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COMMISSION ON STATE MANDATES
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February 10, 2016

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

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

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

Re: **Draft Proposed Decision, Schedule for Comments, and Notice of Hearing**
Health Fee Elimination, 09-4206-I-24 and 10-4206-I-34
Former Education Code Section 72246 (Renumbered as 76355)
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1);
Statutes 1987, Chapter 1118 (AB 2336)
Fiscal Years: 2002-2003, 2003-2004, 2004-2005, and 2005-2006
Foothill-DeAnza Community College District, Claimant

Dear Mr. Petersen and Ms. Kanemasu:

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

Written Comments

Written comments may be filed on the draft proposed decision by **March 2, 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. Please see http://www.csm.ca.gov/dropbox.shtml on the Commission's website for instructions on electronic filing. (Cal. Code Regs., tit. 2, § 1181.3.)

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

Hearing

This matter is set for hearing on **Friday, May 27, 2016**, at 10:00 a.m., State Capitol, Room 447, Sacramento, California. The proposed decision will be issued on or about May 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-24 (Consolidated with 10-4206-I-34)\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 2002-2003, 2003-2004, 2004-2005, and 2005-2006

09-4206-I-24 and 10-4206-I-34

Foothill-DeAnza Community College District, Claimant

EXECUTIVE SUMMARY

Overview

This analysis addresses the consolidated incorrect reduction claims (IRC) filed by Foothill-DeAnza Community College District (claimant) regarding net reductions of $284,615 made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during fiscal years 2002-2003 through 2005-2006 under the *Health Fee Elimination* program.[2]

The following issues are in dispute:

- The period of limitation applicable to audits by the Controller;
- The reduction of costs based on asserted faults in the development and application of indirect cost rates; and
- The amount of offsetting revenue to be applied from health service fee authority.

Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts that voluntarily provided health supervision and services, direct and indirect medical and hospitalization services, or operation of student health centers to charge almost all students a health service fee not to exceed $7.50 for each semester or $5 for each quarter or summer

[1] Statutes 1993, chapter 8.

[2] The total net reduction over four years is $284,615, based the Controller offsetting the understated health fee revenues against other unclaimed costs, which were not disputed by the claimant, and adjustments made to some of the reductions in the revised audit report.

session, to fund these services.[3] In 1984, the Legislature repealed the community colleges' fee authority for health services.[4] However, the Legislature also reenacted section 72246, operative on January 1, 1988, 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, the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.[7] In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than $7.50 for each semester, or $5 for each quarter or summer session.[8] As a result, beginning January 1, 1988 all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with limited fee authority to offset the costs of those services. In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.[9]

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[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.].

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

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

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

Procedural History

On January 12, 2005, claimant's fiscal year 2002-2003 and 2003-2004 claims were filed.[10] On December 13, 2005, claimant's fiscal year 2004-2005 claim was filed.[11] On July 2, 2007, claimant's fiscal year 2005-2006 claim was filed.[12]

On October 25, 2006, the fiscal year 2002-2003 claim was first paid by the Controller. The fiscal year 2003-2004, 2004-2005, and 2005-2006 claims have not been paid.[13]

On September 11, 2008, the audit entrance conference was held.[14] On May 20, 2009, the Controller issued its audit report.[15] On October 5, 2009, the claimant filed IRC 09-4206-I-24.[16] On August 18, 2010, the Controller issued a revised final audit report.[17] On November 22, 2010, the claimant filed IRC 10-4206-I-34.[18] On December 2, 2010, Commission staff issued the notice of complete filing and request for comments for 10-4206-I-34 and notice of consolidation of 09-4206-I-24 and 10-4206-I-34. On December 2, 2014, the Controller submitted late comments on the consolidated IRCs.[19]

Commission staff issued the draft proposed decision on February 10, 2016.

Commission Responsibilities

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

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

The Commission must review questions of law, including interpretation of parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes

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[10] Exhibit A, IRC 09-4206-I-24, page 18.

[11] Exhibit A, IRC 09-4206-I-24, page 136.

[12] Exhibit A, IRC 09-4206-I-24, page 145.

[13] Exhibit A, IRC 09-4206-I-24, page 72; Exhibit C, Controller's Late Comments on IRC, page 22; Exhibit B, IRC 10-4206-I-34, pages 27-28.

[14] Exhibit A, IRC 09-4206-I-24, page 18.

[15] Exhibit A, IRC 09-4206-I-24, page 9.

[16] Exhibit A, IRC 09-4206-I-24, page 1.

[17] Exhibit B, IRC 10-4206-I-34, page 6.

[18] Exhibit B, IRC 10-4206-I-34, page 1.

[19] Exhibit C, Controller's Late Comments on IRC.

over the existence of state-mandated programs within the meaning of article XIII B, section 6.[20] 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."[21]

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.[22]

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.[23] 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.[24]

Claims

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

Issue	Description	Staff Recommendation
The limitation period applicable to the Controller's audits of mandate reimbursement claims.	The claimant asserts that the fiscal year 2002-2003 and 2003-2004 claims, were filed and filed-as-amended, respectively, on January 12, 2005, and that therefore an audit entrance conference occurring on September 11, 2008 would not constitute timely initiation of the audit. The Controller argues that because the claims were not paid until October 25, 2006, the	*The audit was timely initiated and timely completed* – Section 17558.5 provides that if no payment is made on a reimbursement claim, the time to initiate an audit begins to run when initial payment is made: here, October 25, 2006. Thus the

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

[21] *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.

[22] *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.

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

[24] 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.

	three year period did not begin to run until that time, pursuant to Government Code section 17558.5.	audit entrance conference prior to October 25, 2009 was timely. In addition, section 17558.5 requires an audit to be completed within two years. Here, both the first final audit report and the revised final audit report were completed in less than two years from the entrance conference held September 11, 2008.
Reductions of indirect cost rates for fiscal years 2002-2003 and 2003-2004 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 did not claim indirect costs in accordance with the claiming instructions. Claimant argues that the claiming instructions are not enforceable, and the recalculation of indirect costs by the Controller was arbitrary and capricious.	*Correct* – This reduction based on claimant's failure to obtain federal approval for its claimed rates developed by the OMB circular A-21 methodology is correct as a matter of law, because the methodology itself requires federal approval. Recalculation of indirect costs for fiscal years 2002-2003 and 2003-2004 pursuant to the state FAM-29C method is not arbitrary, capricious, or entirely lacking in evidentiary support. With respect to fiscal years 2004-2005 and 2005-2006, the revised audit report found an increase in reimbursement, not a reduction, and the Commission therefore does not have jurisdiction to evaluate the propriety of that adjustment.
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.	*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. The claimant is required to report fee amounts that it is authorized to collect, not just the fee amounts it actually received.

<u>Staff Analysis</u>

A. The Audit Was Timely Initiated and Timely Completed Pursuant to Government Code Section 17558.5.

The claimant argues that the Controller did not timely conduct the audit pursuant to Government Code section 17558.5. Section 17558.5, as applicable to the claim years here at issue, requires a valid audit to be initiated no later than three years after the date that the reimbursement claim is filed or last amended. However, the section also provides that *if no funds are appropriated or no payment is made* "to a claimant for the program for the fiscal year for which the claim is filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim."[25] "In any case," section 17558.5 requires the audit to be completed no later than two years after it is commenced.[26]

1. <u>The Audit Was Timely Initiated Pursuant to Government Code Section 17558.5.</u>

Government Code section 17558.5 states that if funds are not appropriated or no payment is made to the claimant for a given year, section 17558.5 states the "time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim."[27]

Here, the fiscal year 2002-2003 reimbursement claim was amended on or about January 12, 2005,[28] but was not paid, based on the evidence in the record, until October 25, 2006.[29] Therefore, the time to initiate an audit, in this case, commenced to run from October 25, 2006, and an audit initiated before October 25, 2009 would be timely.

Based on the evidence in the record, staff finds that the audit in issue was initiated no later than September 11, 2008, the date of the entrance conference, and the audit was therefore timely initiated.

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

[26] Government Code section 17558.5 (as amended, Stats. 2004, ch. 890 (AB 2856)).

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

[28] The Controller's final audit report states that the amended claim was received on January 13, 2004, but the claimant states that it was mailed on January 12, 2004. Whether the filing date for purposes of annual reimbursement claims is measured upon receipt or upon dispatch is not necessary to resolve the period of limitation issue in this claim. (Exhibit A, IRC 09-4206-I-24, page 72.)

[29] Exhibit A, IRC 09-4206-I-24, pages 19; 72.

2. The Audit Was Timely Completed.

Government Code section 17558.5 also prescribes the time in which an audit must be completed: "In any case, an audit shall be completed not later than two years after the date that the audit is commenced."[30] Based on the evidence in the record, the first audit report was issued May 20, 2009, well within two years of the entrance conference;[31] the second was issued August 18, 2010, also prior to the expiration of the two year period beginning September 11, 2008.

Based on the foregoing, staff finds that both the first final audit report and the revised final audit report were timely completed in accordance with Government Code section 17558.5.

B. The Controller's Reduction of Indirect Costs Claimed for Fiscal Years 2002-2003 and 2003-2004 Is Correct as a Matter of Law, and the Commission Does Not Have Jurisdiction Over the Adjustment of Indirect Costs in Favor of the Claimant for Fiscal Years 2004-2005 and 2005-2006.

The Controller's audit found both an overstatement and an understatement of indirect costs during the audit period. For fiscal years 2002-2003 and 2003-2004, the claimant claimed indirect costs based on a rate calculated pursuant to the OMB Circular A-21 method, which was authorized under the claiming instructions at that time. However, the Controller found that the claimant did not obtain federal approval for its claimed rate, which is required by the OMB Circular. The Controller therefore reduced the indirect costs and recalculated based on the state FAM-29C method, using data available from the claimant's annual financial and budget reporting to the Chancellor's Office on the CCFS-311. For fiscal years 2004-2005 and 2005-2006, the Controller found an understatement of indirect costs, based on the claimant's allocation of direct and indirect costs using the state FAM-29C method.

Based on the analysis herein, staff finds that the Controller's reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 on the basis of the claimant's failure to obtain federal approval for indirect cost rates developed in accordance with the OMB Circular A-21 method is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support. If a claimant chooses to use the OMB Circular A-21 methodology, claimant must obtain federal approval for the rate calculated through formal negotiation, an informal correspondence process or a simplified method which sets the indirect cost rate using a salaries and wage base.[32] 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."[33] Moreover, there is no evidence that the Controller's recalculation in accordance with the FAM-29C methodology described in the claiming instructions was arbitrary, capricious, or entirely lacking in evidentiary support. Additionally, staff finds that for fiscal years 2004-2005 and 2005-2006 the Controller did not

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[30] Government Code section 17558.5 (Stats. 2004, ch. 890).

[31] Exhibit A, IRC 09-4206-I-24, page 52.

[32] Exhibit X, OMB Circular A-21, pages 37-39.

[33] Exhibit X, OMB Circular A-21, page 6.

reduce, but rather increased, indirect costs claimed, and the Commission therefore does not have jurisdiction over this audit adjustment.

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

The Controller determined that the claimant understated its authorized offsetting health fee revenues by $716,795 over the four fiscal years at issue.[34] These reductions were made on the basis of the fee authority available to claimant, multiplied by the number of students subject to the fee, less the amount of offsetting revenue claimed.

Claimant disputes the reduction, arguing that the relevant Education Code provisions permit, but do not require, a community college district to levy a health services fee, and that the parameters and guidelines require a community college district to deduct from its reimbursement claims "[a]ny offsetting savings that the claimant *experiences* as a direct result of this statute…"[35]

Staff finds that the correct calculation and application of offsetting revenue from student health fees has been resolved by the *Clovis Unified* decision,[36] 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. Therefore, 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 from whom the claimant is able to collect, is correct as a matter of law.

Conclusion

Staff concludes that reductions of indirect costs, based on the claimant's failure to obtain federal approval for the development of its indirect cost rate, and the Controller's recalculation of indirect costs using the method described in the claiming instructions, were correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support. The Commission further finds that the reduction of costs over the audit period based on understated offsetting health fee revenues was correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

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.

[34] Exhibit A, IRC 09-4206-I-24, page 66.

[35] Exhibit A, IRC 09-4206-I-24, pages 67-68.

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

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON:	Case No.: 09-4206-I-24 and 10-4206-I-34
Former Education Code Section 72246 (Renumbered as 76355)[37]	*Health Fee Elimination*
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1) and Statutes 1987, Chapter 1118 (AB 2336)	DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5. ARTICLE 7
Fiscal Years 2002-2003, 2003-2004, 2004-2005, and 2005-2006	(*Adopted May 27, 2016*)
Foothill-DeAnza Community College District, Claimant	

DECISION

The Commission on State Mandates (Commission) heard and decided this consolidated incorrect reduction claim (IRC) during a regularly scheduled hearing on May 27, 2016. [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	

[37] Statutes 1993, chapter 8.

Summary of the Findings

This analysis addresses the consolidated IRCs filed by Foothill-DeAnza Community College District (claimant) regarding reductions made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during fiscal years 2002-2003 through 2005-2006 under the *Health Fee Elimination* program. Over the four fiscal years in question, reductions totaling $284,615 were made based on understated offsetting health fees authorized to be collected and disallowed indirect costs.

The Commission finds that the audit was both timely initiated and timely completed in accordance with Government Code section 17558.5. Additionally, the Commission concludes that reductions of indirect costs claimed, based on the claimant's failure to obtain federal approval for its indirect cost rate calculated pursuant to the federal OMB Circular A-21 method, and the Controller's recalculation of indirect costs using another method authorized by the parameters and guidelines and claiming instructions, was correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support. The Commission further finds that the reduction of costs based on understated offsetting health fee revenues was correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.[38]

COMMISSION FINDINGS

I. Chronology

09/11/2008	The entrance conference for the audit of fiscal years 2002-2003 through 2005-2006 was held.
02/06/2009	Controller issued the draft audit report.[39]
02/23/2009	Claimant responded by letter to the draft audit report.[40]
05/20/2009	Controller issued the final audit report.[41]
10/05/2009	Claimant filed IRC 09-4206-I-24.[42]
08/18/2010	Controller issued the revised final audit report.[43]
11/22/2010	Claimant filed IRC 10-4206-I-34.[44]

[38] The total net reduction for the audit period is only $284,615, because understated indirect costs for fiscal years 2004-2005 and 2005-2006, as well as understated student insurance costs and understated salaries and benefits, were offset against the overstated indirect costs for fiscal years 2002-2003 and 2003-2004 and understated health fees for all four years.

[39] Exhibit A, IRC 09-4206-I-24, page 75.

[40] Exhibit A, IRC 09-4206-I-24, page 75.

[41] Exhibit A, IRC 09-4206-I-24, page 52.

[42] Exhibit A, IRC 09-4206-I-24, page 1.

[43] Exhibit B, IRC 10-4206-I-34, page 21.

[44] Exhibit B, IRC 10-4206-I-34, page 1.

12/02/2010	Commission staff issued a notice of complete filing, consolidation of 09-4206-I-24 and 10-4206-I-34, and request for comments.
12/02/2014	Controller submitted late comments on the consolidated IRCs.[45]
02/10/2016	Commission staff issued the draft proposed decision.[46]

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.[47] In 1984, the Legislature repealed the community colleges' fee authority for health services.[48] 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).[49]

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.[50] 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.[51] 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.[52] As a result, beginning January 1, 1988 all community college districts were required

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[45] Exhibit C, Controller's Late Comments on IRC.

[46] Exhibit D, Draft Proposed Decision.

[47] 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.].

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

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

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

[51] 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).

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

to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with limited fee authority to offset the costs of those services. In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.[53]

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 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 costs claimed for fiscal years 2002-2003 through 2005-2006 under the *Health Fee Elimination* program, totaling $284,615, based on the net of overstatements and understatements. The following issues are in dispute:

- The period of limitation applicable to audits by the Controller.
- 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

Foothill-DeAnza Community College District

In IRC 09-4206-I-24, the claimant asserts that the Controller incorrectly reduced costs claimed for fiscal years 2002-2003 through 2005-2006, totaling $440,752.[54] The claimant did not dispute the Controller's findings that the claimant understated counseling-related salaries and benefits, and student insurance costs for the audit period, resulting in a net increase in reimbursement of $688,882 plus $215,540 in related indirect costs.[55] However, the claimant disputes the Controller's reduction of $511,782 in 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 offsetting health fee authority, required to be deducted, by $716,795 for the audit period.[56]

Subsequent to the final audit report and the filing of IRC 09-4206-I-24, the Controller revised some of its findings and issued a revised audit report. The revised audit report adjusted the

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[53] 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.)

[54] Exhibit A, IRC 09-4206-I-24, page 2.

[55] Exhibit A, IRC 09-4206-I-24, pages 10; 60-61.

[56] Exhibit A, IRC 09-4206-I-24, pages 10-18; 63-70.

reduction for indirect costs claimed from $511,782 to $241,031. In response to the revised audit report, the claimant filed the second of two consolidated IRCs, which continues to dispute the net reduction over the audit period for indirect costs claimed and understated health fee revenues. Specifically, claimant disputes the finding that it overstated indirect costs for fiscal years 2002-2003 and 2003-2004 because it did not obtain federal approval for its indirect cost rate. However, the revised audit report finds that the claimant understated indirect costs for fiscal years 2004-2005 and 2005-2006, and the claimant responds: "Because the Controller's method of utilizing depreciation expenses in lieu of CCFS-311 capital costs is also a reasonable method, the district does not dispute that choice of methods for [fiscal years] 2004-05 and 2005-06."[57] With respect to the net reduction, the claimant argues that the claiming instructions are not enforceable, and notes that the recalculation for fiscal years 2002-2003 and 2003-2004 excluded both capital costs and depreciation expenses.[58] Moreover, the claimant argues that the Controller did not make findings that the claimant's rate was excessive or unreasonable.[59]

And, claimant argues that the reduction of $716,795 based on understated authorized health service fees, is 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 actually receive.[60]

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 $284,615.

Finally, the claimant argues that the Controller's audit of reimbursement claims for fiscal years 2002-2003 and 2003-2004 was not timely; that the period of limitation for these claims expired on January 12, 2008, based on the filing date of January 12, 2005,[61] but the audit entrance conference did not occur until September 11, 2008.[62] Although the audit report states that the audit was timely because initial payment on the claims did not occur until October 25, 2006, the claimant argues that this alternative time period, as authorized in Government Code section 17558.5, is impermissibly vague, and is contrary to the purpose of a statute of limitations.[63]

<u>State Controller's Office</u>

The Controller determined that the claimant understated counseling-related salaries and benefits for the audit period, plus related indirect costs, resulting in a net increase of $717,126.[64] In

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[57] Exhibit B, IRC 10-4206-I-34, pages 8-9.

[58] Exhibit A, IRC 09-4206-I-24, pages 10-14; Exhibit B, IRC 10-4206-I-34, page 8.

[59] Exhibit A, IRC 09-4206-I-24, pages 10-14.

[60] Exhibit A, IRC 09-4206-I-24, pages 14-15.

[61] Exhibit A, IRC 09-4206-I-24, pages 18-19 (Note that the 2002-2003 and 2003-2004 claims were filed at the same time).

[62] Exhibit A, IRC 09-4206-I-24, page 18.

[63] Exhibit A, IRC 09-4206-I-24, pages 18-21.

[64] Exhibit A, IRC 09-4206-I-24, page 61.

addition, the Controller determined that the claimant understated allowable student insurance costs, plus related indirect costs, totaling $187,296 for the audit period.[65]

The Controller further asserted that the claimant overstated its indirect costs for fiscal years 2002-2003 and 2003-2004, finding that the claimant did not obtain federal approval for its indirect cost rate developed pursuant to OMB Circular A-21 guidelines, totaling $436,827. And, the Controller found that the claimant understated its indirect costs for fiscal years 2004-2005 and 2005-2006, based on recalculation pursuant to the Controller's FAM-29C method, including allowable depreciation expenses that were excluded in the prior years. This resulted in an increase of $195,796.[66]

The Controller also found that the claimant understated its authorized health service fees for the audit period by $716,795. Using enrollment and exemption data obtained from the California Community Colleges Chancellor's Office, 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.[67] The Controller states: "We agree that community college districts may choose not to levy a health service fee or to levy a fee less than the authorized amount…[but] Education Code section 76355, subdivision (a) provides districts the *authority* to levy the fee."[68] The Controller concludes that: "To the extent that districts have authority to charge a fee, they are not required to incur a cost."[69] This finding is unchanged in the revised audit report.[70]

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 decision to the Controller and request that the costs that were incorrectly reduced 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.[71] The Commission must also interpret the Government Code and implementing regulations in

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[65] Exhibit A, IRC 09-4206-I-24, page 62.

[66] Exhibit B, IRC 10-4206-I-34, page 32.

[67] Exhibit A, IRC 09-4206-I-24, page 66.

[68] Exhibit A, IRC 09-4206-I-24, page 69.

[69] Exhibit A, IRC 09-4206-I-24, page 70.

[70] Exhibit B, IRC 10-4206-I-34, pages 35-39.

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

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."[72]

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.[73] 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.]' "[74]

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.[75] 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.[76]

A. The Audit Was Timely Initiated and Timely Completed Pursuant to Government Code Section 17558.5.

The claimant argues that the Controller did not timely conduct the audit pursuant to Government Code section 17558.5. Section 17558.5, as applicable to the claim years here at issue, requires a valid audit to be initiated no later than three years after the date that the reimbursement claim is filed or last amended. However, the section also provides that *if no funds are appropriated or no payment is made* "to a claimant for the program for the fiscal year for which the claim is filed,

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[72] *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.

[73] *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.

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

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

[76] 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.

the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim."[77] "In any case," section 17558.5 requires the audit to be completed no later than two years after it is commenced.[78]

1. <u>The Audit Was Timely Initiated Pursuant to Government Code Section 17558.5.</u>

The claimant asserts that the audit of the 2002-2003 and 2003-2004 claim years was not timely initiated, based on the date that the claims were "filed or last amended" (January 12, 2005), and the date that the audit entrance conference took place (September 11, 2008). However, the Controller points out that the fiscal year 2002-2003 claim was not paid until October 25, 2006, and that therefore section 17558.5 provides for a timely audit to be initiated as late as October 25, 2009.[79]

Government Code section 17558.5 states that "[a] reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than three years after the date that the actual reimbursement claim is filed or last amended …." However, if funds are not appropriated or no payment is made to the claimant for a given year, section 17558.5 states the "time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim."[80]

The claimant argues that this provision "is void because it is impermissibly vague,"[81] and that "the only specific and enforceable time limitation to commence an audit is three years from the date the claim was filed." The claimant argues that "the annual reimbursement claims for FY 2002-03 and FY 2003-04 were past this time period when the audit was commenced on September 11, 2008."[82]

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

[78] Government Code section 17558.5 (as amended, Stats. 2004, ch. 890 (AB 2856)).

[79] Government Code section 17558.5 (as amended, Statutes 2004, ch. 890 (AB 2856)). Neither the filing date of the subject reimbursement claims, nor the date the audit was commenced, controls whether the later-amended version(s) of section 17558.5 are applicable. See *Scheas v. Robertson* (1951) 38 Cal.2d 119, 126 ["It is settled that the Legislature may enact a statute of limitations 'applicable to existing causes of action or shorten a former limitation period…"]; *California Employment Stabilization Commission v. Payne* (1947) 31 Cal.2d 210, 215 ["…the power of the Legislature to lessen a statute of limitations is subject to the restriction that an existing right cannot be cut off summarily without giving a reasonable time after the act becomes effective to exercise such right. [citation] This principle, however, does not apply where the state gives up a right previously possessed by it or by one of its agencies. Except where such an agency is given powers by the Constitution, it derives its authority from the Legislature, which may add to or take away from those powers and therefore a statute which adversely affects only the right of the state is not invalid merely because it operates to cut off an existing remedy of an agency of the state."].

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

[81] Exhibit A, IRC 09-4206-I-24, page 21.

[82] Exhibit A, IRC 09-4206-I-24, page 21.

But article III, section 3.5 of 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…"[83] Here, the fiscal year 2002-2003 reimbursement claim was amended on or about January 12, 2004,[84] but was not paid, based on the evidence in the record, until October 25, 2006.[85] Therefore, the time to initiate an audit, in this case, commenced to run from October 25, 2006, and an audit initiated before October 25, 2009 would be timely.

Based on the evidence in the record, the Commission finds that the audit in issue was initiated no later than September 11, 2008, the date of the entrance conference, and the audit was therefore timely initiated.

2. The Audit Was Timely Completed.

Government Code section 17558.5 also prescribes the time in which an audit must be completed: "In any case, an audit shall be completed not later than two years after the date that the audit is commenced."[86] Based on the evidence in the record, the audit in issue was initiated no later than September 11, 2008, the date of the entrance conference.[87] And here, there are two final audit reports in the record that identify and explain the adjustments in accordance with Government Code section 17558.5(c).[88] The first audit report was issued May 20, 2009, well within two years of the entrance conference;[89] the second was issued August 18, 2010, also prior to the expiration of the two year period beginning September 11, 2008.

Based on the foregoing, the Commission finds that both the first final audit report and the revised final audit report were timely completed in accordance with Government Code section 17558.5.

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

[84] The Controller's final audit report states that the amended claim was received on January 13, 2004, but the claimant states that it was mailed on January 12, 2004. Whether the filing date for purposes of annual reimbursement claims is measured upon receipt or upon dispatch is not necessary to resolve the period of limitation issue in this claim. (Exhibit A, IRC 09-4206-I-24, page 72.)

[85] Exhibit A, IRC 09-4206-I-24, pages 19; 72.

[86] Government Code section 17558.5 (Stats. 2004, ch. 890).

[87] Exhibit A, IRC 09-4206-I-24, pages 18; 72.

[88] Government Code section 17558.5(c) states the following:

> The Controller shall notify the claimant in writing within 30 days after issuance of a remittance advice of any adjustment to a claim for reimbursement that results from an audit or review. The notification shall specify the claim components adjusted, the amounts adjusted, interest charges on claims adjusted to reduce the overall reimbursement to the local agency or school district, and the reason for the adjustment. Remittance advices and other notices of payment actions shall not constitute notice of adjustment from an audit or review.

[89] Exhibit A, IRC 09-4206-I-24, page 52.

B. The Controller's Reduction of Indirect Costs Claimed for Fiscal Years 2002-2003 and 2003-2004 Is Correct as a Matter of Law, and the Commission Does Not Have Jurisdiction Over the Adjustment of Indirect Costs in Favor of the Claimant for Fiscal Years 2004-2005 and 2005-2006.

The Controller's audit found both an overstatement and an understatement of indirect costs during the audit period. For fiscal years 2002-2003 and 2003-2004, the claimant claimed indirect costs based on a rate calculated pursuant to the OMB Circular A-21 method, which was authorized under the claiming instructions at that time. However, the Controller found that the claimant did not obtain federal approval for its claimed rate, which is required by the OMB Circular. The Controller therefore reduced the indirect costs and recalculated based on the state FAM-29C method, using data available from the claimant's annual financial and budget reporting to the Chancellor's Office on the CCFS-311. For fiscal years 2004-2005 and 2005-2006, the Controller found an understatement of indirect costs, based on the claimant's allocation of direct and indirect costs using the state FAM-29C method.

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, 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] With respect to the understatement found for fiscal years 2004-2005 and 2005-2006, the claimant states that because the Controller's recalculation "is also a reasonable method, the District does not dispute that choice…and will utilize that method in future annual claims..."[92]

Based on the analysis herein, the Commission finds that the Controller's reduction of indirect costs for fiscal years 2002-2003 and 2003-2004 on the basis of the claimant's failure to obtain federal approval for indirect cost rates developed in accordance with the OMB Circular A-21 method is correct as a matter of law, and recalculation in accordance with the FAM-29C methodology described in the claiming instructions was not arbitrary, capricious, or entirely lacking in evidentiary support. Additionally, the Commission finds that for fiscal years 2004-2005 and 2005-2006 the Controller did not reduce, but rather increased, indirect costs claimed, and the Commission therefore does not have jurisdiction over this audit adjustment.

1. <u>If a Claimant Chooses to Claim Indirect Costs Using the Federal OMB Circular A-21 Method, the Claimant Must Obtain Federal Approval for the Claimed Indirect Cost Rates.</u>

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 the program.[93] 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

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[90] Exhibit A, IRC 09-4206-I-24, page 14.

[91] *Ibid*.

[92] Exhibit B, IRC 10-4206-I-34, page 9.

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

17559 or amended by the filing of a request pursuant to Government Code section 17557.[94] 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*."[95] 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.[96]

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

The claiming instructions specific to the *Health Fee Elimination* mandate, are found in the School Mandated Cost Manual which is revised each year and contains claiming instructions applicable to all school and community college mandated programs. The cost manual issued by the Controller's Office in September 2003 governs the reimbursement claim filed for fiscal year 2002-2003.[97] This cost manual provides two options for claiming indirect costs:

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

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[94] *California School Boards Assoc. v. State of California* (2009) 171 Cal.App.4th 1183, 1200, which stated the following: "[U]nless a party to a quasi-judicial proceeding challenges the agency's adverse findings made in that proceeding, by means of a mandate action in superior court, those findings are binding in later civil actions." [Citation omitted.] See also, Government Code section 17557.

[95] Exhibit A, IRC 09-4206-I-24, page 35.

[96] Exhibit A, IRC 09-4206-I-24, page 11.

[97] Exhibit X, School Mandated Cost Manual excerpt.

> [¶]
>
> The [FAM-29C] computation is based on total expenditures as reported in "California Community Colleges Annual Financial and Budget Report, Expenditures by Activity (CCFS-311)." Expenditures classified by activity are segregated by the function they serve. Each function may include expenses for salaries, fringe benefits, supplies, and capital outlay. OMB Circular A-21 requires expenditures for capital outlays to be excluded from the indirect cost rate computation.
>
> Generally, a direct cost is one incurred specifically for one activity, while indirect costs are of a more general nature and are incurred for the benefit of several activities. As previously noted, the objective of this computation is to equitably allocate administrative support costs to personnel that perform mandated cost activities claimed by the college. For the purpose of this computation we have defined indirect costs to be those costs which provide administrative support to personnel who perform mandated cost activities. We have defined direct costs to be those indirect costs that do not provide administrative support to personnel who perform mandated costs activities and those costs that are directly related to instructional activities of the college. Accounts that should be classified as indirect costs are: Planning and Policy Making, Fiscal Operations, General Administrative Services, and Logistical Services. If any costs included in these accounts are claimed as a mandated cost, i.e., salaries of employee performing mandated cost activities, the cost should be reclassified as a direct cost. Accounts in the following groups of accounts should be classified as direct costs: Instruction, Instructional Administration, Instructional Support Services, Admissions and Records, Counseling and Guidance, Other Student Services, Operation and Maintenance of Plant, Community Relations, Staff Services, Non-instructional Staff-Retirees' Benefits and Retirement Incentives, Community Services, Ancillary Services and Auxiliary Operations. A college may classify a portion of the expenses reported in the account Operation and Maintenance of Plant as indirect. The claimant has the option of using a 7% or a higher expense percentage is allowable if the college can support its allocation basis.
>
> The rate, derived by determining the ratio of total indirect expenses and total direct expenses when applied to the direct costs claimed, will result in an equitable distribution of the college's mandate related indirect costs. . . .[98]

The claiming instructions for fiscal year 2003-2004 were substantially similar.[99]

If a claimant chooses to use the OMB Circular A-21 methodology, claimant must obtain federal approval for the rate calculated through formal negotiation, an informal correspondence process or a simplified method which sets the indirect cost rate using a salaries and wage base.[100] The end result of the negotiation process is a sponsored agreement in which final approval lies with

[98] Exhibit X, School Mandated Cost Manual, issued September 2003, pages 16-17.

[99] Exhibit X, School Mandated Cost Manual, issued September 2004.

[100] Exhibit X, OMB Circular A-21, pages 37-39.

the federal government negotiating the rate and must be supported by "adequate documentation to support costs charged to sponsored agreements."[101] The OMB Circular A-21 establishes principles for determining costs applicable to grants, contracts, and other agreements between the federal government and educational institutions. Section G(11) of the OMB Circular A-21 governs the determination of indirect cost rates and requires the federal approval of a proposed rate by the "cognizant federal agency," which is normally either the federal Department of Health and Human Services or the Department of Defense's Office of Naval Research.[102] Thus, a claimant that has received federal approval for their indirect cost rate has negotiated specific direct costs with the relevant federal approving agency.

Here, claimant did not negotiate a particular rate but applied the general principles of the OMB Circular A-21 to direct costs it determined to be applicable. Claimant used the methodology in the OMB Circular A-21 for fiscal years 2002-2003 and 2003-2004, and asserts that its indirect cost rates are more consistent from year to year, and that the Controller has the burden to show that the rates were excessive or unreasonable, "not to recalculate the rate according to its unenforceable ministerial preferences."[103] That assertion is in essence a challenge to the Controller's entire claiming instructions as an underground regulation adopted without complying with the APA.

However, the Commission does not need to reach the alleged underground regulation issue for the use of the FAM-29C because the claimant failed to obtain federal approval for its use of the OMB Circular A-21 methodology as required by the OMB Circular A-21 itself.

As claimant did not negotiate with a federal agency to determine appropriate direct costs used to calculate the indirect costs rate, it cannot be determined whether the claimed rates would have received federal approval. Moreover, federal approval is clearly required by both the claiming instructions and the OMB methodology itself, but the Controller has no power to grant federal approval for an OMB-calculated rate.

Thus, the reduction of costs for failure to obtain federal approval is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

2. The Controller's Recalculation of Indirect Costs Is Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

Here, instead of reducing indirect costs to $0, the Controller recalculated claimant's indirect cost rate by using its own Form FAM-29C, a method of calculating indirect costs that the Controller has included in its claiming instructions for many years, and which has been incorporated into parameters and guidelines for several state-mandated programs. The claiming instructions provide:

> 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:

[101] Exhibit X, OMB Circular A-21, page 6.

[102] Exhibit X, OMB Circular A-21.

[103] Exhibit A, IRC 10-4206-I-34, page 8; Exhibit A, IRC 09-4206-I-24, page 12.

> 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. OMB Circular A-21 requires expenditures for capital outlays to be excluded from the indirect cost rate computation.
>
> Generally, a direct cost is one incurred specifically for one activity, while indirect costs are of a more general nature and are incurred for the benefit of several activities. As previously noted, the objective of this computation is to equitably allocate administrative support costs to personnel that perform mandated cost activities claimed by the college. For the purpose of this computation we have defined indirect costs to be those costs which provide administrative support to personnel who perform mandated cost activities. We have defined direct costs to be those costs that do not provide administrative support to personnel who perform mandated cost activities and those costs that are directly related to instructional activities of the college.[104]

Thus, the calculation of indirect costs under Form FAM-29C are similar to the calculation under OMB Circular A-21, but not identical. However, because the OMB method is intended to be negotiated with and approved by either the federal Department of Health and Human Services or the Department of Defense's Office of Naval Research,[105] the Controller is not in a position to unilaterally recalculate and approve indirect costs under the OMB Circular A-21 method.

As previously stated, 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."[106] Thus, the Commission cannot compel the Controller to use other auditing procedures in place of the Form FAM-29C and there is no evidence that the Controller's recalculation of indirect costs was arbitrary, capricious, or entirely lacking in evidentiary support.

Accordingly, the Commission finds the reduction of indirect costs for fiscal years 2002-2003 and 2003-2004, and recalculation by the FAM-29C method, is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

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[104] Exhibit X, Excerpt Community Colleges Mandated Cost Manual 09/03, page 16.

[105] Exhibit X, OMB Circular A-21.

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

3. The Commission Does Not Have Jurisdiction over the Adjustment of Indirect Costs Claimed for Fiscal Years 2004-2005 and 2005-2006, Because There Has Been No Reduction.

The claimant challenges the enforceability of the Controller's claiming instructions with respect to indirect cost claiming in both its response to the draft audit report and its IRC narrative. Specifically, the claimant argues that "[s]ince the Controller's claiming instructions were never adopted as law, or regulations pursuant to the Administrative Procedure Act, the claiming instructions are a statement of the Controller's interpretation and not law." However, as noted above, for fiscal years 2004-2005 and 2005-2006, the revised audit found a net increase, rather than a reduction, over which the Commission has no jurisdiction in the context of an IRC.

Government Code section 17551 provides that the Commission "shall hear and decide upon a claim by a local agency or school district filed on or after January 1, 1985, *that the Controller has incorrectly reduced payments* to the local agency or school district…" pursuant to an audit.[107] The plain language of section 17551, which directs the Commission to hear IRCs in the first instance, applies only to claims that are reduced. Here, the revised audit report finds an adjustment in favor of the claimant for fiscal years 2004-2005 and 2005-2006. Without a reduction alleged, the Commission does not have jurisdiction to determine whether the adjustment is correct.

C. 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 $716,795 over the four fiscal years at issue.[108] 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.[109] For the audit period, the authorized fee amounts identified by the Chancellor ranged from $9 per student to $11 per student. The Controller states that it "obtained student enrollment and Board of Governors Grant (BOGG) recipient data from the CCCCO" 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.[110]

Claimant disputes the reduction, arguing that the relevant Education Code provisions permit, but do not require, a community college district to levy a health services fee, and that the parameters and guidelines require a community college district to deduct from its reimbursement claims "[a]ny offsetting savings that the claimant *experiences* as a direct result of this statute…"

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[107] Government Code section 17551 (Stats. 2007, ch. 329 (AB 2224)) [emphasis added].

[108] Exhibit A, IRC 09-4206-I-24, page 66.

[109] Education Code section 76355.

[110] Exhibit A, IRC 09-4206-I-24, page 66.

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..."[111]

The Commission finds that the correct calculation and application of offsetting revenue from student health fees has been resolved by the *Clovis Unified* decision,[112] 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 IRC 09-4206-I-24, 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.[113] (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).[114]

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

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[111] Exhibit A, IRC 09-4206-I-24, pages 67-68.

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

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

[114] 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)].

[115] See Education Code section 76355 (Stats. 1995, ch. 758 (AB 446)). The Implicit Price Deflator for State and Local Purchase of Goods and Services is a number computed annually (and quarterly) by the United States Department of Commerce as part of its statistical series on

governing boards of all community colleges when a fee increase is triggered.[116] 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.[117]

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.'"[118] 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,"[119] 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*.[120] (Italics added.)

Thus, pursuant to the court's decision in *Clovis Unified*, the Health Fee Rule used by the Controller to adjust reimbursement claims filed by claimant for the *Health Fee Elimination* program is valid. Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.[121] In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.[122] 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

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

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

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

[118] *Ibid.*

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

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

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

[122] 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.

proceeding; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue.[123] 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."[124]

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."[125] 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.

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 from whom the claimant collects, is correct as a matter of law.

V. Conclusion

The Commission concludes that reductions of indirect costs, based on the claimant's failure to obtain federal approval for the development of its indirect cost rate, and the Controller's recalculation of indirect costs using the method described in the claiming instructions, were correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support. The Commission further finds that the reduction of costs over the audit period based on understated offsetting health fee authority was correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

Based on the foregoing, the Commission denies this IRC.

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

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

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

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

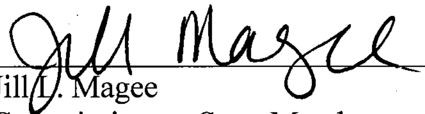
I am a resident of the County of Sacramento and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On February 10, 2016, I served the:

> **Draft Proposed Decision, Schedule for Comments, and Notice of Hearing**
> *Health Fee Elimination*, 09-4206-I-24 and 10-4206-I-34
> Former Education Code Section 72246 (Renumbered as 76355)
> Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1);
> Statutes 1987, Chapter 1118 (AB 2336)
> Fiscal Years: 2002-2003, 2003-2004, 2004-2005, and 2005-2006
> Foothill-DeAnza 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 February 10, 2016 at Sacramento, California.



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COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 1/14/16

Claim Number: 09-4206-I-24 and 10-4206-I-34

Matter: Health Fee Elimination

Claimant: Foothill-De Anza Community College District

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