STATE of CALIFORNIA
COMMISSION ON STATE MANDATES

October 17, 2016

Mr. Thomas Burke
Kern Community College District
2100 Chester Avenue
Bakersfield, CA 93301

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

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

Re: **Draft Proposed Decision, Schedule for Comments, and Notice of Hearing**
Health Fee Elimination, 09-4206-I-21 and 10-4206-I-36
Former Education Code Section 72246 (Renumbered as 76355)
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1); and
Statutes 1987, Chapter 1118 (AB 2336)
Fiscal Years 2003-2004, 2004-2005, 2005-2006, and 2006-2007
Kern Community College District, Claimant

Dear Mr. Burke and Ms. Kanemasu:

The Draft Proposed Decision for the above-captioned matter is enclosed for your review and comment.

Written Comments

Written comments may be filed on the Draft Proposed Decision by **November 7, 2016**. You are advised that comments filed with the Commission on State Mandates (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. Refer to http://www.csm.ca.gov/dropbox_procedures.php on the Commission's website for electronic filing instructions. (Cal. Code Regs., tit. 2, § 1181.3.)

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

Hearing

This matter is set for hearing on **Friday, January 27, 2017** at 10:00 a.m., State Capitol, Room 447, Sacramento, California. The Proposed Decision will be issued on or about January 13, 2016. Please let us know in advance if you or a representative of your agency will testify at the hearing, and if other witnesses will appear. If you would like to request postponement of the hearing, please refer to section 1187.9(b) of the Commission's regulations.

Sincerely,

Heather Halsey
Executive Director

J:\MANDATES\IRC\2009\4206 (Health Fee Elimination)\09-4206-I-21 (Consolidated with 10-4206-I-36)\Correspondence\draftPDtrans.docx

ITEM __

INCORRECT REDUCTION CLAIM

DRAFT PROPOSED DECISION

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

Health Fee Elimination

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

09-4206-I-21 and 10-4206-I-36

Kern Community College District, Claimant

EXECUTIVE SUMMARY

Overview

This analysis addresses these consolidated Incorrect Reduction Claims (IRCs) filed by Kern Community College District (claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during fiscal years 2003-2004 through 2006-2007 under the *Health Fee Elimination* program.

The following issues are in dispute:

- Reduction of $79,213 based on asserted faults in the development and application of indirect cost rates; and
- Reduction of $1,145,224 based on health service fee authority.[2]

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.[3] In 1984, the Legislature repealed the

[1] Statutes 1993, chapter 8.

[2] The total net reduction over four years is $762,882, based on the Controller offsetting the understated health fee revenues against other unclaimed costs, which were not disputed by the claimant.

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

community colleges' fee authority for health services.[4] However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, in order to reauthorize the fee, at $7.50 for each semester (or $5 per quarter or summer session).[5]

In addition to temporarily repealing community college districts' authority to levy a health services fee, the 1984 enactment required any district that provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.[6] As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987,[7] the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.[8] In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than $7.50 for each semester, or $5 for each quarter or summer session.[9] As a result, beginning January 1, 1988 all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services. In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.[10]

Procedural History

The claimant's fiscal year 2003-2004 claim was signed on January 5, 2006.[11] The claimant's fiscal year 2004-2005 claim was signed on January 5, 2006.[12] The claimant's fiscal year 2005-

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

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

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

[7] Statutes 1987, chapter 1118.

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

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

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

[11] Exhibit A, IRC 09-4206-I-21, page 183.

[12] Exhibit A, IRC 09-4206-I-21, page 192.

2006 claim was signed on January 9, 2007.[13] The claimant's fiscal year 2006-2007 claim was signed on February 9, 2009.[14]

On April 24, 2009, the Controller issued a draft audit report.[15] On May 18, 2009, the claimant responded to the draft audit report.[16] On June 30, 2009, the Controller issued a final audit report. On September 25, 2009, the claimant filed the first of two consolidated IRCs.[17] On August 20, 2010, the Controller issued a revised final audit report.[18] On December 9, 2010, the claimant filed the second of two consolidated IRCs.[19] On October 3, 2014, the Controller submitted late comments on these consolidated IRCs.[20]

Commission staff issued the Draft Proposed Decision on October 17, 2016.[21]

Commission Responsibilities

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

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

The Commission must review questions of law, including interpretation of parameters and guidelines, de novo, without consideration of conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[22] 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

[13] Exhibit A, IRC 09-4206-I-21, page 201.

[14] Exhibit A, IRC 09-4206-I-21, page 210.

[15] Exhibit A, IRC 09-4206-I-21, page 57.

[16] Exhibit A, IRC 09-4206-I-21, pages 57; 76.

[17] Exhibit A, IRC 09-4206-I-21, page 1.

[18] Exhibit B, IRC 10-4206-I-36, page 17.

[19] Exhibit B, IRC 10-4206-I-36, page 1.

[20] Exhibit C, Controller's Late Comments on the IRCs.

[21] Exhibit D, Draft Proposed Decision.

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

remedy to cure the perceived unfairness resulting from political decisions on funding priorities."[23]

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.[24]

The Commission must also review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.[25] In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[26]

Claims

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

Issue	Description	Staff Recommendation
Reductions based on asserted flaws in the development of indirect cost rates.	The claimant asserts that the Controller incorrectly reduced indirect costs claimed on grounds that the claimant utilized prior year cost data to develop its indirect cost rates under FAM-29C and included capital costs rather than depreciation expenses. Claimant argues that the Parameters and Guidelines are silent with respect to whether current or prior year costs may be used to develop indirect cost rates, and that the claimant was not on notice that depreciation expenses were required, instead of capital costs. Claimant further argues that the claiming instructions are not enforceable, and the recalculation of	*Correct* – To the extent the Controller's reduction is based in part on the claimant's use of the prior year's CCFS-311 financial reporting, rather than the current year data, which the claimant was required to provide to the Chancellor's Office, and did provide in each claim year at least fifty-eight days prior to the deadline for filing annual claims, the reduction is correct as a matter of law, because the prior year

[23] *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

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

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

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

	indirect costs by the Controller was arbitrary and capricious.	financial reporting does not reflect actual costs incurred in the claim year, as required by Government Code sections 17560 and 17564. The Controller's subsequent recalculation of indirect costs using its preferred FAM-29C methodology is not arbitrary, capricious, or entirely lacking in evidentiary support.
Reductions based on understated offsetting revenues from student health fees.	Claimant asserts that the Controller incorrectly reduced costs claimed based on the Controller's application of health service fees that the claimant was authorized to collect, but did not, as offsetting revenue. Specifically, the claimant asserts that some of its students do not have practical or reasonable access to health services at the campus at which they attend classes, and therefore those students are not subject to the health services fees.	*Correct* – In *Clovis Unified School District v. Chiang* (2010) 188 Cal.App.4th 794, the court held that to the extent a local agency or school district "has the authority" to charge for the mandated program or increased level of service, that charge cannot be recovered as a state-mandated cost. Moreover, the Commission finds that in accordance with *Clovis Unified* and *Connell v. Superior Court* (1997) 59 Cal.App.4th 382, a practical or economic impairment to the collection of a fee or other offsetting revenue does not necessarily also constitute a legal impediment to the authority of the local government entity to levy that fee. Fee "authority" is to be interpreted broadly, and Education Code section 76355 does not permit an exemption for students that do not have practical access to health services at the campus location where they attend classes.

Staff Analysis

A. The Controller's Reduction and Recalculation of Indirect Costs Is Correct as a Matter of Law and Is Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The first final audit report stated a total disallowance of $167,604 for the audit period.[27] The disallowance determination was based on the claimant's failure to use the current year's financial reporting information, the CCFS-311; the omission of capital costs for fiscal year 2003-2004; the substitution of depreciation expenses in lieu of capital costs for fiscal years 2004-2005 and 2005-2006; and an asserted incorrect allocation of direct and indirect costs for fiscal year 2006-2007. The revised final audit report did not alter the Controller's determinations with respect to the use of the prior year's CCFS-311 report, or the findings that direct and indirect costs were not allocated consistently with the claiming instructions, but did find that depreciation expenses were required to be added to the indirect cost calculation beginning in fiscal year 2004-2005, which reduced the disallowance for the latter part of the audit period from $106,444 to $18,053, for a total of $79,213 for the entire audit period.[28]

The claimant disputes these adjustments, arguing that claimants had no notice of the treatment of capital and depreciation costs at the time the annual claims were filed; that there is no enforceable requirement to use the most current CCFS-311; and that the claiming instructions with respect to the allocation of direct and indirect costs are not enforceable.[29] Furthermore, the claimant disputes the enforceability of the claiming instructions as a whole, arguing that "[n]either state law nor the parameters and guidelines make compliance with the Controller's claiming instructions a condition of reimbursement."[30] And finally, the claimant asserts that the Controller has not made a determination that the claimed indirect cost rates were either excessive or unreasonable, and that the only available audit standard requires such a determination.[31]

Staff finds that the claimant is required to claim actual costs, along with indirect costs, for the current claim year. Accordingly, the Controller's reduction on the basis of claimant's use of the prior year's CCFS-311 financial report is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

The claimant alleges that as a practical matter the current year's financial report is often not available at the time annual claims are being prepared for filing. However, there is evidence in the record that the claimant submitted the annual CCFS-311 to the Chancellor's office not later than mid-November during the audit period.[32] In addition, regulations governing "Budgets and Reports" adopted by the Chancellor's Office require the governing board of each community

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[27] Exhibit A, IRC 09-4206-I-21, page 61 [Final Audit Report].

[28] Exhibit A, IRC 09-4206-I-21, page 61; Exhibit B, IRC 10-4206-I-36, page 26 [Revised Final Audit Report].

[29] Exhibit A, IRC 09-4206-I-21, pages 62-65 [Final Audit Report].

[30] Exhibit A, IRC 09-4206-I-21, page 16.

[31] Exhibit A, IRC 09-4206-I-21, page 63 [Final Audit Report].

[32] Exhibit C, Controller's Late Comments on the IRCs, page 16.

college district, by September 15 of each year, to prepare and keep on file for public inspection a statement of all receipts and expenditures for the *preceding fiscal year* and a statement of the estimated expenses for the current fiscal year.[33] Reimbursement claims for fiscal years 2003-2004, 2004-2005, and 2005-2006 were due to the Controller by January 15 of the following year, and for fiscal year 2006-2007, by February 15.[34] Thus, the actual expenditures for the claim years subject to audit were known and were required to be made available to the public before the deadline for filing the reimbursement claims at issue in this case.

Moreover, the Government Code and Parameters and Guidelines for this program require community college districts to claim reimbursement for the costs incurred for the fiscal year being claimed. Government Code section 17560 authorizes local agencies and school districts to file an annual reimbursement claim "that details the costs actually incurred *for that fiscal year*…." Government Code section 17564(b) states that "[c]laims for direct and indirect costs filed pursuant to Section 17561 shall be in the manner described in the parameters and guidelines…." Further, the Parameters and Guidelines require that "[a]ctual costs for one fiscal year should be included in each claim."[35] Thus, the requirement to calculate indirect costs for the claim year based on that year's actual expenses, which are known by the claimant, is supported by the law and evidence in the record.

Having determined that the Controller's reduction of indirect costs is correct as a matter of law, staff also finds that the recalculation using the Controller's FAM-29C method is not arbitrary, capricious, or entirely lacking in evidentiary support.

Even though the claimant incorrectly calculated indirect costs, the Controller did not reduce indirect costs to $0. Instead, the Controller recalculated the indirect cost rate for the four fiscal years using the FAM-29C methodology in accordance with the claiming instructions.[36] The Controller's recalculation resulted in indirect cost rates of 24.46 percent, 34.28 percent, 33.28 percent, and 35.02 percent for fiscal years 2003-2004, 2004-2005, 2005-2006, and 2006-2007, respectively.[37]

The standard of review which the Commission employs to review the Controller's audit provides that the Commission may "not reweigh the evidence or substitute its judgment for that of the agency."[38] Thus, the Commission cannot compel the Controller to use other auditing procedures in place of the form FAM-29C.

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[33] California Code of Regulations, title 5, section 58300.

[34] Former Government Code section 17560 (as amended, Stats. 1998, ch. 681 (AB 1963)). Government Code section 17560 was amended by Statutes 2007, chapter 179, to change the deadline for filing reimbursement claims from January 15 to February 15, effective August 24, 2007, which affected the reimbursement claims for costs incurred in fiscal year 2006-2007.

[35] Exhibit A, IRC 09-4206-I-21, page 31.

[36] Exhibit A, IRC 09-4206-I-21, page 62.

[37] *Ibid*.

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

Accordingly, the Commission finds the recalculation of indirect costs for fiscal years 2003-2004, 2004-2005, 2005-2006, and 2006-2007 is not arbitrary, capricious, or entirely lacking in evidentiary support.

B. The Controller's Reduction for Understated Offsetting Revenues Is Correct as a Matter of Law.

The Controller reduced the reimbursement claims by $1,145,224 for the four years at issue.[39] These reductions were made on the basis of the fee authority available to claimant, multiplied by the number of students subject to the fee, less the amount of offsetting revenue claimed.

The claimant argues that the Parameters and Guidelines only require a claimant to declare offsetting revenues that the claimant "experiences," and that while the fee amount that community college districts were authorized to impose may have increased during the applicable audit period, nothing in the Education Code made the increase of those fees mandatory. The claimant argues that the issue is the difference between fees collected and fees collectible.

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 noted that, "[c]laimants can choose not to require these fees, but not at the state's expense.'"[40] Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.[41]

Here, the claimant also raises the issue whether students for whom no health services are available are students subject to the community college's fee authority. The claimant asserts that "Cerro Coso College and the Learning Centers do not collect student health service fees because no such services are provided at those locations."

The claimant's argument essentially rests on the premise that it would be impractical or unfair to charge health services fees to students that have no practical access to a community college district's health service center(s). But in accordance with the broad interpretation of the Health Fee Rule in *Clovis Unified*, the alleged unfairness to students does not render the fee authority legally untenable, or incapable of being applied as offsetting revenues.

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, and as applied to all students as authorized by law, and not just those that the claimant determines have reasonable or practical access to health services at the campus where they attend classes, is correct as a matter of law.

Conclusion

Pursuant to Government Code section 17551(d), staff finds that the reduction of indirect costs by $79,213 based on reduction and recalculation in accordance with the claiming instructions is correct as a matter of law, and is not arbitrary, capricious or entirely lacking in evidentiary support.

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[39] Exhibit A, IRC 09-4206-I-21, pages 16; 65.

[40] *Ibid.*

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

Staff further finds that the reduction of $1,145,224 based on health service fee authority is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.[42]

Staff Recommendation

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

[42] The total net reduction over four years is $762,882, based the Controller offsetting the understated health fee revenues against other unclaimed costs, which were not disputed by the claimant.

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Former Education Code Section 72246 (Renumbered as 76355)[43] Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1); and Statutes 1987, Chapter 1118 (AB 2336) Fiscal Years 2003-2004, 2004-2005, 2005-2006, and 2006-2007 Kern Community College District, Claimant.	Case No.: 09-4206-I-21 and 10-4206-I-36 *Health Fee Elimination* DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5, ARTICLE 7 (*Adopted January 27, 2017*)

DECISION

The Commission on State Mandates (Commission) heard and decided these consolidated Incorrect Reduction Claims (IRCs) during a regularly scheduled hearing on January 27, 2017. [Witness list will be included in the adopted Decision.]

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

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

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

[43] Statutes 1993, chapter 8.

Summary of the Findings

This analysis addresses these consolidated IRCs filed by Kern Community College District (claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during fiscal years 2003-2004 through 2006-2007 under the *Health Fee Elimination* program. Over the four fiscal years in question, reductions totaling $762,882 were made based on alleged understated offsetting health fees authorized to be collected and disallowed indirect cost rates.

The Commission finds that the Controller's reduction and recalculation of indirect costs for fiscal years 2003-2004 through 2006-2007 is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support, because the claimant was required to use the current claim year's CCFS-311 financial reporting information in order to claim actual costs for the claim year. Additionally, the Commission finds that the correct calculation and application of offsetting revenue from student health fees has been resolved by the *Clovis Unified* decision, and that a reduction to the extent of fee revenue *authorized*, rather than fee revenue collectible as a practical matter, is correct as a matter of law.[44]

COMMISSION FINDINGS

I. Chronology

01/05/2006	Claimant's fiscal year 2003-2004 and 2004-2005 claims were signed.[45]
01/09/2007	Claimant's fiscal year 2005-2006 claim was signed.[46]
02/09/2009	Claimant's fiscal year 2006-2007 claim was signed.[47]
04/24/2009	Controller issued a draft audit report.[48]
05/18/2009	Claimant responded by letter to the draft audit report.[49]
06/30/2009	Controller issued its final audit report for fiscal years 2003-2004 through 2006-2007.[50]
09/25/2009	Claimant filed IRC 09-4206-I-21.[51]

[44] The total net reduction for the audit period is only $762,882, because unclaimed student insurance costs for two of the four audit years were offset against the understated health fees.

[45] Exhibit A, IRC 09-4206-I-21, pages 183; 192.

[46] Exhibit A, IRC 09-4206-I-21, page 201.

[47] Exhibit A, IRC 09-4206-I-21, page 210.

[48] Exhibit A, IRC 09-4206-I-21, page 57.

[49] Exhibit A, IRC 09-4206-I-21, pages 57; 76.

[50] Exhibit A, IRC 09-4206-I-21, page 52.

[51] Exhibit A, IRC 09-4206-I-21, page 1.

08/20/2010	Controller issued revised final audit report for fiscal years 2003-2004 through 2006-2007.[52]
12/09/2010	Claimant filed IRC 10-4206-I-36.[53]
10/03/2014	Controller submitted late comments on consolidated IRCs.[54]
10/17/2014	Commission staff issued the Draft Proposed Decision.[55]

II. Background

Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts that voluntarily provided health supervision and services, direct and indirect medical and hospitalization services, or operation of student health centers to charge almost all students a health service fee not to exceed $7.50 for each semester or $5 for each quarter or summer session, to fund these services.[56] In 1984, the Legislature repealed the community colleges' fee authority for health services.[57] However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, in order to reauthorize the fee, at $7.50 for each semester (or $5 per quarter or summer session).[58]

In addition to temporarily repealing community college districts' authority to levy a health services fee, the 1984 enactment required any district that provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.[59] As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987,[60] the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of

[52] Exhibit B, IRC 10-4206-I-36, page 17.

[53] Exhibit B, IRC 10-4206-I-36, page 1.

[54] Exhibit C, Controller's Late Comments on the IRCs.

[55] Exhibit D, Draft Proposed Decision.

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

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

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

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

[60] Statutes 1987, chapter 1118.

January 1, 1988.[61] In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than $7.50 for each semester, or $5 for each quarter or summer session.[62] As a result, beginning January 1, 1988, all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services. In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.[63]

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

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

Controller's Audit and Summary of the Issues

The Controller reduced the reimbursement claims for costs allegedly incurred during fiscal years 2003-2004 through 2006-2007 under the *Health Fee Elimination* program, totaling $762,882. The following issues are in dispute:

- Reduction of indirect costs based on asserted faults in the development and application of indirect cost rates; and
- The amount of offsetting revenue to be applied from health service fee authority.

III. Positions of the Parties

Kern Community College District

In the first of two consolidated IRCs, the claimant asserts that the Controller incorrectly reduced costs claimed for fiscal years 2003-2004 through 2006-2007 totaling $814,081.[64] The claimant did not dispute the Controller's findings that the claimant understated student insurance costs and failed to support an item "recorded in its books as 'Out-indirect Cost (Expense),'" resulting in a net increase in the reimbursement claim of $207,646 in direct costs and $81,904 in related indirect costs.[65] However, the claimant disputes the Controller's adjustment of $167,604 in

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

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

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

[64] Exhibit A, IRC 09-4206-I-21, page 2.

[65] Exhibit A, IRC 09-4206-I-21, pages 10; 60.

indirect costs, on the ground that indirect costs were not correctly calculated consistently with the claiming instructions; and the Controller's finding that the claimant understated authorized health fee revenues by $1,145,224 for the audit period.[66]

Subsequent to the final audit report and the filing of the first incorrect reduction claim, the Controller revised some of its findings and issued a revised audit report. In response to the revised audit report, the claimant filed the second of two consolidated IRCs, asserting that the Controller incorrectly reduced costs claimed for fiscal years 2003-2004 through 2006-2007, totaling $762,882.[67] Although some costs were reinstated, or recalculated, the substantive grounds of dispute are largely unchanged from the original final audit report and the first of the two consolidated IRCs. Specifically, the claimant asserts that the reduction of $79,213 in overstated indirect costs on grounds that the claimant "did not correctly compute the FAM-29C rate" was incorrect. The claimant argues that the claiming instructions are not enforceable, and that the claimant's indirect cost rate was developed using the same source document as the Controller used, but using the prior year's documentation, while the Controller recalculated the rates with the more recent documentation. In addition, the claimant argues that the Controller's finding that capital costs were to be excluded from the indirect cost computation, in favor of depreciation expenses, "was a result of a change in the Controller's audit policy…[and] Claimants were not on notice…"[68] Moreover, the claimant argues that the Controller did not make findings that the claimant's rate was excessive or unreasonable.[69]

And, the claimant argues that a reduction in the amount of $1,145,224, based on understated authorized health service fees, was incorrect, because the Parameters and Guidelines require claimants to state offsetting savings "experienced," and the claimant did not experience offsetting savings for fees that it did not charge to students or was unable to collect from students.[70] The claimant maintains that "[s]tudent health centers that are located hours away from the location where students attend classes are not practically available to those students," and therefore "the District did not actually have the authority to charge a health services fee to the students at Cero Coso [*sic*] College and the Learning Centers, and their enrollment cannot be included in calculating authorized health service fees."[71]

Because these adjustments were offset against other underclaimed amounts, the total net reduction is actually less than the adjustment made for offsetting revenues, as shown above; the total net reduction for the audit period pursuant to the revised audit report, is $762, 882.

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[66] Exhibit A, IRC 09-4206-I-21, pages 10-16; 61-66.

[67] See Exhibit B, IRC 10-4206-I-36, page 2.

[68] Exhibit A, IRC 09-4206-I-21, page 63.

[69] Exhibit A, IRC 09-4206-I-21, pages 10-16.

[70] Exhibit A, IRC 09-4206-I-21, pages 66; 16-21. See Exhibit B, 10-4206-I-36, page 9.

[71] Exhibit A, IRC 09-4206-I-21, at pp. 19-21.

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The Controller determined in the first audit report that the claimant "understated allowable services and supplies by $207,646 for the audit period…[including] related indirect costs total[ing] $81,904."[72]

The Controller further asserted that the claimant overstated its indirect costs, finding that the claimant "did not correctly compute the FAM-29C rate."[73] The Controller first asserted, in its draft audit report, that the claimant had applied the OMB Circular A-21 method for calculating indirect costs for fiscal year 2003-2004, and that the OMB method was not permitted; however, the Controller revised that finding, and recognized that the claimant utilized the FAM-29C method, but still concluded that the indirect costs were not supported.[74] The Controller asserts that the claimant did not correctly calculate indirect costs based on the FAM-29C method for each of the four audit years, in part because the claimant included capital costs rather than depreciation expenses, and in part because the claimant used the prior years' financial and budget reporting (the CCFS-311 forms). With respect to the incorrect application of the FAM-29C, the Controller states that "the claiming instructions for FY 2004-05 and FY 2005-06 both state…that 'indirect cost rate computation(s) include any depreciation or use allowance applicable to district buildings and equipment,'" and that therefore the claimant's indirect cost rates were not calculated consistently with the claiming instructions. With respect to the use of the prior year's financial reporting information, the Controller states that "there are no mandate-related authoritative criteria supporting this methodology."[75] In the revised audit report the grounds for reduction of indirect costs are not changed, but the amount of the reduction was revised from $167,604 to $79,213, on the basis of including allowable depreciation expenses.[76]

The Controller also found that the claimant understated its authorized health service fees for the audit period in the amount of $1,145,224. Using enrollment and exemption data, the Controller recalculated the health fees that the claimant was authorized to collect, and reduced the claim by the amount not stated as offsetting revenues.[77] The Controller states: "We agree that community college districts may choose not to levy a health service fee or to levy a fee less that the authorized amount…[but] Education Code section 76355, subdivision (a) provides districts the *authority* to levy a fee."[78] The Controller concludes that: "To the extent that districts have authority to charge a fee, they are not required to incur a cost."[79] This finding is unchanged in the revised audit report.[80]

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[72] Exhibit A, IRC 09-4206-I-21, page 60.

[73] Exhibit A, IRC 09-4206-I-21, page 61.

[74] Exhibit A, IRC 09-4206-I-21, page 64.

[75] Exhibit A, IRC 09-4206-I-21, pages 64-65.

[76] Exhibit B, IRC 10-4206-I-36, page 29.

[77] Exhibit A, IRC 09-4206-I-21, page 66.

[78] Exhibit A, IRC 09-4206-I-21, page 71.

[79] Exhibit A, IRC 09-4206-I-21, page 72.

[80] Exhibit B, IRC 10-4206-I-36, page 35.

IV. Discussion

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

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

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6, of the California Constitution.[81] 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."[82]

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.[83] Under this standard, the courts have found that:

> When reviewing the exercise of discretion, "[t]he scope of review is limited, out of deference to the agency's authority and presumed expertise: 'The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]'" ... "In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . ." [Citations.] When making that inquiry, the " ' "court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "[84]

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

[82] *County of Sonoma v. Commission on State Mandates* (2000) 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

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

[84] *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 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.[85] In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[86]

A. The Controller's Reduction and Recalculation of Indirect Costs Is Correct as a Matter of Law and Is Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The first final audit report stated a total disallowance of $167,604 for the audit period.[87] The disallowance determination was based on the claimant's failure to use the current year's financial reporting information, the CCFS-311, when calculating costs using the FAM-29C method; the omission of capital costs for fiscal year 2003-2004; the substitution of depreciation expenses in lieu of capital costs for fiscal years 2004-2005 and 2005-2006; and an asserted incorrect allocation of direct and indirect costs for fiscal year 2006-2007. The revised final audit report did not alter the Controller's determinations with respect to the use of the prior year's CCFS-311 report, or the findings that direct and indirect costs were not allocated consistently with the claiming instructions, but did find that depreciation expenses were required to be added to the indirect cost calculation beginning in fiscal year 2004-2005, which reduced the disallowance for the latter part of the audit period from $106,444 to $18,053, for a total of $79,213 for the entire audit period.[88]

The claimant disputes these adjustments, arguing that claimants had no notice of the treatment of capital and depreciation costs at the time the annual claims were filed; that there is no enforceable requirement to use the most current CCFS-311; and that the claiming instructions with respect to the allocation of direct and indirect costs are not enforceable.[89] Furthermore, the claimant disputes the enforceability of the claiming instructions as a whole, arguing that "[n]either state law nor the parameters and guidelines make compliance with the Controller's claiming instructions a condition of reimbursement."[90] And finally, the claimant asserts that the Controller has not made a determination that the claimed indirect cost rates were either excessive or unreasonable, and that the only available audit standard requires such a determination.[91]

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

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

[87] Exhibit A, IRC 09-4206-I-21, page 61 [Final Audit Report].

[88] Exhibit A, IRC 09-4206-I-21, page 61; Exhibit B, IRC 10-4206-I-36, page 26 [Revised Final Audit Report].

[89] Exhibit A, IRC 09-4206-I-21, pages 62-65 [Final Audit Report].

[90] Exhibit A, IRC 09-4206-I-21, page 16.

[91] Exhibit A, IRC 09-4206-I-21, page 63 [Final Audit Report].

Government Code section 17561(d) authorizes the Controller to audit the claims filed by local agencies and school districts and to reduce any claim for reimbursement of state mandated costs that the Controller determines is excessive or unreasonable. The Commission's review is limited to determining whether the Controller's audit decision was arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency, in the case of an adjudicatory decision for which the agency is not required to hold an evidentiary hearing.[92] Under this standard, the courts have found that:

> When reviewing the exercise of discretion, "[t]he scope of review is limited, out of deference to the agency's authority and presumed expertise: 'The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]'" ... "In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . ." [Citations.] When making that inquiry, the " ' "court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "[93]

Based on this standard of review, and giving due consideration to the Controller's audit authority, the Commission finds that the Controller's reduction and recalculation of indirect costs for fiscal years 2003-2004, 2004-2005, 2005-2006, and 2006-2007 is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support, because the claimant was required to use the current claim year's CCFS-311 financial reporting information to claim actual costs for the claim year.

1. The reduction of indirect costs for fiscal years 2003-2004, 2004-2005, 2005-2006, and 2006-2007, based on the claimant's use of expenditures from the prior year's CCFS-311 reports, instead of the expenditures incurred in the claim year, is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

The Parameters and Guidelines adopted for this program, in addition to identifying the reimbursable activities, provide instructions for eligible claimants to prepare reimbursement claims for the direct and indirect costs of a state-mandated program.[94] The Commission's adoption of parameters and guidelines is quasi-judicial and, therefore, the parameters and guidelines are final and binding on the parties unless set aside by a court pursuant to Government Code section 17559 or amended by the filing of a request pursuant to Government Code section 17557.[95] In this case, the Parameters and Guidelines for the *Health Fee Elimination* program

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[92] *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.

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

[94] Government Code section 17557; California Code of Regulations, title 2, section 1183.7.

[95] *California School Boards Assoc. v. State of California* (2009) 171 Cal.App.4th 1183, 1200, which stated the following: "[U]nless a party to a quasi-judicial proceeding challenges the

have not been challenged, and no party has requested they be amended. The Parameters and Guidelines are therefore binding and must be applied to the reimbursement claims here.

The Controller issues claiming instructions for mandated programs, which provide greater detail than the parameters and guidelines. The claiming instructions specific to the *Health Fee Elimination* mandate are found in the Community Colleges Mandated Cost Manual, which is revised each year and contains claiming instructions applicable to all school and community college mandated programs. The cost manual issued by the Controller's Office in September 2004 governs the reimbursement claim filed for fiscal year 2003-2004.[96] That manual provides, in pertinent part:

> A community college has the option of using a federally approved rate, utilizing the cost accounting principles from Office of Management and Budget Circular A-21 "Cost Principles for Educational Institutions," or the Controller's methodology outlined in the following paragraphs.
>
> The Controller allows the following methodology for use by community colleges in computing an indirect cost rate for state mandates. The objective of this computation is to determine an equitable rate for use in allocating administrative support to personnel that performed the mandated cost activities claimed by the community college. This methodology assumes that administrative services are provided to all activities of the institution in relation to the direct costs incurred in the performance of those activities. Form FAM-29C has been developed to assist the community college in computing an indirect cost rate for state mandates. Completion of this form consists of three main steps:
>
> 1. The elimination of unallowable costs from the expenses reported on the financial statements.
>
> 2. The segregation of the adjusted expenses between those incurred for direct and indirect activities.
>
> 3. The development of a ratio between the total indirect expenses and the total direct expenses incurred by the community college.
>
> The computation is based on total expenditures as reported in "California Community Colleges Annual Financial and Budget Report, Expenditures by Activity (CCFS-311)." Expenditures classified by activity are segregated by the function they serve. Each function may include expenses for salaries, fringe benefits, supplies, and capital outlay.[97]

The mandated cost manual and claiming instructions issued for 2004-2005, and issued in December 2005, require claimants claiming under the state's FAM-29C method to exclude

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agency's adverse findings made in that proceeding, by means of a mandate action in superior court, those findings are binding in later civil actions." [Citation omitted.] See also, Government Code section 17557.

[96] Exhibit X, Community Colleges Mandated Cost Manual excerpt, issued September 2004.

[97] Exhibit X, Community Colleges Mandated Cost Manual excerpt, issued September 2004, page 17.

capital outlay, and include depreciation expenses, in an effort to align with the policies of the OMB Circular A-21:

> A CCD may claim indirect costs using the Controller's methodology (FAM-29C) outlined in the following paragraphs. If specifically allowed by a mandated program's P's & G's, a district may alternately choose to claim indirect costs using either (1) a federally approved rate prepared in accordance with Office of Management and Budget (OMB) Circular A-21, Cost Principles for Educational Institutions; or (2) a flat 7% rate.
>
> The SCO developed FAM-29C to be consistent with OMB Circular A-21, cost accounting principles as they apply to mandated cost programs. The objective is to determine an equitable rate to allocate administrative support to personnel who performed the mandated cost activities. The FAM-29C methodology uses a direct cost base comprised of salary and benefit costs and operating expenses. Form FAM-29C provides a consistent indirect cost rate methodology for all CCD's mandated cost programs.
>
> FAM-29C uses total expenditures that districts report in their California Community Colleges Annual Financial and Budget Report (CCFS-311), Expenditures by Activity for the General Fund – Combined. The computation excludes Capital Outlay and Other Outgo in accordance with OMB Circular A-21. The indirect cost rate computation includes any depreciation or use allowance applicable to district buildings and equipment. Districts calculate depreciation or use allowance costs separately from the CCFS-311 report and should calculate them in accordance with OMB Circular A-21.[98]

The claiming instructions for fiscal years 2005-2006 and 2006-2007 continue to provide similarly, with respect to the option for claiming a federal rate, and the exclusion of capital costs and inclusion of depreciation expenses.[99]

The claimant used the FAM-29C methodology, but used the expenditures from the prior year's CCFS-311 reports instead of the expenditures for the claim year. The Commission finds that the Controller's reduction, based on the claimant's use of expenditures from the prior year's CCFS-311 reports, instead of the expenditures incurred in the claim year, is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

Regulations governing "Budgets and Reports," adopted by the Chancellor's Office require the governing board of each community college district, by September 15 of each year, to prepare and keep on file for public inspection a statement of all receipts and expenditures for the *preceding fiscal year* and a statement of the estimated expenses for the current fiscal year.[100] After a public hearing, the district is required to adopt a final budget on or before September 15, and complete and adopt the annual financial and budget report (CCFS-311) by September 30 of

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[98] Exhibit X, Community Colleges Mandated Cost Manual excerpt, issued December 2005.

[99] Exhibit X, Community Colleges Mandated Cost Manual excerpt, issued December 2006; Community Colleges Mandated Cost Manual excerpt, issued October 2007.

[100] California Code of Regulations, title 5, section 58300.

each year. The annual CCFS-311 identifies all the district's actual revenues and expenditures from *the preceding fiscal year* and the estimated revenues and expenditures for the current fiscal year, and is considered a public record pursuant to the Government Code.[101] By October 10th of each year, the district is required to submit a copy of its adopted CCFS-311 to the Chancellor. In this case, the Controller contends that the claimant submitted its CCFS-311 report identifying 2003-2004 actual expenditures on November 18, 2004; its CCFS-311 report identifying 2004-2005 actual expenditures on November 15, 2005; its CCFS-311 for fiscal year 2005-2006 on November 1, 2006; and its CCFS-311 for fiscal year 2006-2007 on October 14, 2007.[102] The claimant has not disputed these allegations and, in any event, the claimant was required by the regulations to adopt the annual report identifying actual expenditures by September 30 – four months *before* the reimbursement claims were due for fiscal year 2003-2004 through 2005-2006. Reimbursement claims for fiscal years 2003-2004, 2004-2005, 2005-2006 were due to the Controller by January 15 of the following year.[103] Government Code section 17560 was amended by Statutes 2007, chapter 179, to change the deadline for filing reimbursement claims from January 15 to February 15, effective August 24, 2007, which affected the reimbursement claims for costs incurred in fiscal year 2006-2007. Thus, the actual expenditures for the claim years subject to audit were known and were required to be made available to the public before the deadline for filing the reimbursement claims at issue in this case.

Moreover, the Government Code and Parameters and Guidelines for this program require community college districts to claim reimbursement for the costs incurred for the fiscal year being claimed. Government Code section 17560 authorizes local agencies and school districts to file an annual reimbursement claim "that details the costs actually incurred *for that fiscal year*…." Government Code section 17564(b) states that "[c]laims for direct and indirect costs filed pursuant to Section 17561 shall be in the manner described in the parameters and guidelines…." Further, the Parameters and Guidelines require that "[a]ctual costs for one fiscal year should be included in each claim."[104] Thus, the requirement to calculate indirect costs for the claim year based on that year's actual expenses, which are known by the claimant, is supported by the law and evidence in the record.

The Commission finds that the Controller's reduction of indirect costs is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

2. <u>The Controller's recalculation of indirect costs using the FAM-29C is not arbitrary, capricious, or entirely lacking in evidentiary support</u>.

Even though the claimant incorrectly calculated indirect costs, the Controller did not reduce indirect costs to $0. Instead, the Controller recalculated the indirect cost rate for the four fiscal years using the FAM-29C methodology in accordance with the claiming instructions.[105] The

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

[102] Exhibit C, Controller's Late Comments on the IRCs, page 16.

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

[104] Exhibit A, IRC 09-4206-I-21, page 31.

[105] Exhibit A, IRC 09-4206-I-21, page 62.

Controller's recalculation resulted in indirect cost rates of 24.46 percent, 34.28 percent, 33.28 percent, and 35.02 percent for fiscal years 2003-2004, 2004-2005, 2005-2006, and 2006-2007, respectively.[106]

The claimant disputes the recalculation, which excludes capital costs from the calculation and replaces capital costs with depreciation expenses.[107] However, there is no evidence in the record that the Controller's recalculation is arbitrary, capricious, or totally lacking in evidentiary support. Since the claimant's calculation of indirect costs was based on its CCFS-311 from the preceding year, that calculation is incorrect in any event and the Controller had the choice of recalculating in accordance with FAM-29C or reducing to zero. Therefore, in accordance with the claiming instructions, the Controller excluded capital costs as required by OMB Circular A-21 (as dictated by the FAM-29C) and recalculated the indirect costs based on the claimant's actual costs.

As previously stated, the standard of review which the Commission employs to review the Controller's audit decisions provides that the Commission may "not reweigh the evidence or substitute its judgment for that of the agency."[108]

Accordingly, the Commission finds the recalculation of indirect costs for fiscal years 2003-2004, 2004-2005, 2005-2006, and 2006-2007 is not arbitrary, capricious, or entirely lacking in evidentiary support.

B. The Controller's Reduction for Understated Offsetting Revenues Is Correct as a Matter of Law.

The Controller determined that the claimant understated its authorized health fee revenues by $1,145,224 over the four fiscal years at issue.[109] These reductions were made on the basis of the fee authority available to claimant, multiplied by the number of students subject to the fee, less the amount of offsetting revenue claimed. The plain language of Education Code section 76355 provides authority to collect health fees for all students except those who depend exclusively on prayer for healing, those attending a community college under an approved apprenticeship training program, or those who demonstrate financial need.[110] For the audit period, the authorized fee amounts identified by the Chancellor ranged from $9 per student for summer and $12 for regular session to $12 for summer and $15 for regular session. The Controller states that it "obtained student enrollment and Board of Governors Grant (BOGG) recipient data…" and identified exempt students based on the information available, and multiplied those enrollment data by the authorized fee amounts for each semester during the audit period.[111] And finally, the Controller argues that "[t]he district had the ability to collect health fees from students at Cerro

[106] Exhibit A, IRC 09-4206-I-21, page 62.

[107] Exhibit A, IRC 09-4206-I-21, page 62.

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

[109] Exhibit A, IRC 09-4206-I-21, page 67; Exhibit B, IRC 10-4206-I-36, page 24.

[110] Education Code section 76355. See also, Exhibit A, IRC 09-4206-I-21, page 65 [Final Audit Report].

[111] Exhibit A, IRC 09-4206-I-21, pages 65-66.

Cost College [*sic*] and Learning Centers, even if no health centers were present." The Controller relies in part on a legal opinion issued by the Community Colleges Chancellor's Office, which states that "a health fee may be charged to students who take only online classes or who attend classes at sites away from where the health services center is physically located."[112]

The claimant disputes the reduction, arguing that the relevant Education Code provisions permit, but do not require, a community college district to levy a health services fee, and that "the draft audit report does not provide the statutory basis for the calculation of the [maximum] 'authorized' rate, nor the source of the legal basis for any state entity to 'authorize' student health services rates…"[113] In addition, the claimant argues that the Parameters and Guidelines require a community college district to deduct from its reimbursement claims "[a]ny offsetting savings that the claimant *experiences* as a direct result of this statute…" The claimant argues that "[s]tudent fees *actually collected* must be used to offset costs, but not student fees that could have been collected and were not..."[114]

Accordingly, the claimant argues that some of its students are not subject to the health services fee because there are no health services provided at the location or campus that those students attend.[115] The claimant argues that Education Code section 76355 "does not require community college district governing boards to provide a student health services program at every district location." The claimant reasons that if it does not provide student health services to those students at a particular campus or location, "there are no collected or collectible fees" for the students at that location.[116] The claimant asserts that "Cerro Coso College and the Learning Centers do not collect student health service fees because no such services are provided at those locations." Those facilities, the claimant asserts, "are located several hours from either the Porterville or Bakersfield college campuses where the student health service programs are located." The claimant continues, "[a]pparently, the Controller believes that Education Code Section 76355 grants community college districts the authority to charge a health service fee even if no health services are offered at all." The claimant holds that "[w]hile the Chancellor legal opinion [*sic*] is correct in pointing out that the student health fee is not a 'use' fee, in that it is not charged for actual usage of the student health services, it is a fee charged to maintain the availability of student health services." The claimant maintains that "[s]tudent health centers that are located hours away from the location where students attend classes are not practically available to those students," and therefore "the District did not actually have the authority to charge a health services fee to the students at Cero Coso [*sic*] College and the Learning Centers, and their enrollment cannot be included in calculating authorized health service fees."[117]

The claimant continues: "it is merely an opinion, and does not even cite the source of its conclusions regarding the health service fee authority, other that Education Code Section 76355

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[112] Exhibit A, IRC 09-4206-I-21, page 73.

[113] Exhibit A, IRC 09-4206-I-21, pages 67-68.

[114] Exhibit A, IRC 09-4206-I-21, page 69 [emphasis added].

[115] Exhibit A, IRC 09-4206-I-21, page 69.

[116] Exhibit A, IRC 09-4206-I-21, page 69.

[117] Exhibit A, IRC 09-4206-I-21, pages 20-21.

itself." The claimant cites to *Santa Clara Valley Transportation Authority v. Rea*,[118] for the proposition that an agency interpretation "is one among several tools available to the court…" and "it may be helpful, enlightening, even convincing…" but may also "sometimes be of little worth."[119] Here, the claimant argues "[t]he Chancellor's legal opinion may be considered, but it should be given little weight because it does not provide a legal basis for the conclusion in question, and the passage relied upon by the Controller appears contrary to the plain language of the statute."[120]

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

After the claimant filed the first of these two consolidated 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.[121] (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

[118] (2006) 140 Cal.App.4th 1303, 1314.

[119] Exhibit A, IRC 09-4206-I-21, pages 20-21 [citing *Santa Clara Valley Transportation Authority v. Rea* (2006) 140 Cal.App.4th 1303, 1314.].

[120] Exhibit A, IRC 09-4206-I-21, page 21.

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

> calculation produces an increase of one dollar ($1) above the existing fee, the fee may be increased by one dollar ($1).[122]

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.[123] The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered.[124] Therefore the *authority* to impose the health service fees increases automatically with the Implicit Price Deflator, as noticed by the Chancellor. Accordingly, the court in *Clovis Unified* upheld the Controller's use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. In making its decision the court noted 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.[125]

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.'"[126] Additionally, in responding to claimant's argument that, "since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission's P&G's,"[127] 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*.[128] (Italics added.)

Thus, pursuant to the court's decision in *Clovis Unified*, the Health Fee Rule used by the Controller to adjust reimbursement claims filed by claimant for the *Health Fee Elimination* program is valid. Since the *Clovis* case is a final decision of the court addressing the merits of

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[122] Education Code section 76355(d)(2) (Stats. 1993, ch. 8 (AB 46); Stats. 1993, ch. 1132 (AB 39); Stats. 1994, ch. 422 (AB 2589); Stats. 1995, ch. 758 (AB 446); Stats. 2005, ch. 320 (AB 982)) [Formerly Education Code section 72246(e) (Stats. 1987, ch. 118)].

[123] See Education Code section 76355 (Stats. 1995, ch. 758 (AB 446)). The Implicit Price Deflator for State and Local Purchase of Goods and Services is a number computed annually (and quarterly) by the United States Department of Commerce as part of its statistical series on measuring national income and product, and is used to adjust government expenditure data for the effect of inflation.

[124] See, e.g., Exhibit X, Memorandum from Chancellor.

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

[126] *Ibid.*

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

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

the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.[129] In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.[130] Collateral estoppel applies when (1) the issue necessarily decided in the previous proceeding is identical to the one that is currently being decided; (2) the previous proceeding terminated with a final judgment on the merits; (3) the party against whom collateral estoppel is asserted is a party to or in privity with a party in the previous proceeding; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue.[131] Although the claimant in this IRC was not a party to the *Clovis* action, the claimant is in privity with the petitioners in *Clovis*. "A party is adequately represented for purposes of the privity rule if his or her interests are so similar to a party's interest that the latter was the former's virtual representative in the earlier action."[132]

With respect to the Chancellor's opinion of the scope of districts' fee authority, the Commission finds that as the agency responsible for overseeing the community college system, the interpretation of the Chancellor of the California Community Colleges office is entitled to great weight; 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."[133] While the Commission has exclusive jurisdiction to determine the existence of a state mandate, and by extension to consider whether fee authority is sufficient under Government Code section 17556 to reduce or eliminate reimbursement of a mandate, the Commission is, like a court, expected to give deference to an agency with expertise in a particular matter.

Moreover, *Clovis Unified*, and *Connell* before it, interpret fee authority broadly, and in terms of statutory "*authority, i.e.*, the right or the power, to levy fees…"[134] In *Connell v. Superior Court*[135] a water district argued that fee authority available under law was not "sufficient" fee authority because the fees necessary to offset the costs of the mandate were not economically feasible. The court rejected this argument:

> The Districts in effect ask us to construe "authority," as used in the statute, as a practical ability in light of surrounding economic circumstances. However, this construction cannot be reconciled with the plain language of the statute and would create a vague standard not capable of reasonable adjudication. Had the

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

[130] The petitioners in the *Clovis* case included Clovis Unified School District, El Camino Community College District, Fremont Unified School District, Newport-Mesa Unified School District, Norwalk-La Mirada Unified School District, Riverside Unified School District, San Mateo Community College District, Santa Monica Community College District, State Center Community College District, and Sweetwater Union High School District.

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

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

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

[134] *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812 [emphasis added].

[135] *Connell v. Superior Court* (1997) 59 Cal.App.4th 382.

> Legislature wanted to adopt the position advanced by the Districts, it would have used "reasonable ability" in the statute rather than "authority."[136]

Here, the claimant's argument essentially rests on the premise that it would be impractical or unfair to charge health services fees to students that have no practical access to a community college district's health service center(s). But in accordance with *Connell*, and with the broad interpretation of the Health Fee Rule in *Clovis Unified*, the alleged unfairness to students does not render the fee authority legally untenable, or incapable of being applied as offsetting revenues. As in Connell, "[t]he question is whether the [Community College] Districts have authority, i.e., the right or power, to levy fees…" Here, based on the plain language of section 76355, only students identified in the statute are exempt from the health service fees, and the practical ability to access one of the district's health services centers is not one of the qualifying criteria. Moreover, as the Chancellor explained, the health services fee is not a use fee, but is intended to maintain availability of health services, and may be levied even upon students who take only online courses or take courses at facilities that do not have health centers.[137]

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, and as applied to all students, not just those that the claimant determines have reasonable or practical access to health services at the campus where they attend classes, is correct as a matter of law.

V. Conclusion

The Commission finds that the Controller's reduction of costs based on understated health service fees and overstated indirect costs is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

Based on the foregoing, the Commission denies these consolidated IRCs.

[136] *Connell v. Superior Court* (1997) 59 Cal.App.4th 382, 401.

[137] See, Exhibit A, IRC 09-4206-I-21, pages 20-21; 142.

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

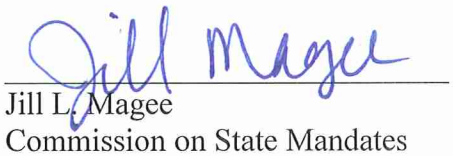
I am a resident of the County of Sacramento and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On October 17, 2016 I served the:

> **Draft Proposed Decision, Schedule for Comments, and Notice of Hearing**
> *Health Fee Elimination*, 09-4206-I-21 and 10-4206-I-36
> Former Education Code Section 72246 (Renumbered as 76355)
> Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1); and
> Statutes 1987, Chapter 1118 (AB 2336)
> Fiscal Years 2003-2004, 2004-2005, 2005-2006, and 2006-2007
> Kern Community College District, Claimant

by making it available on the Commission's website and providing notice of how to locate it to the email addresses provided on the attached mailing list.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on October 17, 2016 at Sacramento, California.



Jill L. Magee
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814
(916) 323-3562

COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 10/14/16

Claim Number: 09-4206-I-21 Consolidated with 10-4206-I-36

Matter: Health Fee Elimination

Claimant: Kern Community College District

TO ALL PARTIES, INTERESTED PARTIES, AND INTERESTED PERSONS:

Each commission mailing list is continuously updated as requests are received to include or remove any party or person on the mailing list. A current mailing list is provided with commission correspondence, and a copy of the current mailing list is available upon request at any time. Except as provided otherwise by commission rule, when a party or interested party files any written material with the commission concerning a claim, it shall simultaneously serve a copy of the written material on the parties and interested parties to the claim identified on the mailing list provided by the commission. (Cal. Code Regs., tit. 2, § 1181.3.)

Socorro Aquino, *State Controller's Office*
Division of Audits, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 322-7522
SAquino@sco.ca.gov

Lacey Baysinger, *State Controller's Office*
Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 324-0254
lbaysinger@sco.ca.gov

Thomas Burke, *Kern Community College District*
Claimant Representative
2100 Chester Avenue, Bakersfield, CA 93301
Phone: (661) 336-5117
tburke@kccd.edu

Marieta Delfin, *State Controller's Office*
Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 322-4320
mdelfin@sco.ca.gov

Donna Ferebee, *Department of Finance*
915 L Street, Suite 1280, Sacramento, CA 95814
Phone: (916) 445-3274
donna.ferebee@dof.ca.gov

Susan Geanacou, *Department of Finance*
915 L Street, Suite 1280, Sacramento, CA 95814
Phone: (916) 445-3274
susan.geanacou@dof.ca.gov

Rebecca Hamilton, *Department of Finance*
Education Systems Unit, 915 L Street, 7th Floor, Sacramento, CA 95814
Phone: (916) 445-0328
Rebecca.Hamilton@dof.ca.gov

Ed Hanson, *Department of Finance*
Education Systems Unit, 915 L Street, 7th Floor, Sacramento, CA 95814
Phone: (916) 445-0328
ed.hanson@dof.ca.gov

Jill Kanemasu, *State Controller's Office*
Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 322-9891
jkanemasu@sco.ca.gov

Dan Kaplan, Fiscal & Policy Analyst, *Legislative Analyst's Office*
925 L Street, Suite 1000, Sacramento, CA 95814
Phone: (916) 319-8353
Dan.Kaplan@lao.ca.gov

Anne Kato, *State Controller's Office*
Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 324-5919
akato@sco.ca.gov

Jay Lal, *State Controller's Office (B-08)*
Division of Accounting & Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 324-0256
JLal@sco.ca.gov

Yazmin Meza, *Department of Finance*
915 L Street, Sacramento, CA 95814
Phone: (916) 445-0328
Yazmin.meza@dof.ca.gov

Robert Miyashiro, *Education Mandated Cost Network*
1121 L Street, Suite 1060, Sacramento, CA 95814
Phone: (916) 446-7517
robertm@sscal.com

Andy Nichols, *Nichols Consulting*
1857 44th Street, Sacramento, CA 95819
Phone: (916) 455-3939
andy@nichols-consulting.com

Christian Osmena, *Department of Finance*
915 L Street, Sacramento, CA 95814
Phone: (916) 445-0328
christian.osmena@dof.ca.gov

Arthur Palkowitz, *Artiano Shinoff*
2488 Historic Decatur Road, Suite 200, San Diego, CA 92106
Phone: (619) 232-3122
apalkowitz@as7law.com

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

Phone: (916) 419-7093
kbpsixten@aol.com

Sandra Reynolds, *Reynolds Consulting Group,Inc.*
P.O. Box 894059, Temecula, CA 92589
Phone: (951) 303-3034
sandrareynolds_30@msn.com

Carla Shelton, *Commission on State Mandates*
980 9th Street, Suite 300, Sacramento, CA 95814
Phone: (916) 327-6490
carla.shelton@csm.ca.gov

Jim Spano, Chief, Mandated Cost Audits Bureau, *State Controller's Office*
Division of Audits, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 323-5849
jspano@sco.ca.gov

Dennis Speciale, *State Controller's Office*
Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816
Phone: (916) 324-0254
DSpeciale@sco.ca.gov

William Tunick, Attorney , *Dannis Woliver Kelley*
275 Battery Street, Suite 1150, San Francisco, CA 94111
Phone: (415) 543-4111
wtunick@dwkesq.com