

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



March 18, 2016

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

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

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

Re: **Draft Proposed Decision, Schedule for Comments, and Notice of Hearing**
Health Fee Elimination, 10-4206-I-33
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 Year: 2003-2004
El Camino 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

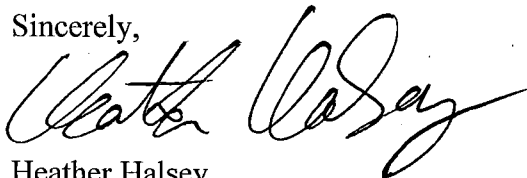
Written comments may be filed on the draft proposed decision by **April 8, 2016**. You are advised that comments filed with the Commission on State Mandates (Commission) are required to be simultaneously served on the other interested parties on the mailing list, and to be accompanied by a proof of service. However, this requirement may also be satisfied by electronically filing your documents. Refer to http://www.csm.ca.gov/dropbox_procedures.php on the Commission's website for electronic filing instructions. (Cal. Code Regs., tit. 2, § 1181.3.)

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

Hearing

This matter is set for hearing on **Friday, 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

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);
Statutes 1987, Chapter 1118 (AB 2336)

Health Fee Elimination

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

10-4206-I-33

El Camino Community College District, Claimant

EXECUTIVE SUMMARY

Overview

This analysis addresses the incorrect reduction claim (IRC) filed by El Camino Community College District (claimant) regarding reductions of \$674,212 made by the State Controller's Office (Controller) to reimbursement claims for costs incurred during fiscal years 2003-2004 through 2006-2007 under the *Health Fee Elimination* program.

The following issues are in dispute:

- The statutory deadline applicable to the audit of claimant's 2003-2004 reimbursement claim;
- 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 session, to fund these services.² In 1984, the Legislature repealed the community colleges' fee

¹ Statutes 1993, chapter 8.

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

authority for health services.³ 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).⁴

In addition to temporarily repealing community college districts' authority to levy a health services fee, the 1984 enactment required any district that provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.⁵ As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987, 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, 1988.⁶ 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.⁷ 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.⁸

Procedural History

On January 7, 2005, the claimant signed the transmittal letter for the 2003-2004 reimbursement claim. On January 9, 2007, the claimant signed the transmittal letter for the 2004-2005 and 2005-2006 reimbursement claims. On February 13, 2008, the claimant signed the transmittal letter for the 2006-2007 reimbursement claim. On September 11, 2008, the audit entrance conference was conducted. On August 28, 2009, the Controller issued the final audit report. On October 20, 2010, the claimant filed this IRC. On December 2, 2012, the Controller filed late comments on the IRC which, among other things, included a statement that as of April 12, 2011 claimant had not received payment on its 2003-2004 claim.⁹ The claimant did not file a rebuttal to the Controller's comments.

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

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

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

⁶ 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).

⁷ Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

⁸ 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).

⁹ Exhibit B, Controller's Late Comments on IRC, page 25.

On March 18, 2016, Commission staff issued the Draft Proposed Decision.¹⁰

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 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 6.¹¹ 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."¹²

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.¹³

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.¹⁴ 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.¹⁵

¹⁰ Exhibit C, Draft Proposed Decision.

¹¹ Government Code sections 17551, 17552; *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334;.

¹² *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.

¹³ *Johnston v. Sonoma County Agricultural Preservation and Open Space District* (2002) 100 Cal.App.4th 973, 983-984; *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547. .

¹⁴ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

¹⁵ 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

Claims

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

Issue	Description	Staff Recommendation
Statutory deadline applicable to the audit of claimant's 2003-2004 reimbursement claim.	When the 2003-2004 reimbursement claim was filed on January 7, 2005, Government Code section 17558.5 stated: "A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to the initiation of an audit by the Controller no later than three years after the date that the actual reimbursement claim is filed or last amended, whichever is later. However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the claim is filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim. In any case, an audit shall be completed not later than two years after the date that the audit is commenced."	<p><i>The audit was timely initiated and timely completed</i>– The 2003- 2004 reimbursement claim was filed January 7, 2005. As of April 11, 2011, the 2003-2004 reimbursement claim had not yet been paid. The audit was initiated no later than September 11, 2008, when the audit entrance conference occurred. The plain language of section 17558.5, which allows the initiation of an audit to be tolled when no appropriation or payment has been made to the claimant for the fiscal year, is presumed valid and enforceable. Staff finds that because no payment was made for the program in fiscal year 2003- 2004, the statutory deadline to initiate an audit was properly tolled and had not passed.</p> <p>Additionally, staff finds that the Controller timely completed the audit approximately one year after initiation, when it issued the final audit report on August 28, 2009.</p>
Reduction based on student health fees	The Controller reduced costs claimed based on health service fees authorized to be charged and calculated the authorized fees based upon student enrollment at all	<i>Correct</i> —In <i>Clovis Unified School District v. Chiang</i> (2010) 188 Cal.App.4th 794, the court held that to the

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.

<p>authorized to be charged, but not offset from costs claimed.</p>	<p>claimant’s campuses and students enrolled in the Compton Center (which the district was providing services to under contract with Compton Community College), and BOGG recipient data from the Chancellor’s Office that claimant’s records supported.</p> <p>Claimant asserts that the Controller incorrectly reduced costs claimed because only the fee revenue collected, and not the revenue authorized to be charged, is required to be deducted from costs claimed. Claimant also asserts that the Controller incorrectly included Compton Center students in the calculation of the fee revenue authorized to be charged.</p>	<p>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. Therefore, the reduction is correct as a matter of law.</p> <p>Further, there is no evidence that Controller’s calculation of authorized health service fees, based upon student enrollment and BOGG recipient data from the Chancellor’s Office that claimant’s records supported, is arbitrary, capricious, or entirely lacking in evidentiary support.</p> <p>Finally, the fee revenue authorized to be charged and required to be identified as offsetting revenue in fiscal year 2006-2007, <i>excluding</i> the amount attributable to students enrolled in the Compton Center, exceeds the direct and indirect costs claimed for that fiscal year. Therefore, since there are no costs mandated by the state for that fiscal year the proposed decision does not address the remaining substantive issues relating to the fiscal year 2006-2007 reimbursement claim.</p>
<p>Reduction based on asserted flaws in the development of the indirect cost rate.</p>	<p>The Controller reduced indirect costs claimed by \$63,502 for fiscal year 2003-2004 and a total of \$21,908 total for fiscal years 2004-2005 and 2005-2006. For fiscal year 2003-2004, claimant used the OMB Circular A-21 to calculate its indirect cost rate, using expenditures from</p>	<p><i>Correct</i>—Claimant did not obtain federal approval of its rates, as required by the OMB A-21 and, thus, the reduction of indirect costs in fiscal year 2003-2004 is correct as a matter of law.</p>

	<p>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. For fiscal years 2004-2005, 2005-2006, and 2006-2007, claimant used the state Form FAM 29-C methodology to calculate indirect costs, using expenditures from the prior year's CCSF-311 annual financial and budget report. For these fiscal years, the Controller also found the claimant did not allocate direct and indirect costs as specified in the claiming instructions. The Controller recalculated indirect costs for all three fiscal years at issue using the state Form FAM-29C in accordance with the claiming instructions.</p>	<p>Staff further finds that the Controller's reduction of indirect costs in fiscal years 2004-2005 and 2005-2006, based on the claimant's use of expenditures from the prior year's CCFS-311 reports, instead of the expenditures incurred in the claim year, is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support. The actual expenditures for the 2004-2005 and 2005-2006 claim years were known and were required to be made available to the public before the deadline for filing the reimbursement claims at issue in this case. Moreover, the Government Code sections 17560 and 17564, and parameters and guidelines for this program, require local agencies and school districts to claim reimbursement for the costs incurred for the fiscal year being claimed.</p> <p>Finally, the Controller recalculated the indirect cost rate for the three fiscal years using the FAM-29C methodology in accordance with the claiming instructions and there is no evidence that the recalculation is arbitrary, capricious, or entirely lacking in evidentiary support.</p>
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Staff Analysis

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

The claimant signed the 2003-2004 reimbursement claim on January 7, 2005. The audit entrance conference was conducted on September 11, 2008, at which time the claim had not yet been paid.¹⁶ The Controller issued its final audit report on August 28, 2009.

At the time the 2003-2004 reimbursement claim was submitted in January 2005, 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.

Staff finds that the Controller timely initiated the audit of the 2003-2004 reimbursement claim. The fiscal year 2003-2004 reimbursement claim was filed on January 7, 2005, and the Controller started the audit no later than September 11, 2008. Staff finds that because no payment was made for the program in fiscal year 2003- 2004, the statutory deadline to initiate an audit was properly tolled and had not passed.

Staff 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 of two years after the audit is commenced, for the Controller to complete an audit. Here the Controller's audit of the relevant claim year was "commenced," within the meaning of section 17558.5, no later than September 11, 2008, and the final audit report was issued approximately one year later, on August 28, 2009. Thus, the final audit was timely completed.

B. The Controller's Reduction for Understated Offsetting Revenues Authorized to Be Charged Is Correct as a Matter of Law, and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced costs based on understated offsetting health service fees authorized to be charged, pursuant to Education Code section 76355, totaling \$699,317 for all years at issue. The claimant reported and deducted only the fee revenue that it actually collected from students, and not the amount authorized by statute to be charged. The Controller recalculated authorized health fee revenue by using student enrollment data and Board of Governors Grant (BOGG) recipient data from the Chancellor's Office.

For fiscal year 2006-2007, the Controller's calculation of student enrollment included 5,609 students enrolled in the Compton Center, to which the Controller attributed \$84,135 in health fee authority for that fiscal year. The Compton Center was created in 2006 based on a partnership agreement between the claimant and Compton Community College District to provide instructional services, financial aid, and related student support services while Compton Community College District regained full accreditation as a two-year public college. Based on the agreement, and the statute that provided specific legal authority for the agreement, the Controller contends that the claimant had the legal authority to charge Compton students the health service fee. However, claimant argues that the statute and MOU set out claimant's authority and they did not provide authority for claimant to impose health fees on the Compton

¹⁶ On December 2, 2012, the Controller filed late comments on the IRC which, among other things, included a statement that as of April 12, 2011 claimant had not received payment on its 2003-2004 claim.

Community College students in the fiscal years at issue.¹⁷ However, as discussed below, staff finds that the Commission need not reach the issue of whether the reduction based on fee authority attributable to the Compton Center students was correct since the fee authority attributable to the claimant district's students exceeds the full amount of the costs claimed for the 2006-2007 fiscal year.

Staff finds that the Controller's reduction is correct as a matter of law. In 2010, the Third District Court of Appeal issued its opinion in *Clovis Unified School Dist. v. Chiang*, 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. 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."¹⁸ 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.'¹⁹ 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.²⁰

Staff further finds that the recalculation of authorized offsetting fee revenues is not arbitrary, capricious, or entirely lacking in evidentiary support. The Controller's calculation of authorized health service fees was based upon student enrollment and BOGG recipient data from the Chancellor's Office that claimant's records supported.

In addition, the fee revenue authorized to be charged and required to be identified as offsetting revenue in fiscal year 2006-2007, *excluding* the amount attributable to students enrolled in the Compton Center, totals \$708,690.²¹ Since this amount in offsetting revenues exceeds the direct and indirect costs claimed for that fiscal year (\$708,271),²² there are no increased costs mandated by the state in that year and the Controller's total reduction of costs claimed for that year is correct as a matter of law. Therefore, the proposed decision does not address the remaining substantive issues relating to the fiscal year 2006-2007 reimbursement claim (including the legal issue surrounding the Compton Center and the Controller's reduction of \$1,556 for indirect costs claimed for that fiscal year).

¹⁷ See, generally, Exhibit A, Incorrect Reduction Claim, pages 24-30 and specifically, Education Code section 74292(d)(1), as amended by Statutes 2005, chapter 60 for support for this argument.

¹⁸ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

¹⁹ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

²⁰ *Fenske v. Board of Administration* (1980) 103 Cal.App.3d 590, 596.

²¹ Exhibit A, Incorrect Reduction Claim, pages 73, 78 (Schedule 1, Final Audit Report; \$792,825 authorized fee revenue minus \$84,135 attributable to students at the Compton Center = \$708,690).

²² Exhibit A, Incorrect Reduction Claim, pages 73, 78.

C. The Controller's Reduction and Recalculation of Indirect Costs Claimed for Fiscal Years 2003-04, 2004-05 and 2005-06 Is Correct as a Matter of Law and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced indirect costs claimed by \$63,502 for fiscal year 2003-2004²³ and \$21,908 for fiscal years 2004-2005 and 2005-2006.²⁴ 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. For fiscal years 2004-2005, 2005-2006, and 2006-2007, claimant used the state Form FAM 29-C methodology to calculate indirect costs, using expenditures from the prior year's CCSF-311 annual financial and budget report. For these fiscal years, the Controller also found the claimant did not allocate direct and indirect costs as specified in the claiming instructions. The Controller recalculated indirect costs for all three fiscal years at issue using the state Form FAM-29C in accordance with the claiming instructions.²⁵

1. The reduction of indirect costs claimed in fiscal year 2003-2004 for failure to obtain federal approval pursuant to OMB Circular A-21 is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

The Controller reduced indirect costs claimed for fiscal year 2003-2004 by \$63,502 because claimant utilized the OMB Circular A-21 method for claiming indirect costs, but did not obtain federal approval of its indirect cost rate as required by OMB Circular A-21.

The OMB Circular A-21 methodology requires a claimant to 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.²⁶ 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."²⁷

As claimant did not negotiate with a federal agency to determine appropriate direct costs used to calculate the indirect cost rate, it cannot be determined whether the claimed rates would have received federal approval. Moreover, the Controller has no power to grant federal approval for an OMB-calculated rate.

Thus, the reduction of indirect costs claimed in fiscal year 2003-2004 for failure to obtain federal approval pursuant to OMB Circular A-21 is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

2. The reduction of indirect costs in fiscal years 2004-2005 and 2005-2006 based on the claimant's use of expenditures from the prior year's CCFS-311 reports, instead of the

²³ Exhibit A, Incorrect Reduction Claim, page 74.

²⁴ Exhibit A, Incorrect Reduction Claim, page 74.

²⁵ Exhibit A, Incorrect Reduction Claim, page 74.

²⁶ Exhibit X, OMB Circular A-21, pages 37-39.

²⁷ Exhibit X, OMB Circular A-21, page 6.

expenditures incurred in the claim year, is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

The claimant used the FAM-29C methodology to calculate indirect costs for fiscal years 2004-2005 and 2005-2006. The Controller, however, reduced indirect costs by \$21,908 in these fiscal years because the claimant did not allocate direct and indirect costs as specified in the claiming instructions and used expenditures from the prior year's CCFS-311 annual financial and budget report instead of the claim year's expenses.

Staff finds that the Controller's reduction, based on the claimant's use of expenditures from the prior year's CCFS-311 reports, instead of the expenditures incurred in the claim year, is supported by the law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

Regulations governing "Budgets and Reports" adopted by the Chancellor's Office require the governing board of each community college district, by September 15 of each year, to prepare and keep on file for public inspection a statement of all receipts and expenditures for the *preceding fiscal year* and a statement of the estimated expenses for the current fiscal year.²⁸

After a public hearing, the district is then required to adopt a final budget on or before September 15, and complete and adopt the annual financial and budget report (CCFS-311) by September 30 of each year. The annual financial and budget report (CCFS-311) identifies all the district's actual revenues and expenditures from *the preceding fiscal year* and the estimated revenues and expenditures for the current fiscal year, and is considered a public record pursuant to the Government Code.²⁹ By October 10th of each year, the district is required to submit a copy of the adopted annual financial and budget report (CCFS-311) to the Chancellor. In this case, the Controller contends that the claimant submitted its CCFS-311 report identifying 2004-2005 actual expenditures on October 17, 2005, and its CCFS-311 report identifying 2005-2006 actual expenditures on October 16, 2006.³⁰ The claimant has not disputed these allegations and, in any event, the claimant was required by the regulations to adopt the annual report identifying actual expenditures for fiscal year 2004-2005 by September 30, 2005, and the actual expenditures for fiscal year 2005-2006 by September 30, 2006 – four months *before* the reimbursement claims were due. Reimbursement claims for fiscal years 2004-2005 and 2005-2006 were due to the Controller by January 15, 2006 and January 15, 2007.³¹ Thus, in this case, the actual expenditures for the 2004-2005 and 2005-2006 claim years were known and were required to be made available to the public before the deadline for filing the reimbursement claims at issue in this case.

²⁸ California Code of Regulations, title 5, section 58300.

²⁹ California Code of Regulations, title 5, section 58305; California Community Colleges, Budget and Accounting Manual (2012), page 1-8.

³⁰ Exhibit B, Controller's Late Comments on IRC, page 15.

³¹ Former Government Code section 17560 (as amended, Stats. 1998, ch. 681 (AB 1963)). Government Code section 17560 was amended by Statutes 2007, chapter 179, to change the deadline for filing reimbursement claims from January 15 to February 15, effective August 24, 2007, which affected the reimbursement claims for costs incurred in fiscal year 2006-2007.

Moreover, the Government Code and parameters and guidelines for this program require local agencies and school districts to claim reimbursement for the costs incurred for the fiscal year being claimed. Government Code section 17560 authorizes local agencies and school districts to file an annual reimbursement claim “that details the costs actually incurred *for that fiscal year...*” Government Code section 17564(b) states that “[c]laims for direct and indirect costs filed pursuant to Section 17561 shall be in the manner described in the parameters and guidelines....” Further, the parameters and guidelines require that “[a]ctual costs for one fiscal year should be included in each claim.”³² Thus, the requirement to calculate indirect costs for the claim year based on that year’s actual expenses, which are known by the claimant, is supported by the law and evidence in the record.

3. The Controller’s recalculation of indirect costs using the FAM-29C is not arbitrary, capricious, or entirely lacking in evidentiary support.

Even though the claimant incorrectly calculated indirect costs, the Controller did not reduce indirect costs to \$0. Instead, the Controller recalculated the indirect cost rate for the three fiscal years using the FAM-29C methodology in accordance with the claiming instructions.³³ The Controller’s recalculation resulted in indirect cost rates of 17.26 percent, 33.99 percent, and 31.89 percent in fiscal years 2003-2004, 2004-2005, and 2005-2006, respectively.³⁴

The claimant’s main dispute is that the recalculation excludes capital costs from the calculation, and replaces capital costs with depreciation expenses.³⁵ However, there is no evidence in the record that the Controller’s recalculation is arbitrary, capricious, or entirely lacking in evidentiary support. As explained in the claiming instructions, the Controller excluded capital costs in accordance with the OMB Circular A-21.³⁶

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.”³⁷ Thus, the Commission cannot compel the Controller to use other auditing procedures in place of the Form FAM-29C.

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

Conclusion

Staff finds that the Controller’s reductions are correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

³² Exhibit A, Incorrect Reduction Claim, page 45.

³³ Exhibit A, Incorrect Reduction Claim, page 74.

³⁴ *Ibid.* Compared to the claimed indirect cost rates for those years of 30.97 percent, 35.22 percent, and 35.02 percent.

³⁵ Exhibit A, Incorrect Reduction Claim, page 12.

³⁶ Exhibit B, Controller’s Late Comments on IRC, page 42; See also, Exhibit X, Community Colleges Mandated Cost Manual excerpt 2005-2006, page 17.

³⁷ *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

Staff Recommendation

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

BEFORE THE
 COMMISSION ON STATE MANDATES
 STATE OF CALIFORNIA

**IN RE INCORRECT REDUCTION CLAIM
 ON:**

Former Education Code Section 72246
 (Renumbered as 76355)³⁸

Statutes 1984, Chapter 1 (1983-1984 2nd Ex.
 Sess.) (AB2X 1); Statutes 1987, Chapter 1118
 (AB 2336)

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

El Camino Community College District,
 Claimant

Case Nos.: 10-4206-I-33

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 May 27, 2016)

DECISION

The Commission on State Mandates (Commission) heard and decided this 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	

³⁸ Statutes 1993, chapter 8.

Summary of the Findings

This decision addresses reductions made by the State Controller's Office (Controller) to El Camino Community College District's (claimant's) reimbursement claims for fiscal years 2003-2004, 2004-2005, 2005-2006, and 2006-2007 under the *Health Fee Elimination* program. Over the four fiscal years in question, the Controller reduced costs totaling \$674,212. The Controller found that the claimant incorrectly calculated indirect cost rates for the four fiscal years and understated offsetting fees.

The Commission finds 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:

- Reduction based on understated offsetting health service fee authority of \$699,317 for fiscal years 2003-2004, 2004-2005, 2005-2006, and 2006-2007. In addition, the fees authorized to be charged and required to be identified as offsetting in fiscal year 2006-2007, *excluding* the amount attributable to students enrolled in the Compton Center (\$84,135), exceed the direct and indirect costs claimed for that fiscal year. Therefore, there are no increased costs mandated by the state for fiscal year 2006-2007 and the Controller's total reduction of costs claimed for that year is correct as a matter of law. Accordingly, the Commission does not address the remaining substantive issues relating to the fiscal year 2006-2007 reimbursement claim (including the legal issue surrounding the Compton Center and the Controller's reduction of \$1,556 for indirect costs claimed for that fiscal year).
- Indirect costs of \$63,502 for fiscal year 2003-2004 based on the claimant's failure to obtain federal approval of the indirect cost rate pursuant to OMB Circular A-21, and the Controller's recalculation of indirect costs using the FAM-29C.
- Indirect costs of \$21,908 for fiscal years 2004-2005 and 2005-2006 based on the claimant's failure to use expenditures incurred in the claim year to calculate the indirect cost rate, which were known and available before the reimbursement claims were filed, and the Controller's recalculation of indirect costs using the FAM-29C in accordance with the claiming instructions.

Accordingly, the Commission denies this IRC.

COMMISSION FINDINGS

I. Chronology

- 01/07/2005 Transmittal letter for claimant's fiscal year 2003-2004 reimbursement claim was signed.³⁹
- 01/09/2007 Transmittal letter for claimant's fiscal years 2004-2005 and 2005-2006 reimbursement claims was signed.⁴⁰

³⁹ Exhibit A, Incorrect Reduction Claim, page 143. (References to page numbers are to the PDF page number.)

⁴⁰ Exhibit A, Incorrect Reduction Claim, pages 151 and 159.

- 02/13/2008 Transmittal letter for claimant's fiscal year 2006-2007 reimbursement claim was signed.⁴¹
- 09/11/2008 The audit entrance conference was conducted.⁴²
- 08/28/2009 The Controller, Division of Audits, issued its final audit report.⁴³
- 10/20/2010 Claimant filed this IRC.⁴⁴
- 12/02/2014 The Controller filed late comments on the IRC.⁴⁵
- 03/18/2016 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, 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 session).⁴⁹

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

⁴¹ Exhibit A, Incorrect Reduction Claim, page 167.

⁴² Exhibit A, Incorrect Reduction Claim, page 32; Exhibit B, Controller's Late Comments on IRC, page 32.

⁴³ Exhibit A, Incorrect Reduction Claim, page 10; Exhibit B, Controller's Late Comments on IRC, page 8.

⁴⁴ Exhibit A, Incorrect Reduction Claim, page 1.

⁴⁵ Exhibit B, Controller's Late Comments on IRC, page 1.

⁴⁶ Exhibit C, 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.]. Effective January 31, 2006, the exemption for low income students was removed in what was formerly Education Code section 76355(c)(3) [Stats. 2005, ch. 320 (AB 982)].

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

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

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 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.⁵³ 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.⁵⁴

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 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 claimant submitted reimbursement claims for the four fiscal years at issue, claiming costs totaling \$885,825 (less a \$1,000 penalty for late filing). Following a field audit, the Controller reduced the costs claimed by \$674,212, based on the following audit findings:

- Reduction of \$63,502 for fiscal year 2003-2004 based on asserted faults in the development and application of the indirect cost rate. The claimant developed an indirect

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).

⁵³ 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).

⁵⁴ 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).

cost rate proposal based on the OMB Circular A-21 methodology, but did not obtain federal approval for its proposal. The District also used expenditures from the prior year's annual financial and budget report (CCFS-311) submitted to the Chancellor's Office to prepare the claim year's indirect cost rates. The Controller contends that Government Code section 17558.5 requires the claimant to file reimbursement claims based on the actual mandate-related costs for the claim year, which are not based on expenses from the prior year. The Controller recalculated indirect costs using the FAM-29C methodology allowed in the claiming instructions.⁵⁵

- Reduction of \$23,464 for indirect costs claimed for fiscal years 2004-2005, 2005-2006 and 2006-2007. The claimant developed the indirect cost rates for these fiscal years based on the FAM-29C methodology, but used expenditures from the prior year's financial and budget report (form CCSF-311) to prepare the indirect cost rate. In addition, the claimant did not allocate direct and indirect costs as specified in the claiming instructions. The Controller recalculated indirect costs using the FAM-29C methodology in accordance with the claiming instructions.⁵⁶
- Reduction based on understated offsetting health service fee revenue authorized to be charged of \$699,317 for fiscal years 2003-2004, 2004-2005, 2005-2006 and 2006-2007. The claimant reported and deducted only the fee revenue that it collected from students, rather than the amount authorized by statute to be charged. The Controller recalculated authorized health fee revenue by using student enrollment data and Board of Governors Grant (BOGG) recipient data from the Chancellor's Office. For fiscal year 2006-2007, the Controller's calculation of student enrollment included 5,609 students enrolled in Compton Community College Educational Center (the Compton Center). In 2006, a partnership agreement between the claimant and Compton Community College District was created because Compton's accreditation was at risk of being terminated by the regional accrediting body recognized by the Board of Governors of the California Community Colleges. Statutes 2006, chapter 50 added Education Code sections 74292 et seq., to codify the terms of the agreement, and the Controller's interprets the agreement and the statutes to require the claimant to provide instructional services, financial aid, and related student support services while Compton regained full accreditation as a two-year public college. The Controller contends the claimant had the legal authority to charge Compton students the health service fee.⁵⁷

III. Positions of the Parties

El Camino Community College District

⁵⁵ Exhibit A, Incorrect Reduction Claim, page 74 (Finding 1, Final Audit Report).

⁵⁶ Exhibit A, Incorrect Reduction Claim, page 74 (Finding 1, Final Audit Report).

⁵⁷ Exhibit A, Incorrect Reduction Claim, page 78 (Finding 2, Final Audit Report); Exhibit B, Controller's Late Comments on IRC, pages 24.

Claimant contends that the Controller's reductions are incorrect and should be reinstated. Claimant asserts that the audit of the 2003-2004 claim was not timely initiated under Government Code section 17558.5 and is void.⁵⁸

Claimant asserts that the Controller's reduction of \$63,502 in indirect costs for fiscal year 2003-2004 on the basis that "the District used an indirect cost rate that was not derived from a cost study approved by the federal government"⁵⁹ was incorrect. Claimant also asserts that Controller's reduction of \$23,464 in indirect costs for fiscal years 2004-2005, 2005-2006 and 2006-2007 on the basis that "the district did not allocate direct and indirect costs as specified in the claiming instructions" was incorrect.⁶⁰ The claimant asserts that for fiscal years 2004-2005 through 2006-2007, costs were classified as either direct or indirect following the CCFS-311 and that the audit used a different classification based on the claiming instructions.⁶¹ The claimant argues that the Controller's finding that the district incorrectly used the prior year CCSF-311 for all four fiscal years is wrong because there is no requirement to use the current year CCFS-311 and "[a]s a practical matter, the CCFS-311 for the current year is often not available at the time that the mandate reimbursement claims are due."⁶² Claimant asserts that the claiming instructions are "a statement of the Controller's interpretation and not law."⁶³ Claimant argues that there is no requirement in law that claimant's indirect costs be claimed in the manner specified by the Controller; "[n]either state law nor the parameters and guidelines made compliance with the Controller's claiming instructions a condition of reimbursement,"⁶⁴ and the Controller did not make findings that claimant's rate was excessive or unreasonable.⁶⁵

Claimant asserts that the reduction of costs based on authorized health service fees was incorrect, because the parameters and guidelines require claimants to state offsetting savings the claimant "experiences" and claimant did not experience offsetting savings for fees that it did not charge to students.⁶⁶ Claimant also asserts that the students from the Compton Center should not have been included in calculating the offsetting authorized fees.⁶⁷ The claimant argues that the District does not have the authority to charge students at the Compton Center a health services fee and that Compton Center students are not provided health services and therefore the District cannot collect a fee for health supervision or services.⁶⁸

⁵⁸ Exhibit A, Incorrect Reduction Claim, page 32-33.

⁵⁹ Exhibit A, Incorrect Reduction Claim, page 11.

⁶⁰ Exhibit A, Incorrect Reduction Claim, pages 15, 74.

⁶¹ Exhibit A, Incorrect Reduction Claim, page 12.

⁶² Exhibit A, Incorrect Reduction Claim, page 13.

⁶³ Exhibit A, Incorrect Reduction Claim, page 15.

⁶⁴ Exhibit A, Incorrect Reduction Claim, page 15.

⁶⁵ Exhibit A, Incorrect Reduction Claim, page 18.

⁶⁶ Exhibit A, Incorrect Reduction Claim, page 22.

⁶⁷ Exhibit A, Incorrect Reduction Claim, pages 26-27.

⁶⁸ Exhibit A, Incorrect Reduction Claim, pages 26-27.

State Controller's Office

The Controller argues that the IRC should be denied. The Controller asserts that it timely conducted the audit because the claimant has not received payment for the 2003-2004 fiscal year claim. Thus, the requirements of Government Code section 17558.5(a) were met when it initiated its audit on September 11, 2008.⁶⁹

The Controller found that the claimant overstated indirect cost rates in all four years because the district used prior year expenditures reported in the CCFS-311, rather than the claim year expenses to prepare the indirect cost rate. The Controller also 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 the OMB Circular A-21.⁷⁰ The Controller further found that claimant overstated its indirect costs for fiscal years 2004-2005, 2005-2006, and 2006-2007 because the claimant used the FAM-29C methodology, but did not allocate direct and indirect costs as specified in the claiming instructions.⁷¹

The Controller found that claimant understated its health service fee authority, which was required to be taken as an offset, for the audit period by \$699,317.⁷² Using enrollment and exemption data, including the enrollment numbers for the students at the Compton Center, the Controller recalculated the health fees that claimant was authorized to collect, and reduced the claim by the amount not stated as offsetting revenues.⁷³ Regarding the Compton Center student enrollment, the Controller asserts that the partnership agreement between El Camino Community College District and Compton Community College District includes that El Camino CCD provide "instructional services, as well as financial aid and related student support services, to the students at the Compton Center," and that under the Education Code students enrolling at classes provided by a partner district shall be considered students of the partner district. Therefore the student support services provided to Compton Center students by El Camino Community College District under the partnership agreement, includes the health center.⁷⁴ The Controller argues that, "[t]o the extent community college districts can charge a fee, they are not required to incur a cost."⁷⁵

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.

⁶⁹ Exhibit B, Controller's Late Comments on IRC, page 32.

⁷⁰ Exhibit A, Incorrect Reduction Claim, page 74.

⁷¹ Exhibit A, Incorrect Reduction Claim, page 74.

⁷² Exhibit A, Incorrect Reduction Claim, page 78.

⁷³ Exhibit A, Incorrect Reduction Claim, page 79.

⁷⁴ Exhibit A, Incorrect Reduction Claim, page 78.

⁷⁵ Exhibit A, Incorrect Reduction Claim, page 86.

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.⁸¹

A. The Controller Met the Statutory Deadlines for the Audit of the 2003-2004 Reimbursement Claim 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 date the reimbursement claim was submitted to the Controller (January 7, 2005), and the date that the audit entrance conference took place nearly four years later (September 11, 2008).⁸²

When the 2003-2004 reimbursement claim was submitted in January 2005, 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 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.*⁸³

The Controller does not dispute the filing date of the 2003-2004 claim, or that the audit was not initiated until September 2008, but asserts that the time was tolled pursuant to the second sentence in section 17558.5, since the 2003-2004 claim was not paid.⁸⁴

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 to the date of initial payment when no payment has been made, "is void because it is impermissibly vague."⁸⁵ 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

⁸¹ 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.

⁸² Exhibit A, Incorrect Reduction Claim, page 32.

⁸³ Statutes 2002, chapter 1128, effective January 1, 2003, emphasis added.

⁸⁴ Exhibit B, Controller's Late Comments on IRC, page 32.

⁸⁵ Exhibit A, Incorrect Reduction Claim, page 33.

limitations.”⁸⁶ Claimant argues that the January 7, 2005 submission date of the reimbursement claim should control the time to audit, requiring that the audit be initiated no later than January 7, 2008. Since the audit was initiated with the entrance conference nine months past that date, on September 11, 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 submitted on January 7, 2005, but the claim was not paid at the time the Controller started the audit in September 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.⁸⁷ 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.*”⁸⁸ 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 August 28, 2009, states that the allowable amount to be reimbursed will be paid “contingent upon available appropriations.”⁸⁹

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.⁹⁰ 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...” 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.*...”⁹¹ In the event that the amount appropriated for reimbursement pursuant to Government Code section 17561 is not sufficient to pay all of the

⁸⁶ Exhibit A, Incorrect Reduction Claim, page 34.

⁸⁷ Statutes 2003, chapter 157, Item 6870-295-0001, schedule 1.

⁸⁸ *California School Boards Assoc. v. State of California* (2011) 192 Cal.App.4th 770, 791, emphasis added.

⁸⁹ Exhibit A, Incorrect Reduction Claim, p. 70.

⁹⁰ *Kraus v. Trinity Management Services, Inc.* (2000) 23 Cal.4th 116, 129.

⁹¹ Government Code section 17561(d), as amended by Statutes 2002, chapter 1124, emphasis added.

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.”⁹²

Therefore, the time to initiate an audit in this case had not commenced to run and the audit initiated no later than September 11, 2008 was timely pursuant to Government Code section 17558.5(a).

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. In any case, an audit shall be completed not later than two years after the date that the audit is commenced.⁹³

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 January 1, 2005), the restriction in the new law becomes effective immediately upon the operative date of the change in law for all pending claims.⁹⁴

Here, the Controller’s audit of the relevant claim years was “commenced,” within the meaning of section 17558.5, no later than September 11, 2008, when the entrance conference was held. Therefore, a timely audit must be completed by September 11, 2010. The audit was completed when the final audit report was issued on August 28, 2009, well before the two year deadline of September 11, 2010, to complete the audit.

Based on the foregoing, the Commission finds that the audit was timely completed pursuant to Government Code section 17558.5(a).

B. The Controller’s Reduction for Understated Offsetting Fees Authorized to Be Charged Is Correct as a Matter of Law, and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced costs claimed based on understated offsetting health service fee authority totaling \$699,317 for fiscal years 2003-2004, 2004-2005, 2005-2006, and 2006-2007. The claimant reported and deducted only the fee revenue that it actually collected from students, and not the amount authorized by statute to be charged. The Controller recalculated the offsetting health fee authority by using student enrollment data and Board of Governors Grant (BOGG)

⁹² Government Code section 17567, as last amended by Statutes 2007, chapter 179.

⁹³ Statutes 2004, chapter 890.

⁹⁴ *California Employment Stabilization Commission v. Payne* (1948) 31 Cal.2d 210, 215-216.

recipient data from the Chancellor's Office. For fiscal year 2006-2007, the Controller's calculation of student enrollment included 5,609 students enrolled in the Compton Center, which resulted in understated offsetting health service fees for that fiscal year of \$84,135. The Compton Center was created in 2006 based on a partnership agreement between the claimant and Compton Community College District to provide instructional services, financial aid, and related student support services while Compton Community College District regained full accreditation as a two-year public college. Based on the agreement, and the statute that codified the agreement, the Controller contends that the claimant had the legal authority to charge Compton students the health service fee.⁹⁵

As described below, the Commission finds that, even *excluding* the amount attributable to students enrolled in the Compton Center, the Controller's reduction is correct as a matter of law, and that the recalculation of authorized offsetting fee revenues is not arbitrary, capricious, or entirely lacking in evidentiary support. The fees authorized to be charged and required to be identified as offsetting revenue for fiscal year 2006-2007, *excluding* the amount attributable to students enrolled in the Compton Center, totals \$708,690.⁹⁶ Since this amount in offsetting revenues exceeds the direct and indirect costs claimed for that fiscal year (\$708,271),⁹⁷ there are no increased costs mandated by the state in that year and the Controller's total reduction of costs claimed for that year is correct as a matter of law. As a result, the Commission need not determine whether the district had authority to impose fees on the Compton Center students. Therefore, the Commission does not address the remaining substantive issues relating to the fiscal year 2006-2007 reimbursement claim.

1. The Controller's reductions based on fees authorized to be charged is correct as a matter of law.

Claimant disputes the reduction based on authorized student health fees, 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...."⁹⁸ The Claimant argues that "[i]n order for the district to 'experience' these 'offsetting savings' the District must actually have collected these fees." Claimant concludes that "[s]tudent fees actually collected must be used to offset costs, but not student fees that could have been collected and were not."⁹⁹

⁹⁵ Exhibit A, Incorrect Reduction Claim, page 78 (Finding 2, Final Audit Report); Exhibit B, Controller's Late Comments on IRC, pages 24.

⁹⁶ Exhibit A, Incorrect Reduction Claim, pages 73, 78 (Schedule 1, Final Audit Report; \$792,825 authorized fee revenue minus \$84,135 attributable to students at the Compton Center = \$708,690).

⁹⁷ *Ibid.*

⁹⁸ Exhibit A, Incorrect Reduction Claim, page 22.

⁹⁹ Exhibit A, Incorrect Reduction Claim, page 22.

The Commission finds that the issue of offsetting fee revenue from student health fees has been resolved by the court in *Clovis Unified School Dist. v. Chiang*, and that the reduction is correct as a matter of law.¹⁰⁰

In October 2010, a month before claimant filed this IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the Controller’s practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge students, whether or not a district chooses to charge its students those fees. As cited by the court, the Health Fee Rule states in pertinent part:

Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.¹⁰¹ (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).¹⁰²

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.¹⁰³

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

¹⁰⁰ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794.

¹⁰¹ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 811.

¹⁰² 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)].

¹⁰³ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

state's expense.”¹⁰⁴ 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,”¹⁰⁵ 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*.¹⁰⁶ (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 correct as a matter of law. 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.¹⁰⁷ In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.¹⁰⁸ 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.¹⁰⁹ Here, the claimant was a party 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.¹¹⁰

Accordingly, the Commission finds that the Controller's reductions based on fee revenue authorized to be charged is correct as a matter of law.

2. The Controller's recalculation of authorized health services fees is not arbitrary, capricious, or entirely lacking in evidentiary support.

¹⁰⁴ *Ibid.*

¹⁰⁵ *Ibid.* (Original italics.)

¹⁰⁶ *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

¹⁰⁷ *Fenske v. Board of Administration* (1980) 103 Cal.App.3d 590, 596.

¹⁰⁸ 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.

¹⁰⁹ *Roos v. Red* (2006) 130 Cal.App.4th 870, 879-880.

¹¹⁰ *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.

The Controller calculated the offsetting revenue using student enrollment and BOGG recipient data obtained from the Chancellor's Office, as reported by the claimant.¹¹¹ The number of enrolled students was multiplied by the authorized health service fee rate to determine the total authorized health service fee.¹¹² This data is a public record maintained by the claimant in the normal course of business, and claimant has provided no other documents or evidence to support the offsetting health service fee revenue authorized for this program, or to support a conclusion that the Controller's recalculation is arbitrary, capricious, or entirely lacking in evidentiary support.

Claimant also argues that the Controller's inclusion of students enrolled at the Compton Center to determine the total number of enrolled students that could be charged the health service fee in fiscal year 2006-2007 is incorrect. Claimant contends that Compton Community College District did not provide a student health service program in fiscal year 1986-1987 and does not operate a student health center. Nor did Compton Community College District previously collect student health service fees. Therefore, claimant contends that those students should not be included in the enrollment count.¹¹³ The Controller disagrees with the claimant on this issue, and contends the claimant is currently charging Compton students the health service fee and that the 2006 agreement and statute that codified the agreement provide the legal authority for the claimant to charge Compton students the health service fee.¹¹⁴ However, the Commission does not need to resolve this legal issue. Even when the revenue that the Controller attributes to the students enrolled at the Compton Center (\$84,135) is excluded, the total health services fee authority of the district is \$708,690 for fiscal year 2006-2007, which exceeds the total direct and indirect costs claimed for that fiscal year (\$708,271).¹¹⁵ Thus, the authorized fees for the El Camino Community College District students alone were sufficient to cover the costs of the program in fiscal year 2006-2007 and, thus, the claimant did not incur increased costs mandated by the state and is not entitled to any reimbursement from the state for that year.¹¹⁶

Accordingly, the Commission finds that the Controller's reduction based on offsetting fee authority for all four fiscal years is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

Since there are no increased costs mandated by the state for fiscal year 2006-2007 and the reduction of costs claimed for that fiscal year is correct as a matter of law, the remaining analysis

¹¹¹ Exhibit A, Incorrect Reduction Claim, page 79. The BOGG recipients were not deducted for Spring 2006 because, effective January 31, 2006, the exemption for the fee for BOGG recipients was removed in what was formerly Education Code section 76355(3)(c). [Education Code section 76355(c)(3) (Stats. 2005, ch. 320 (AB 982)).]

¹¹² Exhibit A, Incorrect Reduction Claim, page 79.

¹¹³ Exhibit A, Incorrect Reduction Claim, page 28.

¹¹⁴ Exhibit A, Incorrect Reduction Claim, pages 78, 87-89; Exhibit B, Controller's Late Comments on IRC, page 27.

¹¹⁵ Exhibit A, Incorrect Reduction Claim, pages 73, 78.

¹¹⁶ Government Code section 17556(d); *County of Fresno v. State of California* (1991) 53 Cal.3d 482, 487.

focuses on the reductions made to the fiscal year 2003-2004, 2004-2005, and 2005-2006 reimbursement claims.

C. The Controller's Reduction and Recalculation of Indirect Costs Claimed for Fiscal Years 2003-04, 2004-05 and 2005-06 Is Correct as a Matter of Law and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced indirect costs claimed by \$63,502 for fiscal year 2003-2004¹¹⁷ and a total of \$21,908 for fiscal years 2004-2005 and 2005-2006.¹¹⁸ 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. For fiscal years 2004-2005, 2005-2006, and 2006-2007, claimant used the state Form FAM 29-C methodology to calculate indirect costs, using expenditures from the prior year's CCSF-311 annual financial and budget report. For these fiscal years, the Controller also found the claimant did not allocate direct and indirect costs as specified in the claiming instructions. The Controller recalculated indirect costs for all three fiscal years at issue using the state Form FAM-29C in accordance with the claiming instructions.¹¹⁹

Claimant disputes the Controller's findings that the indirect cost rate proposal was incorrectly applied, charging that the Controller's conclusions were based on the Controller's policy and not on the law. Claimant contends that the Controller's claiming instructions are unenforceable underground regulations because they were unilaterally created and modified without public notice as required by the Administrative Procedures Act. And the claimant asserts that the Controller has not made a determination that the indirect cost rates were excessive or unreasonable, and that the only available audit standard requires such a determination.¹²⁰

As described below, the Commission finds that the Controller's reduction and recalculation of indirect costs in accordance with the FAM-29C methodology described in the claiming instructions was correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

1. The reduction of indirect costs claimed for fiscal year 2003-2004 for failure to obtain federal approval pursuant to OMB Circular A-21 is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

The parameters and guidelines adopted for this program, in addition to identifying the reimbursable activities, provide instructions for eligible claimants to prepare reimbursement claims for the direct and indirect costs of a state-mandated program.¹²¹ The Commission's adoption of parameters and guidelines is quasi-judicial and, therefore, the parameters and guidelines are final and binding on the parties unless set aside by a court pursuant to Government Code section 17559 or amended by the filing of a request pursuant to Government Code section

¹¹⁷ Exhibit A, Incorrect Reduction Claim, page 74.

¹¹⁸ Exhibit A, Incorrect Reduction Claim, page 74.

¹¹⁹ Exhibit A, Incorrect Reduction Claim, page 74.

¹²⁰ Exhibit A, Incorrect Reduction Claim, pages 15-18.

¹²¹ Government Code section 17557; California Code of Regulations, title 2, section 1183.7.

17557.¹²² 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.*”¹²³ 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.¹²⁴

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 Community Colleges Mandated Cost Manual which is revised each year and contains claiming instructions applicable to all school and community college mandated programs. The cost manual issued by the Controller’s Office in September 2004 governs the reimbursement claim filed for fiscal year 2003-2004.¹²⁵ This cost manual provides two options for claiming indirect costs by either using the OMB Circular A-21, or the FAM-29C:

A community college has the option of using a federally approved rate, utilizing the cost accounting principles from *Office of Management and Budget Circular A-21* “Cost Principles for Educational Institutions,” or the Controller’s methodology outlined in the following paragraphs.

The Controller allows the following methodology for use by community colleges in computing an indirect cost rate for state mandates. The objective of this computation is to determine an equitable rate for use in allocating administrative support to personnel that performed the mandated cost activities claimed by the community college. This methodology assumes that administrative services are provided to all activities of the institution in relation to the direct costs incurred in the performance of those activities. *Form FAM-29C* has been developed to assist the community college in computing an indirect cost rate for state mandates. . . .

[¶]

¹²² *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.

¹²³ Exhibit A, Incorrect Reduction Claim, page 49.

¹²⁴ Exhibit A, Incorrect Reduction Claim, page 15.

¹²⁵ Exhibit X, Community Colleges Mandated Cost Manual excerpt, issued September 2004.

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. . . .¹²⁶

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.¹²⁷ 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.”¹²⁸ The OMB Circular A-21 establishes

¹²⁶ Exhibit X, Community Colleges Mandated Cost Manual excerpts, issued September 2004, pages 16-17.

¹²⁷ Exhibit X, OMB Circular A-21, pages 37-39.

¹²⁸ Exhibit X, OMB Circular A-21, page 6.

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.¹²⁹ 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 used the methodology in the OMB Circular A-21 for fiscal year 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.¹³⁰ 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 in this case 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 indirect costs claimed in fiscal year 2003-2004 for failure to obtain federal approval pursuant to OMB Circular A-21 is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

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

The mandated cost manual and claiming instructions issued for 2004-2005 and 2005-2006 fiscal year reimbursement claims provide, in pertinent part the following:

A CCD may claim indirect costs using the Controller’s methodology (FAM-29C) outlined in the following paragraphs. If specifically allowed by a mandated program’s P’s & G’s, a district may alternately choose to claim indirect costs using either (1) a federally approved rate prepared in accordance with Office of Management and Budget (OMB) Circular A-21, *Cost Principles for Educational Institutions*; or (2) a flat 7% rate.

The SCO developed FAM-29C to be consistent with OMB Circular A-21, cost accounting principles as they apply to mandated cost programs. The objective is to determine an equitable rate to allocate administrative support to personnel who

¹²⁹ Exhibit X, OMB Circular A-21.

¹³⁰ Exhibit A, Incorrect Reduction Claim, pages 11, 17-18.

performed the mandated cost activities. The FAM-29C methodology uses a direct cost base comprised of salary and benefit costs and operating expenses. Form FAM-29C provides a consistent indirect cost rate methodology for all CCD's mandated cost programs.

*FAM-29C uses total expenditures that districts report in their California Community Colleges Annual Financial and Budget Report (CCFS-311), Expenditures by Activity for the General Fund – Combined. The computation excludes Capital Outlay and Other Outgo in accordance with OMB Circular A-21. The indirect cost rate computation includes any depreciation or use allowance applicable to district buildings and equipment. Districts calculate depreciation or use allowance costs separately from the CCFS-311 report and should calculate them in accordance with OMB Circular A-21.*¹³¹

The claimant used the FAM-29C methodology to calculate indirect costs. The Controller, however, reduced indirect costs by a total of \$21,908 for fiscal years 2004-2005 and 2005-2006 because the claimant did not allocate direct and indirect costs as specified in the claiming instructions and used expenditures from the prior year's CCFS-311 annual financial and budget report instead of the claim year's expenses.¹³² The claimant states that it used "the FAM-29C method, including capital costs, but correcting for instances where the Controller's method did not follow the CCFS-311 characterization of costs as direct or indirect."¹³³ Claimant states that the Controller's classification of direct and indirect costs is "a source of minor differences."¹³⁴ The claimant also contends that the law does not support "the Controller's insistence that the current year CCFS-311 report must be used."¹³⁵ The claimant asserts that the current year CCFS-311 is often not available at the time the mandate reimbursement claims are due, so the prior year CCFS-311 must be used to determine the indirect cost rate.¹³⁶

For the reasons below, the Commission finds that the Controller's reduction, based on the claimant's use of expenditures from the prior year's CCFS-311 reports, instead of the expenditures incurred in the claim year, is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

Regulations governing "Budgets and Reports" adopted by the Chancellor's Office require the governing board of each community college district, by September 15 of each year, to prepare and keep on file for public inspection a statement of all receipts and expenditures for the *preceding fiscal year* and a statement of the estimated expenses for the current fiscal year.¹³⁷

¹³¹ Exhibit B, Controller's Late Comments on IRC, pages 42-43 (Community Colleges Mandated Costs Manual excerpt 2004-2005) [emphasis added]; See also, Exhibit X, Community Colleges Mandated Costs Manual excerpt 2005-2006, pages 17-18.

¹³² Exhibit A, Incorrect Reduction Claim, page 74.

¹³³ Exhibit A, Incorrect Reduction Claim, page 12.

¹³⁴ *Ibid.*

¹³⁵ Exhibit A, Incorrect Reduction Claim, page 13.

¹³⁶ Exhibit A, Incorrect Reduction Claim, page 13.

¹³⁷ California Code of Regulations, title 5, section 58300.

After a public hearing, the district is required to adopt a final budget on or before September 15, and complete and adopt the annual financial and budget report (CCFS-311) by September 30 of each year. The annual financial and budget report (CCFS-311) identifies all the district's actual revenues and expenditures from *the preceding fiscal year* and the estimated revenues and expenditures for the current fiscal year, and is considered a public record pursuant to the Government Code.¹³⁸ By October 10th of each year, the district is required to submit a copy of the adopted annual financial and budget report (CCFS-311) to the Chancellor. In this case, the Controller contends that the claimant submitted its CCFS-311 report identifying 2004-2005 actual expenditures on October 17, 2005, and its CCFS-311 report identifying 2005-2006 actual expenditures on October 16, 2006.¹³⁹ The claimant has not disputed these allegations and, in any event, the claimant was required by the regulations to adopt the annual report identifying actual expenditures for fiscal year 2004-2005 by September 30, 2005, and the actual expenditures for fiscal year 2005-2006 by September 30, 2006 – four months *before* the reimbursement claims were due. Reimbursement claims for fiscal years 2004-2005 and 2005-2006 were due to the Controller by January 15, 2006 and January 15, 2007.¹⁴⁰ Thus, the actual expenditures for the 2004-2005 and 2005-2006 claim years were known and were required to be made available to the public before the deadline for filing the reimbursement claims at issue in this case.

Moreover, the Government Code and parameters and guidelines for this program require local agencies and school districts to claim reimbursement for the costs incurred for the fiscal year being claimed. Government Code section 17560 authorizes local agencies and school districts to file an annual reimbursement claim “that details the costs actually incurred *for that fiscal year...*” Government Code section 17564(b) states that “[c]laims for direct and indirect costs filed pursuant to Section 17561 shall be in the manner described in the parameters and guidelines....” Further, the parameters and guidelines require that “[a]ctual costs for one fiscal year should be included in each claim.”¹⁴¹ Thus, the requirement to calculate indirect costs for the claim year based on that year's actual expenses, which are known by the claimant, is supported by the law and evidence in the record.

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

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

Even though the claimant incorrectly calculated indirect costs, the Controller did not reduce indirect costs to \$0. Instead, the Controller recalculated the indirect cost rate for the three fiscal

¹³⁸ California Code of Regulations, title 5, section 58305; California Community Colleges, Budget and Accounting Manual (2012), page 1-8.

¹³⁹ Exhibit B, Controller's Late Comments on IRC, page 15.

¹⁴⁰ Former Government Code section 17560 (as amended, Stats. 1998, ch. 681 (AB 1963)). Government Code section 17560 was amended by Statutes 2007, chapter 179, to change the deadline for filing reimbursement claims from January 15 to February 15, effective August 24, 2007, which affected the reimbursement claims for costs incurred in fiscal year 2006-2007.

¹⁴¹ Exhibit A, Incorrect Reduction Claim, page 45.

years using the FAM-29C methodology in accordance with the claiming instructions.¹⁴² The Controller's recalculation resulted in indirect cost rates of 17.26 percent, 33.99 percent, and 31.89 percent for fiscal years 2003-2004, 2004-2005, and 2005-2006, respectively.¹⁴³

The claimant's main dispute is that the recalculation excludes capital costs from the calculation, and replaces capital costs with depreciation expenses.¹⁴⁴ However, there is no evidence in the record that the Controller's recalculation is arbitrary, capricious, or totally lacking in evidentiary support. As explained in the claiming instructions, the Controller excluded capital costs in accordance with the OMB Circular A-21.

The SCO developed FAM-29C to be consistent with OMB Circular A-21, cost accounting principles as they apply to mandated cost programs. The objective is to determine an equitable rate to allocate administrative support to personnel who performed the mandated cost activities. The FAM-29C methodology uses a direct cost base comprised of salary and benefit costs and operating expenses. Form FAM-29C provides a consistent indirect cost rate methodology for all CCD's mandated cost programs.

FAM-29C uses total expenditures that districts report in their *California Community Colleges Annual Financial and Budget Report* (CCFS-311), Expenditures by Activity for the General Fund—Combined. The computation excludes Capital Outlay and Other Outgo in accordance with OMB Circular A-21. The indirect cost rate computation includes any depreciation or use allowance applicable to district buildings and equipment. Districts calculate depreciation or use allowance costs separately from the CCFS-311 and should calculate them in accordance with OMB Circular A-21.¹⁴⁵

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."¹⁴⁶ Thus, the Commission cannot compel the Controller to use other auditing procedures in place of the Form FAM-29C.

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

Conclusion

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

¹⁴² Exhibit A, Incorrect Reduction Claim, page 74.

¹⁴³ *Ibid.* Compared to the claimed indirect cost rates for those years of 30.97 percent, 35.22 percent, and 35.02 percent.

¹⁴⁴ Exhibit A, Incorrect Reduction Claim, page 12.

¹⁴⁵ Exhibit B, Controller's Late Comments on IRC, page 42; See also, Exhibit X, Community Colleges Mandated Cost Manual excerpt 2005-2006, page 17.

¹⁴⁶ *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547-548.

Based on the foregoing, the Commission denies this IRC.

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 March 18, 2016, I served the:

Draft Proposed Decision, Schedule for Comments, and Notice of Hearing

Health Fee Elimination, 10-4206-I-33

Former Education Code Section 72246 (Renumbered as 76355)

Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1);

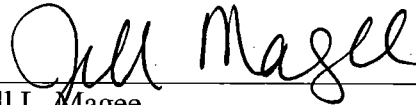
Statutes 1987, Chapter 1118 (AB 2336)

Fiscal Year: 2003-2004

El Camino 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 March 18, 2016 at Sacramento, California.



Jill L. Magee

Commission on State Mandates

980 Ninth Street, Suite 300

Sacramento, CA 95814

(916) 323-3562

COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 3/14/16

Claim Number: 10-4206-I-33

Matter: Health Fee Elimination

Claimant: El Camino Community College District

TO ALL PARTIES, INTERESTED PARTIES, AND INTERESTED PERSONS:

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

Socorro Aquino, *State Controller's Office*

Division of Audits, 3301 C Street, Suite 700, Sacramento, CA 95816

Phone: (916) 322-7522

SAquino@sco.ca.gov

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

Susan Geanacou, *Department of Finance*

915 L Street, Suite 1280, Sacramento, CA 95814

Phone: (916) 445-3274

susan.geanacou@dof.ca.gov

Rebecca Hamilton, *Department of Finance*

Education Systems Unit, 915 L Street, 7th Floor, Sacramento, CA 95814

Phone: (916) 445-0328

Rebecca.Hamilton@dof.ca.gov

Ed Hanson, *Department of Finance*

Education Systems Unit, 915 L Street, 7th Floor, Sacramento, CA 95814

Phone: (916) 445-0328

ed.hanson@dof.ca.gov

Jo Ann Higdon, *El Camino Community College District*

Administrative Services, 16007 Crenshaw Boulevard, Torrance, CA 90506-0002

Phone: (310) 660-3593

jhigdon@elcamino.edu

Jill Kanemasu, *State Controller's Office*

Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816

Phone: (916) 322-9891

jkanemasu@sco.ca.gov

Dan Kaplan, *Fiscal & Policy Analyst, Legislative Analyst's Office*

925 L Street, Suite 1000, Sacramento, CA 95814

Phone: (916) 319-8353

Dan.Kaplan@lao.ca.gov

Anne Kato, *State Controller's Office*

Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816

Phone: (916) 324-5919

akato@sco.ca.gov

Jay Lal, *State Controller's Office (B-08)*

Division of Accounting & Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816

Phone: (916) 324-0256

JLal@sco.ca.gov

Yazmin Meza, *Department of Finance*

915 L Street, Sacramento, CA 95814

Phone: (916) 445-0328

Yazmin.meza@dof.ca.gov

Robert Miyashiro, *Education Mandated Cost Network*

1121 L Street, Suite 1060, Sacramento, CA 95814

Phone: (916) 446-7517

robertm@sscal.com

Andy Nichols, *Nichols Consulting*

1857 44th Street, Sacramento, CA 95819

Phone: (916) 455-3939

andy@nichols-consulting.com

Christian Osmena, *Department of Finance*

915 L Street, Sacramento, CA 95814

Phone: (916) 445-0328

christian.osmena@dof.ca.gov

Arthur Palkowitz, *Artiano Shinoff & Holtz, APC*

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

kbsixten@aol.com

Sandra Reynolds, *Reynolds Consulting Group, Inc.*

P.O. Box 894059, Temecula, CA 92589

Phone: (951) 303-3034

sandrareynolds_30@msn.com

Carla Shelton, *Commission on State Mandates*

980 9th Street, Suite 300, Sacramento, CA 95814

Phone: (916) 327-6490

carla.shelton@csm.ca.gov

Jim Spano, Chief, Mandated Cost Audits Bureau, *State Controller's Office*

Division of Audits, 3301 C Street, Suite 700, Sacramento, CA 95816

Phone: (916) 323-5849

jspano@sco.ca.gov

Dennis Speciale, *State Controller's Office*

Division of Accounting and Reporting, 3301 C Street, Suite 700, Sacramento, CA 95816

Phone: (916) 324-0254

DSpeciale@sco.ca.gov