees, but not at the state's expense.'"[133] Additionally, in responding to 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",[134] 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*.[135] (Italics added.)

Thus, pursuant to the court's decision in *Clovis Unified*, the Health Fee Rule used by the Controller to adjust reimbursement claims filed by claimant for the *Health Fee Elimination* program is valid. Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.[136] In addition, the Clovis decision is binding on the claimant

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(and quarterly) by the United States Department of Commerce as part of its statistical series on measuring national income and product, and is used to adjust government expenditure data for the effect of inflation.

[129] See, e.g., Exhibit A, Incorrect Reduction Claim [Letter from Chancellor, at pp. 69-70].

[130] See Exhibit B, Controller's Comments, at pp. 16-18; Exhibit A, Incorrect Reduction Claim, at pp. 69-70.

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

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

[133] *Ibid.*

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

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

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

under principles of collateral estoppel.[137] 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.[138] Although the claimant to this IRC was not a party to the *Clovis* action, the claimant is in privity with the petitioners in *Clovis*. "A party is adequately represented for purposes of the privity rule if his or her interests are so similar to a party's interest that the latter was the former's virtual representative in the earlier action."[139]

Based on the foregoing the Commission finds that the Controller's reduction of reimbursement to the extent of the fee authority found in Education Code section 76355 is correct as a matter of law.

V. Conclusion

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

- Reduction for both fiscal years of $11,869 for athletic insurance costs that are beyond the scope of the mandate.
- Reductions of indirect costs claimed of $70,710 for fiscal year 2001-2002, and $68,383 for fiscal year 2002-2003, based on the claimant's failure to comply with the claiming instructions in the development of its indirect cost rate, and the Controller's use of an alternative method to calculate indirect costs authorized by the parameters and guidelines and claiming instructions.
- Reduction for both fiscal years of $217,409 based on understated offsetting health fee revenues.

Based on the foregoing, the Commission denies this IRC.

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[137] 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.

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

[139] *Rodgers v. Sargent Controls & Aerospace* (2006) 136 Cal.App.4th 82, 91.

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Claim Number: 05-4206-I-03

Matter: Health Fee Elimination

Claimant: Long Beach Community College District

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