

COMMISSION ON STATE MANDATES

980 NINTH STREET, SUITE 300
SACRAMENTO, CA 95814
PHONE: (916) 323-3562
FAX: (916) 445-0278
E-mail: csminfo@csm.ca.gov



August 2, 2013

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

Mr. Jim Spano
Division of Audits
State Controller's Office
3301 C Street, Suite 700
Sacramento, CA 95816

And Affected State Agencies and Interested Parties (See Mailing List)

RE: Notice of Draft Staff Analysis, Schedule for Comments, and Notice of Hearing
Health Fee Elimination, 05-4206-I-04 and 05-4206-I-08
Education Code Section 76355
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.); Statutes 1987, Chapter 1118
Fiscal Years 1999-2000, 2000-2001, 2001-2002, and 2002-2003
San Mateo County Community College District and San Bernardino
Community College District, Claimants

Dear Mr. Petersen and Mr. Spano:

The draft staff analysis for the above-named matter is enclosed for your review and comment.

Written Comments

Written comments may be filed on the draft staff analysis by **August 23, 2013**. 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, § 1181.2.)

If you would like to request an extension of time to file comments, please refer to section 1183.01(c)(1) of the Commission's regulations.

Hearing

This matter is set for hearing on **Friday, September 27, 2013**, at 10:00 a.m., in the State Capitol, Room 447, Sacramento, California. The final staff analysis will be issued on or about September 13, 2013. 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

Mr. Petersen and Mr. Spano

August 2, 2013

Page 2

postponement of the hearing, please refer to section 1183.01(c)(2) of the Commission's regulations.

Please contact Matt Jones at (916) 323-3562 if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Heather Halsey", written in a cursive style.

Heather Halsey
Executive Director

ITEM __
INCORRECT REDUCTION CLAIM
DRAFT STAFF ANALYSIS
AND
PROPOSED STATEMENT OF DECISION

Education Code Section 76355

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

Health Fee Elimination

Fiscal Years 1999-2000, 2000-2001, 2001-2002 and 2002-2003

05-4206-I-04 and 05-4206-I-08

San Mateo Community College District and San Bernardino Community College District,
Claimants

Attached is the draft proposed statement of decision for this matter. The executive summary and the proposed statement of decision also function as the draft staff analysis, as required by section 1185.05 of the Commission's regulations.

EXECUTIVE SUMMARY

Overview

This analysis addresses the consolidated incorrect reduction claims (IRCs) filed by two community college districts (districts) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during fiscal years 1999-2000 through 2002-2003 under the *Health Fee Elimination* program. The executive director has consolidated these claims pursuant to section 1185.4 of the Commission's regulations.

The following issues are in dispute in this consolidated IRC:

- The statute of limitations applicable to audits of reimbursement claims by the Controller;
- The appropriate extent of offsetting revenue available from health service fees, pursuant to the *Clovis Unified* decision;
- Disallowances found against both districts based on asserted faults in the development and application of indirect cost rates;
- Disallowance of salaries and benefits against San Mateo based on asserted insufficient documentation of hours and duties;
- Disallowance of other outgoing expenses against San Mateo based on asserted insufficient documentation;

- Disallowance of discrete health services against San Bernardino based on an asserted failure to substantiate services provided in the base year;
- Disallowance of costs for student health insurance against San Bernardino based on the scope of reimbursement excluding student athletic costs.

Health Fee Elimination Program

Prior to 1984, community college districts were authorized to charge almost all students a general fee (health service fee) for the purpose of providing health services. Statutes 1984, chapter 1 eliminated community college districts' fee authority for health services. The 1984 statute also required any district which provided health services during the 1983-1984 fiscal year, for which the district was 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. As a result, community college districts, which previously had fee authority to provide health services, were then required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose.

In 1987, the Legislature required the maintenance of effort requirement to continue after January 1, 1988, and reestablished the health fee authority. As a result, all community college districts that provided health services during the 1986-1987 fiscal year were required to maintain those services every subsequent fiscal year, and were granted authority to charge a health service fee to offset the costs of providing those services.

Commission Decisions

At the November 20, 1986 Commission hearing, the Commission determined that the 1984 statute, which required community college districts to maintain health services without fee authority for those services, 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.

At the May 25, 1989 Commission hearing, the Commission adopted amendments to the parameters and guidelines for the *Health Fee Elimination* program to reflect amendments made by Statutes 1987, chapter 1118. The 1989 parameters and guidelines reflected a change in eligible claimants (those districts that provided health services in the 1986-87 fiscal year, and were required to continue doing so), and the reestablishment of community college districts' fee authority for the *Health Fee Elimination* program.

At the October 27, 2011 Commission hearing, the Commission adopted a decision regarding seven consolidated IRCs under the *Health Fee Elimination* program, which addressed some of the same substantive issues present in the current consolidated IRCs.

Procedural History

San Mateo Community College District filed claims with the Controller for the 1999-2000 through the 2001-2002 fiscal years for actual costs incurred under the *Health Fee Elimination* program, including offsetting revenue received from health service fees collected. On January 7, 2005 the Controller issued its audit report, concluding that the district had overstated its costs for the program, including salary and benefit costs that the Controller concluded were not supported, and indirect costs that the Controller concluded were not allowable; and

understated its offsetting fee authority. San Mateo filed IRC 05-4206-I-04, as a result of its disagreement over the Controller's audit report, on September 1, 2005.¹

San Bernardino Community College District filed claims with the Controller for the 2001-2002 and 2002-2003 fiscal years for actual costs incurred under the *Health Fee Elimination* program, including offsetting revenue received from health service fees collected. On November 10, 2004, the Controller issued its audit report, concluding that the district had overstated its costs for the program, including athletic insurance costs and certain health services that the Controller concluded were not within the scope of the maintenance of effort requirement, and including indirect costs that the Controller concluded were not allowable; and concluding that the district understated its offsetting fee authority. San Bernardino filed IRC 05-4206-I-08, as a result of its disagreement over the Controller's audit report, on September 13, 2005.²

On December 31, 2007, the Controller submitted written comments on the IRC filed by San Bernardino, reiterating the audit findings and asserting that its adjustments were appropriate. On April 24, 2008, the Controller submitted written comments on the IRC filed by San Mateo, in which it stressed the proper application of the statute of limitations, and restated its contention that the audit adjustments were proper. On July 13, 2009, San Mateo submitted rebuttal comments in response to the Controller's comments on its IRC, in which it recognized the Controller's authority to audit but renewed its objections to the lack of explanation of the reasons for disallowance of specific costs, and to the application of an average benefit rate where actual benefit costs were available; reiterated its disagreement with the Controller's adjustment on the basis of health fees authorized; restated its claim that the indirect cost rate proposal had been improperly rejected; and continued to challenge the statute of limitations asserted by the Controller.

On September 21, 2010, after the filing of the IRCs, the Third District Court of Appeal issued its opinion in *Clovis Unified*,³ which specifically addressed two of the key disputed issues. The court found that community college districts were required to offset costs claimed for the *Health Fee Elimination* program by the amount of health service fees that community college districts were *authorized* to charge, rather than, as the claimants have argued, the fees actually collected; and, the court held that the contemporaneous source document rule (CSDR) was, as applied to the audits of several mandated programs, an unenforceable underground regulation. The scope and effect of the *Clovis Unified* decision is addressed below, where relevant.

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.

¹ Exhibit A, San Mateo IRC.

² Exhibit B, San Bernardino IRC.

³ *Clovis Unified School Dist. v. Chiang (Clovis)* (Cal. Ct. App. 3d Dist. 2010) 188 Cal.App.4th 794.

If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.7 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 determine in this case whether the Controller's audit decisions 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.⁴ In addition, the Commission must determine whether the Controller correctly interpreted the law.

Staff Analysis

A. Statute of Limitations and Retention of Source Documents Applicable to Audits of Mandate Reimbursement Claims

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.*"⁵ San Mateo asserts that the fiscal year 1999-2000 and 2000-2001 claims were no longer subject to audit at the time the final audit report was issued on January 5, 2005, based on filing dates of January 10, 2001 and January 10, 2002.

The Controller argues that section 17558.5 does not require an audit to be *completed* within two years; "subject to audit," the Controller holds, means subject to *initiation* of an audit. A later amendment to the relevant code section clarifies that reimbursement claims are subject to "the initiation of an audit" within a specified time,⁶ and there is no reason to interpret the prior version of the code differently.

Based on the plain language of the statute, and the Legislature's subsequent clarifying amendment to the statute, staff finds that the statute of limitations found in section 17558.5 does not bar the audit of the 1999-2000 and 2000-2001 reimbursement claims.

San Mateo asserts, with respect to the disallowance of employee salaries and benefits, discussed below in section D, that "[o]ne of the stated reasons for the disallowance was that claimants must retain source documentation on file 'for a period of no less than three years from the date of the final payment of the claim.'" San Mateo argues that "[n]o legal citation was provided for this assertion."

The Controller counters that document retention was not a stated reason for the disallowance of costs; the Controller also points to the parameters and guidelines of the *Health Fee Elimination* mandate, which state:

For auditing purposes, all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs...*These documents must be kept on file by the agency submitting the claim for a period of*

⁴ *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.

⁵ Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11).

⁶ Government Code section 17558.5 (Stats. 2002, ch. 1128 (AB 2834)).

no less than three years from the date of the final payment of the claim pursuant to this mandate, and made available on the request of the State Controller or his agent.

San Mateo's assertion that the document retention period "appears to be a ministerial preference of the Controller's" is clearly in error. Staff finds that the parameters and guidelines clearly require claimants to retain source documents for no less than three years.

B. Understated Offsetting Revenues: Clovis Unified and the Health Fee Rule

The Controller reduced the reimbursement claims filed by San Mateo by \$13,175 for fiscal year 1999-2000, and \$57,428 for fiscal year 2001-2002. San Bernardino's reimbursement claims were similarly reduced, by \$97,642 for fiscal year 2001-2002, and \$52,389 for fiscal year 2002-2003. These reductions were made on the basis of the fee authority available to the districts, multiplied by the number of students subject to the fee, less any amount of offsetting revenue claimed.

Both San Mateo and San Bernardino disputed the Controller's finding that offsetting revenues from student health fees had been understated in the relevant claim years. Both districts 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 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. The claimants argue that the issue is the difference between fees collected and fees collectible.

After the Districts filed their IRCs, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which 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 declared:

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.⁷

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.'"⁸

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 was legally correct, and not arbitrary, capricious, or entirely lacking in evidentiary support.

C. Application of an Indirect Cost Rate Proposal

The Controller reduced indirect costs claimed by San Mateo by \$30,417 for fiscal year 1999-2000, \$32,728 for fiscal year 2000-2001, and \$49,098 for fiscal year 2001-2002, on grounds that the indirect cost rate was applied to direct costs beyond the scope of the distribution base employed to develop the rate. The Controller also reduced the indirect costs claimed by

⁷ *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 812.

⁸ *Ibid.*

San Bernardino by \$122,795 for fiscal year 2001-2002, and \$158,699 for fiscal year 2002-2003, on grounds that San Bernardino did not utilize a federally approved indirect cost rate.

The districts dispute the Controller's findings that the indirect cost rate proposal was incorrectly applied, and was required to be federally approved, charging that the Controller's conclusions were without basis in the law.

1. *The parameters and guidelines expressly reference the Controller's claiming instructions, which in turn provide for an indirect cost rate to be developed in accordance with federal OMB guidelines.*

Both districts argue that claimants are not required to adhere to the claiming instructions in developing an indirect cost rate. The parameters and guidelines plainly state that "indirect costs may be claimed in the manner described by the State Controller," but the districts argue that the word "may" is permissive. 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. This interpretation is urged by the Controller.

Reference to the Controller's claiming instructions necessarily includes the general provisions of the School Mandated Cost Manual, which provides general claiming instructions for a number of programs, including instructions for indirect cost rates. Therefore, San Bernardino'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.

Both districts also argue that because the claiming instructions "were never adopted as law, or regulations pursuant to the Administrative Procedure Act, the claiming instructions are merely a statement of the ministerial interests of the Controller and not law." In *Clovis Unified*, discussed above, 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.⁹ Here, the districts imply the same fault in the claiming instructions with respect to indirect cost rates. But the distinction here is that the parameters and guidelines, which were duly adopted at a Commission hearing, require compliance with the claiming instructions.

2. *San Mateo did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rate, but a minimum 7 percent indirect cost rate is provided if a claimant cannot support a greater amount; therefore reduction to zero for indirect costs, to the extent direct costs were allowed, was arbitrary.*

In its audit of San Mateo's reimbursement claims for the period of July 1, 1999 through June 30, 2002, the Controller concluded that San Mateo "improperly applied its claimed indirect cost rate to costs beyond those approved by the U.S. Department of Health and Human Services."

San Mateo asserts that the Controller accepted its 30% indirect cost rate but "did not accept application of the rate to costs other than salary and benefits because the rate was calculated using only salary and benefit costs." The Controller asserts that "if the district wishes to apply its indirect cost rate to a distribution base other than salaries and wages, the district's approved

⁹ *Clovis Unified, supra*, 188 Cal.App.4th at p. 805.

A-21 rate must be based on modified total direct costs.” San Mateo asserts that “no accounting rationale or legal basis for this peculiar conclusion is provided by the Controller.”

As discussed above, the claiming instructions are made applicable to the reimbursement claims of the community college districts by the parameters and guidelines; those instructions reveal that while federal approval of an indirect cost rate is not strictly required, it is one of two options for developing an indirect cost rate. The claiming instructions provide that either a district can use a federally approved rate, incorporating the accounting principles of the OMB Circular A-21; or the district can use the alternative state procedure. The claiming instructions also provide a third option for claiming: a flat rate of 7% if a claimant cannot support a higher rate.

The OMB Circular A-21 provides that a salaries and wages base rate, developed in accordance with the steps described, is to be applied “to direct salaries and wages for individual agreements to determine the amount of F&A costs allocable to such agreements.” An indirect cost rate developed on the basis of salaries and wages, by analogy, should be applied to salaries and wages *only*, while an indirect cost rate developed on the basis of other (or all) direct costs could be applied more broadly. This is consistent with the interpretation urged by the Controller, and is a reasonable reading of the OMB guidance.

Based on the foregoing, staff finds that San Mateo’s application of the indirect cost rate to direct costs other than salaries and wages for the mandated activities was inconsistent with the parameters and guidelines and the claiming instructions.

In its audit of San Mateo’s claim, the Controller reduced indirect costs claimed by a total of \$112,243 for the three audit years, finding that the district “improperly applied the indirect cost rate to direct services and supplies, other operating expenses, and capital outlay costs.” But a claimant is still entitled to some amount of indirect costs, and a failure to correctly apply an indirect cost rate does not require an adjustment to zero. As noted above, the claiming instructions provide for a default 7 percent rate for indirect costs when a claimant is unable to substantiate a higher rate.

Based on the foregoing, staff finds that the Controller’s reduction to zero of allowable indirect costs was arbitrary, capricious, or entirely lacking in evidentiary support; a minimum 7 percent indirect cost rate should have been allowed, but if the Controller has sufficient information to support a higher indirect cost rate by applying the alternate state procedure, the Controller should apply a reasonable and fair indirect cost rate calculated consistently with the Controller’s claiming instructions.

3. San Bernardino did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rates.

In the audit of San Bernardino’s reimbursement claims for the period of July 1, 2001 through June 30, 2003, the Controller concluded that the district’s claimed indirect costs were based on a rate not federally approved, and that the costs were highly disproportionate to the Controller’s calculations. San Bernardino counters that “there is no requirement in law that the claimant’s indirect cost rate must be ‘federally’ approved,” and that “[n]o particular indirect cost rate calculation is required by law.” San Bernardino argues that “the District has computed its ICRPs utilizing cost accounting principles from the Office of Management and Budget Circular A-21, and the Controller has disallowed it without a determination of whether the product of the

District's calculation would, or would not, be excessive, unreasonable, or inconsistent with cost accounting principles.”

As discussed above, the claiming instructions are made applicable to the reimbursement claims of community colleges by the parameters and guidelines, and the instructions reveal that while federal approval of an indirect cost rate is not strictly required, it is one of two options for developing an indirect cost rate. There is no third option in the claiming instructions to develop an indirect cost rate in accordance with the OMB Circular principles but then decline to seek federal approval.

In its audit of San Bernardino’s reimbursement claim, the Controller, concluding that the rate was not approved and therefore not supported consistently with the parameters and guidelines and claiming instructions, recalculated the indirect cost rate using the alternative state procedure, the “FAM-29C method,” outlined in the School Mandated Cost Manual. San Bernardino 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;” and that this represents “an arbitrary choice of the Controller, not a ‘finding’ enforceable by fact or law.”

The claiming instructions do provide a default indirect cost rate of 7 percent as follows: “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 Controller did not seek to reduce San Bernardino’s claim of indirect costs to 7 percent, as would appear to be valid and reasonable, given the failure to support a higher rate. Rather, the Controller recalculated the indirect cost rate pursuant to the state procedure outlined in the claiming instructions (the FAM-29C method), resulting in a more generous indirect cost rate than the 7 percent default.

Staff finds that the Controller’s reduction is based on an alternative method of calculating indirect costs, and is therefore not arbitrary, capricious, or entirely lacking in evidentiary support.

D. Disallowance of Salaries and Application of Audited Benefit Rates

The Controller reduced the reimbursement claims filed by San Mateo for salaries and benefits by \$281,607 for fiscal year 1999-2000, \$246,609 for fiscal year 2000-2001, and \$264,949 for fiscal year 2001-2002, on grounds that “the district did not provide documentation supporting the validity of the distribution made to the mandate.”

San Mateo disputes the Controller’s disallowance of certain employee salaries and the application of an “audited” benefit rate to the remaining employees, based on the Controller’s conclusion that San Mateo did not adequately support the claimed costs.

- 1. The Controller’s documentation requirements must be consistent with the parameters and guidelines, and must be applied consistently in order to be enforceable: the disallowance of salaries and benefits for certain disputed employees was arbitrary, in light of salaries and benefits allowed for other employees based on the same or similar documentation.*

In its reimbursement claims for fiscal years 1999-2000, 2000-2001, and 2001-2002, San Mateo stated its salary and benefit costs for the mandate, certified under penalty of perjury, on the Controller’s claim forms. The Controller’s position is that “[t]he district did not provide documentation supporting the validity of the distribution made to the mandate.”

The parameters and guidelines provide that claimants are required to support salaries and benefits claimed with documentation that identifies the employees and their classification, describes the mandated functions performed, and specifies “the actual number of hours devoted to each function.” For several employees, the Controller disallowed salaries and benefits, finding that the actual number of hours devoted to mandated functions was not supported. The Controller requested additional documentation, and San Mateo provided additional information for some of the questioned employees. For example, a letter from San Mateo to the Controller explains that “[f]or Ernest Rodriguez, in March 2002, he took on a teacher assignment which is reflected in the account code... 201000. This was not charged to the claim.” Similarly, the letter shows that Dee Howard, who is identified as “Full-time Faculty” in the Controller’s schedules, worked as a counselor in departments other than “Health Services,” and therefore only the portion of her wages attributed to the health services account was claimed. Similarly, the letter states that Gloria D’Ambra, identified as an office assistant, earned overtime pay in fiscal year 1999-2000, which was not charged to the claim. Along with the letter, San Mateo submitted employee earnings reports, which demonstrate that several employees were paid from multiple sources or accounts.

The documents in the record pertaining to this IRC do not show “the actual number of hours devoted to each [mandated] function,” as required by the parameters and guidelines, but the Controller has apparently allowed salary and benefit costs for some employees on the basis of job titles,¹⁰ and in some cases on the basis of earnings reports that show an employee’s salary paid from an account recognized to be related to the provision of health services.¹¹ In contrast, and without any explanation of its differential treatment, the Controller *disallowed* salary and benefit costs for employees that San Mateo (under penalty of perjury) claims worked at least a portion of their salaried time for the health services department. The Controller made this disallowance citing an absence of employee time records supporting the hours worked performing mandated activities.

Although the documents in the record do not substantiate actual hours performing mandated activities for Dee Howard and Ernest Rodriguez, the same type of documents were accepted by the Controller to substantiate *omitting* from the reimbursement claim overtime hours worked by Gloria D’Ambra; and the same documents were accepted by the Controller as evidence that both D’Ambra and Donna Elliot, identified as office assistants, were engaged in mandate-related activities at the health services department. In other words, if the account codes to which the salaries of D’Ambra and Elliot were charged are sufficient to substantiate costs for their salaries, disallowing costs for Howard and Rodriguez on the basis of the same documentation is arbitrary and capricious.

Based on the foregoing, staff finds that the Controller’s disallowance of salaries and benefits for Dee Howard and Ernest Rodriguez was arbitrary, capricious, or entirely lacking in evidentiary support, and the costs claimed for these two employees should be reinstated.

¹⁰ See Exhibit C, Controller’s Comments on San Mateo IRC, at pp. 52-54 [allowable salaries for nurses and doctors].

¹¹ See Exhibit C, Controller’s Comments on San Mateo IRC, at pp. 48-50 [allowable salaries for and office assistants, apparently on the basis of employee earnings reports].

2. *There is no evidence in the record to support the benefits claimed by San Mateo*

San Mateo disputes the application of an “audited” benefit rate. San Mateo asserts that “[t]he Controller calculated a benefit rate to be applied to the salaries to determine the total allowable salary and employee benefits for each employee.” The resulting rates were between 16.62719 percent and 17.66762 percent for the three years subject to audit. San Mateo objects to this calculation, arguing that “[t]he Controller has not indicated why it was necessary to calculate an average benefit rate when the District reported actual benefit costs in its general ledger, that is, why an average rate is better than actual benefit costs.” San Mateo also asserts that the claiming instructions provide for a “default” benefit rate of 21 percent, which can be added to hourly payroll costs.

There is no evidence in the record of actual benefit amounts paid to each employee, only the benefit totals included in San Mateo’s worksheets.¹² San Mateo makes reference to its “general ledger,” but no such document is found in the record, and the existence of “actual benefit costs,” assertedly provided to the Controller, cannot be verified. The only benefit amounts in the record are the audited benefit amounts in the Controller’s “schedule of allowable salaries and benefits.”¹³ Absent any documentation substantiating the benefit amounts claimed, the Controller’s reductions cannot be evaluated. The 21 percent rate asserted by the district applies to the *Collective Bargaining* program, and is not evidently applicable to these claiming instructions.

Based on the foregoing, staff finds that the Controller’s audited benefit rate is not arbitrary, capricious, or entirely lacking in evidentiary support.

E. Disallowance of Other Outgoing Expenses

In its audit of San Mateo’s reimbursement claims the Controller identified unallowable costs for “other outgoing expenses” for fiscal year 2001-2002, in the amount of \$41,375, “recorded on three separate journal transactions.” The Controller found that these transactions were not supported by documentation, “e.g., in invoices or other source documentation.” The district did not respond to that finding prior to issuance of the final audit report.

San Mateo argues that “the Controller should provide the derivation of “outgoing expense costs,” which is not described in generally accepted accounting principles.”

The Controller counters that “expenses” and “costs” are synonymous, and that the district “makes no mention whatsoever as to the factual nature of the finding nor does it offer any documentation that supports the three journal voucher entries.”

The parameters and guidelines require that all costs claimed must be traceable to source documents that show evidence of the validity of such costs. Those documents, in turn are required to be certified under penalty of perjury, but certification alone cannot substitute for probative value. It is not necessary, under the parameters and guidelines, and consistent with *Clovis Unified, supra*, that claimants produce unimpeachable proof of costs incurred, produced at or near the time the costs were incurred so as to reinforce the reliability of those documents. However, the documentation must show some evidence that costs are related to the mandate, and

¹² Exhibit A, San Mateo IRC, at pp. 89; 104; 119.

¹³ Exhibit C, Controller’s Comments on San Mateo IRC, at pp. 52-54.

the term “other outgoing expenses,” even if claimed and certified to be related to the mandate, is not sufficient to show the validity of the costs. The record indicates that the Controller offered the district an opportunity to substantiate these costs, and the district declined to do so, instead asserting that the burden should be on the Controller to show that the costs are not mandate-related. A claimant’s certification that costs are related to the mandate is not sufficient in itself to substantiate the costs.

Based on the foregoing, staff finds that the Controller’s finding regarding “other outgoing expenses” was not arbitrary, capricious, or entirely lacking in evidentiary value, and a reduction of San Mateo’s claim in the amount of \$41,375 is supported.

F. Disallowance of Health Services Not Substantiated in the Base Year

The Controller reduced health services costs claimed by San Bernardino in amounts of \$41,389 for fiscal year 2001-2002, and \$61,739 for fiscal year 2002-2003, on grounds that the district claimed costs for services not provided in the base year, fiscal year 1986-87. San Bernardino asserts that the Controller incorrectly reduced reimbursement for health services costs claimed, on the basis of comparison between the audit years and the health services inventory for fiscal year 1997-1998.

In the test claim statement of decision the Commission found that the statutes imposed a “maintenance of effort” requirement on community college districts requiring them to continue to provide health services at the level provided in the base year, without the continuing authority to levy health service fees. The amended parameters and guidelines provide a long list of services, which are stated to be “reimbursable to the extent they were provided by the community college district in fiscal year 1986-87.” And the parameters and guidelines require, under the heading “Supporting Data:”

For auditing purposes, all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs. *This would include documentation for the fiscal year 1986-87 program to substantiate a maintenance of effort.*

Exactly what documents are needed “to substantiate a maintenance of effort” is not stated. Pursuant to *Clovis Unified*, as discussed above, whatever is required by the Controller should generally be consistent with the parameters and guidelines; the Controller cannot enforce an auditing standard that is unreasonable in the context of the parameters and guidelines.

San Bernardino argues that the Controller inappropriately compared the inventory of available services for the audit years “to the health services inventory for FY 1997-98,” and those activities listed in the inventory for the audit years but not also listed in fiscal year 1997-1998 were “assumed to be ‘new services not offered in 86/87.’” San Bernardino argues that this comparison “established FY 1997-98 as an alternative base year, contrary to the Education Code and the parameters and guidelines.” San Bernardino further argues that there is a difference between services rendered in a given year and services available in a given year, and that the maintenance of effort requirement is to maintain services available in the base year 1986-87.

San Bernardino is correct that the Controller may not establish an alternate base year; the services provided in 1986-87 are mandated under the plain language of the test claim decision and the parameters and guidelines, and to the extent those services are not offset by student health fees, costs to provide those services are reimbursable. San Bernardino’s audited claims,

certified under penalty of perjury, include a health services inventory comparing the claim years to the base year. It is not consistent with the mandate for the Controller to disallow costs for health services on the basis of comparing the audit years to a health services inventory from any other year.

Moreover, San Bernardino's reasoning with respect to the distinction between services rendered and services available is sound: comparing the health services inventory of the audit years to the inventory of any other year, *including the base year*, is not necessarily reflective of the services that were *available* in the base year and that therefore must be maintained. There is a distinction between services "rendered" in a particular year, including the base year, and services "available" to students. The maintenance of effort requirement of the test claim statute turns on the services "provided" in the base year, and the district's interpretation of services *provided* as being equivalent to services *available* is consistent with the purpose and intent of a maintenance of effort requirement.

Finally, there is nothing in the parameters and guidelines to suggest that a certification by the claimant of the services "provided" in the base year is insufficient to substantiate the maintenance of effort.

Based on the foregoing, staff finds that the disallowance of health services not rendered in the 1997-98 fiscal year was arbitrary, capricious, and entirely lacking in evidentiary value. The Controller must allow reimbursement for those services that the district certifies under penalty of perjury were available in the 1986-87 fiscal year.

G. Disallowance of Insurance Premiums

The Controller reduced amounts claimed by San Bernardino for "services and supplies" in amounts of \$37,348 for fiscal year 2001-2002, and \$38,322 for fiscal year 2002-2003, on grounds that athletic insurance costs are beyond the scope of the mandate. San Bernardino disputes the disallowance of "overstated services and supplies," arguing that the Controller inappropriately disallowed costs for student insurance premiums.

The Controller explains that the district carried three types of insurance coverage in fiscal years 2001-2002 and 2002-2003: basic coverage for students as well as athletes, super catastrophic coverage for athletes, and catastrophic coverage for students. The Controller asserts that the disallowed costs are only the "intercollegiate athletes' portion of the basic coverage and the intercollegiate athletes' portion of the super catastrophic coverage," along with a small amount of costs that the Controller finds unsupported. The maintenance of effort requirement, pursuant to section 76355, applies only to those health services for which community college districts are permitted to charge a fee; and because section 76355(d) prohibits expenditures of health fees on athletic-related costs, the costs of athletic insurance are not mandated, and must be disallowed.¹⁴

San Bernardino has not disputed the Controller's argument that costs related to athletics are not included within the maintenance of effort requirement, nor submitted any documentation in answer to the Controller's worksheet attributing the disallowed costs to portions of insurance premiums applicable to collegiate athletic programs.

¹⁴ Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 17-19.

Based on the foregoing, staff finds that the disallowance of costs related to insurance premiums for intercollegiate athletes was not arbitrary, capricious, or entirely lacking in evidentiary value.

Conclusion

Pursuant to Government Code section 17551(d) and section 1185.7 of the Commission's regulations, staff finds that the following reductions by the Controller's Office are incorrect and that the costs, as specified, should be reinstated:

- Reduction to zero of San Mateo's claimed indirect costs for services and supplies, other operating expenses, and capital outlay costs was arbitrary, capricious, or entirely lacking in evidentiary support, and to the extent direct costs were permitted for the specified items claimed, a minimum 7 percent indirect cost rate should be reinstated, unless a higher rate can be supported on the basis of applying an alternative method to the evidence in the record.
- Disallowance of salaries and benefits for Ernest Rodriguez and Dee Howard in San Mateo's reimbursement claims was arbitrary, capricious, or entirely lacking in evidentiary support, in light of costs allowed for other employees based on the same or similar documentation; costs for the salaries and benefits of Ernest Rodriguez and Dee Howard should be reinstated, to the extent those costs are supported by the district's accounting records substantiating amounts paid from health services accounts.
- Disallowance of health services costs on the basis of comparing the audit years against a health services inventory from fiscal year 1996-1997 was arbitrary, capricious, or entirely lacking in evidentiary support, and health services costs claimed should be reinstated on the basis of the services provided by the entire district in fiscal year 1986-1987, as certified under penalty of perjury by San Bernardino Community College District.

The Commission further finds that the reductions to the following costs were reasonable and supported by the law and the record, and thus, not "incorrectly" reduced:

- Reduction of both districts' reimbursement claims, on the basis of understated health fee revenues, in the amounts of \$70,603 for San Mateo, and \$150,031 for San Bernardino.
- The reduction of indirect costs claimed by San Bernardino, in the amount of \$281,494, based on the district'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.
- The reduction of benefits claimed by San Mateo, in the amount of \$88,633, based on the district's failure to support its claimed benefit amounts.
- The reduction of costs claimed for "other outgoing expenses" by San Mateo, in the amount of \$41,375, based on the district's failure to support claimed expenses.
- The reduction of health insurance costs and other overstated services and supplies in San Bernardino's reimbursement claims, in the amounts of \$37,348 for fiscal year 2001-2001, and \$38,322 for fiscal year 2002-2003, based on the documentation submitted by the Controller.

Staff Recommendation

Staff recommends that the Commission adopt the proposed statement of decision to partially approve 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:

Education Code Section 76355

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

Fiscal Years 1999-2000, 2000-2001, 2001-
2002 and 2002-2003

San Mateo Community College District and
San Bernardino Community College District,
Claimants.

Case Nos.: 05-4206-I-04 and 05-4206-I-08

Health Fee Elimination

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

(Proposed for Adoption: September 27, 2013)

STATEMENT OF DECISION

The Commission on State Mandates (Commission) heard and decided these consolidated incorrect reduction claims (IRCs) during a regularly scheduled hearing on September 27, 2013. [Witness list will be included in the final statement of 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 staff analysis to [approve/partially approve/deny] the consolidated IRCs at the hearing by a vote of [vote count will be included in the final statement of decision].

Summary of the Findings

These IRCs were filed in response to audits conducted by the Controller, in which reimbursement was reduced to the claimant districts on several discrete bases. The analysis below addresses IRCs filed by two community college districts disputing adjustments made by the Controller, pursuant to audits of the districts' cost claims filed under the *Health Fee Elimination* mandate (CSM-4206). The executive director has consolidated these claims pursuant to section 1185.4 of the Commission's regulations.¹⁵

The Commission partially approves these IRCs, finding that some of those reductions were appropriate, and some were incorrect. The Commission therefore remands the matter to the Controller with instructions to reinstate the incorrect reductions specified below consistent with this statement of decision.

¹⁵ Code of Regulations, title 2, section 1185.4 (Register 2010, No. 44).

Pursuant to Government Code section 17551(d) and section 1185.7 of the Commission's regulations, the Commission finds that the following reductions by the Controller's Office are incorrect and that the costs, as specified, should be reinstated:

- Reduction to zero of San Mateo's claimed indirect costs for services and supplies, other operating expenses, and capital outlay costs was arbitrary, capricious, or entirely lacking in evidentiary support, and to the extent direct costs were permitted for the specified items claimed, a minimum 7 percent indirect cost rate should be reinstated, unless a higher rate can be supported on the basis of applying an alternative method to the evidence in the record.
- Disallowance of salaries and benefits for Ernest Rodriguez and Dee Howard in San Mateo's reimbursement claims was arbitrary, capricious, or entirely lacking in evidentiary support, in light of costs allowed for other employees based on the same or similar documentation; costs for the salaries and benefits of Ernest Rodriguez and Dee Howard should be reinstated, to the extent those costs are supported by the district's accounting records substantiating amounts paid from health services accounts.
- Disallowance of health services costs on the basis of comparing the audit years against a health services inventory from fiscal year 1996-1997 was arbitrary, capricious, or entirely lacking in evidentiary support, and health services costs claimed should be reinstated on the basis of the services provided by the entire district in fiscal year 1986-1987, as certified under penalty of perjury by San Bernardino Community College District.

The Commission further finds that the reductions to the following costs were reasonable and supported by the law and the record, and thus, not "incorrectly" reduced:

- Reduction of both districts' reimbursement claims, on the basis of understated health fee revenues, in the amounts of \$70,603 for San Mateo, and \$150,031 for San Bernardino.
- The reduction of indirect costs claimed by San Bernardino, in the amount of \$281,494, based on the district'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.
- The reduction of benefits claimed by San Mateo, in the amount of \$88,633, based on the district's failure to support its claimed benefit amounts.
- The reduction of costs claimed for "other outgoing expenses" by San Mateo, in the amount of \$41,375, based on the district's failure to support claimed expenses.
- The reduction of health insurance costs and other overstated services and supplies in San Bernardino's reimbursement claims, in the amounts of \$37,348 for fiscal year 2001-2001, and \$38,322 for fiscal year 2002-2003, based on the documentation submitted by the Controller.

I. 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.¹⁶ Statutes 1984, chapter 1 repealed the community colleges' fee authority for health services.¹⁷ However, it also included a provision to reauthorize the fee, which was to become operative on January 1, 1988.¹⁸

In addition to temporarily repealing community college districts' fee authority, Statutes 1984, chapter 1 required any district which provided health services during the 1983-1984 fiscal year, for which it was 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, 1988.¹⁹ 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.

Statutes 1987, chapter 1118 amended former Education Code section 72246,²⁰ which was to become operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5.²¹ As a result, in 1988 all community college districts were required to maintain the same level of health services they provided in the 1987-1988 fiscal year and each year thereafter. In addition, the community college districts regained a limited fee authority for the provision of the required health services.²²

Commission Decisions

At the November 20, 1986 Commission hearing, the Commission determined that Statutes 1984, chapter 1, which required community college districts to maintain health services while repealing community college districts' fee authority for those services, imposed a reimbursable state-mandated new program upon community college districts.²³ On August 27, 1987, the Commission adopted parameters and guidelines for the *Health Fee Elimination* program.

At the May 25, 1989 Commission hearing, the Commission adopted amendments to the parameters and guidelines for the *Health Fee Elimination* program to reflect amendments made by Statutes 1987, chapter 1118.²⁴ The 1989 parameters and guidelines reflected a change in

¹⁶ Statutes 1981, chapter 763. Students with low-incomes, students that depend upon prayer for healing, and students attending a college under an approved apprenticeship training program, were exempt from the fee.

¹⁷ Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4 [repealing Education Code section 72246].

¹⁸ Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4.5.

¹⁹ Education Code section 72246.5 (Stats. 1984, 2d. Ex. Sess., ch. 1, § 4.7).

²⁰ In 1993, former Education Code section 72246 was renumbered to Education Code section 76355. (Stats. 1993, ch. 8).

²¹ Statutes 1987, chapter 1118.

²² Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

²³ Statement of decision, *Health Fee Elimination* (CSM 4206, adopted January 22, 1987). Reference to 1984 legislation refers to Statutes 1984, 2nd Extraordinary Session 1984, chapter 1.

²⁴ Amendments to parameters and guidelines, *Health Fee Elimination* (CSM 4206, adopted May 25, 1989). Reference to 1987 legislation refers to Statutes 1987, chapter 1118.

eligible claimants for the *Health Fee Elimination* program, (those districts that provided health services in the 1986-87 fiscal year, and would be required to continue to do so) and the reestablishment of community college districts' fee authority for the *Health Fee Elimination* program.

At the October 27, 2011 Commission hearing the Commission adopted a decision regarding seven consolidated IRCs under the *Health Fee Elimination* program, which addressed some of the same substantive issues present in these consolidated IRCs.

This IRC addresses the following issues:

- The statute of limitations applicable to audits of reimbursement claims by the Controller;
- The appropriate extent of offsetting revenue available from health service fees, pursuant to the *Clovis Unified* decision;
- Disallowances found against both districts based on asserted faults in the development and application of indirect cost rates;
- Disallowance of salaries and benefits against San Mateo based on asserted insufficient documentation of hours and duties;
- Disallowance of other outgoing expenses against San Mateo based on asserted insufficient documentation;
- Disallowance of discrete health services against San Bernardino based on an asserted failure to substantiate services provided in the base year;
- Disallowance of costs for student health insurance against San Bernardino based on the scope of reimbursement excluding student athletic costs.

II. Procedural History

On January 10, 2001, San Mateo filed a reimbursement claim for fiscal year 1999-2000.²⁵ On January 10, 2002, San Mateo filed its reimbursement claim for fiscal year 2000-2001.²⁶ On January 15, 2003, San Mateo filed its reimbursement claim for fiscal year 2001-2002.²⁷

On October 28, 2004, the Controller issued a draft audit report addressing these three fiscal years.²⁸ On November 15, 2004, San Mateo issued a letter to the Controller responding to the draft audit report findings, disputing the Controller's adjustments and disallowance of costs.²⁹ On January 7, 2005, the Controller issued its final audit report, finding that \$1,017,386 of

²⁵ Exhibit A, San Mateo IRC, at p. 105.

²⁶ Exhibit A, San Mateo IRC, at p. 90.

²⁷ Exhibit A, San Mateo IRC, at p. 75.

²⁸ Exhibit A, San Mateo IRC, at p. 67.

²⁹ Exhibit A, San Mateo IRC, at pp. 67-68.

claimed costs was unallowable, of \$1,259,226 total costs claimed in the relevant audit period.³⁰ On September 1, 2005, San Mateo filed IRC 05-4206-I-04.³¹

On December 27, 2002, San Bernardino filed its reimbursement claim for fiscal year 2001-2002.³² On January 5, 2004, San Bernardino filed its reimbursement claim for fiscal year 2002-2003.³³

On September 30, 2004, the Controller issued a draft audit report addressing these two fiscal years. On October 13, 2004, San Bernardino issued a letter to the Controller responding to the draft audit report, disputing the Controller's findings regarding the overstatement of health services provided in the base year, and disputing the Controller's interpretation of what was intended by the maintenance of effort requirement of the test claim statute.³⁴ On November 10, 2004, the Controller issued its final audit report, concluding that \$610,323 of claimed costs were unallowable, of \$1,130,569 total costs claimed in the relevant audit period.³⁵ On September 13, 2005, San Bernardino filed IRC 05-4206-I-08.³⁶

On December 31, 2007, the Controller submitted written comments on the San Bernardino IRC, reiterating the audit findings and asserting that its adjustments were appropriate. On April 24, 2008, the Controller submitted written comments on the San Mateo IRC, in which it stressed the proper application of the statute of limitations, and restated its contention that the audit adjustments were proper. On July 13, 2009, San Mateo submitted rebuttal comments in response to the Controller's comments on its IRC, in which it renewed its objections to the lack of explanation of the reasons for disallowance of specific costs, and to the application of an average benefit rate where actual benefit costs were available; reiterated its disagreement with the Controller's adjustment on the basis of health fees authorized; restated its claim that the indirect cost rate proposal had been improperly rejected; and continued to challenge the statute of limitations asserted by the Controller.

On September 21, 2010, after the filing of the IRCs, the Third District Court of Appeal issued its opinion in *Clovis Unified*,³⁷ which specifically addressed two of the key disputed issues. The court found that community college districts were required to offset costs claimed for the *Health Fee Elimination* program by the health service fees that community college districts were *authorized* to charge, rather than, as the claimants have argued, the fees actually collected; and, the court held that the contemporaneous source document rule (CSDR) was, as applied to the

³⁰ Exhibit A, San Mateo IRC, at p. 45.

³¹ Exhibit A, San Mateo IRC, at p. 1.

³² Exhibit B, San Bernardino IRC, at p. 74.

³³ Exhibit B, San Bernardino IRC, at p. 95.

³⁴ Exhibit B, San Bernardino IRC, at pp. 61-63.

³⁵ Exhibit B, San Bernardino IRC, at p. 45.

³⁶ Exhibit B, San Bernardino IRC, at p. 1.

³⁷ *Clovis Unified School Dist. v. Chiang (Clovis)* (Cal. Ct. App. 3d Dist. 2010) 188 Cal.App.4th 794.

audits of several mandated programs, an unenforceable underground regulation. The scope and effect of the *Clovis Unified* decision is addressed below, where relevant.

III. Positions of the Parties

San Mateo Community College District

San Mateo argues that the Controller inappropriately reduced reported costs of salaries and benefits, and other indirect costs claimed.³⁸ San Mateo argues that the Controller reduced “outgoing expense costs” without explaining the distinction between “expenses” and “costs,” and that “the district was not on notice of any particular reporting or audit standard with respect to journal voucher transactions.”³⁹ San Mateo also takes issue with the Controller’s finding that “the district improperly applied its claimed indirect cost rate to costs beyond those approved by the U.S. Department of Health and Human Services (DHHS).”⁴⁰ San Mateo argues that by reducing claims on the basis of fees collectible, but not collected, the Controller improperly disallowed a portion of the districts’ reimbursable costs.⁴¹ Finally, San Mateo disputes the application of the statute of limitations to allow audits of the subject fiscal years.⁴²

In its rebuttal comments San Mateo maintains that the Controller has the burden of proof in showing that the district’s claimed costs were not allowable, and that therefore several discrete costs that were disallowed were improperly reduced. San Mateo also argues that the application of an average benefit rate is inappropriate where actual benefit costs are available. San Mateo renews its contention regarding the health fee authority, and restates its challenge to the statute of limitations for audits asserted by the Controller.⁴³

San Bernardino Community College District

San Bernardino disputes the disallowance of costs for certain health services, arguing that “[t]he Controller established FY 1997-98 as an alternative base year, contrary to the Education Code and the parameters and guidelines.”⁴⁴ San Bernardino further argues that the Controller improperly disallowed costs related to insurance premiums for the general student population, and “does not describe how the disallowance was calculated.”⁴⁵ San Bernardino also disputes the Controller’s finding that indirect costs were overstated because the indirect cost rate proposal was not federally approved. The district argues that there is no requirement of federal

³⁸ Exhibit A, San Mateo IRC, at p. 13.

³⁹ Exhibit A, San Mateo IRC, at p. 15.

⁴⁰ Exhibit A, San Mateo IRC, at pp. 17-18.

⁴¹ Exhibit A, San Mateo IRC, at pp. 19-23.

⁴² Exhibit A, San Mateo IRC, at pp. 23-26.

⁴³ Exhibit E, San Mateo Rebuttal Comments, at pp. 1-4.

⁴⁴ Exhibit B, San Bernardino IRC, at p. 12-13.

⁴⁵ Exhibit B, San Bernardino IRC, at p. 19.

approval.⁴⁶ Finally, San Bernardino argues that the proper measure of offsetting revenues should be the health fees collected, not the amount of fees authorized.⁴⁷

State Controller's Office

San Mateo Audit and IRC

The final audit report concluded that \$793,165 in salaries and benefits were unallowable, because “the district did not provide documentation supporting the validity of the distribution made to the mandate.”⁴⁸ The Controller maintains that San Mateo “was unable to support that salary costs claimed for several employees were directly attributable to the mandate.” The Controller argues that San Mateo did not provide any documentation showing that the disallowed employees were tasked to the mandated activities. The Controller further maintains that it has calculated an appropriate benefit rate to apply to San Mateo’s claim.

The audit report also disallowed \$41,375 in “other outgoing expenses,” finding that “the district did not provide any documentation supporting the validity of the costs claimed.”⁴⁹ Additionally, the audit report concluded that “the district improperly applied its claimed indirect cost rate to costs beyond those approved by the U.S. Department of Health and Human Services,” and thus “overstated indirect costs by \$112,243.”⁵⁰ And finally, by claiming health fees received rather than health fees collectible, the Controller concluded that San Mateo “understated offsetting health fee revenues by \$70,603.”⁵¹ Finally, the Controller argues that the statute of limitations for audits under section 17558.5 permitted the Controller to audit fiscal years 1999-2000 and 2000-2001.⁵²

San Bernardino Audit and IRC

The final audit report concluded that San Bernardino “overstated health services costs by \$103,128 for the audit period...because the services were not provided in FY 1986-87.”⁵³ The Controller also concluded that “[t]he district overstated service and supply costs by \$75,670 because it claimed ineligible athletic insurance costs of \$72,554 and did not support costs of \$3,116.”⁵⁴ In addition, the Controller concluded that San Bernardino overstated indirect costs by \$281,494, because the district “claimed indirect costs based on an indirect cost rate proposal prepared for each year by an outside consultant...[and] did not obtain federal approval for its rate.”⁵⁵ And finally, the Controller concluded that San Bernardino “understated authorized

⁴⁶ Exhibit B, San Bernardino IRC, at pp. 20-22.

⁴⁷ Exhibit B, San Bernardino IRC, at pp. 23-27.

⁴⁸ Exhibit A, San Mateo IRC, at p. 52.

⁴⁹ Exhibit A, San Mateo IRC, at p. 54.

⁵⁰ Exhibit A, San Mateo IRC, at p. 54.

⁵¹ Exhibit A, San Mateo IRC, at pp. 56-58.

⁵² Exhibit C, Controller’s Comments on San Mateo IRC, at pp. 1-3.

⁵³ Exhibit B, San Bernardino IRC, at p. 53.

⁵⁴ Exhibit B, San Bernardino IRC, at p. 55.

⁵⁵ Exhibit B, San Bernardino IRC, at pp. 55-57.

health fee revenue by \$150,031” by claiming “actual rather than authorized health fee revenues.”⁵⁶

III. 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 12410 further requires the Controller to:

[S]uperintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment.

Although the Controller’s Office is required to follow the parameters and guidelines when auditing a claim for mandate reimbursement, the Controller has broad discretion in its audit and determination of what is properly reimbursable. Government Code section 12410 provides in relevant part:

Whenever, in [the Controller’s] opinion, the audit provided for by [Government Code section 925 et seq.] is not adequate, the Controller *may make such field or other audit* of any claim or disbursement of state money *as may be appropriate to such determination.* (Italics added.)

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 1185.7 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 determine in this case whether the Controller’s audit decisions 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.⁵⁷ 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.’ ”⁵⁸

⁵⁶ Exhibit B, San Bernardino IRC, at p. 57.

⁵⁷ *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.

⁵⁸ *American Bd. of Cosmetic Surgery, Inc, supra*, 162 Cal.App.4th at pgs. 547-548.

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.⁵⁹ As more fully discussed in the analysis below, the parameters and guidelines governing these reimbursement claims require that costs claimed be supported by documentation maintained by the claimant.

In addition, the Commission must review questions of law *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 6.⁶⁰ 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

A. Statute of Limitations Applicable to Audits of Mandate Reimbursement Claims

San Mateo asserts that the statute of limitations applicable to audits of mandate reimbursement claims bars the Controller's audits of the claims filed for fiscal years 1999-2000 and 2000-2001. San Mateo disputes also the document retention requirements asserted by the Controller, which are based on the period during which claims are subject to audit.

1. *The audit of community college district claims beginning in 1999-2000 is not barred by the statute of limitations found in Government Code section 17558.5.*

San Mateo asserts that "the first two years of the three claim years audited, fiscal years 1999-00 and 2000-01, were beyond the statute of limitations for an audit when the Controller issued its audit report on January 7, 2005."⁶² San Mateo cites Government Code section 17558.5, as added by Statutes 1995, chapter 945 (operative July 1, 1996), which 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.*"⁶³ San Mateo contends that the relevant periods for which those claims would be *subject to audit* expired as of December 31, 2003 for the 1999-2000 reimbursement claim, filed January 10, 2001; and December 31, 2004 for the 2000-2001 reimbursement claim, filed January 10, 2002. San Mateo reasons that the January 7, 2005 audit report was completed outside the period subject to audit.

The Controller argues that San Mateo'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."⁶⁴ The Controller argues that section 17558.5 does not require an audit to be completed

⁵⁹ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

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.

⁶² Exhibit A, San Mateo IRC, at pp. 23-24.

⁶³ Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)); Exhibit A, San Mateo IRC, at p. 25.

⁶⁴ Exhibit C, Controller's Comments on San Mateo IRC, at p. 2.

within two years; “subject to audit,” the Controller holds, means subject to *initiation* of an audit. The Controller asserts that the audit in this case was initiated as of the entrance conference conducted on January 2, 2003, “well before the earliest deadline [cited by San Mateo] of December 31, 2003.”⁶⁵

In addition, the Controller argues that Government Code section 17558.5, *as amended by Statutes 2002, chapter 1128* (AB 2834), provides the proper statute of limitations, because “[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 Controller reasons that the amendment made by AB 2834 would be effective January 1, 2003, and even under San Mateo’s interpretation the earliest claim (fiscal year 1999-2000) would not have been barred until December 31, 2003. Therefore the expanded statute of limitations is applicable, providing that a reimbursement claim “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.”⁶⁶ Therefore, because the 2003 version of section 17558.5 would require an audit to be initiated “not later than” January 10, 2004 (three years after the earlier claim was filed), and the audit in issue was initiated January 2, 2003, the statute of limitations does not bar the audit.

The Controller’s analysis is persuasive; the courts have long held that “[a]n agency interpretation of the meaning and legal effect of a statute is entitled to consideration and respect by the courts;”⁶⁷ and here, the Commission owes to the Controller the same consideration and respect, with regard to the statute of limitations applicable to audits. The audits of reimbursement claims filed January 10, 2001 and January 10, 2002, respectively, were initiated “no later than January 2, 2003, when the entrance conference was held.”⁶⁸ Based only upon the plain language of the former section, the reimbursement claims in issue would be “subject to audit” until the end of the calendar year 2003, for a claim filed in January of 2001. The only reading of these facts and of section 17558.5 that could bar the subject audits would be to hold that section 17558.5 requires an audit to be *completed* within two years, in which case the final audit report issued January 7, 2005 would be barred. This is the interpretation urged by San Mateo, but this reading of the code is not supported. The later amendment to the code section (2002) clarifies that claims are subject to “the initiation of an audit” within a specified time,⁶⁹ and there is no reason to interpret the prior version of the code differently. Neither is there any evidence in the record to support departing from the interpretation of the Controller.

Based on the foregoing, the Commission finds that the audit of San Mateo’s reimbursement claims is not barred by the statute of limitations.

2. *Document retention requirements cited by the Controller are consistent with the parameters and guidelines, and are not dependent on the period subject to audit.*

⁶⁵ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 3.

⁶⁶ Government Code section 17558.5 (Stats. 2002, ch. 1128 (AB 2834)).

⁶⁷ *Yamaha Corp. of America v. State Bd. of Equalization*, (1998) 19 Cal.4th 1.

⁶⁸ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 3.

⁶⁹ Government Code section 17558.5 (Stats. 2002, ch. 1128 (AB 2834)).

San Mateo asserts, with respect to the disallowance of employee salaries and benefits, discussed below under section D, that “[o]ne of the stated reasons for the disallowance was that claimants must retain source documentation on file ‘for a period of no less than three years from the date of the final payment of the claim.’” San Mateo argues that “[n]o legal citation was provided for this assertion.”⁷⁰

The Controller counters that document retention was not a stated reason for the disallowance of costs.⁷¹ However, the Controller also points to the parameters and guidelines of the *Health Fee Elimination* mandate, which state:

For auditing purposes, all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs...*These documents must be kept on file by the agency submitting the claim for a period of no less than three years from the date of the final payment of the claim pursuant to this mandate*, and made available on the request of the State Controller or his agent.

The Commission’s current regulations state that parameters and guidelines must include a statement that documents are to be retained *during the period subject to audit*.⁷² Accordingly, the most recent amendment to the parameters and guidelines for the Health Fee Elimination mandate provides that “[a]ll documents used to support the reimbursable activities, as described in Section V, must be retained during the period subject to audit.”⁷³ The regulation, and the boilerplate changes, are consistent with the parameters and guidelines here; although the cited language above does not reference the period subject to audit, it does require retention of documents for three years after payment of the claim, which coincides with the period subject to audit under section 17558.5, as amended by Statutes 2002, chapter 1128 (AB 2834), cited above. San Mateo’s assertion that the document retention period “appears to be a ministerial preference of the Controller’s” is clearly in error.⁷⁴

Based on the foregoing, the Commission finds that source documents are required to be retained for a minimum of three years after final payment of the claim.

B. Understated Offsetting Revenues: Clovis Unified and the Health Fee Rule

The Controller reduced the reimbursement claims filed by San Mateo by \$13,175 for fiscal year 1999-2000, and \$57,428 for fiscal year 2001-2002.⁷⁵ San Bernardino’s reimbursement claims were similarly reduced, by \$97,642 for fiscal year 2000-2001, and \$52,389 for fiscal year 2001-2002.⁷⁶ These reductions were made on the basis of the fee authority available to the districts,

⁷⁰ Exhibit A, San Mateo IRC, at p. 13.

⁷¹ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 15.

⁷² Code of Regulations, title 2, section 1183.1 (Register 2005, No. 36).

⁷³ Exhibit X, Health Fee Elimination Parameters and Guidelines, as amended 1/29/10.

⁷⁴ Exhibit A, San Mateo IRC, at p. 12.

⁷⁵ Exhibit A, San Mateo IRC, at p. 56.

⁷⁶ Exhibit B, San Bernardino IRC, at p. 57.

multiplied by the number of students subject to the fee, less any amount of offsetting revenue claimed.

Both San Mateo and San Bernardino disputed the Controller's findings that offsetting revenues from student health fees had been understated in the relevant claim years. Both districts 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 districts were authorized to impose may have increased for the applicable period, nothing in the Education Code made the increase of those fees mandatory. The claimants argue that the issue is the difference between fees collected and fees collectible.⁷⁷

After the districts filed their IRCs, 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] 76355.⁷⁸ (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).

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.⁷⁹ Both San Mateo and San Bernardino argue that the actual increase of the fee

⁷⁷ Exhibit A, San Mateo IRC, at pp. 20-23; Exhibit B, San Bernardino IRC, at pp. 23-27.

⁷⁸ *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 811.

⁷⁹ 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

imposed upon students requires action of the community college district governing board,⁸⁰ and that “the issue is one of student health fees revenue actually received, rather than student health fees which might be collected.”⁸¹ But the *authority* to impose the fee increases without any legislative action by a community college district, or any other entity (state or local), and 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.⁸²

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.’”⁸³ Additionally, in responding to the community college districts’ argument that, “since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission’s P&G’s.”⁸⁴ 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*.⁸⁵ (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 the Districts for the *Health Fee Elimination* program is valid. The Commission is bound by the court’s decision in *Clovis Unified*, and bound to apply the Health Fee Rule set forth by the court.

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 was not arbitrary, capricious, or entirely lacking in evidentiary support.

C. Application of an Indirect Cost Rate Proposal

The Controller reduced indirect costs claimed by San Mateo by \$30,417 for fiscal year 1999-2000, \$32,728 for fiscal year 2000-2001, and \$49,098 for fiscal year 2001-2002, on grounds that the indirect cost rate was applied to direct costs beyond the scope of the distribution base

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

⁸⁰ Exhibit A, San Mateo IRC, at p. 69. See also Exhibit B, San Bernardino IRC, at pp. 25-27.

⁸¹ Exhibit A, San Mateo IRC, at pp. 22-23; Exhibit B, San Bernardino IRC, at pp. 26-27.

⁸² *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 812.

⁸³ *Ibid.*

⁸⁴ *Ibid.* (Original italics.)

⁸⁵ *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 812.

employed to develop the rate.⁸⁶ The Controller also reduced the indirect costs claimed by San Bernardino by \$122,795 for fiscal year 2001-2002, and \$158,699 for fiscal year 2002-2003, on grounds that San Bernardino did not utilize a federally approved indirect cost rate.⁸⁷

The districts dispute the Controller's findings that the indirect cost rate proposal was incorrectly applied, and was required to be federally approved, charging that the Controller's conclusions were without basis in the law.

1. *The parameters and guidelines expressly reference the Controller's claiming instructions, which in turn provide for an indirect cost rate to be developed in accordance with federal OMB guidelines.*

Both districts argue that claimants are not required to adhere to the claiming instructions.⁸⁸ In addition, San Bernardino argues that "[n]either state law nor the parameters and guidelines made compliance with the Controller's claiming instructions a condition of reimbursement."⁸⁹ The districts' argument is unsound: the parameters and guidelines plainly state that "indirect costs *may be claimed in the manner described by the State Controller.*" The districts argue 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.⁹⁰ 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. This interpretation is urged by the Controller.⁹¹

The claiming instructions specific to the *Health Fee Elimination* mandate, included in the submissions of both claimants and of the Controller,⁹² do not discuss specific rules or guidelines for claiming indirect costs with respect to this mandate. However, the School Mandated Cost Manual⁹³ provides *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 provision to the contrary. More recently the manuals for school districts and community college districts have been printed separately, and therefore *both the general instructions, and the instructions specific to the Health Fee Elimination Mandate*, are now provided in the Mandated Cost Manual for Community Colleges, available on the

⁸⁶ Exhibit A, San Mateo IRC, at p. 55.

⁸⁷ Exhibit B, San Bernardino IRC, at p. 56.

⁸⁸ Exhibit A, San Mateo IRC, at pp. 16-17; Exhibit B, San Bernardino IRC, at pp. 21-22.

⁸⁹ Exhibit B, San Bernardino IRC, at p. 22.

⁹⁰ See Exhibit A, San Mateo IRC, at pp. 16-17; Exhibit B, San Bernardino IRC, at pp. 21-22.

⁹¹ See, e.g., Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 20-21.

⁹² Exhibit A, San Mateo IRC, at pp. 40-42; Exhibit B, San Bernardino IRC, at pp. 40-42; Exhibit C, Controller's Comments on San Mateo IRC, at pp. 35-46; Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 34-45.

⁹³ Exhibit C, Controller's Comments on San Mateo IRC, at pp. 30-33; Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 29-32.

Controller's web site.⁹⁴ The Mandated Cost Manual 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.*⁹⁵

The Controller submitted copies of the Mandated Cost Manual addressing indirect cost rates, revised September 2002, in response to both IRCs.⁹⁶ 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.⁹⁷ This last suggests that all community college claiming instructions were, at or near the relevant time period, published in the School Mandated Cost Manual; certainly the current Community College Mandated Cost Manual includes claiming instructions for all programs.⁹⁸ 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 the manual provides ample notice to claimants as to how they may properly claim indirect costs. San Bernardino'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 therefore clearly in error.⁹⁹

Both districts also argue that because the claiming instructions "were never adopted as law, or regulations pursuant to the Administrative Procedure Act, the claiming instructions are merely a statement of the ministerial interests of the Controller and not law."¹⁰⁰ In *Clovis Unified*, discussed above, 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.¹⁰¹ Here, the districts imply the same fault in the claiming instructions with respect to indirect cost rates. But the distinction

⁹⁴ See, e.g., Exhibit X, Community College Mandated Cost Manual General Instructions Revised 0712

⁹⁵ Exhibit X, Community College Mandated Cost Manual Foreword.

⁹⁶ Exhibit C, SCO Comments on San Mateo IRC, at pp. 30-33; Exhibit D, SCO Comments on San Bernardino IRC, at pp. 29-32.

⁹⁷ Exhibit C, SCO Comments on San Mateo IRC, at pp. 35-46; Exhibit D, SCO Comments on San Bernardino IRC, at pp. 34-45.

⁹⁸ Available at: http://www.sco.ca.gov/Files-ARD-Local/Manuals/ccd_1112_print.pdf

⁹⁹ Exhibit B, San Bernardino IRC, at p. 22.

¹⁰⁰ See, e.g., Exhibit A, San Mateo IRC, at p. 16.

¹⁰¹ *Clovis Unified, supra*, 188 Cal.App.4th, at p. 807.

is that here the parameters and guidelines, which were duly adopted at a Commission hearing, require compliance with the claiming instructions.

2. *San Mateo did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rate, but a minimum 7 percent indirect cost rate is provided if a claimant cannot support a greater amount; therefore reduction to zero for indirect costs, to the extent direct costs were allowed, was arbitrary, capricious, or entirely lacking in evidentiary support.*

In its audit of San Mateo's reimbursement claims for the period of July 1, 1999 through June 30, 2002, the Controller concluded that San Mateo "improperly applied its claimed indirect cost rate to costs beyond those approved by the U.S. Department of Health and Human Services." The Controller concluded that the indirect cost rate was approved using "a base consisting of 'Direct Salaries and Wages including all fringe benefits,'" but improperly applied, the Controller asserts, to "direct services and supplies, other operating expenses, and capital outlay costs."¹⁰² San Mateo counters that federal approval of an indirect cost rate proposal is merely a "ministerial preference," and not based on any requirement in law.¹⁰³ San Mateo asserts that the Controller accepted its 30 percent indirect cost rate but "did not accept application of the rate to costs other than salary and benefits because the rate was calculated using only salary and benefit costs."¹⁰⁴ The Controller asserts that "if the district wishes to apply its indirect cost rate to a distribution base other than salaries and wages, the district's approved A-21 rate must be based on modified total direct costs."¹⁰⁵ San Mateo asserts that "no accounting rationale or legal basis for this peculiar conclusion is provided by the Controller,"¹⁰⁶ despite having sought to employ a federally approved rate, evidence of which is included in the Controller's comments on the IRC.¹⁰⁷

Moreover, San Mateo argues that "cost accounting principles allow indirect cost rates to be established based on a variety of bases...without regard for the scope of the distribution base except that the source of the rate has to be representative of the 'distribution base.'"¹⁰⁸ In other words, an indirect cost rate does not necessarily have to be developed on the basis of the same direct costs to which it will be applied, as long as the basis is "representative of" the direct costs to which it will be applied. But San Mateo has provided no evidence in the record to show that the basis of the rate is representative of the distribution base. San Mateo denies the existence and validity of the requirements asserted by the Controller, but then fails to demonstrate that it has met even the requirements that it asserts arise from "cost accounting principles."

As discussed above, the claiming instructions referenced in the parameters and guidelines provide guidance for the claimants and the state with respect to indirect cost rates; those

¹⁰² Exhibit A, San Mateo IRC, at pp. 54-55.

¹⁰³ Exhibit A, San Mateo IRC, at p. 16.

¹⁰⁴ Exhibit A, San Mateo IRC, at pp. 14-15.

¹⁰⁵ Exhibit A, San Mateo IRC, at p. 56.

¹⁰⁶ Exhibit A, San Mateo IRC, at pp. 15-16.

¹⁰⁷ Exhibit C, Controller's Comments on San Mateo IRC, at pp. 62-63.

¹⁰⁸ Exhibit A, San Mateo IRC, at pp. 16-17.

instructions reveal that while federal approval of an indirect cost rate is not strictly required, it is one of two options for developing an indirect cost rate. The claiming instructions provide, in pertinent part:

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.¹⁰⁹

The plain language of the above-cited paragraph provides that either a district can use a federally approved rate, incorporating the accounting principles of the OMB Circular A-21; or, the district can use the alternative state procedure. The claiming instructions also provide a third option for claiming: a flat rate of 7% if a claimant cannot support a higher rate.¹¹⁰

The OMB Circular A-21, an excerpt of which the Controller submitted along with its comments on San Mateo’s IRC, provides two options for the development of an indirect cost rate for facilities and administrative costs (referred to as F&A in the text). The first option is a simplified rate based on “salaries and wages,” and the second is labeled a “modified total direct cost base.” The OMB Circular provides that a salaries and wages base rate, developed in accordance with the steps described, is to be applied “to direct salaries and wages for individual agreements to determine the amount of F&A costs allocable to such agreements.”¹¹¹ A modified total direct cost base rate, developed in accordance with the OMB guidelines, is to be applied to the modified *total direct costs*. Applying these guidelines by analogy to state mandates, rather than federal programs, an indirect cost rate developed on the basis of salaries and wages should be applied to salaries and wages only, while an indirect cost rate developed on the basis of all direct and indirect costs could be applied more broadly. This is consistent with the interpretation urged by the Controller, and is a reasonable reading of the OMB requirements.

Based on the foregoing, the Commission finds that San Mateo’s application of the indirect cost rate to direct costs other than salaries and wages for the mandated activities was inconsistent with the parameters and guidelines and the claiming instructions.

In its audit of San Mateo’s claim, the Controller reduced indirect costs claimed by a total of \$112,243 for the three audit years, finding that the district “improperly applied the indirect cost rate to direct services and supplies, other operating expenses, and capital outlay costs.”¹¹² As discussed above, San Mateo was required, if it chose to utilize a federally approved rate, to apply that rate consistently with the manner in which the rate was developed, and San Mateo did not do so. Consequently, a reduction in reimbursement was called for.

However, a claimant is still entitled to some amount of indirect costs, and a failure to correctly apply an indirect cost rate does not require an adjustment to zero. It appears from the record that indirect costs for services and supplies, other operating expenses, and capital outlay costs were

¹⁰⁹ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 30.

¹¹⁰ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 31.

¹¹¹ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 59.

¹¹² Exhibit C, Controller’s Comments on San Mateo IRC, at p. 18.

disallowed entirely.¹¹³ To the extent that *direct* costs for these items were allowed, the claimant should have also been permitted to claim *some amount of indirect costs*. As noted above, the claiming instructions provide for a default 7 percent rate for indirect costs when a claimant is unable to substantiate a higher rate. What, if any, information was available to substantiate a higher rate is unknown.

Based on the foregoing, the Commission finds that the Controller's reduction to zero of allowable indirect costs was arbitrary, capricious, or entirely lacking in evidentiary support; a minimum 7 percent indirect cost rate should have been allowed, but if the Controller has sufficient information to support a higher indirect cost rate by applying the alternate state procedure, the Controller should apply a reasonable and fair indirect cost rate calculated consistently with the Controller's claiming instructions.

3. *San Bernardino did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rates.*

In the audit of San Bernardino's reimbursement claims for the period of July 1, 2001 through June 30, 2003, the Controller concluded that the district's claimed indirect costs were based on a rate not federally approved, and that the costs were highly disproportionate to the Controller's calculations. San Bernardino claimed indirect costs of \$210,961 for fiscal year 2001-2002, against direct costs of \$467,227; and \$249,766 for fiscal year 2002-2003, against direct costs of \$522,176. Those claimed costs represent indirect costs at a rate of approximately 45 percent for 2001-2002 and 48 percent for 2002-2003. The Controller reduced the claimed indirect costs to \$88,166 (an 18.87% rate) for fiscal year 2001-2002 and \$91,067 (a 17.44% rate) for fiscal year 2002-2003.

The Controller maintains that the claiming instructions required the district to use either a federally approved rate "prepared in accordance with OMB Circular A-21, or the SCO's alternate methodology using Form FAM-29C."¹¹⁴ The Controller argues that the district claimed its indirect costs "based on an indirect cost rate proposal (ICRP) prepared for each fiscal year by an outside consultant using OMB Circular simplified indirect cost rate methodology." The Controller continues: "However, the district did not obtain federal approval for its rate." The Controller then calculated indirect cost rates using the alternative method allowed by the claiming instructions, and found that "the calculated indirect cost rates did not support the indirect cost rates claimed."¹¹⁵

San Bernardino counters that "there is no requirement in law that the claimant's indirect cost rate must be 'federally' approved," and that "[n]o particular indirect cost rate calculation is required by law." San Bernardino argues that the Controller's claiming instructions "were never adopted as law, or regulations pursuant to the Administrative Procedure Act," and are therefore "merely a statement of the ministerial interests of the Controller and not law."¹¹⁶ As discussed above, the Commission's duly adopted parameters and guidelines require compliance with the Controller's

¹¹³ Exhibit A, San Mateo IRC, at p. 55.

¹¹⁴ Exhibit B, San Bernardino IRC, at pp. 55-56.

¹¹⁵ Exhibit B, San Bernardino IRC, at p. 55.

¹¹⁶ Exhibit B, San Bernardino IRC, at pp. 20-21.

claiming instructions; the parameters and guidelines incorporate the claiming instructions by reference, and the claiming instructions are therefore presumed to be valid and enforceable.

San Bernardino stands on its assertion that there is no requirement that a rate be federally approved, arguing that “the District has computed its ICRPs utilizing cost accounting principles from the Office of Management and Budget Circular A-21, and the Controller has disallowed it without a determination of whether the product of the District's calculation would, or would not, be excessive, unreasonable, or inconsistent with cost accounting principles.”¹¹⁷

As discussed above, the claiming instructions provide guidance for both the state and the claimants, and the instructions reveal that while federal approval of an indirect cost rate is not strictly required, it is an element of one of two options for developing an indirect cost rate. There is no third option in the claiming instructions to develop an indirect cost rate in accordance with the OMB Circular principles but then decline to seek federal approval.

San Bernardino asserts that “[n]either the Commission nor the Controller has ever specified the federal agencies which have the authority to approve indirect cost rates.”¹¹⁸ However, the OMB Circular A-21, which San Bernardino claims to have followed, states that “[c]ost negotiation cognizance is assigned to the Department of Health and Human Services...[or the Department of Defense, depending on which provides more funding to the educational agency]...In cases where neither HHS or DOD provides Federal funding to an educational institution, the cognizant agency assignment *shall default to HHS*.”¹¹⁹ Therefore, while the Commission and the Controller may not have directly identified the responsible agency, the OMB guidelines clearly direct claimants to HHS for approval of their federally recognized rates.

Based on the foregoing, San Bernardino’s application of an indirect cost rate prepared without federal approval was inconsistent with the parameters and guidelines and the claiming instructions.

In its audit of San Bernardino’s reimbursement claim, 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.¹²⁰

San Bernardino asserts that the difference between its claimed rate and the audited rate is “the determination of which of those cost elements are direct costs and which are indirect costs.” San Bernardino continues, “[i]ndeed, federally ‘approved’ rates which the Controller will accept without further action, are ‘negotiated’ rates calculated by the district and submitted for approval, indicating that the process is not an exact science, but a determination of the relevance and reasonableness of the cost allocation assumptions made for the method used.”¹²¹ San Bernardino 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

¹¹⁷ Exhibit B, San Bernardino IRC, at p. 22.

¹¹⁸ Exhibit B, San Bernardino IRC, at p. 20.

¹¹⁹ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 59 [emphasis added].

¹²⁰ See Exhibit D, Controller’s Comments on San Bernardino IRC, at p. 29.

¹²¹ Exhibit B, San Bernardino IRC, at p. 21.

reported by the District.” San Bernardino also argues that the Controller’s decision to recalculate indirect costs by its own method “is an arbitrary choice of the Controller, not a ‘finding’ enforceable by fact or law.”¹²²

Note that the claiming instructions also provide for a default indirect cost rate: “The claimant has the option of using a 7% or a higher expense percentage is allowable if the college can support its allocation basis.”¹²³ The Controller did not seek to reduce San Bernardino’s claim of indirect costs to 7 percent, as would appear to be valid and enforceable, given the district’s failure to support a higher rate. Rather, the Controller recalculated the indirect cost rate pursuant to the state procedure outlined in the claiming instructions (the FAM-29C method), resulting in a more generous indirect cost rate than the 7 percent default. San Bernardino argues that this substitution of methods was arbitrary. But, based on the above analysis, San Bernardino failed to comply with the requirements of the claiming instructions with respect to the OMB method of calculating indirect cost rates. San Bernardino also concedes that the difference between the claimed and audited methods turns on what costs are considered direct or indirect, and that “the process is not an exact science.” San Bernardino does not assert that the rate calculated was arbitrary; only that it was arbitrary to substitute the state method outlined in the claiming instructions for the claimant’s preferred but incorrectly executed method.

The Commission does not have evidence in the record suggesting a finding that the Controller’s reductions to San Bernardino’s claim were unreasonable; the determination of which costs are direct and which are indirect is not sufficiently explained in the record, nor are any specific delineations made. Based on the foregoing, the Commission finds that the Controller’s reduction was based on an alternative method authorized by the claiming instructions for calculating indirect costs, and is therefore not arbitrary, capricious, or entirely lacking in evidentiary support.

D. Disallowance of Salaries and Application of Audited Benefit Rates

The Controller reduced the reimbursement claims filed by San Mateo for salaries and benefits by \$281,607 for fiscal year 1999-2000, \$246,609 for fiscal year 2000-2001, and \$264,949 for fiscal year 2001-2002, on grounds that “the district did not provide documentation supporting the validity of the distribution made to the mandate.”¹²⁴

San Mateo disputes the Controller’s disallowance of certain employee salaries and the application of an “audited” benefit rate to the remaining employees, based on the Controller’s conclusion that San Mateo did not adequately support the claimed costs.

1. *The Controller’s documentation requirements must be consistent with the parameters and guidelines, and must be applied consistently, in order to be enforceable: the disallowance of salaries and benefits was arbitrary, in light of other costs allowed based on the same or similar documentation.*

San Mateo argues that the Controller is attempting to enforce an auditing standard, with respect to the documentation required, that is not consistent with the parameters and guidelines.¹²⁵ The

¹²² Exhibit B, San Bernardino IRC, at p. 22.

¹²³ See Exhibit D, Controller’s Comments on San Bernardino IRC, at p. 30.

¹²⁴ Exhibit A, San Mateo IRC, at p. 52.

¹²⁵ Exhibit A, San Mateo IRC, at p. 12.

Controller does not specifically describe an auditing standard, but states that “the district did not provide documentation supporting the validity of the distribution made to the mandate.”¹²⁶ The Controller also notes the absence of “time logs, time studies, or other corroborating documentation” supporting the claimed salaries and benefits.¹²⁷

In *Clovis Unified*, the court of appeal considered the Controller’s “contemporaneous source document rule” (CSDR), included in claiming instructions issued and relied upon to reduce reimbursement in audits conducted by the Controller.¹²⁸ The CSDR defines a “source document” as “a document created at or near the same time the actual cost was incurred for the event or activity in question.” Source documents, the rule provides, “may include, but are not limited to, employee time records or time logs, sign-in sheets, invoices, and receipts.” The language of the parameters and guidelines in the *School District Choice* program, requiring all costs to be traceable to source documents, was held by the court to most closely resemble the contemporaneous source document rule, in comparison to the other three programs under scrutiny.¹²⁹ Nevertheless, the court of appeal concluded that the CSDR was an unenforceable and invalid underground regulation as applied to all programs under review, being *inconsistent* with the parameters and guidelines, and allowing the Controller to penalize eligible claimants for failing to produce documentation more specific than that required by the parameters and guidelines.

The court therefore invalidated the audits in question to the extent that they relied on the CSDR, and concluded:

If it chooses to do so, the Controller may re-audit the relevant reimbursement claims based on the documentation requirements of the P & G’s and claiming instructions when the mandate costs were incurred (i.e., not using the CSDR).¹³⁰

Therefore, pursuant to the holding in *Clovis Unified*, the Controller is not empowered to enforce the contemporaneous source document rule, and to the extent that audit standards require documentation and evidence inconsistent with that required by the parameters and guidelines, those standards are unenforceable as against local government claimants.

The parameters and guidelines under which San Mateo’s audited claims were filed provide, in pertinent part:

Claimed costs should be supported by the following information:

Employee Salaries and Benefits

Identify the employee(s), show the classification of the employee(s) involved, describe the mandated functions performed and specify the actual number of hours devoted to each function, the productive hourly rate, and the related

¹²⁶ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 14.

¹²⁷ *Ibid.*

¹²⁸ (Cal. Ct. App. 3d Dist. 2010) 188 Cal.App.4th 794.

¹²⁹ *Id.*, at p. 805.

¹³⁰ *Id.*, at pp. 812-813.

benefits. The average number of hours devoted to each function may be claimed if supported by a documented time study.

¶...¶

*For auditing purposes, all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs...*¹³¹

In its reimbursement claims for fiscal years 1999-2000, 2000-2001, and 2001-2002, San Mateo stated its salary and benefit costs for the mandate, certified under penalty of perjury, on the Controller's claim forms.¹³² The claim forms submitted to the Commission along with San Mateo's IRC showed only the *total* salaries and benefits for the audit years,¹³³ but the district asserts that "salary and benefits were reported in the District general ledger in the normal course of financial accounting," and that it "has also provided employee names, positions (job titles), hours worked, salary and benefit amounts, and a description of the tasks performed as they relate to this mandate, and in some cases declarations."¹³⁴ In addition, the Controller's comments filed on the IRC included worksheets and schedules that show disallowed salaries and benefits identified by employee and classification, suggesting that somewhat more detailed information was submitted to the Controller prior to the final audit.¹³⁵ The Controller's comments on the IRC also included emails between the district's chief financial officer and the Controller's audit manager discussing the accounts from which the disputed employees were paid and their job descriptions.¹³⁶

The Controller's audit report provides the totals of salaries and benefits disallowed,¹³⁷ and the "schedule of allowable salaries and benefits" submitted in the Controller's comments on the IRC identifies employees whose time spent on mandated activities was not verified to the satisfaction of the Controller.¹³⁸ In emails exchanged between the district and the Controller's audit manager, the Controller asked for more information regarding certain employees whose activities were not clearly attributable to the mandate, while salaries for persons identified as nurses and doctors, for example, were allowed without question.¹³⁹ In response to these emails, San Mateo submitted additional documentation and explanation to the Controller showing that the district omitted from its reimbursement claim certain costs charged to accounts outside the health services department. For example, a letter to the Controller explains that "[f]or Ernest Rodriguez, in March 2002, he took on a teacher assignment which is reflected in the account

¹³¹ See Exhibit A, San Mateo IRC, at pp. 32-38 [Health Fee Elimination parameters and guidelines, as amended 1/29/89].

¹³² Exhibit A, San Mateo IRC, at pp. 75; 89; 90; 104; 105; 119.

¹³³ Exhibit A, San Mateo IRC, at pp. 89; 104; 119.

¹³⁴ Exhibit A, San Mateo IRC, at p. 13.

¹³⁵ Exhibit C, Controller's Comments on San Mateo IRC, at pp. 52-54.

¹³⁶ Exhibit C, Controller's Comments on San Mateo IRC, at pp. 48-50.

¹³⁷ Exhibit A, San Mateo IRC, at p. 52.

¹³⁸ Exhibit C, Controller's Comments on San Mateo IRC, at pp. 52-54.

¹³⁹ Costs were allowed for persons named as nurses without question.

code... 201000. This was not charged to the claim.”¹⁴⁰ Similarly, the letter shows that Dee Howard, who is identified as “Full-time Faculty” in the Controller’s schedules,¹⁴¹ worked as a counselor in departments other than “Health Services,” and therefore only the portion of her wages attributed to the health services account was claimed.¹⁴² Similarly, the letter states that Gloria D’Ambra, identified as an office assistant, earned overtime pay in fiscal year 1999-2000, which was not charged to the claim.¹⁴³ Additional documentation was submitted along with this letter, including employee earnings reports for several persons, detailing the accounts from which employees were paid, and the portions of total salary attributable to each account.

Ultimately the Controller accepted this type of documentation for some employees, including “\$5762 of salary expense for Donna Elliot,” which San Mateo had explained was incorrectly charged to account 543000, instead of 643000. The Controller also allowed the costs for Gloria D’Ambra based on the amounts reported as non-overtime wages charged to account code 643000; overtime wages charged to account code 649001 were not claimed, and the Controller accepted the omission of those amounts from the claim.¹⁴⁴ The Controller therefore accepted the earnings reports and other documentation to support the validity of salaries claimed for two persons identified as “office assistant.” But for Dee Howard and Ernest Rodriguez, each of whom had a portion of their salary charged to “code 643000,” the Controller ultimately disallowed salaries “in the absence of time records supporting the hours worked performing mandate activities at the Health Center.”¹⁴⁵

The Controller maintains that “the audit determined that the claimant was unable to support that salary costs claimed for several employees were directly attributable to the mandate.” The Controller asserts that the district provided information regarding salaries, but “no documentation supporting the validity of the distribution of those costs to the performance of mandated activities.”¹⁴⁶ San Mateo argues that its August 31, 2004 letter to the Controller’s audit manager, issued prior to the final audit report, “clearly distinguishes between claimed costs, which relate to the mandate, and those costs that were not claimed and did not relate to the mandate.”¹⁴⁷

The documents in the record pertaining to this IRC do not show “the actual number of hours devoted to each [mandated] function,” as required by the parameters and guidelines, but the Controller has apparently allowed salary and benefit costs for some employees on the basis of

¹⁴⁰ Exhibit E, San Mateo Rebuttal Comments, at pp. 23-25.

¹⁴¹ Exhibit C, Controller’s Comments on San Mateo IRC, at pp. 52-54.

¹⁴² Exhibit E, San Mateo Rebuttal Comments, at pp. 23-25.

¹⁴³ Exhibit E, San Mateo Rebuttal Comments, at pp. 27-30.

¹⁴⁴ Account code 643000 appears, in context, to be accepted by the Controller as related to the health services department.

¹⁴⁵ Exhibit C, Controller’s Comments on San Mateo IRC, at pp. 48-49.

¹⁴⁶ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 2.

¹⁴⁷ Exhibit E, San Mateo Rebuttal Comments, at pp. 5; 23-24.

job titles,¹⁴⁸ and in some cases on the basis of earnings reports that show an employee's salary paid from an account recognized to be related to the provision of health services.¹⁴⁹ In the case of those employees, the Controller did not insist on hours worked toward the mandate, even for the non-overtime wages paid to Gloria D'Ambra, a health services center office assistant. In contrast, and without any explanation of its differential treatment, the Controller *disallowed* salary and benefit costs for employees that San Mateo (under penalty of perjury) claimed worked at least a portion of their salaried time for the health services department. The Controller made this disallowance citing an absence of employee time records supporting the hours worked performing mandated activities. Although the documents in the record do not substantiate actual hours performing mandated activities for Dee Howard and Ernest Rodriguez, the same type of documents were accepted by the Controller to substantiate omitting from the reimbursement claim overtime hours worked by Gloria D'Ambra; and the same documents were accepted by the Controller as evidence that D'Ambra and Donna Elliot, identified as office assistants, were both engaged in mandate-related activities at the health services department. In other words, if the account codes to which the salaries of D'Ambra and Elliot were charged are sufficient to substantiate costs for their salaries, disallowing costs for Howard and Rodriguez on the basis of the same documentation is arbitrary and capricious.

Based on the foregoing, the Commission finds that the Controller's disallowance of salaries and benefits for Dee Howard and Ernest Rodriguez was arbitrary, capricious, or entirely lacking in evidentiary support, and the costs claimed for these two employees should be reinstated.

2. *There is no evidence in the record to support the benefits claimed by San Mateo*

San Mateo disputes the application of an "audited" benefit rate. San Mateo asserts that "[t]he Controller calculated a benefit rate to be applied to the salaries to determine the total allowable salary and employee benefits for each employee." The resulting rates were between 16.62719 percent and 17.66762 percent for the three years subject to audit. San Mateo objects to this calculation, arguing that "[t]he Controller has not indicated why it was necessary to calculate an average benefit rate when the District reported actual benefit costs in its general ledger, that is, why an average rate is better than actual benefit costs." San Mateo also asserts that the claiming instructions provide for a "default" benefit rate of 21 percent, which can be added to hourly payroll costs.¹⁵⁰

The Controller maintains that the 21 percent rate asserted by the district applies to the *Collective Bargaining* program, and is not applicable to these claiming instructions.¹⁵¹ Accordingly, the

¹⁴⁸ See Exhibit C, Controller's Comments on San Mateo IRC, at pp. 52-54 [allowable salaries for nurses and doctors].

¹⁴⁹ See Exhibit C, Controller's Comments on San Mateo IRC, at pp. 48-50 [allowable salaries for and office assistants, apparently on the basis of employee earnings reports].

¹⁵⁰ Exhibit A, San Mateo IRC, at p. 12.

¹⁵¹ Exhibit C, Controller's Comments on San Mateo IRC, at p. 14.

claiming instructions submitted to the Commission by both parties contain no default benefit rate applicable to this mandate.¹⁵²

The Controller also argues that the district disputes the audited rate “but fails to provide any alternative.” The Controller maintains that San Mateo “failed to provide any documentation supporting actual benefit amounts paid to each employee, so the auditor calculated a benefit rate by dividing total benefits claimed by total salaries claimed.”¹⁵³ San Mateo makes reference to its “general ledger,” but no such document is found in the record, and the existence of “actual benefit costs,” assertedly provided to the Controller, cannot be verified.¹⁵⁴

There is no evidence in the record of actual benefit amounts paid to each employee, only the benefit totals included in San Mateo’s worksheets.¹⁵⁵ The only benefit amounts in the record are the audited benefit amounts in the Controller’s “schedule of allowable salaries and benefits.”¹⁵⁶ Absent any documentation substantiating the benefit amounts claimed, the Controller’s reductions cannot be evaluated; however, neither can the district’s claims be supported.

Based on the foregoing, the Controller’s audited benefit rate is not arbitrary, capricious, or entirely lacking in evidentiary support.

E. Disallowance of Other Outgoing Expenses

In its audit of San Mateo’s reimbursement claims the Controller identified unallowable costs for “other outgoing expenses” for fiscal year 2001-2002, in the amount of \$41,375, “recorded on three separate journal transactions.” The Controller found that these transactions were not supported by documentation, “e.g., in invoices or other source documentation.” The district did not respond to that finding prior to issuance of the final audit report.¹⁵⁷

San Mateo disputes the disallowance of “other outgoing expense costs,” and challenges the Controller to explain what is meant by these terms. San Mateo argues that “the Controller should provide the derivation of “outgoing expense costs,” which is not described in generally accepted accounting principles.” The district argues that “there is no documentation standard for which the district was on notice that requires journal voucher transactions to comply with any documentation standard other than the financial reporting standards mandated by the state for community colleges.”¹⁵⁸

The Controller counters that “expenses” and “costs” are synonymous, and that the district “makes no mention whatsoever as to the factual nature of the finding nor does it offer any

¹⁵² See Exhibit A, San Mateo IRC, at pp. 40-42; Exhibit C, Controller’s Comments on San Mateo IRC, at pp. 35-37.

¹⁵³ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 2.

¹⁵⁴ Exhibit A, San Mateo IRC, at p. 12.

¹⁵⁵ Exhibit A, San Mateo IRC, at pp. 89; 104; 119.

¹⁵⁶ Exhibit C, Controller’s Comments on San Mateo IRC, at pp. 52-54.

¹⁵⁷ Exhibit A, San Mateo IRC, at p. 54.

¹⁵⁸ Exhibit A, San Mateo IRC, at p. 15.

documentation that supports the three journal voucher entries.”¹⁵⁹ In rebuttal comments, San Mateo maintains that the Controller “does not state why these costs are not mandate-related, excessive, or unreasonable.”¹⁶⁰

As discussed above, the parameters and guidelines requires that all costs claimed must be traceable to source documents that show evidence of the validity of such costs. Those documents, in turn are required to be certified under penalty of perjury, but certification alone cannot substitute for probative value. It is not necessary, under the parameters and guidelines, and consistent with *Clovis Unified*, as discussed above, that claimants produce unimpeachable proof of costs incurred, produced at or near the time the costs were incurred so as to reinforce the reliability of those documents. However, the documentation must show some evidence that costs are related to the mandate, and the term “other outgoing expenses,” even if claimed and certified to be related to the mandate, is not sufficient to show the validity of the costs. The record indicates that the Controller offered the district an opportunity to substantiate these costs, and the district declined to do so, instead asserting that the burden should be on the Controller to show that the costs are not mandate-related. A claimant’s certification that costs are related to the mandate is not sufficient in itself to substantiate the costs.

Based on the foregoing, the Commission finds that the Controller’s finding regarding “other outgoing expenses” was not arbitrary, capricious, or entirely lacking in evidentiary support, and a reduction of San Mateo’s claim in the amount of \$41,375 is therefore supported.

F. Disallowance of Health Services Not Substantiated in the Base Year

The Controller reduced health services costs claimed by San Bernardino in amounts of \$41,389 for fiscal year 2001-2002, and \$61,739 for fiscal year 2002-2003, on grounds that the district claimed costs for services not provided in the base year, fiscal year 1986-87.¹⁶¹

San Bernardino asserts that the Controller incorrectly reduced reimbursement for health services costs claimed, on the basis of comparison between the audit years and the health services inventory for fiscal year 1997-1998.¹⁶²

In the test claim statement of decision the Commission found that the statute imposed a “maintenance of effort” requirement on community college districts requiring them to continue to provide health services at the level provided in the base year, without the continuing authority to levy health service fees.¹⁶³ The test claim statute eliminated the fee authority, and required community colleges to maintain health services provided in fiscal year 1983-1984. The fee authority was to be reinstated as of January 1, 1988.¹⁶⁴ The statute was amended in 1987 to expressly reinstate the fee, and to provide that community colleges must maintain services at the

¹⁵⁹ Exhibit C, Controller’s Comments on San Mateo IRC, at p. 17.

¹⁶⁰ Exhibit E, San Mateo Rebuttal Comments, at p. 8.

¹⁶¹ Exhibit B, San Bernardino IRC, at p. 53.

¹⁶² *Id.*, at pp. 11-13.

¹⁶³ Exhibit X, Test Claim Decision CSM-4206.

¹⁶⁴ Education Code section 72246 (Stats. 1984, ch. 1, 2d Ex. Sess.).

level provided in fiscal year 1986-1987.¹⁶⁵ The parameters and guidelines were amended to reflect the later statute and the maintenance of effort requirement. To the extent the fee authority is not sufficient to cover the costs of mandated activities, the Commission's test claim decision and parameters and guidelines provide reimbursement for mandated costs.¹⁶⁶ The parameters and guidelines provide a long list of services, which are stated to be "reimbursable to the extent they were provided by the community college district in fiscal year 1986-87." And the parameters and guidelines require, under the heading "Supporting Data:"

For auditing purposes, all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs. *This would include documentation for the fiscal year 1986-87 program to substantiate a maintenance of effort.*¹⁶⁷

Exactly what documents are needed "to substantiate a maintenance of effort" is not stated. Pursuant to *Clovis Unified*, as discussed above, whatever is required by the Controller should generally be consistent with the parameters and guidelines; the Controller cannot enforce an auditing standard that is unreasonable in the context of the parameters and guidelines.

The Controller explains:

In an attempt to determine if the health services in question were reported in prior year mandated cost claims, we asked district personnel to provide the earliest mandated cost claims available. The district provided up a copy of the FY 1997-98 Health Fee Elimination cost claim. We observed that the health services in question were not listed on this claim. If the district staff believes information in prior year claims is inaccurate, it has the responsibility to corroborate its position.

The Controller concludes that "[t]he district was not able to prove that the new services it identified on the claim during the audit period were also provided in the 1986-87 base year."

San Bernardino argues that the inventory of available services for the audit years "was compared to the health services inventory for FY 1997-98, and those activities listed in the inventory for the audit years but not also listed in fiscal year 1997-1998 were "assumed to be 'new services not offered in 86/87.'" San Bernardino argues that this comparison "established FY 1997-98 as an alternative base year, contrary to the Education Code and the parameters and guidelines."¹⁶⁸ San Bernardino further argues that there is a difference between services rendered in a given year and services available in a given year, and that the maintenance of effort requirement is to maintain services *available* in the base year 1986-87.¹⁶⁹

San Bernardino is correct that the Controller may not establish an alternate base year; the services provided in 1986-87 are mandated under the plain language of the test claim decision and the parameters and guidelines, and to the extent those services are not offset by student

¹⁶⁵ Education Code section 72246 (Stats. 1987, ch. 1118).

¹⁶⁶ See Health Fee Elimination Parameters and Guidelines, Exhibit A, San Mateo IRC, at p. 32.

¹⁶⁷ Exhibit B, San Bernardino IRC, at pp. 33-37.

¹⁶⁸ Exhibit B, San Bernardino IRC, at p. 12.

¹⁶⁹ Exhibit B, San Bernardino IRC, at pp. 13-15.

health fees, costs to provide those services are reimbursable.¹⁷⁰ San Bernardino’s audited claims, certified under penalty of perjury, include a health services inventory comparing the claim years to the base year.¹⁷¹ It is inappropriate for the Controller to disallow costs for health services on the basis of comparing the audit years to data from any other year.

Moreover, San Bernardino’s reasoning with respect to the distinction between services *rendered* and services *available* is sound: comparing the *health services inventory* of the audit years to the inventory of any other year, including the base year, is not necessarily reflective of the services that were *available* in the base year and that therefore must be maintained. The maintenance of effort requirement of the test claim statute turns on the services “provided” in the base year, and the district’s interpretation of services provided being equivalent to services *available* is consistent with the purpose and intent of a maintenance of effort requirement.¹⁷² It would work an absurd result to require a district to continue providing only services that were utilized by at least one student in the base year; a district might be compelled to discontinue availability of a particular service only because it was not utilized in the arbitrarily-selected base year. Moreover, if the health services inventory for any subsequent year can be used as a basis for comparison to disallow any service not utilized in the selected year, the maintenance of effort requirement is seriously jeopardized.

Finally, there is nothing in the parameters and guidelines to suggest that a certification by the claimant of the services “provided” in the base year is insufficient to substantiate the maintenance of effort. The parameters and guidelines state only that the supporting data “would include documentation for the fiscal year 1986-87 program to substantiate a maintenance of effort.”¹⁷³ The parameters and guidelines do not provide what documentation for that year would be required; and, as discussed above, relying upon an inventory of services rendered in the base year would likely force a number of districts to discontinue services or provide services without the reimbursement to which they are entitled.

Additionally, San Bernardino argues that services provided in the base year should be viewed in terms of classes of services, rather than focusing on distinctions within those classes, for purposes of the maintenance of effort. For example, San Bernardino argues that the Controller disallowed “flu shots” and “Hepatitis B shots,” finding that those services were not provided in the base year.¹⁷⁴ San Bernardino argues, “[n]otwithstanding the previously discussed factual deficiencies regarding [the Controller’s] lack of findings on FY 1986-87 and the Controller’s insistence on auditing services rendered as opposed to services available, the characterization of these services as new services is also incorrect.” San Bernardino argues that “*immunization*

¹⁷⁰ See Exhibit B, San Bernardino IRC, at p. 33.

¹⁷¹ Exhibit B, San Bernardino IRC, at pp. 74; 92-95; 100-102.

¹⁷² See Exhibit B, San Bernardino IRC, at p. 32 [requirement to continue providing health services “at the level provided during the 1986-87 fiscal year”].

¹⁷³ Exhibit B, San Bernardino IRC, at p. 37.

¹⁷⁴ Exhibit B, San Bernardino IRC, at p. 12.

services were available in FY 1986-87,” and Hepatitis and flu vaccinations “are just a part of the whole scope of services which may comprise immunization services.”¹⁷⁵

This argument is persuasive, with respect to services that can be classified within a fairly narrow scope, such as immunizations. The maintenance of effort requirement of the test claim statute should not be read so narrowly as to limit the provision of reimbursable health services to the state of medical technology and knowledge available in 1986-1987; such limitation might well endanger public health, especially with respect to services such as immunizations. The districts should be encouraged to keep pace with medical technology and knowledge in their health service offerings, and a maintenance of effort requirement can be read to provide for those changes. Such a general approach to the concept of services provided is also consistent with the parameters and guidelines, which provide a list of services “reimbursable to the extent they were provided by the community college district in fiscal year 1986-87.”¹⁷⁶ The list describes many of the services in general terms, such as “dental services,” “lab reports,” and “birth control.” The list does not provide specific dental services or lab reports that are provided, nor limit birth control to any specific methods or treatments. The list does provide for certain immunizations, including “influenza,” “measles/rubella,” and “diphtheria/tetanus.”¹⁷⁷ The list does not provide for immunization against hepatitis B, which was one of the disallowed services, but given the general nature of many of the other items listed in the parameters and guidelines, it would be reasonable to conclude that the immunizations named in the parameters and guidelines are illustrative, rather than exhaustive, in nature.

Finally, San Bernardino argues that the Controller is disallowing services on the basis of a college-level examination of the base year services, rather than a district-level examination.¹⁷⁸ The Controller argues that the parameters and guidelines provide that “[o]nly services provided in FY 1986-87 may be claimed,” and that “[t]hroughout the audit field work and until December 26, 2006 (the date of this response), the district did not provide us with any documentation to substantiate its assertion that the health services in question were provided at the San Bernardino Valley College and/or at Crafton Hills College in FY 1986-87.”¹⁷⁹

San Bernardino’s argument on this issue is persuasive. The parameters and guidelines are addressed to eligible claimants, meaning community college *districts*, not individual schools. The test claim statute, likewise, addresses itself to districts, not individual campuses or colleges, and requires districts to maintain health services at the level provided in the base year.¹⁸⁰ There is no reference in the test claim statute or the parameters and guidelines to services provided at individual schools. Consequently, there is no support in the record for the Controller’s narrow view of a maintenance of effort based on services provided at a single campus. Finally, although

¹⁷⁵ Exhibit B, San Bernardino IRC, at p. 17.

¹⁷⁶ Exhibit B, San Bernardino IRC, at pp. 33-36

¹⁷⁷ Exhibit B, San Bernardino IRC, at p. 34.

¹⁷⁸ Exhibit B, San Bernardino IRC, at p. 15.

¹⁷⁹ Exhibit D, Controller’s Response to San Bernardino IRC, at p. 15.

¹⁸⁰ Exhibit B, San Bernardino IRC, at p. 33.

the costs of salaries and benefits are broken down by college, the health services inventory certified by the claimant is asserted to apply to the entire district.¹⁸¹

Based on the foregoing, the Commission finds that the disallowance of health services not rendered in the 1997-98 fiscal year was arbitrary, capricious, or entirely lacking in evidentiary support. The Controller must allow reimbursement for those services that the district certifies under penalty of perjury were available in the 1986-87 fiscal year, including services that fit the classifications provided in the parameters and guidelines.

G. Disallowance of Insurance Premiums

The Controller reduced amounts claimed by San Bernardino for “services and supplies” in amounts of \$37,348 for fiscal year 2001-2002, and \$38,322 for fiscal year 2002-2003, on grounds that athletic insurance costs are beyond the scope of the mandate.¹⁸²

San Bernardino disputes the disallowance of “overstated services and supplies,” arguing that the Controller inappropriately disallowed costs for student insurance premiums.

The Controller explains that the district carried three types of insurance coverage in fiscal years 2001-2002 and 2002-2003: basic coverage for students as well as athletes, super catastrophic coverage for athletes, and catastrophic coverage for students. The Controller asserts that the disallowed costs are only the “intercollegiate athletes’ portion of the basic coverage and the intercollegiate athletes’ portion of the super catastrophic coverage,” along with a small amount of costs that the Controller finds unsupported. The maintenance of effort requirement, pursuant to section 76355, applies only to those health services for which community college districts are permitted to charge a fee; and because section 76355(d) prohibits expenditures of health fees on athletic-related costs, the costs of athletic insurance are not mandated, and must be disallowed.¹⁸³

The Controller submitted a worksheet detailing the disallowed portions of insurance, showing that only the portions of basic coverage and catastrophic coverage attributable to intercollegiate athletes were disallowed.¹⁸⁴ The amounts disallowed were \$37,348 for fiscal year 2001-2002, and \$35,206 for fiscal year 2002-2003,¹⁸⁵ and in addition \$3,116 in “unsupported costs.”¹⁸⁶

San Bernardino argues that “the adjustment is inappropriate since student athletes are part of the student population for purpose of the general student population insurance premium.”

San Bernardino reasons that the athletic insurance premiums “[pertain] to coverage while participating in intercollegiate sports, not while they are attending class or on campus in their capacity [as] a member of the general student population.”¹⁸⁷

¹⁸¹ Exhibit B, San Bernardino IRC, at pp. 92-94; 100-102.

¹⁸² Exhibit B, San Bernardino IRC, at p. 55.

¹⁸³ Exhibit D, Controller’s Comments on San Bernardino IRC, at pp. 17-19.

¹⁸⁴ Exhibit D, Controller’s Comments on San Bernardino IRC, at pp. 79-82.

¹⁸⁵ *Ibid.*

¹⁸⁶ Exhibit B, San Bernardino IRC, at p. 55.

¹⁸⁷ Exhibit B, San Bernardino IRC, at pp. 16-17.

San Bernardino has not disputed the Controller's argument that costs related to athletics are not included within the maintenance of effort requirement, nor submitted any documentation in answer to the Controller's worksheet attributing the disallowed costs to portions of insurance premiums applicable to collegiate athletic programs. San Bernardino's assertion that intercollegiate athletes are covered by the college's general student population insurance premiums "while they are attending class" is logically true and correct, but the idea that the disallowed costs extend to any portion of the general student population premiums is not substantiated by any documentation in the record.

The Controller's documentation clearly supports the disallowance, and nothing in the record supports the additional \$3,116 that the Controller found was "unsupported." Based on the foregoing, the Commission finds that the disallowance of costs related to insurance premiums for intercollegiate athletes not arbitrary, capricious, or entirely lacking in evidentiary support.

IV. Conclusion

The Commission partially approves this IRC. Pursuant to Government Code section 17551(d) and section 1185.7 of the Commission's regulations, the Commission finds that the following reductions are incorrect and should be reinstated, as specified:

- Reduction to zero of San Mateo's claimed indirect costs for services and supplies, other operating expenses, and capital outlay costs was arbitrary, capricious, or entirely lacking in evidentiary support, and to the extent direct costs were permitted for the specified items, a minimum 7 percent indirect cost rate should be reinstated, unless a higher rate can be supported on the basis of an alternative method.
- Disallowance of salaries and benefits for Ernest Rodriguez and Dee Howard in San Mateo's reimbursement claims was arbitrary, capricious, or entirely lacking in evidentiary support, in light of costs allowed for other employees based on the same or similar documentation; costs for the salaries and benefits of Ernest Rodriguez and Dee Howard should be reinstated, to the extent those costs are supported by the district's accounting records substantiating amounts paid from health services accounts.
- Disallowance of health services costs on the basis of comparing the audit years against a health services inventory from fiscal year 1996-1997 was arbitrary, capricious, or entirely lacking in evidentiary support, and health services costs claimed should be reinstated on the basis of the services provided by the entire district in fiscal year 1986-1987, as certified under penalty of perjury by San Bernardino Community College District.

The Commission further finds that the following reductions were reasonable and supported by the law and the record:

- Reduction of both districts' reimbursement claims, on the basis of understated health fee revenues, in the amounts of \$70,603 for San Mateo, and \$150,031 for San Bernardino.
- The reduction of indirect costs claimed by San Bernardino, in the amount of \$281,494, based on the district'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.
- The reduction of benefits claimed by San Mateo, in the amount of \$88,633, based on the district's failure to support its claimed benefit amounts.

- The reduction of costs claimed for “other outgoing expenses” by San Mateo, in the amount of \$41,375, based on the district’s failure to support claimed expenses.
- The reduction of health insurance costs and other overstated services and supplies in San Bernardino’s reimbursement claims, in the amounts of \$37,348 for fiscal year 2001-2001, and \$38,322 for fiscal year 2002-2003, based on the documentation submitted by the Controller.

The Commission hereby remands the subject claims to the Controller, with instructions to reinstate the incorrect reductions specified above consistent with these findings.