STATE OF CALIFORNIA
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December 10, 2014

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Ms. Jill Kanemasu
State Controller's Office
Accounting and Reporting
3301 C Street, Suite 700
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And Parties, Interested Parties, and Interested Persons (See Mailing List)

Re: **Decision**
Health Fee Elimination, 05-4206-I-12
Education Code Section 76355
Statutes 1984, Chapter 1; Statutes 1987, Chapter 1118
Fiscal Years 2001-2002 and 2002-2003
Santa Monica Community College District, Claimant

Dear Mr. Petersen and Ms. Kanemasu:

On December 5, 2014, the Commission on State Mandates adopted the decision on the above-entitled matter.

Sincerely,

Heather Halsey
Executive Director

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BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Former Education Code Section 72246 (Renumbered as §76355)[1] Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1) and Statutes 1987, Chapter 1118 (AB 2336) Fiscal Years 2001-2002 and 2002-2003 Santa Monica Community College District, Claimant.	Case No.: 05-4206-I-12 *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 December 5, 2014*) (*Served December 10, 2014*)

DECISION

The Commission on State Mandates (Commission) heard and decided this incorrect reduction claim (IRC) during a regularly scheduled hearing on December 5, 2014. Keith Petersen appeared on behalf of claimant. Jim Spano and Jim Venneman appeared on behalf of the State Controller's Office (Controller).

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

The Commission adopted the proposed decision to deny the IRC by a vote of 6 to 0.

Summary of the Findings

The Commission concludes that the following reductions in the Controller's audit of the 2001-2002 and 2002-2003 reimbursement claims are correct as a matter of law, and are not arbitrary, capricious, or entirely lacking in evidentiary support:

- The reduction of indirect costs claimed for fiscal years 2001-2002 and 2002-2003, in the amount of $146,966, based on claimant's failure to comply with the claiming instructions in the development of its indirect cost rate, and the Controller's use of an alternative method authorized by the claiming instructions to calculate indirect costs.
- The reduction of $538,244 during fiscal years 2001-2002 and 2002-2003, because claimant reported the health fee revenue collected, rather than the revenue it was authorized to collect, pursuant to the court's ruling in *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

Accordingly, the Commission denies this IRC.

[1] Statutes 1993, chapter 8.

COMMISSION FINDINGS

I. Chronology

01/08/03 Claimant signed and dated reimbursement claim for fiscal year 2001-2002.[2]

01/05/04 Claimant signed and dated reimbursement claim for fiscal year 2002-2003.[3]

12/09/05 Controller issued the draft audit report.

01/04/06 Claimant submitted comments on the draft audit report.[4]

03/17/06 Controller issued the final audit report.[5]

04/19/06 Controller issued a revised final audit report.[6]

06/16/06 Claimant Santa Monica Community College District (claimant) filed the IRC.[7]

12/23/08 Controller submitted comments on the IRC.[8]

09/04/14 Commission staff issued the draft proposed decision.[9]

09/22/14 Claimant filed comments on the draft proposed decision.[10]

09/25/14 Controller filed comments on the draft proposed decision.[11]

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 general, health service fee not to exceed $7.50 for each semester or $5 for each quarter or

[2] Exhibit A, Incorrect Reduction Claim (IRC), attachment, page 74.

[3] Exhibit A, IRC, attachment, page 85.

[4] Exhibit A, IRC, attachment, pages 67-69.

[5] Exhibit A, IRC, attachment, pages 49-61.

[6] Exhibit A, IRC, attachment, page 45.

[7] Exhibit A, IRC.

[8] Exhibit B, State Controller's comments.

[9] Exhibit C, draft proposed decision.

[10] Exhibit D, Claimant comments on the draft proposed decision.

[11] Exhibit E, State Controller's comments on the draft proposed decision.

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

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

In 1987, the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.[16] In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than $7.50 for each semester, or $5 for each quarter or summer semester.[17] As a result, beginning January 1, 1988 all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with limited fee authority to offset the costs of those services.[18] In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.[19]

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

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

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

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

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

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

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

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

On November 20, 1986, the Commission determined that Statutes 1984, chapter 1 imposed a reimbursable state-mandated new program on 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 program to reflect amendments made by Statutes1987, chapter 1118.

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

The Controller's Audit and Summary of the Issues

For the fiscal years in question, 2001-2002 and 2002 and 2003, the Controller made reductions based on disallowed indirect cost rates and on understated offsetting health fee authority. Specifically, claimant claimed indirect costs for 2001-2002 of $166,485 (32.56%) and $165,612 (33.49%) in 2002-2003 using the OMB Circular A-21, but did not obtain federal approval for its rate. When the Controller recalculated the indirect cost rate using the FAM-29C methodology allowed by the claiming instructions, it found that $95,872 (18.75%) was authorized in 2001-2002 and $89,259 (18.05%) was authorized in 2002-2003. The Controller reduced indirect costs claimed by $146,966.

Also, claimant identified and deducted $973,519 of offsetting health fee revenue for both fiscal years; the amount of fee revenue collected. The Controller determined that claimant was authorized by law to collect $1,511,763, finding that $538,244 in offsetting revenues "authorized" to be charged pursuant to Education Code section 76355(a) was underreported. The Controller recalculated offsetting revenue using student enrollment for full-time and part-time students after subtracting Board of Governor's Grants (BOGG) waiver counts and other exemptions, and then applied to fees authorized to be charged; $9 per student for the summer semester and $12 per student for the fall and spring semesters. After the Controller's calculation of authorized offsetting revenue, the amount of fee revenue authorized to be charged exceeded the direct and recalculated indirect costs, resulting in no reimbursement to the claimant.

Thus, the following issues are disputed in this IRC for fiscal years 2001-2002 and 2002-2003:

- Reduction of costs claimed based on the claimant's development and application of indirect cost rates.
- The amount of offsetting revenue to be applied from health service fee authority.

III. Positions of the Parties

A. Santa Monica Community College District

Claimant asserts that the Controller incorrectly reduced its claims for reimbursement and requests that the Commission request the Controller to reinstate all costs incorrectly reduced. Claimant argues that the Controller inappropriately reduced indirect costs claimed.[20] Claimant disputes the Controller's finding that indirect costs were overstated because the indirect cost rate

[20] Exhibit A, IRC, page 11.

proposal was not federally approved, arguing that there is no requirement for federal approval, and no particular cost rate calculation required by statute. Since the claiming instructions were never adopted as regulations pursuant to the Administrative Procedure Act, they are merely a statement of the ministerial interest of the Controller and not law. [21] According to claimant, the burden of proof is on the Controller to show that the district's calculation is unreasonable rather than recalculate the rate according to its preferences.[22]

Claimant, in the original IRC filing, argued that it is inappropriate to reduce from the claims revenues not received. According to claimant, neither Education Code section 76355 nor the *Health Fee Elimination* parameters and guidelines require a community college district to charge the student a health fee. Claimant also asserts that Government Code sections 17514 and 17556 do not require collection of a fee. And claimant argues that the Controller has not indicated that its determination of student accounts would be more accurate than the reported claims.[23] In comments on the draft proposed decision, claimant now agrees that the *Clovis* decision applies to this IRC, and that fee revenue authorized to be charged must be deducted from the claim. However, claimant states that the conclusion, finding that the Controller's adjustment is not arbitrary or lacking in evidentiary support, is unfounded because the Controller did not rely on MIS enrollment data, but on BOGG waiver data in recalculating offsetting revenues.[24]

B. State Controller's Office

It is the Controller's position that the audit adjustments are correct and that this IRC should be denied. The Controller asserts that the claimant did not claim its indirect costs rate in accordance with the parameters and guidelines and claiming instructions, which require federal approval when using the OMB Circular A-21. Since federal approval was not obtained, the Controller recalculated indirect costs using the FAM-29C, also authorized by the claiming instructions.

The Controller's also found that claimant underreported offsetting revenues of $538,244 that were "authorized" to be charged pursuant to Education Code section 76355(a) during fiscal years 2001-2002 and 2002-2003. Instead, the claimant identified as offsetting revenue only the amount of fee revenue "collected." For the *Health Fee Elimination* program, the Controller said that the Commission clearly recognized the availability of another funding source by including the fees as offsetting revenue in the parameter and guidelines. To the extent that districts have authority to charge a fee, they are not required to incur a cost.

The Controller filed comments concurring with the draft proposed decision.

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.

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[21] Exhibit A, IRC pages 8-10.

[22] Exhibit A, IRC page 11. Exhibit D, Claimant comments on the draft proposed decision.

[23] Exhibit A, IRC page 11-16.

[24] Exhibit D, Claimant's comments on the draft proposed decision.

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to the local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.7 of the Commission's regulations requires the Commission to send the 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.[25] 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."[26]

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.[27] Under this standard, the courts have found that:

> When reviewing the exercise of discretion, "[t]he scope of review is limited, out of deference to the agency's authority and presumed expertise: 'The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]'" ... "In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . ." [Citations.] When making that inquiry, the " ' "court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." [Citation.]' "[28]

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.[29] In addition, section 1185.2(c) of the Commission's regulations requires that any assertion of fact by the parties to an

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

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

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

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

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

IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[30]

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

In its audit, the Controller reduced indirect costs claimed by $146,966 for 2001-2002 and 2002-2003 because claimant did not utilize a federally approved indirect cost rate. Claimant disputes that federal approval is required, and challenges the Controller's substitution of the alternative state method and the resulting adjustment of costs. Specifically, indirect costs of $166,485 (32.56%) were claimed for fiscal year 2001-2002 and $165,612 (33.49%) for 2002-2003, but the claimant did not obtain federal approval of these rates. The Controller reduced the claimed indirect cost rates, based on the alternative state FAM 29-C method outlined in the School Mandated Cost Manual, to $95,872 (18.75%) for 2001-2002 and $89,259 (18.05%) for 2002-2003.[31]

The parameters and guidelines specify as follows: "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." Thus, the Commission finds that the parameters and guidelines require claimants to adhere to the Controller's claiming instructions when claiming indirect costs, and that the claimant here did not do so. Therefore, the Controller's reduction of these costs is correct as a matter of law. The Commission further finds that the Controller's use of the FAM 29-C, which is another authorized method in the claiming instructions to calculate indirect costs, was not arbitrary, capricious, or entirely lacking in evidentiary support.

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

Parameters and guidelines adopted by the Commission are required to provide instructions for eligible claimants to prepare reimbursement claims for the direct and indirect costs of a state-mandated program.[32] In addition, at that time the reimbursement claims were filed in this case (2003 and 2004), the law required that the claims be filed in accordance with the parameters and guidelines.[33] The parameters and guidelines for the *Health Fee Elimination* program expressly

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[30] 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.

[31] Exhibit A, IRC, attachment, page 56.

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

[33] Government Code section 17564(b) as amended by Statutes 1999, chapter 643.

provide that "*indirect costs may be claimed in the manner described by the State Controller in his claiming instructions*."[34]

Claimant argues that it is not required to adhere to the claiming instructions.[35] Claimant also argues that the word "may" in the language quoted above is permissive, and that therefore the parameters and guidelines do not require that indirect costs be claimed in the manner described by the Controller.[36] In addition, claimant argues that "[n]either state law nor the parameters and guidelines made compliance with the Controller's claiming instructions a condition of reimbursement."[37] Claimant also argues that "there is no requirement in law that the claimant's indirect cost rate must be 'federally' approved,"[38] and that "the Commission has never specified the federal agencies which have the authority to approve indirect cost rates."[39]

Claimant is incorrect. The parameters and guidelines are regulatory in nature, and constitute a final, binding decision of the Commission.[40] The parameters and guidelines state that "indirect costs may be claimed in the manner described by the State Controller." 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 is required to adhere to the Controller's claiming instructions.

The claiming instructions specific to the *Health Fee Elimination* mandate, revised September 1997, state that "college districts have the option of using a federally approved rate (i.e., utilizing the cost accounting principles from the Office of Management and Budget Circular A-21), or the State Controller's methodology outlined in "Filing a Claim" of the Mandated Cost Manual for Schools."[41] In this case, claimant used the OMB Circular A-21 to calculate indirect costs. The OMB Circular A-21 establishes principles for determining costs applicable to grants, contracts, and other agreements between the federal government and educational institutions. Section G(11) of the OMB Circular A-21 governs the determination and federal approval of indirect cost rates 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.[42]

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[34] Exhibit A, IRC, page 29.

[35] Exhibit A, IRC, page 11-13. See also Exhibit D, Claimant comments on the draft proposed decision.

[36] Exhibit A, IRC, page 10.

[37] *Id.* at page 12.

[38] Exhibit A, IRC, page 11.

[39] *Ibid*.

[40] *California School Boards Association v. State of California* (2009) 171 Cal.App.4th 1183, 1201.

[41] Exhibit B, State Controller's Comments, tab 4, page 35.

[42] Exhibit F, OMB Circular A-21.

In addition, the School Mandated Cost Manual[43] provides more detailed instructions with respect to claiming indirect costs and those instructions provide guidance to claimants for all mandates, absent specific provisions in the program specific claiming instructions to the contrary. More recently the manuals for school districts and community college districts have been printed separately, and therefore both the general instructions, and the instructions specific to the *Health Fee Elimination* mandate, are now provided in the Mandated Cost Manual for Community Colleges.[44] These Mandated Cost Manuals state the following:

> A college has the option of using a *federally approved rate*, utilizing the cost accounting principles from Office of Management and Budget Circular A-21 "Cost Principles for Educational Institutions," or the Controller's methodology outlined in the following paragraphs.[45] *If the federal rate is used, it must be from the same fiscal year in which the costs were incurred*. (Emphasis added.)[46]

The reference in the parameters and guidelines to the Controller's claiming instructions necessarily includes the general provisions of the School Mandated Cost Manual, and the manual provides ample notice to claimants as to how they may properly claim indirect costs, including the requirement to get federal approval when using the OMB Circular A-21 method for calculating indirect costs. Claimant's assertion that "[n]either State law or the parameters and guidelines made compliance with the Controller's claiming instructions a condition of reimbursement"[47] is therefore not correct. The parameters and guidelines, which were duly adopted at a Commission hearing, require compliance with the claiming instructions.

Claimant also argues that because the claiming instructions "were never adopted as law, or regulations pursuant to the Administrative Procedure Act (APA), the claiming instructions are merely a statement of the ministerial interests of the Controller and not law."[48] In comments on the draft proposed decision, claimant argues:

> The Commission does not need a court to declare the claiming instructions to be underground regulations or to ascertain whether they are consistent with the claiming instructions. The Commission need only ask the Controller if the claiming instructions have been adopted pursuant to the required process. If the answer is no, the Commission cannot enforce the claiming instructions for the Controller.[49]

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[43] Exhibit B, State Controller's comments, tab 3.

[44] Exhibit F, Community College Mandated Cost Manual General Instructions Updated September 28, 2001. The same language exists in the Manual updated September 29, 2000 and September 30, 2003.

[45] Note that the methodology later outlined is the state Form FAM-29C.

[46] Exhibit B, State Controller's comments, tab 3, page 22.

[47] Exhibit A, IRC, page 10.

[48] Exhibit A, IRC, page 10.

[49] Exhibit D, Claimant's Comments on the draft proposed decision, page 3.

In the *Clovis* case, the Controller's contemporaneous source document rule, or CSDR, was held to be an unenforceable underground regulation because it was applied generally against school districts and had never been adopted as a regulation under the APA.[50] Here, claimant implies the same fault in the claiming instructions with respect to indirect cost rates. But the distinction is that here, the parameters and guidelines, which were duly adopted at a Commission hearing, require compliance with the claiming instructions on indirect cost rates.

More importantly, the claimant had notice of the requirement in the parameters and guidelines to comply with the claiming instructions and notice of the claiming instructions' requirements for claiming indirect costs, both prior to and during the claim years in issue and did not challenge the parameters and guidelines or the claiming instructions when they were adopted.[51]

Therefore, the Commission finds that the parameters and guidelines expressly require claimants to claim indirect costs in the manner described in the Controller's claiming instructions, which in turn provide that an indirect cost rate may be developed in accordance with federal OMB Circular A-21 guidelines, requiring federal approval of indirect cost rates. Alternatively, a claimant may use the state's Form FAM 29-C for developing indirect costs. Moreover, claimant had notice of the parameters and guidelines and the claiming instructions, and did not challenge them when they were adopted.

2. *Claimant did not comply with the requirements of the claiming instructions in developing its indirect cost rate using the OMB Circular A-21, so the Controller's reduction and recalculation of costs applying the Form FAM-29C calculation is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.*

Claimant claimed indirect costs for 2001-2002 of $166,485 (32.56%) and $165,612 (33.49%) for 2002-2003, but did not obtain federal approval of these rates as required by OMB Circular A-21 and the claiming instructions. The Controller reduced the claimed indirect cost rates, based on the alternative state FAM 29-C method outlined in the School Mandated Cost Manual, to $95,872 (18.75%) for 2001-2002 and $89,259 (18.05%) for 2002-2003.[52]

The claiming instructions provide two options for claiming indirect costs, one of which is using the OMB Circular A-21. However, to use this option, a claimant must obtain federal approval, which the claimant here did not do. Thus, the claimant did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rate to the direct costs claimed, and the Commission finds that the reduction is correct as a matter of law.

Claimant asserts that:

> Indeed, federally 'approved' rates which the Controller will accept without further action, are 'negotiated' rates calculated by the district and submitted for approval to federal agencies which are the source of federal programs to which the indirect

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[50] *Clovis Unified School Dist. v. Chiang* (*Clovis*)(2010) 188 Cal.App.4th 794, 807.

[51] Exhibit F, School Mandated Cost Manual Excerpt, 2001-2002, pages 455-456; Community College Mandated Cost Manual Excerpt, 2002-2003, pages 659-660.

[52] Exhibit A, IRC, attachment, page 56.

cost rate is to be applied, indicating that the process is not an exact science, but a determination of the relevance and reasonableness of the cost allocation assumptions made for the method used.[53]

Claimant argues that the Controller "made no determination as to whether the method used by the District was reasonable, but merely substituted its FAM-29C method for the method reported by the District." Claimant also argues that the Controller's decision to recalculate indirect costs by its own method "is an arbitrary choice of the Controller, not a 'finding' enforceable by fact or law."[54]

The Commission finds because claimant failed to obtain federal approval of its OMB Circular A-21 indirect cost rate, the Controller acted reasonably in recalculating the rate using one of the options provided for in the claiming instructions. The Controller's use of the FAM-29C method for calculating indirect costs is not arbitrary, capricious, or entirely lacking in evidentiary support. The FAM-29C method is expressly authorized by the claiming instructions and the Mandated Cost Manual.[55] Moreover, as claimant points out, "both the District's method and the Controller's method utilized the same source document, the CCFS-311 annual financial and budget report required by the state."[56] Therefore, the Controller's selection of the alternative state method was effectively the only valid alternative available, given that claimant failed to obtain federal approval in accordance with the other (OMB) option.

Based on the foregoing, the Commission finds that the Controller's recalculation and reduction of costs claimed applying the FAM-29C indirect cost rate authorized by the claiming instructions is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

B. The Controller's Reduction of Costs Related to Understated Offsetting Revenues Pursuant to the Health Fee Rule is Correct as a Matter of Law and is not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller found that the claimant understated its offsetting revenue by $538,244 for fiscal years 2001-2002 and 2002-2003 on the ground that the authorized, but uncollected health service fees should have been deducted as offsetting revenue. The claimant reported and deducted only the amounts collected rather than the fee revenue authorized by the statute, which was $9 per student for summer semester and $12 per student for the fall and spring semesters during 2001-2003.[57] The Controller therefore recalculated offsetting revenue using student enrollment for

[53] Exhibit A, IRC, page 9.

[54] Exhibit A, IRC, page 11.

[55] Exhibit B, State Controller's Comments, tab 4, page 35, citing the 1997 Mandated Cost Manual. For the claiming instruction and Mandated Cost Manual revised October 1998, see Exhibit F, pages 332 and 393. For the claiming instructions and Mandated Cost Manual revised September 2001, see Exhibit F, pages 455-456. For the Mandated Cost Manual revised September 2003, see Exhibit F, pages 655-656.

[56] Exhibit A, Incorrect Reduction Claim, page 11.

[57] Exhibit B, State Controller's comments, page 10.

full-time and part-time students after subtracting BOGG waiver counts and other exemptions, and then applied the fees authorized to be charged to the student count.[58] After the Controller's calculation of authorized offsetting revenue, the amount of fee revenue authorized to be charged exceeded the direct and recalculated indirect costs, resulting in no reimbursement to the claimant.

Claimant argued, in its original IRC filing, that the relevant offset is the amount of fee revenue collected and not the amount authorized by statute, stating:

> This issue is one of student health fees revenue actually received, rather than student health fees which might be collected. The Commission determined, as stated in the parameters and guidelines, that the student fees "experienced" [*collected*] would reduce the amount subject to reimbursement. Student fees not collected are student fees not "experienced" and as such should not reduce reimbursement. Further, the amount "collectible" will never equal actual revenues collected due to changes in student's BOGG eligibility, bad debt accounts, and refunds.
>
> Because districts are not required to collect a fee from students for student health services, and if such a fee is collected, the amount is to be determined by the District and not the Controller, the Controller's adjustment is without legal basis.[59]

After claimant filed its IRC, the Third District Court of Appeal issued the *Clovis* decision, which specifically addressed the Controller's practice of reducing claims of community college districts under the *Health Fee Elimination* program 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, calling this practice "The Controller's Health Fee Rule." The Health Fee Rule, as stated in the Controller's *Health Fee Elimination* Program specific claiming instructions, provides that a reimbursements will be reduced by the amount of *student fees authorized*. As quoted 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 <u>Education Code [section] 76355</u>.[60]

Education Code section 76355(a) provides in relevant part the following:

> (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,

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[58] Exhibit A, IRC, attachment, page 57. Exhibit B, State Controller's Comments, pages 10 and 20.

[59] Exhibit A, IRC, page 15.

[60] *Clovis, supra,* 188 Cal.App.4th 794, 811. Emphasis in original.

> 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 this [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).[61]

Pursuant to the plain language of Education Code section 76355(a)(2), the fee authority given to districts automatically increases at the same rate as the Implicit Price Deflator; when that calculation produces an increase of one dollar above the existing fee, the fee may be increased by one dollar.[62] The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered.

Claimant argues that neither Education Code section 76355 nor the *Health Fee Elimination* parameters and guidelines require a community college district to charge the student a health fee. Claimant also asserts that neither Government Code sections 17514 or 17556 require collection of a fee.[63]

But the court in the *Clovis* decision upheld, as a matter of law, the Controller's use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. In its decision, the court noted that its conclusion is consistent with the state mandates process embodied in Government Code sections 17514 and 17556(d), and 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."[64] 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.'"[65]

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[61] Education Code section 76355, as amended by Statutes 1995, chapter 758.

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

[63] Exhibit A, IRC, pages 11-14.

[64] *Clovis*, *supra,*188 Cal.App.4th 794, 812.

[65] *Ibid.*

The court also responded to the argument that, "since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission's P&G's."[66] The court stated:

> 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.[67]

Although the claimant here was not a party to the *Clovis* case, it is binding on the claimant under principles of collateral estoppel.[68] 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.[69] The issue decided by the court is identical to the issue in this IRC. In addition, the claimant here has privity with the petitioners in the *Clovis* action. "A party is adequately represented for purposes of the privity rule if his or her interests are so similar to a party's interest that the latter was the former's virtual representative in the earlier action."[70] In addition, the Controller was a party to the *Clovis* action and is bound to comply with the court's decision for all matters addressing the *Health Fee Elimination* program.

Thus, pursuant to the court's decision in *Clovis*, the Health Fee Rule used by the Controller to adjust reimbursement claims filed by claimants for the *Health Fee Elimination* program is correct. 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.[71]

Claimant, in comments on the draft proposed decision, now agrees that claimants and state agencies are bound to apply the Health Fee Rule as decided law and that this extends to retroactive fiscal years still within the Commission's or Controller's jurisdiction. However, claimant argues that the Commission makes an "unfounded" conclusion that the Controller's adjustment is not arbitrary or lacking in evidentiary support. According to claimant:

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[66] *Ibid.* Emphasis in original.

[67] *Ibid.*

[68] 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.

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

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

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

> On October 27, 2011, the Commission adopted a consolidated statement of decision for seven Health Fee Elimination incorrect reduction claims. The statement of decision for these seven districts included issues presented in this current incorrect reduction claim. The application of the Health Fee Rule, as determined by the Commission's October 27, 2011, statement of decision, however, involves two factual elements: the number of exempt students and the specific enrollment statistics for each semester. That decision approved the Controller's use of specific Community College Chancellor's MIS data to obtain these enrollment amounts. For the audit of this District, completed before the October 27, 2011, Commission decision, the enrollment statistics used by the auditor were different. [The offsetting revenue was calculated after subtracting BOGG waiver counts and other exemptions, and then applying the fees authorized to be charged to the student count.] . . . Therefore, to properly implement the Health Fee Rule, it will be necessary for the Controller to utilize the statistics approved by the October 27, 2011, decision. Until then, the Commission's ultimate conclusion that the adjustments here are not arbitrary or lacking in evidentiary support is unfounded.[72]

The claimant's argument does not alter the above analysis. The Commission made findings in the October 27, 2011 decision on seven consolidated *Health Fee Elimination* IRCs, which identified one reasonable and reliable source for the necessary enrollment data. The Commission did not make findings that *only* the chancellor's MIS data could be used to calculate the health fees collectible. In comments on the IRC, the Controller stated that it "obtained student enrollment information from the 'enrollment census' data run and student waiver information from the list of BOGG used' data run. [sic] The SCO was not provided any other records in support of the authorized health fee revenues."[73] The claimant has not presented any evidence or argument that its own BOGG data provided to the Controller's Office was incapable of producing reliable evidence from which to calculate offsetting revenues.

The Commission finds, therefore, that the Controller's adjustment based on the recalculation of offsetting revenue based on fee authority under the Health Fee Rule, and utilizing the enrollment and exemption information available is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

V. Conclusion

Pursuant to Government Code section 17551(d), the Commission concludes that the following reductions in the Controller's audit of the 2001-2002 and 2002-2003 reimbursement claims are correct as a matter of law, and are not arbitrary, capricious, or entirely lacking in evidentiary support:

- The reduction of indirect costs claimed for fiscal years 2001-2002 and 2002-2003, of $146,966, based on claimant's failure to comply with the claiming instructions in the

[72] Exhibit D, pages 6-7.

[73] Exhibit B, page 20.

development of its indirect cost rate, and the Controller's use of an alternative method authorized by the claiming instructions to calculate indirect costs.

- The reduction of $538,244 for fiscal years 2001-2002 and 2002-2003, because claimant reported the health fee revenue collected, rather than the revenue it was authorized to collect, pursuant to the court's ruling in *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 812.

Accordingly, the Commission denies this IRC.

STATE OF CALIFORNIA

EDMUND G. BROWN JR., Governor

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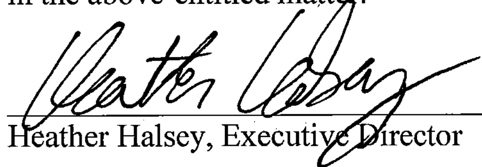
RE: **Decision**

Health Fee Elimination, 05-4206-I-12
Education Code Section 76355
Statutes 1984, Chapter 1; Statutes 1987, Chapter 1118
Fiscal Years 2001-2002 and 2002-2003
Santa Monica Community College District, Claimant

On December 5, 2014, the foregoing decision of the Commission on State Mandates was adopted in the above-entitled matter.



Heather Halsey, Executive Director

Dated: December 10, 2014

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

I am a resident of the County of Solano 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 December 10, 2014, I served the:

> **Decision**
> *Health Fee Elimination,* 05-4206-I-12
> Education Code Section 76355
> Statutes 1984, Chapter 1; Statutes 1987, Chapter 1118
> Fiscal Years 2001-2002 and 2002-2003
> Santa Monica 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 December 10, 2014 at Sacramento, California.

Heidi J. Palchik
Commission on State Mandates
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COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 11/19/14

Claim Number: 05-4206-I-12

Matter: Health Fee Elimination

Claimant: Santa Monica 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.)

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