STATE OF CALIFORNIA
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 4, 2015

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

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: **Decision**
Health Fee Elimination, 09-4206-I-22
Education Code Section 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, and 2005-2006
Long Beach Community College District, Claimant

Dear Mr. Petersen and Ms. Kanemasu:

On July 24, 2015, the Commission on State Mandates adopted the decision on the above-entitled matter.

Sincerely,

Heather Halsey
Executive Director

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.) (AB2X 1) and Statutes 1987, Chapter 1118 (AB 2336) Fiscal Years 2003-2004, 2004-2005, and 2005-2006 Long Beach Community College District, Claimant.	Case Nos.: 09-4206-I-22 *Health Fee Elimination* DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5. ARTICLE 7 (*Adopted July 24, 2015*) (*Served August 4, 2015)*

DECISION

The Commission on State Mandates (Commission) heard and decided this incorrect reduction claim (IRC) during a regularly scheduled hearing on July 24, 2015.

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 the proposed decision on consent to deny the IRC. Commission member Saylor was not present at the hearing.

Summary of the Findings

This analysis addresses reductions made by the State Controller's Office (Controller) to Long Beach Community College District's (claimant's) reimbursement claims for fiscal years 2003-2004, 2004-2005, and 2005-2006 under the *Health Fee Elimination* program. Over the three fiscal years in question, the Controller reduced costs totaling $672,695. The Controller found that claimant incorrectly calculated the indirect cost rate for the 2003-04 fiscal year and under-reported offsetting health service fee revenue authority for the three fiscal years at issue.

Pursuant to Government Code section 17551(d), the Commission concludes that the audit of the 2003-2004 reimbursement claim was timely, and that the following reductions are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support:

- $74,504 in indirect costs claimed for fiscal year 2003-04 is correct because claimant used the OMB Circular A-21 methodology, but did not obtain federal approval for its indirect cost rate proposals.
- $639,989 in offsetting fee authority due to claimant's reporting of offsetting revenue collected, rather than the amount authorized to be charged.

Accordingly, the Commission denies this IRC.

COMMISSION FINDINGS

I. Chronology

12/13/2004 Transmittal letter for claimant's fiscal year 2003-2004 reimbursement claim was signed.[1]

01/17/2006 Transmittal letter for claimant's fiscal year 2004-2005 reimbursement claim was signed.[2]

06/26/2007 Transmittal letter for claimant's fiscal year 2005-2006 reimbursement claim was signed.[3]

10/16/2008 The audit entrance conference was conducted.[4]

06/26/2009 The Controller, Division of Audits, issued its final audit report.[5]

09/24/2009 Claimant filed this incorrect reduction claim.[6]

10/24/2012 The Controller, Division of Audits, issued its revised final audit report.[7]

11/26/2014 The Controller filed comments on the incorrect reduction claim.[8]

05/01/2015 Commission staff issued the draft proposed decision.[9]

05/07/2015 The Controller submitted comments on the draft proposed decision.[10]

05/20/2015 The claimant submitted comments on the draft proposed decision.[11]

II. Background

Health Fee Elimination Program

[1] Exhibit A, Incorrect Reduction Claim, p. 101; Exhibit B, Controller's Comments on IRC, p. 20. (References to page numbers are to the PDF page number.)

[2] Exhibit A, Incorrect Reduction Claim, p. 110.

[3] Exhibit A, Incorrect Reduction Claim, p. 118.

[4] Exhibit A, Incorrect Reduction Claim, p. 20; Exhibit B, Controller's Comments on IRC, p. 20.

[5] Exhibit A, Incorrect Reduction Claim, p. 50.

[6] Exhibit A, Incorrect Reduction Claim, p. 1.

[7] Exhibit E, Claimant's Comments on Draft Proposed Decision, p. 9. The revised report removes the offset of authorized health service fees against the costs of athlete physicals, in response to the Commission decisions issued on October 27, 2011. As a result, allowable costs increased by $4,032 for the audit period.

[8] Exhibit B, Controller's Comments on IRC, p. 1.

[9] Exhibit C, Draft Proposed Decision.

[10] Exhibit D, Controller's Comments Draft Proposed Decision.

[11] Exhibit E, District's Comments on Draft Proposed Decision.

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.[12] In 1984, the Legislature repealed the community colleges' fee authority for health services.[13] However, Legislature also reenacted section 72246, to become operative on January 1, 1988, to reauthorize the fee at $7.50 for each semester (or $5 per quarter or summer semester).[14]

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 districts were previously authorized to charge a fee, to maintain the health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.[15] As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987, the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.[16] In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than $7.50 for each semester, or $5 for each quarter or summer semester.[17] 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.[18] In 1992, section 72246 was amended

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[12] 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.].

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

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

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

[16] 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).

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

[18] In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar. (Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355. (Stats. 1993, ch. 8).

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.[19]

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

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

Controller's Audit and Summary of the Issues

The claimant submitted reimbursement claims totaling $869,531 for costs incurred in fiscal years 2003-2004, 2004-2005, and 2005-2006. The Controller issued a final audit report on June 26, 2009, reducing the claims by $676,727.[20] On October 24, 2012, the Controller issued a revised final audit report, which reinstated $4,032 to the claimant. The revised final audit report explains the revision as follows:

> This revised final report supersedes our previous report dated June 26, 2009. Our original report offset authorized health service fees against all allowable mandated costs claimed by the district. On October 27, 2011, the Commission on State Mandates (CSM) issued a statement of decision in response to multiple incorrect reduction claims filed for the Health Fee Elimination Program. In its statement of decision, the CSM concluded that authorized health service fees may not be offset against the cost of athlete physicals. This revised report offsets authorized health service fees against all allowable costs claimed, excluding costs attributable to athlete physicals. As a result, allowable costs increased by $4,032 for the audit period.[21]

The revised final audit report reduces the reimbursement claims by $672,695for the following reasons:

- Reduction of $74,504 for fiscal year 2003-2004 based on asserted faults in the development and application of the indirect cost rate. The claimant developed the indirect cost rate proposal based on the OMB Circular A-21 methodology, but did not obtain federal approval for its proposal. The Controller recalculated indirect costs using the FAM-29C methodology allowed in the claiming instructions.[22]

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[19] 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).

[20] Exhibit E, Revised Final Audit Report, p. 8.

[21] Exhibit E, Revised Final Audit Report, p. 9.

[22] Exhibit A, Incorrect Reduction Claim, p. 58 (Finding 1, Final Audit Report).

- Reduction of $639,989 for fiscal years 2003-2004, 2004-2005, and 2005-2006 based on offsetting health service fee revenue authorized to be charged, rather than the amount collected by claimant. The Controller recalculated authorized health fee revenue by using student enrollment data that the claimant reported to the Chancellor's Office and health service fee waivers that the claimant's records supported.[23]

III. Positions of the Parties

Long Beach Community College District

Claimant asserts that the Controller's reduction of $74,504 in overstated indirect costs on the basis that "the District's indirect cost was not federally approved"[24] is incorrect. Claimant argues that the claiming instructions are "a statement of the Controller's interpretation and not law...."[25] Claimant also asserts that there is no requirement in law that claimant's indirect costs be claimed by the manner specified by the Controller,[26] and the Controller did not make findings that claimant's rate was excessive or unreasonable.[27] Claimant also asserts that a reduction of $639,989, based on understated authorized health service fees was incorrect, because the parameters and guidelines require claimants to state offsetting savings "experienced," and claimant did not experience offsetting savings for fees that it did not charge to students.[28] The claimant also challenged the validity of the audit as to the 2003-2004 fiscal year based on the statutory deadlines applicable to the audit.[29] Claimant filed comments on the draft decision reiterating the above arguments, and submitting a revised final audit report issued by the Controller on October 24, 2012.[30]

State Controller's Office

The Controller argues that the IRC should be denied. The Controller asserts that claimant overstated its indirect costs for fiscal year 2003-2004 because claimant used the federal OMB Circular A-21, but did not obtain federal approval for its indirect cost rate proposal, as required by the Controller's claiming instructions and by OMB Circular A-21. The Controller asserts that its recalculation of claimant's indirect cost rate using the state Form FAM-29C was reasonable.

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[23] The total amount reduced includes an audit adjustment of $42,246 for a late filing penalty and for audit adjustments that exceeded the costs claimed. (Exhibit E, Revised Final Audit Report, p. 17.) See also, Exhibit A, Incorrect Reduction Claim, p. 61 (Finding 2, Final Audit Report); Exhibit B, Controller's Comments on IRC, pp. 18-20.

[24] Exhibit A, Incorrect Reduction Claim, p. 10.

[25] Exhibit A, Incorrect Reduction Claim, pp. 10-11; Exhibit E, Claimant's Comments on Draft Proposed Decision, p. 5.

[26] Exhibit A, Incorrect Reduction Claim, p. 11.

[27] Exhibit A, Incorrect Reduction Claim, p. 13.

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

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

[30] Exhibit E, Claimant's Comments on Draft Proposed Decision.

The Controller further found that claimant understated its authorized health service fees for the audit period by $639,989. Using enrollment and exemption data, the Controller recalculated the health fees that claimant was authorized to collect, and reduced the claim by the amount not stated as offsetting revenues.[31] The Controller argues that, "to the extent community college districts can charge a fee, they are not required to incur a cost."[32]

The Controller asserts that because the claimant had not received payment for the 2003-2004 fiscal year claim, the requirements of Government Code section 17558.5(a) were met when it initiated its audit on October 16, 2008.[33]

IV. Discussion

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

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

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[34] 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."[35]

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

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[31] Exhibit A, Incorrect Reduction Claim, p.61.

[32] Exhibit B, Controller's Comments on IRC, p. 20.

[33] Exhibit B, Controller's Comments on IRC, p. 22.

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

[35] *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.

[36] *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.

> 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.]' "[37]

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. [38] In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[39]

A. The Controller Met the Statutory Deadlines for the 2003-2004 Fiscal Year Audit Imposed by Government Code Section 17558.5.

1. The audit was timely initiated pursuant to Government Code section 17558.5.

The claimant asserts that the audit of the 2003-2004 claim was not timely initiated under Government Code section 17558.5, based on the filing date of the reimbursement claim (December 13, 2004), and the date that the audit entrance conference took place nearly four years later (October 16, 2008).[40]

At the time the 2003-2004 reimbursement claim was filed in December 2004, Government Code section 17558.5 required the Controller to initiate an audit no later than three years after the claim is filed or last amended. However, if no funds are appropriated or no payment is made to the claimant for the program for the fiscal year at issue, the time for the Controller to initiate the audit is tolled to three years after the date of the initial payment of the claim. The statute reads as follows:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than three years after the date that the actual reimbursement claim is filed or last amended, whichever is later. *However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the*

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

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

[39] 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.

[40] Exhibit A, Incorrect Reduction Claim, p. 17.

claim is filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[41]

The Controller does not dispute the filing date of the 2003-2004 claim, or that the audit was not initiated until October 2008, but asserts that the time to audit was tolled pursuant to the second sentence in section 17558.5, since the 2003-2004 claim was not paid.[42]

The claimant agrees that no payment was made, but argues that the second sentence in section 17558.5, which delays the commencement of the time for the Controller to audit when no payment has been made, "is void because it is impermissibly vague."[43] Claimant asserts that the language "allows the Controller's own unilateral delay, or failure to make payments from funds appropriated for the purpose of paying the claims, to control the tolling of the statute of limitations, which is also contrary to the purpose of a statute of limitations."[44] Claimant argues that the December 13, 2004 filing date of the claim should control the time to audit, requiring that the audit be initiated no later than December 13, 2007. Since the audit was initiated with the entrance conference ten months past that date, on October 16, 2008, claimant asserts that the audit is void.

The Commission finds that the Controller timely initiated the audit of the 2003-2004 reimbursement claim. The fiscal year 2003-2004 reimbursement claim was filed on December 13, 2004, but the claim was not paid at the time the Controller started the audit in October 2008. The Legislature deferred payment for the *Health Fee Elimination* program in fiscal year 2003-2004 by appropriating a nominal amount of $1,000 in the State Budget Act for the program[45] The Fourth District Court of Appeal in *California School Boards Assoc. v. State of California*, concluded that "the Legislature's practice of nominal funding of state mandates [by appropriating $1,000] with the intention to pay the mandate in full with interest at an unspecified time *does not constitute a funded mandate under the applicable constitutional and statutory provisions*." [46] Thus, the $1,000 appropriation was not considered a constitutionally sufficient appropriation to fund the program and essentially amounts no appropriation at all. The final audit report dated June 26, 2009, states that the allowable amount to be reimbursed will be paid "contingent upon available appropriations." [47]

Despite claimant's allegations that Statutes 2002, chapter 1128, which amended Government Code section 17558.5 to allow the tolling of the audit when funds are not appropriated or payment has not been made, is void because it is allegedly "impermissibly vague," the statute is a duly enacted statute and must be presumed valid and constitutional.[48] Article III, section 3.5 of

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[41] Statutes 2002, chapter 1128, effective January 1, 2003, emphasis added.

[42] Exhibit B, Controller's Comments on IRC, p. 22.

[43] Exhibit A, Incorrect Reduction Claim, p. 20.

[44] Exhibit E, Claimant's Comments on Draft Proposed Decision, p. 1.

[45] Statutes 2003, chapter 157, Item 6870-295-0001, schedule 1.

[46] (2011) 192 Cal.App.4th 770, 791, emphasis added.

[47] Exhibit A, Incorrect Reduction Claim, p. 50.

[48] *Kraus v. Trinity Management Services, Inc.* (2000) 23 Cal.4th 116, 129.

the California Constitution states that an administrative agency has no power "[t]o declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional…." Moreover, once funds are appropriated for the program for the fiscal year(s) at issue, the Government Code plainly requires the Controller to pay any eligible claim within 15 days and does not allow the Controller to unilaterally delay payment of a claim, as asserted by the claimant. Government Code section 17561(d), as applicable to the fiscal year at issue, states "[t]he Controller shall pay any eligible claim pursuant to this section within 60 days after the filing deadline for claims for reimbursement *or 15 days after the date the appropriation for the claim is effective, whichever is later*...."[49] In the event that the amount appropriated for reimbursement pursuant to Government Code section 17561 is not sufficient to pay all of the claims approved by the Controller, the Controller is required "to prorate claims in proportion to the dollar amount of approved claims timely filed and on hand at the time of proration."[50]

Therefore, the Commission finds that the time to initiate the audit in this case had not commenced to run, and the audit initiated no later than October 16, 2008 was timely.

2. The audit was timely completed pursuant to Government Code section 17558.5.

The Commission further finds that the audit of the reimbursement claims at issue in this case was timely completed. Government Code section 17558.5 was amended, effective January 1, 2005, before the audit was initiated, adding a deadline for the Controller to complete an audit not later than two years after it is commenced:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than three years after the date that the actual reimbursement claim is filed or last amended, whichever is later. However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the claim is filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim. <u>In any case, an audit shall be completed not later than two years after the date that the audit is commenced.</u>[51]

The courts have held that where the state gives up a right previously possessed by it or one of its agencies (e.g., the Controller's having no statutory deadline to complete an audit before Jan. 1, 2005), the restriction in the new law becomes effective immediately upon the operative date of the change in law for all pending claims.[52]

Here, the Controller's audit of the relevant claim years was "commenced," within the meaning of section 17558.5, no later than October 16, 2008, when the entrance conference was held. Therefore, a timely audit must be completed by October 16, 2010. The audit was completed

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[49] Government Code section 17561(d), as amended by Statutes 2002, chapter 1124, emphasis added.

[50] Government Code section 17567, as last amended by Statutes 2007, chapter 179.

[51] Statutes 2004, chapter 890.

[52] *California Employment Stabilization Commission v. Payne* (1948) 31 Cal.2d 210, 215-216.

when the final audit report was issued on June 26, 2009, well before the two year deadline of October 16, 2010, to complete the audit.

The Controller also issued a revised audit report modifying the original "final" audit report to reinstate $4,032 to the claimant on October 24, 2012, approximately four years after the audit was initiated. The revised audit report falls outside the statutory two year completion requirement imposed by Government Code section 17558.5, as amended by Statutes 2004, chapter 890. Nevertheless, the Commission may take official notice of the revised audit report, since it mitigates the amount of the reduction originally asserted by the Controller. [53]

Based on the foregoing, the Commission finds that the audit was timely completed.

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

The Controller reduced indirect costs claimed by a total of $74,504 for fiscal year 2003-2004. Claimant used the OMB Circular A-21 to calculate its indirect cost rate, using expenditures from the prior year's CCFS-311 Annual Financial and Budget Report, but claimant failed to obtain federal approval as required by the claiming instructions and the OMB Circular A-21. The Controller recalculated indirect costs for fiscal year 2003-2004 using the state Form FAM-29C allowed in the claiming instructions.[54]

Claimant disputes the Controller's findings that the indirect cost rate proposal was incorrectly applied, charging that the Controller's conclusions were without basis in the law.

1. The parameters and guidelines expressly require claimants to claim indirect costs in the manner described in the Controller's claiming instructions, which in turn provide for an indirect cost rate developed in accordance with federal OMB Circular A-21 guidelines or the state Form FAM-29C.

If the Commission approves a test claim and determines there are costs mandated by the state, parameters and guidelines are required to be adopted to determine the amount to be subvened.[55] Parameters and guidelines, 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.[56] 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.[57] Claimants are

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[53] Code of Regulations, title 2, section 1187.5(c) ["Official notice may be taken in the manner and of the information described in Government Code section 11515."].

[54] Exhibit A, Incorrect Reduction Claim, p.58.

[55] Government Code section 17557.

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

[57] *California School Boards Assoc. v. State of California* (2009) 171 Cal.App.4th 1183, 1200, which stated the following: "[U]nless a party to a quasi-judicial proceeding challenges the agency's adverse findings made in that proceeding, by means of a mandate action in superior court, those findings are binding in later civil actions." [Citation omitted.]

required as a matter of law to file reimbursement claims in accordance with the parameters and guidelines.[58] Moreover, the parameters and guidelines cannot be amended by the Commission absent the filing of a request to amend the parameters and guidelines by a local government or state agency pursuant to Government Code section 17557. In this case, the parameters and guidelines for the *Health Fee Elimination* program have not been challenged, and no party has requested they be amended. The parameters and guidelines are therefore binding and must be applied to the reimbursement claims here.

Section VI of the parameters and guidelines provide that "*indirect costs may be claimed in the manner described by the State Controller in his claiming instructions*."[59] Claimant argues that the word "may" in the indirect cost language of the parameters and guidelines is permissive, and that therefore the parameters and guidelines do not require that indirect costs be claimed in the manner described by the Controller.[60]

Claimant's argument is unsound: the parameters and guidelines plainly state that "indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." The interpretation that is consistent with the plain language of the parameters and guidelines is that "indirect costs may be claimed," or may not, but if a claimant chooses to claim indirect costs, the claimant must adhere to the parameters and guidelines and claim indirect costs in the manner described in the Controller's claiming instructions.

Claimant also argues 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 Controller's interpretation and not law."[61] The parameters and guidelines, which were duly adopted at a Commission hearing and are regulatory in nature, require compliance with the claiming instructions. As indicated above, the parameters and guidelines, never having been challenged or amended at the request of the parties, are binding.

The claiming instructions specific to the *Health Fee Elimination* mandate, are found in the School Mandated Cost Manual which is revised each year and which also 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 the 2003-04 fiscal year reimbursement claim in this case.[62] This cost manual allows claimants to use the OMB Circular A-21 methodology with federal approval or the FAM-29C:[63]

> A community college has the option of using a federally approved rate, utilizing the cost accounting principles from ***Office of Management and Budget Circular***

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[58] Government Code sections 17561(d)(1); 17564(b); and 17571. See also, *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 799, finding that the parameters and guidelines are regulatory.

[59] Exhibit A, Incorrect Reduction Claim, p. 33.

[60] Exhibit A, Incorrect Reduction Claim, p. 10.

[61] Exhibit A, Incorrect Reduction Claim, pp. 10-11.

[62] Exhibit B, Controller's Comments on IRC, pp. 25-29.

[63] Exhibit B, Controller's Comments on IRC, p. 26.

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. . . .

[¶]

The [FAM-29C] computation is based on total expenditures as reported in "California Community Colleges Annual Financial and Budget Report, Expenditures by Activity (CCFS-311)." Expenditures classified by activity are segregated by the function they serve. Each function may include expenses for salaries, fringe benefits, supplies, and capital outlay. OMB Circular A-21 requires expenditures for capital outlays to be excluded from the indirect cost rate computation. [64]

Claimants who choose the OMB Circular A-21 methodology must obtain federal approval of the calculation for the proposed rate by the "cognizant federal agency" through formal negotiation, an informal correspondence process, or a simplified method which sets the indirect cost rate using a salaries and wage base.[65] The "cognizant federal agency," is normally either the Federal Department of Health and Human Services or the Department of Defense's Office of Naval Research.[66] The end result of the negotiation process is a sponsored agreement in which final approval lies with the federal government negotiating the rate and must be supported by "adequate documentation to support costs charged to sponsored agreements."[67]

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

2. Claimant did not comply with the requirements of the parameters and guidelines, claiming instructions, and the OMB Circular in developing and applying its indirect cost rate for 2003-2004. Therefore, the Controller's reduction is correct as a matter of law and the recalculation of the indirect cost rate using the FAM-29C was not arbitrary, capricious, or entirely lacking in evidentiary support.

Here, claimant applied the general principles of the OMB Circular A-21, but failed to negotiate with a federal agency to determine appropriate direct costs used to calculate the indirect costs

[64] Exhibit B, Controller's Comments on IRC, p. 26.

[65] Exhibit F, OMB Circular A-21, section G(11) pp.37-39.

[66] *Id.*

[67] Exhibit F, OMB Circular A-21, p 6.

rate. Thus, there has been no federal determination on whether the direct costs used would have received federal approval. The Controller, in auditing the indirect cost rate used by claimant, could therefore not determine whether claimant's direct costs used to calculate the indirect cost rate would have received federal approval or been rejected as including impermissible direct costs.[68] Thus, the reduction of costs is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

The Commission further finds that the Controller's recalculation of indirect costs using the FAM-29C is not arbitrary, capricious or entirely lacking in evidentiary support. The methodology is expressly allowed by the claiming instructions. The Controller's allowable rate was 17.00 percent for fiscal year 2003-2004.[69]

Accordingly, the Commission finds that the Controller's reduction is correct as a matter of law and the recalculation of the indirect cost rate using the state Form FAM-29C rate was not arbitrary, capricious, or entirely lacking in evidentiary support.

C. The Controller's Reduction for Understated Offsetting Revenues is Correct as a Matter of Law, and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced costs for the three fiscal years by $639,989 because claimant understated its offsetting health service fee authority and instead claimed only fees collected.[70] These reductions were made on the basis of the fee authority available to the claimant, multiplied by the number of students subject to the fee, less the amount of offsetting revenue claimed.

Claimant disputes the reduction, arguing that the relevant Education Code provisions permit, but do not require, a community college to levy a health services fee, and that the parameters and guidelines require a community college to deduct from its reimbursement claims "[a]ny offsetting savings that the claimant experiences as a direct result of this statute…."[71] The Claimant argues that "[i]n order for the district to 'experience' these 'offsetting savings' the District must actually have collected these fees."[72] Claimant concluded that "[s]tudent fees actually collected must be used to offset costs, but not student fees that could have been collected and were not."[73]

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

After claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge

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[68] Exhibit F, OMB Circular A-133 compliance supplement 2014, part 3, beginning at p.3-B-36, which addresses allowable and unallowable costs under OMB Circular A-21.

[69] Exhibit A, Incorrect Reduction Claim, p. 58.

[70] Exhibit A, Incorrect Reduction Claim, p. 14.

[71] Exhibit A, Incorrect Reduction Claim, p. 14.

[72] Exhibit A, Incorrect Reduction Claim, p. 15.

[73] Exhibit A, Incorrect Reduction Claim, p. 15.

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.[74] (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).[75]

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.[76]

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.'"[77] 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,"[78] the court held:

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

[75] 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)].

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

[77] *Ibid.*

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

> 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*.[79] (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 claimants for the *Health Fee Elimination* program is valid. Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.[80] In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.[81] 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.[82] Here, the claimant was in privity with parties to the *Clovis* action, and under principles of collateral estoppel, the court's decision is binding on the claimant with respect to these reimbursement claims.[83]

The Commission further finds that the Controller's recalculation of offsetting revenues authorized to be charged, using student enrollment data that claimant reported to the California Community College Chancellor's Office and student waiver data supported by claimant's records, was not arbitrary, capricious, or entirely lacking in evidentiary support. The Controller calculated the offsetting revenue using student enrollment and Board of Governors Grant (BOGG) recipient data obtained from the California Community Colleges Chancellor's Office.[84] For all terms, except Spring 2006, the number of enrolled students was reduced by the number of BOGG recipients, in order to calculate the number students who could have been charged a health fee.[85] This number was then multiplied by the authorized health service fee rate to

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

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

[81] 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.

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

[83] *Ibid*. 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.

[84] Exhibit A, Incorrect Reduction Claim, p. 61.

[85] Exhibit A, Incorrect Reduction Claim, pp. 61-62. The BOGG recipients were not deducted for Spring 2006 because, effective January 31, 2006 the exemption for the fee for BOGG recipients

determine the total authorized health service fee.[86] The CCCCO data is based on student data that the claimant reported. This data is a public record maintained by the claimant in the normal course of business, and claimant has provided no other documents to support the offsetting health service fee revenue authorized for this program.

Accordingly, the Commission finds that the Controller's reduction for understated offsetting revenues is correct as a matter of law, and not arbitrary, capricious or entirely lacking in evidentiary support.

V. Conclusion

Pursuant to Government Code section 17551(d), the Commission finds that the audit of the 2003-2004 reimbursement claim was timely, and that the reductions to the following costs are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support:

- $74,504 for fiscal year 2003-2004 because claimant developed the indirect cost rate proposal based on the OMB Circular A-21 methodology, but did not obtain federal approval.
- $639,989 for fiscal years 2003-2004, 2004-2005 and 2005-2006 based on offsetting health service fee revenue authorized to be charged, rather than the amount collected by claimant.

Based on the foregoing, the Commission denies this IRC.

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was removed in what was formerly Education Code section 76355(3)(c). [Education Code section 76355(c)(3) (Stats. 2005, ch. 320 (AB 982)).]

[86] Exhibit A, Incorrect Reduction Claim, pp. 61-62.

STATE OF CALIFORNIA
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

RE: **Decision**

Health Fee Elimination, 09-4206-I-22
Education Code Section 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, and 2005-2006
Long Beach Community College District, Claimant

On July 24, 2015, the foregoing decision of the Commission on State Mandates was adopted on the above-entitled matter.

Dated: August 4, 2015

Heather Halsey, Executive Director

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

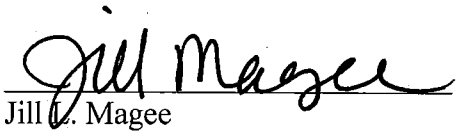
I am a resident of the County of Sacramento and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On August 4, 2015, I served the:

Decision
Health Fee Elimination, 09-4206-I-22
Education Code Section 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, and 2005-2006
Long Beach 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 August 4, 2015 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: 6/4/15

Claim Number: 09-4206-I-22

Matter: Health Fee Elimination

Claimant: Long Beach Community College District

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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

Julia Blair, Senior Commission Counsel, *Commission on State Mandates*
980 9th Street, Suite 300, Sacramento, CA 95814
Phone: (916) 323-3562
julia.blair@csm.ca.gov

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

Ann-Marie Gabel, *Long Beach Community College District*
4901 East Carson Street, Long Beach, CA 90808
Phone: (562) 938-4406
agabel@lbcc.edu

Susan Geanacou, *Department of Finance*
915 L Street, Suite 1280, Sacramento, CA 95814
Phone: (916) 445-3274

susan.geanacou@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

Cheryl Ide, Associate Finance Budget Analyst, *Department of Finance*
Education Systems Unit, 915 L Street, Sacramento, CA 95814
Phone: (916) 445-0328
Cheryl.ide@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

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

Jameel Naqvi, Analyst, *Legislative Analyst's Office*
Education Section, 925 L Street, Suite 1000, Sacramento, CA 95814
Phone: (916) 319-8331
Jameel.naqvi@lao.ca.gov

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, *Stutz Artiano Shinoff & Holtz*
2488 Historic Decatur Road, Suite 200, San Diego, CA 92106
Phone: (619) 232-3122
apalkowitz@sashlaw.com

Keith Petersen, *SixTen & Associates*
Claimant Representative
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

David Scribner, *Max8550*
2200 Sunrise Boulevard, Suite 240, Gold River, CA 95670
Phone: (916) 852-8970
dscribner@max8550.com

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