BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Government Code Sections 3540-3549.9 Statutes 1975, Chapter 961; Statutes 1991, Chapter 1213 Fiscal Years 2001-2002, 2002-2003, 2003-2004 Contra Costa Community College District, Claimant.	Case No.: 08-4425-I-15 *Collective Bargaining and Collective Bargaining Agreement Disclosure* 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.

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 approve the IRC on consent.

Summary of the Findings

The Commission approves this IRC, filed by Contra Costa Community College District (claimant) finding that the audit of the 2001-2002, 2002-2003, and 2003-2004 fiscal year reimbursement claims was not timely completed by the State Controller's Office (Controller) pursuant to Government Code section 17558.5, as amended by Statutes 2004, chapter 313, and is therefore void. Pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, the Commission requests that the Controller reinstate all costs reduced in the amount of $494,564, to the claimant.

COMMISSION FINDINGS

I. Chronology

12/24/02 Claimant filed a reimbursement claim for fiscal year 2001-2002.[1]

01/13/04 Claimant filed a reimbursement claim for fiscal year 2002-2003.[2]

01/14/05 Claimant filed a reimbursement claim for fiscal year 2003-2004[3].

06/28/05 The Controller sent a letter to claimant confirming that an entrance conference to initiate the audit of all three fiscal year claims would be held on July 8, 2005.[4]

07/08/05 The entrance conference was held.[5]

05/30/07 The Controller issued a draft audit report.[6]

06/14/07 Claimant filed comments on the draft audit report.[7]

07/19/07 The Controller issued the final audit report.[8]

07/18/08 Claimant filed this IRC.[9]

07/28/08 Commission staff issued the notice of complete filing and request for comments.

09/26/14 Commission staff issued the draft proposed decision.

II. Background

Collective Bargaining and Collective Bargaining Agreement Disclosure Mandates

On July 17, 1978, the Board of Control, predecessor to the Commission, found that Statutes 1975, chapter 961 imposed a reimbursable state mandate. On October 22, 1980, parameters and guidelines were adopted, which were amended several times. Then, on March 26, 1998, the Commission adopted a second test claim decision on Statutes 1991, chapter 1213.[10] Parameters and guidelines for the two programs were consolidated on August 20, 1998, and have since been amended again, on January 27, 2000.[11]

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[1] Exhibit A, Incorrect Reduction Claim, Exhibit F Reimbursement Claim for FY 2001-2002.

[2] Exhibit A, Incorrect Reduction Claim, Exhibit F Reimbursement Claim for FY 2002-2003.

[3] Exhibit A, Incorrect Reduction Claim, Exhibit F Reimbursement Claim for FY 2003-2004.

[4] Exhibit A, Incorrect Reduction Claim, Exhibit E, p.92.

[5] Exhibit A, Incorrect Reduction Claim, at 24.

[6] Exhibit A, Incorrect Reduction Claim, Exhibit D.

[7] Exhibit A, Incorrect Reduction Claim, Exhibit D.

[8] Exhibit A, Incorrect Reduction Claim, Exhibit D.

[9] Exhibit A, Incorrect Reduction Claim.

[10] Exhibit X, Test Claim Statement of Decision, 97-TC-08.

[11] See Exhibit X, Amended Parameters and Guidelines, January 27, 2000.

The reimbursement claim at issue in this IRC was filed for the 2001-2002, 2002-2003, and 2003-2004 fiscal years, and at the time that claim was prepared and submitted, the last amended version of the parameters and guidelines, adopted on January 27, 2000, were applicable. These parameters and guidelines authorize reimbursement for costs incurred to comply with sections 3540 through 3549.1, and "regulations promulgated by the Public Employment Relations Board," including:

- Determination of appropriate bargaining units for representation and determination of the exclusive representation and determination of the exclusive representatives;
- Elections and decertification elections of unit representatives are reimbursable in the event the Public Employment Relations Board determines that a question of representation exists and orders an election held by secret ballot;
- Negotiations: reimbursable functions include – receipt of exclusive representative's initial contract proposal, holding of public hearings, providing a reasonable number of copies of the employer's proposed contract to the public, development and presentation of the initial district contract proposal, negotiation of the contract, reproduction and distribution of the final contract agreement;
- Impasse proceedings, including mediation, fact-finding, and publication of the findings of the fact-finding panel;
- Collective bargaining agreement disclosure before the adoption of the agreement by the governing body;
- Contract administration and adjudication of contract disputes either by arbitration or litigation, including grievances and administration and enforcement of the contract; and
- Unfair labor practice adjudication process and public notice complaints.[12]

The Audit Findings of the Controller

The Controller reduced the reimbursement claims by a total of $494,564, on the following grounds:

- Claimant failed to provide supporting documentation for claimed salary, benefit, and related indirect costs.
- Claimant claimed unallowable contracted services for activities not permitted in the parameters and guidelines.[13]

III. Positions of the Parties

Contra Costa Community College District, Claimant

[12] Exhibit X, Amended Parameters and Guidelines, January 27, 2000.

[13] Exhibit A, Incorrect Reduction Claim, p. 68.

Claimant argues that the Controller did not complete its final audit within the deadline provided in Government Code section 17558.5. Claimant also asserts that the reimbursement costs claimed for salaries and benefits and related indirect costs and contract services costs were eligible for reimbursement under the parameters and guidelines and reasonable.[14]

State Controller's Office

The Controller has not filed comments on this IRC.

IV. Discussion

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

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

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[15] 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."[16]

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.[17] 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

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[14] This draft decision does not reach these issues as the statute of limitations issue is jurisdictional.

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

[16] *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.

[17] *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.

> 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.]' "[18]

The Commission must review also 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. [19] In addition, section 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[20]

A. The Controller did not complete the audit of the reimbursement claims within the deadline imposed by Government Code section 17558.5.

Claimant raises several issues regarding the statute of limitations applicable to audits, found in Government Code section 17558.5, with respect to the audit of these reimbursement claims. For the reasons below, the Commission finds that the Controller did not complete the audit of these reimbursement claims within the deadline imposed by Government Code section 17558.5, as last amended in 2004 (eff. January 1, 2005).

The reimbursement claims at issue in this case were filed with the Controller on December 24, 2002, January 13, 2004, and January 14, 2005. During this time period, three different versions of Government Code section 17558.5 existed. The first version of section 17558.5 was added in 1995 and was in effect when the first reimbursement claim for fiscal year 2001-2002 was filed on December 24, 2002.[21] Section 17558.5, as added in 1995, required that a reimbursement claim was subject to audit if funds were appropriated, "no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended" as follows:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim. (Emphasis added.)

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

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

[20] 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.

[21] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)).

The Commission has determined that the phrase "subject to audit," when read in the context of the whole statute and as clarified by the Legislature in 2002, means that the Controller has no later than two years after the calendar year in which the reimbursement claim is filed to initiate an audit. Thus, under the 1995 version of section 17558.5, the deadline to initiate an audit of the reimbursement claim for fiscal year 2001-2002 was December 31, 2004.

Effective January 1, 2003, Statutes 2002, chapter 1128, amended the statute of limitations for audits again by clarifying that when funds are appropriated, the claim is subject "to *the initiation of an audit*…" for the statutory period. The 2002 statute also changed the requirement to initiate the audit from *two years after the end of the calendar year* in which the reimbursement claim is filed or last amended, to *three years after the date that the actual reimbursement claim is filed* or last amended. As amended by Statutes 2002, chapter 1128 (AB 2834), effective January 1, 2003, section 17558.5 stated the following:

> 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 ~~two~~ three years after the ~~end of the calendar year in which~~ 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 ~~made~~ filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[22]

The Controller's Office gets the benefit of the additional time provided by the 2002 version of section 17558.5 to initiate the audit of the 2001-2002 reimbursement claim because the audit period for that claim had not expired when the 2002 statute became effective on January 1, 2003. As stated above, the audit period for the 2001-2002 reimbursement claim remained pending until December 31, 2004. Under the law, any enlargement of a statute of limitations that is made by a statutory amendment that becomes effective after a reimbursement claim is filed, but the audit period is still pending and not already barred, applies to those claims already filed. In *Douglas Aircraft*, the court stated the general rules as follows:

> The extension of the statutory period within which an action must be brought is generally held to be valid if made before the cause of action is barred. (*Weldon v. Rogers*, 151 Cal. 432.) The party claiming to be adversely affected is deemed to suffer no injury where he was under an obligation to pay before the period was lengthened. This is on the theory that the legislation affects only the remedy and not a right. (*Mudd v. McColgan*, 30 Cal.2d 463; *Davis & McMillan v. Industrial Acc. Com.*, 198 Cal. 631; 31 Cal.Jur.2d 434.) An enlargement of the limitation period by the Legislature has been held to be proper in cases where the period had not run against a corporation for additional franchise taxes (*Edison Calif. Stores, Inc. v. McColgan*, 30 Cal.2d 472), against an individual for personal income taxes (*Mudd v. McColgan*, *supra*, 30 Cal.2d 463), and against a judgment debtor (*Weldon v. Rogers*, *supra*, 151 Cal. 432). It has been held that unless the statute

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

> expressly provides to the contrary any such enlargement applies to matters pending but not already barred. (*Mudd v. McColgan, supra,* 30 Cal.2d 463.)[23]

Therefore, under the 2002 version of section 17558.5, the deadline to initiate the audit of the 2001-2002 reimbursement claim was extended from December 31, 2004, to December 24, 2005 (three years after the reimbursement claim was filed).

The 2002 version of section 17558.5 was in effect when the claimant filed the reimbursement claim for fiscal year 2002-2003 on January 13, 2004, and, thus, the deadline to initiate the audit for the 2002-2003 claim was January 13, 2007.

Finally, the reimbursement claim for fiscal year 2003-2004 was filed on January 14, 2005, and at that time, the statutory deadline in section 17558.5 to initiate an audit when funds are appropriated or payments made remained three years after the date that the actual reimbursement claim is filed or last amended. With respect to the 2003-2004 reimbursement claim, then, the deadline to initiate the claim was January 14, 2008.

On June 28, 2005, the Controller sent a letter to claimant confirming that an entrance conference to initiate the audit of all three fiscal year claims would be held on July 8, 2005. The entrance conference was held on July 8, 2005.[24] Therefore, the audit was timely initiated, at the latest, on July 8, 2005, well before the deadlines expired to initiate the audits for all three reimbursement claims.

However, effective January 1, 2005 (before the audit for these reimbursement claims was initiated), Statutes 2004, chapter 313 amended section 17558.5, to add a statutory deadline for the Controller to complete the audit no later than two years after the audit is commenced 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. <u>In any case, an audit shall be completed not later than two years after the date that the audit is commenced.</u>[25]

The two-year completion deadline applies to the audit in this case. The courts have held that where the state gives up a right previously possessed by it or one of its agencies (like 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. In *California Employment Stabilization Commission v. Payne* (1948) 1931 Cal.2d 210, 215-216, the court stated the following:

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[23] *Douglas Aircraft Co. v. Cranston* (1962) 58 Cal.2d 462, 465.

[24] Exhibit A, Incorrect Reduction Claim, at 24.

[25] Statutes 2004, chapter 313.

> Accordingly, the power of the Legislature to lessen a statute of limitations is subject to the restriction that an existing right cannot be cut off summarily without giving a reasonable time after the act becomes effective to exercise such right. (See *Davis & McMillan v. Ind. Acc. Comm.*, 198 Cal. 631, 637, 246 P. 1046, 46 A.L.R. 1095.) This principle, however, does not apply where the state gives up a right previously possessed by it or by one of its agencies. Except where such an agency is given powers by the Constitution, it derives its authority from the Legislature, which may add to or take away from those powers and therefore a statute which adversely affects only the right of the state is not invalid merely because it operates to cut off an existing remedy of an agency of the state. The case of Superior Oil Co. v. Superior Court, 6 Cal.2d 113, 56 P.2d 950, is distinguishable since the court was there concerned with the operation of a statute which applied to private persons as well as the state. This distinction was not noted in *Calif. Emp. Stab. Comm. v. Chichester etc. Co.*, 75 Cal.App.2d 899, 172 P.2d 100, which relied on the Superior Oil case and assumed without discussion that the same rule would apply where the state alone would be adversely affected. It was held in the *Chichester* case that the amendment of section 45.2 in 1943 could not operate to deprive the commission of the right to sue on existing causes of action until a reasonable time had passed after the statute became effective. The commission was created by, and derives its powers from, the Legislature, and it does not have rights which are superior to the legislative will. By the enactment in 1939 of section 45.2, the three-year limitation contained in section 338 was rendered inapplicable, and the commission was given the right without limit as to time to enforce contributions where no return had been filed. Thereafter in 1943 the Legislature determined that it was unwise and perhaps unfair to allow the commission an unlimited time within which to enforce contributions where there was no intent to evade the act, and as to those cases, the three-year limitation was restored and the right of action was cut off if the period had run. Thus the Legislature had the power to do insofar as the constitutional requirement of due process is concerned, and the holding to the contrary in the *Chichester* case, 75 Cal.App.2d 899, 172 P.2d 100, is disapproved.

Since the audit in this case was initiated at the latest on July 8, 2005, [26] the Controller had until July 8, 2007 to complete the audit pursuant to section 17558.5 as amended in 2004. The only evidence in this case of when the audit was completed is the final audit report, which is dated July 19, 2007 – eleven days *after* the deadline.[27] Thus, the Controller did not comply with completion deadline of section 17558.5.

Although section 17558.5 does not specify the consequences for failing to meet the deadlines imposed by the statute, the Commission finds that the deadlines in section 17558.5 are jurisdictional and the failure to meet the deadlines makes the audit findings void. Courts have ruled that, when a deadline is for the protection of a person or class of persons, and the language

[26] This is assuming the initiation date is the date of the entrance conference.

[27] Exhibit A, Incorrect Reduction Claim, page 66.

of the statute as a whole indicates the Legislature's intent to enforce the deadline, the deadline is mandatory.

> [T] he intent must be gathered from the terms of the statute construed as a whole, from the nature and character of the act to be done, and from the consequences which would follow the doing or the failure to the particular act at the required time. (Citation.) When the provision is to serve some public purpose, the provision may be held directory or mandatory as will best accomplish that purpose (citation)….[28]

The California Supreme Court specifically rejected the notion that a statute could only be mandatory if it included a means of enforcement. Rather, the Court ruled that the important analysis is whether the purpose of the statute is to require an act.[29] Here, the Legislature specifically amended section 17558.5 to require an audit be completed within two years, stating "[*i]n any case,* an audit shall be completed not later than two years after the date that the audit is commenced." (Emphasis added.) The Controller had more than seven months notice that section 17558.5 had been amended to require completion of an audit within two years when the audit was initiated. The Controller failed to meet that statutory deadline. In these circumstances, failure to complete the audit within the two-year completion deadline is a jurisdictional bar to the Controller's reduction of claimant's reimbursement claims.

Accordingly, the Commission finds that the final audit of the 2001-2002, 2002-2003, and 2003-2004 fiscal year reimbursement claims was not timely completed pursuant to Government Code section 17558.5, as amended by Statutes 2004, chapter 213, and is therefore void.

V. Conclusion

Based on the foregoing, the Commission concludes that the Controller incorrectly reduced the reimbursement claims filed for fiscal years 2001-2002, 2002-2003, and 2003-2004. Pursuant to Government Code section 17551(d) and section 1185.9 of the Commission's regulations, the Commission requests that the Controller reinstate all costs incorrectly reduced, totaling $494,564, to the claimant.

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[28] *People v. McGee* (1977) 19 Cal.3d 948, 962, citing *Morris v. County of Marin* (18 Cal.3d 901, 909-910.

[29] *Id.*

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RE: **Decision**

Collective Bargaining and Collective Bargaining Agreement Disclosure, 08-4425-I-15
Government Code Sections 3540-3549.9
Statutes 1975, Chapter 961; Statutes 1991, Chapter 1213
Fiscal Years 2001-2002, 2002-2003, 2003-2004
Contra Costa 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

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Government Code Sections 3540-3549.9 Statutes 1975, Chapter 961 Fiscal Year 1995-1996 Gavilan Joint Community College District, Claimant.	Case No.: 05-4425-I-11 *Collective Bargaining* 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 11, 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 the claimant. Jim Spano and Jim Venneman appeared on behalf of the 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 at the hearing by a vote of six to zero.

Summary of the Findings

This IRC was filed in response to two letters received by Gavilan Joint Community College District (claimant) from the State Controller's Office (Controller), notifying the claimant of an adjustment to the claimant's fiscal year 1995-1996 reimbursement claim; one on July 30, 1998, which notified the claimant that $126,146 was due the state, and a second on July 10, 2002, notifying the claimant that $60,597 was now due to the claimant as a result of the Controller's review of the claim and "prior collections."

The Commission finds that this IRC was not timely filed. The time for filing an IRC, in accordance with the Commission's regulations, is "no later than three (3) years following the date of the State Controller's remittance advice notifying the claimant of a reduction."[1] Government Code section 17558.5 requires the Controller's notice to the claimant of a reduction to identify the claim components adjusted and the reason(s) for adjustment.[2] Here, the claimant

[1] Code of Regulations, title 2, section 1185 (Register 1999, No. 38).

[2] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)).

first received notice of the adjustment to its 1995-1996 reimbursement claim on July 30, 1998, and received a second notice dated July 10, 2002, and did not file this IRC until December 16, 2005. Though the parties dispute which notice triggers the running of the limitation, that issue need not be resolved here since this claim was filed beyond the limitation in either case. Therefore, the IRC is denied.

COMMISSION FINDINGS

I. Chronology

01/24/1996	Controller notified claimant of a $275,000 payment toward estimated reimbursement for the 1995-1996 fiscal year.[3]
11/25/1996	Claimant submitted its fiscal year 1995-1996 reimbursement claim for $348, 966.[4]
01/30/1997	Controller notified claimant that it would remit an additional $15,270 for a total payment of $290,270 for fiscal year 1995-1996.[5]
07/30/1998	Controller notified claimant of reduction to the fiscal year 1995-1996 reimbursement claim of $184,842, resulting in $126,146 due the state.[6]
08/05/1998	Claimant notified Controller that it was appealing the reduction.[7]
08/08/2001	Controller notified claimant that it was reducing payments for the *Open Meetings Act* mandate in partial satisfaction of the reduction for the 1995-1996 fiscal year reimbursement claim for the *Collective Bargaining* mandate.[8]
07/10/2002	Controller notified claimant of its review of the 1995-1996 reimbursement claim for the *Collective Bargaining* mandate, and its findings that the claim was properly reduced by $124,245, rather than $184,842, and that $60, 597 was now due the claimant.[9]
12/16/2005	Claimant filed this IRC.[10]
12/27/2005	Commission staff notified claimant that the claim was not timely, and deemed it incomplete.[11]

[3] Exhibit A, Incorrect Reduction Claim page 14.

[4] Exhibit A, Incorrect Reduction Claim pages 4-5.

[5] Exhibit A, Incorrect Reduction Claim page 5.

[6] Exhibit A, Incorrect Reduction Claim pages 5; 15.

[7] Exhibit A, Incorrect Reduction Claim pages 5; 21.

[8] Exhibit A, Incorrect Reduction Claim pages 5; 17.

[9] Exhibit A, Incorrect Reduction Claim pages 5-6; 18.

[10] Exhibit A, Incorrect Reduction Claim page 1.

[11] See Exhibit B, Claimant Rebuttal Comments, page 1.

12/30/2005	Claimant submitted rebuttal comments seeking the full Commission's determination on the timeliness of the claim.[12]
03/09/2006	Commission staff deemed the IRC complete and issued a request for comments.
03/23/2010	Controller submitted comments on the IRC.[13]
09/25/2014	Commission staff issued the draft proposed decision.[14]
10/03/2014	The Claimant filed comments on the draft proposed decision.[15]

II. Background

On July 17, 1978, the Board of Control, predecessor to the Commission, found that Statutes 1975, chapter 961 imposed a reimbursable state mandate. On October 22, 1980, parameters and guidelines were adopted, which were amended several times.[16] The reimbursement claim at issue in this IRC was filed for the 1995-1996 fiscal year, and at the time that claim was prepared and submitted, the parameters and guidelines effective on July 22, 1993 were applicable.[17] The 1993 parameters and guidelines provided for reimbursement of costs incurred to comply with sections 3540 through 3549.1, and "regulations promulgated by the Public Employment Relations Board," including:

- Determination of appropriate bargaining units for representation and determination of the exclusive representation and determination of the exclusive representatives;
- Elections and decertification elections of unit representatives are reimbursable in the even the Public Employment Relations Board determines that a question of representation exists and orders an election held by secret ballot;
- Negotiations: Reimbursable functions include – receipt of exclusive representative's initial contract proposal, holding of public hearings, providing a reasonable number of copies of the employer's proposed contract to the public, development and presentation of the initial district contract proposal, negotiation of the contract, reproduction and distribution of the final contract agreement;

[12] Exhibit B, Claimant Rebuttal Comments.

[13] Exhibit C, Controller's Comments.

[14] Exhibit D, Draft Proposed Decision, issued September 25, 2014.

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

[16] Exhibit A, Incorrect Reduction Claim, Exhibit C to the IRC, pp. 3-9. On March 26, 1998, the Commission adopted a second test claim decision on Statutes 1991, chapter 1213. Parameters and guidelines for the two programs were consolidated on August 20, 1998, and have since been amended again, on January 27, 2000. However, this later decision and the consolidated parameters and guidelines are not relevant to this IRC since the IRC addressed reductions in the 1995-1996 fiscal year.

[17] Exhibit A, Incorrect Reduction Claim, Exhibit C to the IRC.

- Impasse proceedings, including mediation, fact-finding, and publication of the findings of the fact-finding panel;
- Contract administration and adjudication of contract disputes either by arbitration or litigation, including grievances and administration and enforcement of the contract;
- Unfair labor practice adjudication process and public notice complaints.[18]

III. Positions of the Parties

The issues raised in this IRC, and the comments filed in response and rebuttal, include the scope of the Controller's audit authority; the notice owed to a claimant regarding both the sufficiency of supporting documentation and the reasons for reductions; and the audit standards applied. However, the threshold issue is whether the IRC filing is timely in the first instance, with respect to which the parties maintain opposing positions.

Gavilan Joint Community College District, Claimant

The claimant argues that the Controller's reductions are not made in accordance with due process, in that the Controller "has not specified how the claim documentation was insufficient for purposes of adjudicating the claim." The letters that claimant cites "merely stated that the District's claim had 'no supporting documentation.'"[19] The claimant further argues that the adjustments made to the fiscal year 1995-1996 claim are "procedurally incorrect in that the Controller did not audit the records of the district…"[20] In addition, the claimant argues that "[t]he Controller does not assert that the claimed costs were excessive or unreasonable, which is the only mandated cost audit standard in statute." The claimant asserts that "[i]f the Controller wishes to enforce other audit standards for mandated cost reimbursement, the Controller should comply with the Administrative Procedure Act."[21]

Addressing the statute of limitations issue, the claimant states that "the incorrect reduction claim asserts as a matter of fact that the Controller's July 10, 2002 letter reports an amount payable to the claimant, which means a subsequent final payment action notice occurred or is pending from which the ultimate regulatory period of limitation is to be measured…" The claimant asserts that any "evidence regarding the date of last payment action, notice, or remittance advice, is in the possession of the Controller."[22]

In comments on the draft proposed decision, the claimant argues that "[w]ell after the incorrect reduction claim was filed, the District received a February 26, 2011, Controller's notice of adjudication of the FY 1995-96 annual claim." The claimant asserts that based on this later notice "the three year statute of limitations for the incorrect reduction claim would be moved forward to February 26, 2014, which is more than eight years after the incorrect reduction claim was filed." The claimant states: "It would seem that the Commission is now required to address

[18] Exhibit A, Incorrect Reduction Claim, Exhibit C to the IRC, pp. 3-9.

[19] Exhibit A, Incorrect Reduction Claim, page 9.

[20] Exhibit A, Incorrect Reduction Claim, page 9.

[21] Exhibit A, Incorrect Reduction Claim, page 10.

[22] Exhibit B, Claimant's Rebuttal Comments, page 2.

the first issue of what constitutes 'notice of adjustment,' that is, the Controller's adjudication of an annual claim, for purposes of the statute of limitations for filing an incorrect reduction claim."[23]

State Controller's Office

The Controller argues that it "is empowered to audit claims for mandated costs and to reduce those that are 'excessive or unreasonable.'" The Controller continues: "If the claimant disputes the adjustments made by the Controller pursuant to that power, the burden is upon them to demonstrate that they are entitled to the full amount of the claim."[24] The Controller notes that the claimant "asserts that a mere lack of documentation is an insufficient basis to reduce a claim…" but the Controller argues that "a claim that is unsupported by valid documentation is both excessive and unreasonable."[25] The Controller further asserts that the claimant "sought reimbursement for activities that are outside the scope of reimbursable activities as defined in the Parameters and Guidelines," including salary costs for expenses of school district officials.[26]

Furthermore, the Controller argues that the IRC is not timely. The Controller notes that the statute of limitations pursuant to section 1185 of the Commission's regulations is "no later than three years following the date of the Office of State Controller's final audit report, letter, remittance advice[,] or other written notice of adjustment…"[27] The Controller argues that based on the first notice sent to the claimant on July 30, 1998, "the time to file a claim would have expired on July 30, 2001."[28] Alternatively, "[e]ven if we accept the Claimant's implied argument that a subsequent letter from the Controller's Office dated July 10, 2002, started a new Statute of Limitations, the claim was still time barred."[29] The Controller concludes that "that time period would have expired on July 10, 2005, five months before this claim was actually filed."[30]

And finally, the Controller argues: "Not satisfied with two bites at the apple, Claimant asserts that the period of the Statute of Limitations 'will be measured from the date of the last payment action…'" and that there is no law to support that position.[31]

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[23] Exhibit E, Claimant's Comments on Draft Proposed Decision, page 2.

[24] Exhibit C, Controller's Comments, page 1.

[25] Exhibit C, Controller's Comments, pages 1-2.

[26] Exhibit C, Controller's Comments, page 2.

[27] Exhibit C, Controller's Comments, page 2 [citing California Code of Regulations, title 2, section 1185 (as amended, Register 2007, No. 19)].

[28] Exhibit C, Controller's Comments, page 2.

[29] Exhibit C, Controller's Comments, page 2.

[30] Exhibit C, Controller's Comments, page 2.

[31] Exhibit C, Controller's Comments, page 2.

IV. Discussion

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

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to the local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9 of the Commission's regulations requires the Commission to send the decision to the Controller and request that the costs 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.[32] 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."[33]

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 by a state agency.[34] 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.]' "[35]

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

[33] *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.

[34] *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.

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

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. [36] In addition, section 1185.2(c) of the Commission's regulations requires that any assertion 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.[37]

This Incorrect Reduction Claim Was Not Timely Filed.

The general rule in applying and enforcing a statute of limitations is that a period of limitation for initiating an action begins to run when the last essential element of the cause of action or claim occurs. There are a number of recognized exceptions to the accrual rule, each of which is based in some way on the wronged party having notice of the wrong or the breach that gave rise to the action.

In the context of an IRC, the last essential element of the claim is the notice to the claimant of a reduction, as defined by the Government Code and the Commission's regulations, which begins the period of limitation; the same notice also defeats the application of any of the notice-based exceptions to the general rule.

Here, there is some question as to whether the reasons for the reduction were stated in the earliest notice, as required by section 17558.5 and the Commission's regulations. The evidence in the record indicates that the claimant had actual notice of the reduction and of the reason for the reduction ("no supporting documentation") as of July 30, 1998.[38] However, the July 10, 2002 letter more clearly states the Controller's reason for reduction.[39] Ultimately, whether measured from the date of the earlier notice, or the July 10, 2002 notice, the period for filing an IRC on this audit expired no later than July 10, 2005, a full seven months before the IRC was filed. The analysis herein also demonstrates that the period of limitation is not unconstitutionally retroactive, as applied to this IRC. The IRC is therefore untimely.

1. <u>The period of limitation applicable to an IRC begins to run at the time an IRC can be filed, and none of the exceptions or special rules of accrual apply.</u>

    a. The general rule is that a statute of limitations attaches and begins to run at the time the cause of action accrues.

The threshold issue in this IRC is when the right to file an IRC based on the Controller's reductions accrued, and consequently when the applicable period of limitation began to run against the claimant. The general rule, supported by a long line of cases, is that a statute of

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

[37] 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.

[38] Exhibit A, IRC 05-44254-I-11, pages 5; 21.

[39] Exhibit A, IRC 05-4425-I-11, page 19.

limitations attaches when a cause of action arises; when the action can be maintained.[40] The California Supreme Court has described statutes of limitations as follows:

> A statute of limitations strikes a balance among conflicting interests. If it is unfair to bar a plaintiff from recovering on a meritorious claim, it is also unfair to require a defendant to defend against possibly false allegations concerning long-forgotten events, when important evidence may no longer be available. Thus, statutes of limitations are not mere technical defenses, allowing wrongdoers to avoid accountability. Rather, they mark the point where, in the judgment of the legislature, the equities tip in favor of the defendant (who may be innocent of wrongdoing) and against the plaintiff (who failed to take prompt action): "[T]he period allowed for instituting suit inevitably reflects a value judgment concerning the point at which the interests in favor of protecting valid claims are outweighed by the interests in prohibiting the prosecution of stale ones."[41]

The Court continued: "Critical to applying a statute of limitations is determining the point when the limitations period begins to run."[42] Generally, the Court noted, "a plaintiff must file suit within a designated period after the cause of action accrues."[43] The cause of action accrues, the Court said, "when [it] is complete with all of its elements."[44] Put another way, the courts have held that "[a] cause of action accrues 'upon the occurrence of the last element essential to the cause of action.'"[45]

Here, the "last element essential to the cause of action," pursuant to Government Code section 17558.5 and former section 1185 (now 1185.1) of the Commission's regulations, is a notice to the claimant of the adjustment, which includes the reason for the adjustment. Government Code section 17558.5(c) provides, in pertinent part:

> The Controller shall notify the claimant in writing within 30 days after issuance of a remittance advice of any adjustment to a claim for reimbursement that results from an audit or review. The notification shall specify the claim components adjusted, the amounts adjusted, interest charges on claims adjusted to reduce the overall reimbursement to the local agency or school district, and the reason for the adjustment… [46]

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[40] See, e.g., *Osborn v. Hopkins* (1911) 160 Cal. 501, 506 ["[F]or it is elementary law that the statute of limitations begins to run upon the accrual of the right of action, that is, when a suit may be maintained, and not until that time."]; *Dillon v. Board of Pension Commissioners* (1941) 18 Cal.2d 427, 430 ["A cause of action accrues when a suit may be maintained thereon, and the statute of limitations therefore begins to run at that time."].

[41] *Pooshs v. Phillip Morris USA, Inc.* (2011) 51 Cal.4th 788, at p. 797.

[42] *Ibid.*

[43] *Ibid* [citing Code of Civil Procedure section 312].

[44] *Ibid* [quoting *Norgart v. Upjohn Co.* (1999) 21 Cal.4th 383, 397].

[45] *Seelenfreund v. Terminix of Northern California, Inc.* (1978) 84 Cal.App.3d 133 [citing *Neel v. Magana, Olney, Levy, Cathcart & Gelfand* (1971) 6 Cal.3d 176].

[46] Government Code section 17558.5 (added, Stats. 1995, ch. 945 (SB 11)).

Accordingly, former section 1185 of the Commission's regulations provides that incorrect reduction claims shall be filed not later than three years following the notice of adjustment, and that the filing must include a detailed narrative describing the alleged reductions and a copy of any "written notice of adjustment from the Office of the State Controller that explains the reason(s) for the reduction or disallowance."[47] Therefore, the Commission finds that the last essential element of an IRC is the issuance by the Controller of a notice of adjustment that includes the reason for the adjustment.

b. More recent cases have relaxed the general accrual rule or recognized exceptions to the general rule based on a plaintiff's notice of facts constituting the cause of action.

Historically, the courts have interpreted the application of statutes of limitation very strictly: in a 1951 opinion, the Second District Court of Appeal declared that "[t]he courts in California have held that statutes of limitation are to be strictly construed and that if there is no express exception in a statute providing for the tolling of the time within which an action can be filed, the court cannot create one."[48] That opinion in turn cited the California Supreme Court in *Lambert v. McKenzie* (1901), in which the Court reasoned that a cause of action for negligence did not arise "upon the date of the discovery of the negligence," but rather "[i]t is the date of the act and fact which fixes the time for the running of the statute."[49] The Court continued:

> Cases of hardship may arise, and do arise, under this rule, as they arise under every statute of limitations; but this, of course, presents no reason for the modification of a principle and policy which upon the whole have been found to make largely for good... And so throughout the law, except in cases of fraud, it is the time of the act, and not the time of the discovery, which sets the statute in operation.[50]

Accordingly, the rule of *Lambert v. McKenzie* has been restated simply: "Generally, the statute of limitations begins to run against a claimant at the time the act giving rise to the injury occurs rather than at the time of discovery of the damage."[51] This historically-strict interpretation of statutes of limitation accords with the plain language of the Code of Civil Procedure, section 312, which states that "[c]ivil actions, *without exception*, can only be commenced within the period prescribed in this title, after the cause of action shall have accrued, unless where, in special cases, a different limitation is prescribed by statute."[52]

However, more recently, courts have applied a more relaxed rule in appropriate circumstances, finding that a cause of action accrues when the plaintiff has knowledge of sufficient facts to

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[47] Code of Regulations, title 2, section 1185 (Register 99, No. 38).

[48] *Marshall v. Packard-Bell Co.* (1951) 106 Cal.App.2d 770, 774.

[49] (1901) 135 Cal. 100, 103 [overruled on other grounds, *Wennerholm v. Stanford University School of Medicine* (1942) 20 Cal.2d 713, 718].

[50] *Ibid.*

[51] *Solis v. Contra Costa County* (1967) 251 Cal.App.2d 844, 846 [citing *Lambert v. McKenzie*, 135 Cal. 100, 103].

[52] Enacted, 1872; Amended, Statutes 1897, chapter 21 [emphasis added].

make out a cause of action: "there appears to be a definite trend toward the discovery rule and away from the strict rule in respect of the time for the accrual of the cause of action..."[53] For example, in *Neel v. Magana, Olney, Levy, Cathcart & Gelfand*, the court presumed "the inability of the layman to detect" an attorney's negligence or misfeasance, and therefore held that "in an action for professional malpractice against an attorney, the cause of action does not accrue until the plaintiff knows, or should know, all material facts essential to show the elements of that cause of action."[54] Similarly, in *Seelenfreund v. Terminix of Northern California, Inc.*, the court held that where the cause of action arises from a negligent termite inspection and report: "appellant, in light of the specialized knowledge required [to perform structural pest control], could, with justification, be ignorant of his right to sue at the time the termite inspection was negligently made and reported…"[55]

Also finding justification for delayed accrual in an attorney malpractice context, but on different grounds, is *Budd v. Nixen*, in which the court framed the issue as a factual question of when actual or appreciable harm occurred: "mere breach of a professional duty, causing only nominal damages, speculative harm, or the threat of future harm - not yet realized - does not suffice to create a cause of action for negligence."[56] Accordingly, in *Allred v. Bekins Wide World Van Services*, it was held that the statute of limitations applicable to a cause of action for the negligent packing and shipping of property should be "tolled until the Allreds sustained damage, and discovered or should have discovered, their cause of action against Bekins."[57]

These cases demonstrate that the plaintiff's *knowledge* of sufficient facts to make out a claim is sometimes treated as the last essential element of the cause of action. Or, alternatively, actual damage must be sustained, and knowledge of the damage, before the statute begins to run.

Here, a delayed discovery rule is inconsistent with the plain language of the Commission's regulations and of section 17558.5, and illogical in the context of an IRC filing, but notice of the reduction and the reason for it constitute the last essential element of the claim. Former section 1185 of the Commission's regulations provides for a period of limitation of three years following the date of a document from the Controller "notifying the claimant of a reduction."[58] Likewise, Government Code section 17558.5 requires the controller to notify the claimant in writing and specifies that the notice must provide "the claim components adjusted, the amounts

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[53] *Warrington v. Charles Pfizer & Co.*, (1969) 274 Cal.App.2d 564, 567 [citing delayed accrual based on discovery rule for medical, insurance broker, stock broker, legal, and certified accountant malpractice and misfeasance cases].

[54] 6 Cal.3d at p. 190.

[55] (1978) 84 Cal.App.3d 133, 138.

[56] *Budd v. Nixen* (1971) 6 Cal.3d 195, 200-201 [superseded in part by statute, Code of Civil Procedure section 340.6 (added, Stats. 1977, ch. 863) which provides for tolling the statute of limitations if the plaintiff has not sustained actual injury].

[57] (1975) 45 Cal.App.3d 984, 991 [Relying on *Neel v. Magana, Olney, Levy, Cathcart & Gelfand, supra*, 6 Cal.3d at p. 190; *Budd v. Nixen*, *supra*, 6 Cal.3d at pp. 200-201].

[58] Code of Regulations, title 2, section 1185 (Register 1999, No. 38).

adjusted…and the reason for the adjustment."[59] Moreover, an IRC is based on the reduction of a claimant's reimbursement during a fiscal year, and the claim could not reasonably be filed before the claimant was aware that the underlying reduction had been made. Therefore, the delayed discovery rules developed by the courts are not applicable to an IRC, because by definition, once it is possible to file the IRC, the claimant has sufficient notice of the facts constituting the claim.

c. Other recent cases have applied the statute of limitations based on the later accrual of a distinct injury or wrongful conduct.

Another line of legal reasoning, which rests not on delayed accrual of a cause of action, but on a new injury that begins a new cause of action and limitation period, is represented by cases alleging more than one legally or qualitatively distinct injury arising at a different time, or more than one injury arising on a recurring basis.

In *Pooshs v. Philip Morris USA, Inc.*, the Court held that applying the general rule of accrual "becomes rather complex when…a plaintiff is aware of both an injury and its wrongful cause but is uncertain as to how serious the resulting damages will be or whether *additional injuries* will later become manifest."[60] In *Pooshs*, the plaintiff was diagnosed with successive smoking-related illnesses between 1989 and 2003. When diagnosed with lung cancer in 2003 she sued Phillip Morris USA, and the defendant asserted a statute of limitations defense based on the initial smoking-related injury having occurred in 1989. The Ninth Circuit Court of Appeals, hearing a motion for summary judgment, certified a question to the California Supreme Court whether the later injury (assuming for purposes of the summary judgment motion that the lung cancer diagnosis was indeed a separate injury) triggered a new statute of limitations, despite being caused by the same conduct. The Court held that for statute of limitations purposes, a later physical injury "can, in some circumstances, be considered 'qualitatively different…'"[61] Relying in part on its earlier decision in *Grisham v. Philip Morris*,[62] in which a physical injury and an economic injury related to smoking addiction were treated as having separate statutes of limitation, the Court held in *Pooshs*:

> As already discussed…we emphasized in *Grisham* that it made little sense to require a plaintiff whose only known injury is economic to sue for personal injury damages based on the speculative possibility that a then latent physical injury might later become apparent. (*Grisham*, *supra*, 40 Cal.4th at pp. 644–645.) Likewise, here, no good reason appears to require plaintiff, who years ago suffered a smoking-related disease that is not lung cancer, to sue at that time for lung cancer damages based on the speculative possibility that lung cancer might later arise.[63]

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[59] Government Code section 17558.5 (added, Stats. 1995, ch. 945 (SB 11)).

[60] *Pooshs v. Philip Morris USA, Inc.* (2011) 51 Cal.4th 788, 797 [emphasis added].

[61] *Id*, at p. 792.

[62] (2007) 40 Cal.4th 623.

[63] *Pooshs*, *supra*, at p. 802.

However, the Court cautioned: "We limit our holding to latent disease cases, without deciding whether the same rule should apply in other contexts."[64] No published cases in California have sought to extend that holding. In effect, the *Pooshs* holding is not an exception to the rule of accrual of a cause of action, but a recognition that in certain limited circumstances (such as latent diseases) a new cause of action, with a new statute of limitations, can arise from the same underlying facts, such as smoking addiction or other exposure caused by a defendant.

A second, and in some ways similar exception to the general accrual rule, can occur in the context of a continuing or recurring injury or wrongful conduct, such as a nuisance or trespass. Where a nuisance or trespass is considered permanent, such as physical damage to property or a hindrance to access, the limitation period runs from the time the injury first occurs; but if the conduct is of a character that may be discontinued and repeated, each successive wrong gives rise to a new action, and begins a new limitation period.[65] The latter rule is similar to the latent physical injury cases described above, in that a continuing or recurring nuisance or trespass could have the same or similar cause but the cause of action is not stale because the injury is later-incurred or later-discovered. However, in the case of a continuing nuisance or trespass, the statute of limitations does not bar the action completely, but limits the remedy to only those injuries incurred within the statutory period; a limitation that would not be applicable to these facts, because the subsequent notice does not constitute a new injury, as explained below.

In *Phillips v. City of Pasadena*,[66] the plaintiff brought a nuisance action against the City for blocking a road leading to the plaintiff's property, which conduct was alleged to have destroyed his resort business. The period of limitation applicable to a nuisance claim against the City was six months, and the trial court dismissed the action because the road had first been blocked nine months before the claim was filed. On appeal, the court treated the obstruction as a continuing nuisance, and thus allowed the action, but limited the recovery to damages occurring six months prior to the commencement of the action, while any damages prior to that were time-barred.[67] In other words, to the extent that the city's roadblock caused injury to the plaintiff's business, Phillips was only permitted to claim monetary damages incurred during the statutory period preceding the initiation of the action.

Here, there is no indication that the "injury" suffered by the claimant is of a type that could be analogized to *Pooshs* or *Phillips*. Although the first notice of adjustment in the record of this IRC is vague as to the reasons for reduction,[68] and the Controller did alter the reduction (i.e.,

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[64] *Id*, at p. 792.

[65] See *Phillips v. City of Pasadena* (1945) 27 Cal.2d 104 ["Where a nuisance is of such a character that it will presumably continue indefinitely it is considered permanent, and the limitations period runs from the time the nuisance is created."]; *McCoy v. Gustafson* (2009) 180 Cal.App.4th 56, 84 ["When a nuisance is continuing, the injured party is entitled to bring a series of successive actions, each seeking damages for new injuries occurring within three years of the filing of the action…"].

[66] (1945) 27 Cal.2d 104.

[67] *Id*, at pp. 107-108.

[68] Exhibit A, IRC 05-4425-I-11, page 15.

reduced the reduction) in a later notice letter,[69] there is no indication that the injury to the claimant is qualitatively different, as was the case in *Pooshs*. Moreover, the later letter in the record in fact provides for a *lesser* reduction, rather than an increased or additional reduction, which would be recoverable under the reasoning of *Phillips*. It could be argued that the Controller has the authority to mitigate or retract its reduction at any time, only to impose a new or increased reduction, but no such facts emerge on this record. Moreover, in cases that apply a continuing or recurring harm theory, only the incremental or increased harm that occurred during the statutory period is recoverable, as in *Phillips*. Here, as explained above, the later notice of reduction (July 10, 2002) indicates a smaller reduction than the earlier, and therefore no incremental increase in harm can be identified during the period of limitation (i.e., three years prior to the filing date of the IRC, December 19, 2005).

d. The general rule still places the burden on the plaintiff to initiate an action even if the full extent or legal significance of the claim is not known.

Even as "[t]he strict rule…is, in various cases, relaxed for a variety of reasons, such as implicit or express representation; fraudulent concealment, fiduciary relationship, continuing tort, continuing duty, and progressive and accumulated injury, all of them excusing plaintiff's unawareness of what caused his injuries…",[70] the courts have continued to resist broadening the discovery rule to excuse a dilatory plaintiff[71] when sufficient facts to make out a claim or cause of action are apparent.[72] And, the courts have held that the statute may commence to run before *all* of the facts are available, or before the legal significance of the facts is fully understood. For example, in *Jolly v. Eli Lilly & Co.*, the Court explained that "[u]nder the discovery rule, the statute of limitations begins to run when the plaintiff suspects or should suspect that her injury was caused by wrongdoing, that someone has done something to her."[73] The Court continued:

> A plaintiff need not be aware of the specific "facts" necessary to establish the claim; that is a process contemplated by pretrial discovery. Once the plaintiff has a suspicion of wrongdoing, and therefore an incentive to sue, she must decide

[69] Exhibit A, IRC 05-4425-I-11, pages 18-19.

[70] *Warrington v. Charles Pfizer & Co.*, (1969) 274 Cal.App.2d 564, 567.

[71] *Regents of the University of California v. Superior Court* 20 Cal.4th 509, 533 [Declining to apply doctrine of fraudulent concealment to toll or extend the time to commence an action alleging violation of Bagley-Keene Open Meetings Act].

[72] *Scafidi v. Western Loan & Building Co.* (1946) 72 Cal.App.2d 550, 566 ["Our courts have repeatedly affirmed that mere ignorance, not induced by fraud, of the existence of the facts constituting a cause of action on the part of a plaintiff does not prevent the running of the statute of limitations."]. See also, *Royal Thrift and Loan Co v. County Escrow, Inc.* (2004) 123 Cal.App.4th 24, 43 ["Generally, statutes of limitation are triggered on the date of injury, and the plaintiff's ignorance of the injury does not toll the statute… [However,] California courts have long applied the delayed discovery rule to claims involving *difficult-to-detect injuries* or the breach of a fiduciary relationship." (Emphasis added, internal citations and quotations omitted)].

[73] (1988) 44 Cal.3d 1103, 1110.

> whether to file suit or sit on her rights. So long as a suspicion exists, it is clear that the plaintiff must go find the facts; she cannot wait for the facts to find her.[74]

Accordingly, in *Goldrich v. Natural Y Surgical Specialties, Inc.*, the court held that the statute of limitations applicable to the plaintiff's injuries for negligence and strict products liability had run, where "…Mrs. Goldrich must have suspected or certainly should have suspected that she had been harmed, and she must have suspected or certainly should have suspected that her harm was caused by the implants."[75] Therefore, even though in some contexts the statute of limitations is tolled until discovery, or in others the last element essential to the cause of action is interpreted to include notice or awareness of the facts constituting the claim, *Jolly*, *supra*, and *Goldrich*, *supra*, demonstrate that the courts have been hesitant to stray too far from the general accrual rule.[76]

Accordingly, here, the claimant argues that "[t]he Controller has not specified how the claim documentation was insufficient for purposes of adjudicating the claim…" and the Controller provides "no notice for the basis of its actions…" However, the history of California jurisprudence interpreting and applying statutes of limitation does not indicate that the claimant's lack of understanding of the "basis of [the Controller's] actions" is a sufficient reason to delay the accrual of an action and the commencement of the period of limitation. In accordance with the plain language of Government Code section 17558.5, the Controller is required to specify the claim components adjusted and the reasons for the reduction; and, former section 1185 of the Commission's regulations requires an IRC filing to include a detailed narrative and a copy of any written notice from the Controller explaining the reasons for the reduction.[77] As long as the claimant has notice of the reason for the adjustment, the underlying factual bases are not necessary for an IRC to lie. Indeed, as discussed above, the courts have held that as a general rule, a plaintiff's ignorance of the person causing the harm, or the harm itself, or the legal significance of the harm, "does not prevent the running of the statute of limitations."[78] Based on the foregoing, the claimant is not required to have knowledge of the "basis of [the Controller's] actions" for the period of limitation to run, as long as a *reason* for the reduction is stated.

e. Where the cause of action is to enforce an obligation or obtain an entitlement, the claim accrues when the party has the right to enforce the obligation.

More pertinent, and more easily analogized to the context of an IRC, are those cases in which an action is brought to enforce or resolve a claim or entitlement that is in dispute, including one administered by a governmental agency. In those cases, the applicable period of limitation attaches and begins to run when the party's right to enforce the obligation accrues.

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[74] *Id*, at p. 1111.

[75] (1994) 25 Cal.App.4th 772, 780.

[76] See *Baker v. Beech Aircraft Corp.* (1974) 39 Cal.App.3d 315, 321 ["The general rule is that the applicable statute…begins to run when the cause of action accrues even though the plaintiff is ignorant of the cause of action or of the identity of the wrongdoer."];

[77] Government Code section 17558.5 (added, Stats. 1995, ch. 945 (SB 11)). Code of Regulations, title 2, section 1185 (Register 99, No. 38).

[78] *Scafidi v. Western Loan & Building Co.* (1946) 72 Cal.App.2d 550, 566.

For example, in cases involving claims against insurance companies, the courts have held that the one-year period of limitation begins to run at the "inception of the loss," defined to mean when the insured *knew or should have known* that appreciable damage had occurred and a reasonable person would be aware of his duty under the policy to notify the insurer.[79] This line of cases does not require that the *total extent of the damage*, or the *legal significance* of the damage, is known at the time the statute commences to run.[80] Rather, the courts generally hold that where the plaintiff knows or has reason to know that damage has occurred, and a reasonable person would be aware of the duty to notify his or her insurer, the statute commences to run at that time.[81] This line of reasoning is not inconsistent with *Pooshs*, *Grisham*, and *Phillips v. City of Pasadena*, discussed above, because in each of those cases the court found (or at least presumed) a recurring injury, which was legally, qualitatively, or incrementally distinct from the earlier injury and thus gave rise to a renewed cause of action.[82]

An alternative line of cases addresses the accrual of claims for benefits or compensation from a government agency, which provides a nearer analogy to the context of an IRC. In *Dillon v. Board of Pension Commissioners of the City of Los Angeles*, the Court held that a police officer's widow failed to bring a timely action against the Board because her claim to her late husband's pension accrued at the time of his death: "At any time following the death she could demand a pension from the board and upon refusal could maintain a suit to enforce such action."[83] Later, *Phillips v. County of Fresno* clarified that "[a]lthough the cause of action accrues in pension cases when the employee first has the power to demand a pension, the limitations period is tolled or suspended during the period of time in which the claim is under consideration by the pension board."[84] In accord is *Longshore v. County of Ventura*, in which the Court declared that "claims for compensation due from a public employer may be said to accrue only when payment thereof can be legally compelled."[85] And similarly, in *California Teacher's Association v. Governing Board*, the court held that "unlike the salary which teachers were entitled to have as they earned

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[79] See *Prudential-LMI Com. Insurance v. Superior Court* (1990) 51 Cal.3d 674, 685; *Campanelli v. Allstate Life Insurance Co.* (9th Cir. 2003) 322 F.3d 1086, 1094.

[80] *Campanelli v. Allstate Life Insurance Co.* (9th Cir. 2003) 322 F.3d 1086, 1094 [Fraudulent engineering reports concealing the extent of damage did not toll the statute of limitations, nor provide equitable estoppel defense to the statute of limitations]; *Abari v. State Farm Fire & Casualty Co.* (1988) 205 Cal.App.3d 530, 534 [Absentee landlord's belated discovery of that his homeowner's policy might cover damage caused by subsidence was not sufficient reason to toll the statute]. See also *McGee v. Weinberg* (1979) 97 Cal.App.3d 798, 804 ["It is the occurrence of some ... cognizable event rather than knowledge of its legal significance that starts the running of the statute of limitations."].

[81] *Ibid*.

[82] *Pooshs v. Philip Morris USA, Inc.* (2011) 51 Cal.4th 788; *Grisham*, *supra*, 40 Cal.4th at pp. 644–645; *Phillips v. City of Pasadena* (1945) 27 Cal.2d 104.

[83] *Dillon v. Board of Pension Commissioners* (1941) 18 Cal.2d 427, 430.

[84] (1990) 225 Cal.App.3d 1240, 1251.

[85] (1979) 25 Cal.3d 14, 30-31.

it…their right to use of sick leave depended on their being sick or injured."[86] Therefore, because they "could not legally compel payment for sick leave to the extent that teachers were not sick, their claims for sick leave did not accrue."[87] This line of cases holds that a statute of limitations to compel payment begins to run when the plaintiff is entitled to demand, or legally compel, payment on a claim or obligation, but the limitation period is tolled while the agency considers that demand.

Here, an IRC cannot lie until there has been a reduction, which the claimant learns of by a notice of adjustment, and the IRC cannot reasonably be filed under the Commission's regulations until at least some reason for the adjustment can be detailed.[88] The claimant's reimbursement claim has already at that point been considered and rejected (to some extent) by the Controller. There is no analogy to the tolling of the statute, as discussed above; the period of limitation begins when the claim is reduced, by written notice, and the claimant is therefore entitled to demand payment through the IRC process.

f. Where the cause of action arises from a breach of a statutory duty, the cause of action accrues at the time of the breach.

Yet another line of cases addresses the accrual of an action on a breach of statutory duty, which is closer still to the contextual background of an IRC. In *County of Los Angeles v. State Department of Public Health*, the County brought actions for mandate and declaratory relief to compel the State to pay full subsidies to the County for the treatment of tuberculosis patients under the Tuberculosis Subsidy Law, enacted in 1915.[89] In 1946 the department adopted a regulation that required the subsidy to a county hospital to be reduced for any patients who were able to pay toward their own care and support, but the County ignored the regulation and continued to claim the full subsidy.[90] Between October 1952 and July 1953 the Controller audited the County's claims, and discovered the County's "failure to report on part-pay patients in the manner contemplated by regulation No. 5198…"[91] Accordingly, the department reduced the County's semiannual claims between July 1951 and December 1953.[92] When the County brought an action to compel repayment, the court agreed that the regulation requiring reduction for patients able to pay in part for their care was inconsistent with the governing statutes, and therefore invalid;[93] but the court was also required to consider whether the County's claim was time-barred, based on the effective date of the regulation. The court determined that the date of the *reduction*, not the effective date of the regulation, triggered the statute of limitations to run:

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[86] (1985) 169 Cal.App.3d 35, 45-46.

[87] *Ibid*.

[88] Government Code section 17558.5 (added, Stats. 1995, ch. 945 (SB 11)); Code of Regulations, title 2, section 1185 (Register 99, No. 38).

[89] (1958) 158 Cal.App.2d 425, 430.

[90] *Id*, at p. 432.

[91] *Id*, at p. 433.

[92] *Ibid*.

[93] *Id*, at p. 441.

> Appellants invoke the statute of limitations, relying on Code of Civil Procedure § 343, the four-year statute. Counsel argue [*sic*] that rule 5198 was adopted in August, 1946, and the County's suit not brought within four years and hence is barred. Respondent aptly replies: "In this case the appellants duly processed and paid all of the County's subsidy claims through the claim for the period of ending [*sic*]June 30, 1951…The first time that Section 5198 was asserted against Los Angeles County was when its subsidy claim for the period July 1, 1951, to December 31, 1951, was reduced by application of this rule of July 2, 1952…This action being for the purpose of enforcing a liability created by statute is governed by the three-year Statute of Limitations provided in Code of Civil Procedure Section 338.1. Since this action was filed May 4, 1954, it was filed well within the three-year statutory period, which commenced July 2, 1952." We agree. Neither action was barred by limitation.[94]

Similarly, in *Snyder v. California Insurance Guarantee Association (CIGA),*[95] the accrual of an action to compel payment under the Guarantee Act was interpreted to require first the rejection of a viable claim. CIGA is the state association statutorily empowered and obligated to "protect policyholders in the event of an insurer's insolvency."[96] Based on statutory standards, "CIGA pays insurance claims of insolvent insurance companies from assessments against other insurance companies…[and] '[i]n this way the insolvency of one insurer does not impact a small segment of insurance consumers, but is spread throughout the insurance consuming public…"[97] "[I]f CIGA improperly denies coverage or refuses to defend an insured on a 'covered claim' arising under an insolvent insurer's policy, it breaches its statutory duties under the Guarantee Act."[98] Therefore, "[i]t follows that in such a case a cause of action *accrues* against CIGA when CIGA denies coverage on a submitted claim."[99] Thus, in *Snyder*, the last essential element of the action was the denial of a "covered claim" by CIGA, which is defined in statute to include obligations of an insolvent insurer that "remain unpaid despite presentation of a timely claim in the insurer's liquidation proceeding." And, the definition in the code excludes a claim "to the extent it is covered by any other insurance of a class covered by this article available to the claimant or insured."[100] Therefore a claimant is required to pursue "any other insurance" before filing a claim with CIGA, and CIGA must reject that claim, thus breaching its statutory duties, before the limitation period begins to run.

Here, an IRC may be filed once a claimant has notice that the Controller has made a determination that the claim must be reduced, and notice of the reason(s) for the reduction.

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[94] *Id*, at pp. 445-446.

[95] (2014) 229 Cal.App.4th 1196.

[96] *Id*, at p. 1203, Fn. 2.

[97] *Ibid*.

[98] *Id*, at p. 1209 [quoting *Berger v. California Insurance Guarantee Association* (2005) 128 Cal.App.4th 989, 1000].

[99] *Id*, at p. 1209 [emphasis added].

[100] *Ibid* [citing Insurance Code §1063.1].

Government Code section 17551 provides that the Commission "shall hear and decide upon" a local government's claim that the Controller incorrectly reduced payments pursuant to section 17561(d)(2), which in turn describes the Controller's audit authority.[101] Moreover, section 1185.1 (formerly section 1185) of the Commission's regulations states that "[t]o obtain a determination that the Office of State Controller incorrectly reduced a reimbursement claim, a claimant shall file an 'incorrect reduction claim' with the commission."[102] And, section 1185.1 further requires that an IRC filing include "[a] written detailed narrative that describes the alleged incorrect reduction(s)," including "a comprehensive description of the reduced or disallowed area(s) of cost(s)." And in addition, the filing must include "[a] copy of any final state audit report, letter, remittance advice, or other written notice of adjustment form the Office of State Controller that explains the reason(s) for the reduction or disallowance."[103] Therefore, the Controller's reduction of a local government's reimbursement claim is the underlying cause of an IRC, and the notice to the claimant of the reduction and the reason for the reduction is the "last element essential to the cause of action,"[104] similar to *County of Los Angeles v. State Department of Public Health*, and *Snyder v. California Insurance Guarantee Association*, discussed above.

2. <u>As applied to this IRC, the three year period of limitation attached either to the July 30, 1998 notice of adjustment or the July 10, 2002 notice of adjustment, and therefore the IRC filed December 16, 2005 was not timely.</u>

As discussed above, the general rule of accrual of a cause of action is that the period of limitations attaches and begins to run when the claim accrues, or in other words upon the occurrence of the last element essential to the cause of action. The above analysis demonstrates that the general rule, applied consistently with Government Code section 17558.5 and Code of Regulations, title 2, section 1185.1 (formerly 1185) means that an IRC accrues and may be filed when the claimant receives notice of a reduction and the reason(s) for the reduction. And, as discussed above, none of the established exceptions to the general accrual rule apply as a matter of law to IRCs generally. However, the claimant has here argued that later letters or notices of payment action in the record control the time "from which the ultimate regulatory period of limitation is to be measured…" The Commission finds that the claimant's argument is unsupported.

a. The general accrual rule must be applied consistently with Government Code section 17558.5(c).

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[101] Government Code section 17551 (Stats. 1985, ch. 179; Stats. 1986, ch. 879; Stats 2002, ch. 1124 (AB 3000); Stats. 2004, ch. 890 (AB 2856); Stats. 2007, ch. 329 (AB 1222)); 17561(d)(2) (Stats. 1986, ch. 879; Stats. 1988, ch. 1179; Stats. 1989, ch. 589; Stats. 1996, ch. 45 (SB 19); Stats. 1999, ch. 643 (AB 1679); Stats. 2002, ch. 1124 (AB 3000); Stats. 2004, ch. 313 (AB 2224); Stats 2004, ch. 890 (AB 2856); Stats. 2006, ch. 78 (AB 1805); Stats. 2007, ch. 179 (SB 86); Stats. 2007, ch. 329 (AB 1222); Stats. 2009, ch. 4 (SBX3 8)).

[102] Code of Regulations, title 2, section 1185.1(a) (Register 2014, No. 21.

[103] Code of Regulations, title 2, section 1185.1(f) (Register 2014, No. 21.

[104] *Seelenfreund v. Terminix of Northern California, Inc.* (1978) 84 Cal.App.3d 133 [citing *Neel v. Magana, Olney, Levy, Cathcart & Gelfand* (1971) 6 Cal.3d 176].

As noted above, the period of limitation for filing an IRC was added to the Commission's regulations effective September 13, 1999. As amended by Register 99, No. 38, section 1185(b) provided:

> All incorrect reduction claims shall be submitted to the commission no later than three (3) years following the date of the State Controller's remittance advice *notifying the claimant of a reduction*.[105]

Based on the plain language of the provision, the Commission's regulation on point is consistent with the general rule that the period of limitation to file an IRC begins to run when the claimant receives notice of a reduction.

However, Government Code section 17558.5, as explained above, provides that the Controller must issue written notice of an adjustment, which includes the claim components adjusted and the reasons for adjustment. And, accordingly, section 1185.1 (formerly 1185) requires an IRC filing to include a detailed narrative which identifies the alleged incorrect reductions, and any copies of written notices specifying the reasons for reduction.

Therefore, a written notice identifying the reason or reasons for adjustment is required to trigger the period of limitation. Here, there is some question whether the July 30, 1998 notice provided sufficient notice of the reason for the reduction. The claimant states in its IRC that the claim was "reduced by the amount of $184,842 due to 'no supporting documentation.'"[106] In addition, the claimant provided a letter addressed to the audit manager at the Controller's Office from the District, stating that "Gavilan College has all supporting documentation to validate our claim…" and "[i]t is possible you need additional information…"[107] However, the notice of adjustment included in the record, issued on July 30, 1998, does not indicate a reason for the adjustment.[108]

The July 10, 2002 letter, however, does more clearly state the reason for adjustment, as "no supporting documentation."[109] And again, the claimant states in its IRC that the later letter reduced the claim "by the amount of $124,245 due to 'no supporting documentation.'"[110]

The issue, then, is whether the claimant had actual notice as early as July 30, 1998 of the adjustment and the reason for the adjustment, or whether the Controller's failure to clearly state the reason means the period of limitation instead commenced to run on July 10, 2002. The case law described above would seem to weigh in favor of applying the period of limitation to the earlier notice of adjustment, even if the reason for the adjustment was not known at that time.[111] Additionally, the evidence in the record indicates that the claimant may have had *actual* notice of

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[105] Code of Regulations, title 2, section 1185(b) (Register 1999, No. 38) [emphasis added].

[106] Exhibit A, IRC 05-4425-I-11, page 5.

[107] Exhibit A, IRC 05-4425-I-11, page 21.

[108] Exhibit A, IRC 05-4425-I-11, page 15.

[109] Exhibit A, IRC 05-4425-I-11, page 19.

[110] Exhibit A, IRC 05-4425-I-11, pages 5-6.

[111] See *Baker v. Beech Aircraft Corp.* (1974) 39 Cal.App.3d 315, 321 ["The general rule is that the applicable statute…begins to run when the cause of action accrues even though the plaintiff is ignorant of the cause of action or of the identity of the wrongdoer."]

the reason for the reduction, even if the Controller's letter dated July 30, 1998 does not clearly state the reason.[112] However, section 17558.5 requires the Controller to specify the reasons for reduction in its notice, and section 1185.1 of the regulations requires a claimant to include a copy of any such notice in its IRC filing.

Ultimately, the Commission is not required to resolve this question here, because the period of limitation attaches *no later than* the July 10, 2002 notice, which does contain a statement of the reason for the reduction. And, pursuant to the case law discussed above, even if the reason stated is cursory or vague, the period of limitation would commence to run where the claimant knows or has reason to know that it has a claim.[113]

b. None of the exceptions to the general accrual rule apply, and therefore the later notices of adjustment in the record do not control the period of limitation.

As discussed at length above, a cause of action is generally held to accrue at the time an action may be maintained, and the applicable statute of limitations attaches at that time.[114] Here, claimant argues that the applicable period of limitation should instead attach to the *last* notice of adjustment in the record: "the incorrect reduction claim asserts as a matter of fact that the Controller's July 10, 2002 letter reports an amount payable to the claimant, which means a subsequent final payment action notice occurred or is pending from which the ultimate regulatory period of limitation is to be measured, which the claimant has so alleged."[115] In its comments on the draft, the claimant identifies a new "notice of adjustment" received by the claimant on February 26, 2011,[116] which the claimant argues "now becomes the last Controller's adjudication notice letter," and sets the applicable period of limitation.[117]

There is no support in law for the claimant's position. As discussed above, statutes of limitation attach when a claim is "complete with all its elements."[118] Exceptions have been carved out when a plaintiff is justifiably unaware of facts essential to the claim,[119] but even those exceptions are limited, and do not apply when the plaintiff has sufficient facts to be on inquiry or

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[112] Exhibit A, IRC 05-4425-I-11, pages 5-6; 15; 21.

[113] See, e.g., *Allred v. Bekins Wide World Van Services* (1975) 45 Cal.App.3d 984, 991 [Relying on *Neel v. Magana, Olney, Levy, Cathcart & Gelfand, supra*, 6 Cal.3d at p. 190; *Budd v. Nixen, supra*, 6 Cal.3d at pp. 200-201].

[114] *Lambert v. McKenzie, supra*, (1901) 135 Cal. 100, 103.

[115] Exhibit B, Claimant Comments, page 2.

[116] The notice in the record is dated February 26, 2011 but stamped received by the District on March 14, 2011.

[117] Exhibit E, Claimant Comments on Draft Proposed Decision, page 2.

[118] *Pooshs v. Phillip Morris USA, Inc.* (2011) 51 Cal.4th 788, 797 [quoting *Norgart v. Upjohn Co.* (1999) 21 Cal.4th 383, 397].

[119] *Allred v. Bekins Wide World Van Services*, (1975) 45 Cal.App.3d 984, 991 [Relying on *Neel v. Magana, Olney, Levy, Cathcart & Gelfand, supra*, 6 Cal.3d at p. 190; *Budd v. Nixen, supra*, 6 Cal.3d at pp. 200-201].

constructive notice that a wrong has occurred and that he or she has been injured.[120] The courts do not accommodate a plaintiff merely because the full extent of the claim, or its legal significance, or even the identity of a defendant, may not be yet known at the time the cause of action accrues.[121] Accordingly, the claimant cannot allege that the earliest notice did not provide sufficient information to initiate an IRC, and the later adjustment notices that the claimant proffers do not toll or suspend the operation of the period of limitation.

The discussion above also explains that in certain circumstances a new statute of limitations is commenced where a new injury results, even from the same or similar conduct, and in such circumstances a plaintiff may be able to recover for the later injury even when the earlier injury is time-barred.[122] Here, the later letters in the record do not constitute either a new or a cumulative injury. The first notice stated a reduction of the claim "by the amount of $184,842…" and stated that "$126,146 was due to the State."[123] The later letters notified the claimant that funds were being offset from other programs,[124] but did not state any new reductions. And the notice dated July 10, 2002 stated that the Controller had further reviewed the claim, and now $60,597 was due the claimant, which represented a reduction of the earlier adjustment amount.[125] The letter that the claimant received on March 14, 2011,[126] states no new reductions, or new reasoning for existing reductions, with respect to the 1995-1996 annual

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[120] *Jolly v. Eli Lilly & Co.* (1988) 44 Cal.3d 1103, 1110 [belief that a cause of action for injury from DES could not be maintained against multiple manufacturers when exact identity of defendant was unknown did not toll the statute]; *Goldrich v. Natural Y Surgical Specialties, Inc.* (1994) 25 Cal.App.4th 772, 780 [belief that patient's body, and not medical devices implanted it it, was to blame for injuries did not toll the statute]; *Campanelli v. Allstate Life Insurance Co.* (9th Cir. 2003) 322 F.3d 1086, 1094 [Fraudulent engineering reports concealing the extent of damage did not toll the statute of limitations, nor provide equitable estoppel defense to the statute of limitations]; *Abari v. State Farm Fire & Casualty Co.* (1988) 205 Cal.App.3d 530, 534 [Absentee landlord's belated discovery of that his homeowner's policy might cover damage caused by subsidence was not sufficient reason to toll the statute]. See also *McGee v. Weinberg* (1979) 97 Cal.App.3d 798, 804 ["It is the occurrence of some ... cognizable event rather than knowledge of its legal significance that starts the running of the statute of limitations."].

[121] *Scafidi v. Western Loan & Building Co.* (1946) 72 Cal.App.2d 550, 566 ["Our courts have repeatedly affirmed that mere ignorance, not induced by fraud, of the existence of the facts constituting a cause of action on the part of a plaintiff does not prevent the running of the statute of limitations."]. See also, *Baker v. Beech Aircraft Corp.* (1974) 39 Cal.App.3d 315, 321 ["The general rule is that the applicable statute…begins to run when the cause of action accrues even though the plaintiff is ignorant of the cause of action or of the identity of the wrongdoer."].

[122] *Pooshs v. Phillip Morris USA, Inc.* (2011) 51 Cal.4th 788; *Phillips v. City of Pasadena* (1945) 27 Cal.2d 104.

[123] Exhibit A, IRC 05-4425-I-11, pages 5; 15.

[124] Exhibit A, IRC 05-4425-I-11, pages 5; 16-17.

[125] Exhibit A, IRC 05-4425-I-11, pages 5; 18.

[126] The claimant refers to this in Exhibit E as a February 26, 2011 letter, but the letter is stamped received by the District on March 14, 2011.

claims for the *Collective Bargaining* program; it provides exactly as the notice dated July 10, 2002: that $60,597 is due the claimant for the program.[127]

Based on the foregoing, the Commission finds none of the exceptions to the commencement or running of the period of limitation apply here to toll or renew the limitation period.

c. The three year period of limitation found in former Section 1185 of the Commission's regulations is applicable to this incorrect reduction claim, and does not constitute an unconstitutional retroactive application of the law.

Former section 1185[128] of the Commission's regulations, pertaining to IRCs, contained no applicable period of limitation as of July 30, 1998.[129] Neither is there any statute of limitations for IRC filings found in the Government Code.[130] Moreover, the California Supreme Court has held that "the statutes of limitations set forth in the Code of Civil Procedure…do not apply to administrative proceedings."[131] Therefore, at the time that the claimant in this IRC first received notice from the Controller of a reduction of its reimbursement claim, there was no applicable period of limitation articulated in the statute or the regulations.[132]

However, in 1999, the following was added to section 1185(b) of the Commission's regulations:

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[127] Compare Exhibit A, IRC 05-4425-I-11, pages 5; 18, with Exhibit E, Claimant Comments on Draft Proposed Decision, page 4.

[128] Section 1185 was amended and renumbered 1185.1 effective July 1, 2014. However, former section 1185, effective at the time the IRC was filed, is the provision applicable to this IRC.

[129] Code of Regulations, title 2, section 1185 (Register 1996, No. 30).

[130] See Government Code section 17500 et seq.

[131] *Coachella Valley Mosquito and Vector Control District v. Public Employees' Retirement System* (2005) 35 Cal.4th 1072, 1088 [citing *City of Oakland v. Public Employees' Retirement System* (2002) 95 Cal.App.4th 29; *Robert F. Kennedy Medical Center v. Department of Health Services* (1998) 61 Cal.App.4th 1357, 1361-1362 (finding that Code of Civil Procedure sections 337 and 338 were not applicable to an administrative action to recover overpayments made to a Medi-Cal provider); *Little Co. of Mary Hospital v. Belshe* (1997) 53 Cal.App.4th 325, 328-329 (finding that the three year audit requirement of hospital records is not a statute of limitations, and that the statutes of limitations found in the Code of Civil Procedure apply to the commencement of civil actions and civil special proceedings, "which this was not"); *Bernd v. Eu*, *supra* (finding statutes of limitations inapplicable to administrative agency disciplinary proceedings)].

[132] *City of Oakland v. Public Employees' Retirement System* (2002) 95 Cal.App.4th 29, 45 [The court held that PERS' duties to its members override the general procedural interest in limiting claims to three or four years: "[t]here is no requirement that a particular type of claim have a statute of limitation."]. See also *Bernd v. Eu* (1979) 100 Cal.App.3d 511, 516 ["There is no specific time limitation statute pertaining to the revocation or suspension of a notary's commission."].

> All incorrect reduction claims shall be submitted to the commission no later than three (3) years following the date of the State Controller's remittance advice notifying the claimant of a reduction.[133]

The courts have held that "[i]t is settled that the Legislature may enact a statute of limitations 'applicable to existing causes of action or shorten a former limitation period if the time allowed to commence the action is reasonable."[134] A limitation period is "within the jurisdictional power of the legislature of a state," and therefore may be altered or amended at the Legislature's prerogative.[135] The Commission's regulatory authority must be interpreted similarly.[136] However, "[t]here is, of course, one important qualification to the rule: where the change in remedy, as, for example, the shortening of a time limit provision, is made retroactive, there must be a reasonable time permitted for the party affected to avail himself of his remedy before the statute takes effect."[137]

The California Supreme Court has explained that "[a] party does not have a vested right in the time for the commencement of an action."[138] And neither "does he have a vested right in the running of the statute of limitations prior to its expiration."[139] If a statute "operates immediately to cut off the existing remedy, or within so short a time as to give the party no reasonable opportunity to exercise his remedy, then the retroactive application of it is unconstitutional as to such party."[140] In other words, a party has no more vested right to the time remaining on a statute of limitation than the opposing party has to the swift expiration of the statute, but if a statute is newly imposed or shortened, due process demands that a party must be granted a reasonable time to vindicate an existing claim before it is barred. The California Supreme Court has held that approximately one year is more than sufficient, but has cited to decisions in other jurisdictions providing as little as thirty days.[141]

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[133] Code of Regulations, title 2, section 1185 (Register 1999, No. 38).

[134] *Scheas v. Robertson* (1951) 38 Cal.2d 119, 126 [citing *Mercury Herald v. Moore* (1943) 22 Cal.2d 269, 275; *Security-First National Bank v. Sartori* (1939) 34 Cal.App.2d 408, 414].

[135] *Scheas*, *supra*, at p. 126 [citing *Saranac Land & Timber Co v. Comptroller of New York*, 177 U.S. 318, 324].

[136] *Yamaha Corp. of America v. State Board of Equalization* (1998) 19 Cal.4th 1, 10 [Regulations of an agency that has quasi-legislative power to make law are treated with equal dignity as to statutes]; *Butts v. Board of Trustees of the California State University* (2014) 225 Cal.App.4th 825, 835 ["The rules of statutory construction also govern our interpretation of regulations promulgated by administrative agencies."].

[137] *Rosefield Packing Company v. Superior Court of the City and County of San Francisco* (1935) 4 Cal.2d 120, 122.

[138] *Liptak v. Diane Apartments, Inc.* (1980) 109 Cal.App.3d 762, 773 [citing *Kerchoff-Cuzner Mill and Lumber Company v. Olmstead* (1890) 85 Cal. 80].

[139] *Liptak, supra*, at p. 773 [citing *Mudd v. McColgan* (1947) 30 Cal.2d 463, 468].

[140] *Rosefield Packing Co., supra*, at pp. 122-123.

[141] See *Rosefield Packing Co.*, *supra*, at p. 123 ["The plaintiff, therefore, had practically an entire year to bring his case to trial…"]; *Kerchoff-Cuzner Mill and Lumber Company v. Olmstead*

Here, the regulation imposing a period of limitation was adopted and became effective on September 13, 1999.[142] As stated above, the section requires that an IRC be filed no later than three years following the date of the Controller's notice to the claimant of an adjustment. The courts have generally held that the date of accrual of the claim itself is excluded from computing time, "[e]specially where the provisions of the statute are, as in our statute, that the time shall be computed *after* the cause of action shall have accrued.[143] Here, the applicable period of limitation states that an IRC must be filed "no later than three (3) years *following* the date…"[144] The word "following" should be interpreted similarly to the word "after," and "as fractions of a day are not considered, it has been sometimes declared in the decisions that no moment of time can be said to be after a given day until that day has expired."[145] Therefore, applying the three year period of limitation to the July 30, 1998 initial notice of adjustment means the limitation period would have expired on July 31, 2001, twenty-two and one-half months after the limitation was first imposed by the regulation. In addition, if the 2002 notice is considered to be the first notice that provides a reason for the reduction, thus triggering the limitation, then the limitation is not retroactive at all. Based on the cases cited above, and those relied upon by the California Supreme Court in its reasoning, that period is more than sufficient to satisfy any due process concerns with respect to application of section 1185 of the Commission's regulations to this IRC.

Based on the foregoing, the Commission finds that the regulatory period of limitation applies from the date that it became effective, and based on the evidence in this record that application does not violate the claimant's due process rights.

V. Conclusion

Based on the foregoing, the Commission finds that this IRC is not timely filed, and is therefore denied.

(1890) 85 Cal. 80 [thirty days to file a lien on real property]. See also *Kozisek v. Brigham* (Minn. 1926) 169 Minn. 57, 61 [three months].

[142] Code of Regulations, title 2, section 1185 (Register 99, No. 38).

[143] *First National Bank of Long Beach v. Ziegler* (1914) 24 Cal.App. 503, 503-504 [Emphasis Added].

[144] Code of Regulations, title 2, section 1185 (Register 99, No. 38).

[145] *First National Bank of Long Beach v. Ziegler* (1914) 24 Cal.App., at pp. 503-504 [Emphasis Added].

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RE: **Decision**

Health Fee Elimination, 05-4206-I-11
Education Code Section 76355
Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118
Fiscal Years 2000-2001, 2001-2002, and 2002-2003
El Camino 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 11, 2014

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RE: **Decision**

Collective Bargaining, 05-4425-I-11
Government Code Sections 3540-3549.9
Statutes 1975, Chapter 961
Fiscal Year 1995-1996
Gavilan Joint Community College District, Claimant

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

Dated: December 11, 2014

Heather Halsey, Executive Director

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Education Code Sections 35295, 35296, 35297, 40041.5 and 40042; Statutes 1984, Chapter 1659 Fiscal Years 2001-2002 and 2002-2003 San Diego Unified School District, Claimant	Case No.: 04-4241-I-01 *Emergency Procedures, Earthquake, and Disasters* 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 11, 2014*)

DECISION

The Commission on State Mandates (Commission) heard and decided this incorrect reduction claims (IRC) during a regularly scheduled hearing on December 5, 2014. Jim Spano and Ken Howell 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 6-0.

Summary of the Findings

This IRC by the San Diego Unified School District (claimant) challenges reductions made by the Controller to salaries and benefits and related indirect costs of $1,127,211 claimed for fiscal years 2001-2002 and 2002-2003 to comply with the *Emergency Procedures, Earthquake, and Disasters* program. The Controller reduced the claims because the claimant did not comply with the documentation requirements of the parameters and guidelines to support the vast majority of the employee hours claimed. Instead, the claimant used a "random moment sampling" methodology to determine the average time spent on the program per employee based on time logs submitted by a limited number of employees. The Controller approved the claims for the actual time that schoolsite employees documented on time logs, and reduced the claims that were not supported by adequate source documentation.

The Commission finds that, under principles of due process discussed in the decision, the documentation requirements in the parameters and guidelines as amended in 1991 apply to the 2001-2002 and 2002-2003 reimbursement claims. These parameters and guidelines authorize reimbursement for actual increased costs and require the claimant to provide "a listing of each employee, describ[ing] their function, their hourly rate of pay and related employee benefit cost

and the number of hours devoted to their function as they relate to this mandate." The parameters and guidelines also require that the costs claimed be traceable to source documents, which must be kept on file and made available to the Controller for auditing purposes.

The Commission finds that the claimant did not comply with the documentation requirements of the parameters and guidelines. There is no authorization in the 1991 parameters and guidelines for a statistical sampling, a unit cost, or any other reimbursement method that estimates or averages time or costs. The parameters and guidelines require actual costs to be claimed, supported by a statement and documentation listing "each employee, describ[ing] their function, their hourly rate of pay and related employee benefit cost *and the number of hours devoted to their function as they relate to this mandate*."

Therefore, the Controller's reduction of salaries and benefits claimed in fiscal years 2001-2002 and 2002-2003 is correct as a matter of law.

COMMISSION FINDINGS

I. Chronology

11/27/2002 Claimant signed reimbursement claim for fiscal year 2001-2002[1]

12/08/2003 Claimant signed reimbursement claim for fiscal year 2002-2003[2]

08/27/2004 Controller issued draft audit report.[3]

09/23/2004 Claimant submitted comments on Controller's draft audit report[4]

10/15/2004 Controller issued final audit report[5]

03/24/2005 Claimant filed this IRC.

10/17/2005 Controller filed comments on the IRC.[6]

08/18/2014 Commission staff issued a draft proposed decision.[7]

09/08/2014 Controller filed comments on the draft proposed decision.[8]

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[1] Exhibit A, Incorrect Reduction Claim, pages 4 and 26.

[2] Exhibit A, Incorrect Reduction Claim, pages 4 and 39.

[3] Exhibit A, Incorrect Reduction Claim, page 71. The draft audit report is not part of the record.

[4] Exhibit A, Incorrect Reduction Claim, page 86.

[5] Exhibit A, Incorrect Reduction Claim, page 67.

[6] Exhibit B, Controller's Comments on the Incorrect Reduction Claim dated October 11, 2005.

[7] Exhibit C, Draft Proposed Decision.

[8] Exhibit D, Controller's Comments on the Draft Proposed Decision filed September 8, 2014.

II. Background

The *Emergency Procedures, Earthquake, and Disasters* Program

The *Emergency Procedures, Earthquake, and Disasters* program was enacted by Statutes 1984, chapter 1659, in recognition that California would experience moderate to severe earthquakes in the foreseeable future and that all public and private schools should develop an earthquake emergency procedure system.[9] The program required the governing board of each school district and the superintendent of schools for each county to establish an earthquake emergency procedure system in every public or private school building having an occupant capacity of 50 or more pupils or more than one classroom that shall include all of the following:

(a) A school building disaster plan, ready for implementation at any time, for maintaining the safety and care of students and staff.

(b) A drop procedure. As used in this article, "drop procedure" means an activity whereby each student and staff member takes cover under a table or desk, dropping to his or her knees, with the head protected by the arms, and the back to the windows. A drop procedure practice shall be held at least once a semester in secondary schools.

(c) Protective measures to be taken before, during, and following an earthquake.

(d) A program to ensure that the students and staff are aware of, and properly trained in, the earthquake emergency procedure system.[10]

The 1984 statute also required the governing board of any school district to: (a) grant the use of school facilities for mass care and welfare shelters to public agencies such as the American Red Cross in the event of a disaster or other emergency affecting the public health and welfare; and (b) cooperate with such public agencies in furnishing and maintaining those services as the governing board may deem necessary to meet the needs of the community.[11]

The Commission approved the test claim on July 23, 1987, and adopted parameters and guidelines for the program on March 23, 1989 for costs incurred beginning July 1, 1985. The parameters and guidelines authorize reimbursement to establish emergency procedure systems; provide instruction to employees and students about the earthquake emergency procedures; and provide district facilities, grounds, and equipment to public agencies for mass care and welfare shelters. On February 28, 1991, the Commission amended the parameters and guidelines to clarify that reimbursement was not required for in-classroom teacher time to instruct students about the earthquake emergency procedure systems.

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[9] Former Education Code section 35295 (Stats. 1984, ch. 895).

[10] Education Code sections 35926, 35297.

[11] Former Education Code section 40041.5. This IRC does not involve the activities required by former Education Code section 40041.5.

On May 29, 2003, the Commission amended the parameters and guidelines for the period of reimbursement from July 1, 2000 through June 30, 2003, to clarify that reimbursement for the emergency and disaster procedures is limited to earthquake emergencies only. The supporting documentation requirements were also amended at that time to require claimants to support all costs claimed with contemporaneous source documents, in addition to other amendments to the boilerplate language. Reimbursement claims for costs incurred after June 30, 2003 were to be filed under consolidated parameters and guidelines for *Emergency Procedures, Earthquake Procedures, and Disasters and Comprehensive School Safety Plans.*

Statutes 2004, chapter 895 (AB 2855) amended former Education Code sections 35295, 35296, and 35297, and repealed section 38132 (former § 40041.5), removing public school districts from the state-mandated requirements to establish earthquake emergency procedure systems. The amended parameters and guidelines state that this program is no longer reimbursable after December 31, 2004.[12]

Controller's Audit Adjustments and Summary of the Issues

The Controller issued its final audit report on October 15, 2004, finding that the claimant did not have documentation of the actual time spent on the program by the vast majority of employees and, instead, calculated an average time spent on the program for each district employee based on the time logs of a small fraction of its employees. The Controller found that the methodology the claimant used to determine the mean time per position was not a valid statistical analysis, and not a methodology authorized by the claiming instructions for a time study, and reduced the costs claimed on the ground that the claimant did not provide adequate source documentation to support the costs claimed.[13] The Controller allowed reimbursement only for employees whose time spent on the mandate was supported by the time logs. The claimant challenges the Controller's findings and requests reinstatement of $1,127,211 that was reduced.

This IRC presents the following issues:

- Which documentation requirements govern the Controller's audit.
- Whether the Controller's reduction of claims is consistent with the documentation requirements in the parameters and guidelines and is correct as a matter of law.

III. Positions of Parties

A. San Diego Unified School District

[12] Commission on State Mandates, *Emergency Procedures, Earthquake Procedures, and Disasters and Comprehensive School Safety* Parameters and Guidelines, 04-PGA-24 (CSM-4241, 98-TC-01, 99-TC-10) Education Code Sections 35294.1, 35294.2, 35294.6, and 35294.8, 35295, 35296, 35297, 40041.5 and 40042, Statutes 1984, Chapter 1659 (AB 2786), Statutes 1997, Chapter 736 (SB 187), Statutes 1999, Chapter 996 (SB 408), as amended March 29, 2006.

[13] Exhibit A, Incorrect Reduction Claim, page 73 (Page 4 of Exhibit F of the IRC, Final Audit Report).

Claimant contends that the Controller incorrectly reduced its claims, arguing that random moment sampling, its method of determining the actual costs of performing the mandated activities, is federally approved. The time logs submitted were completely random because claimant did not play a role in determining which school sites submitted a time log. Moreover, each school site annually reviews and prepares or updates an emergency preparedness plan as required by the Collective Negotiations Contract, which is sufficient documentation to prove each school site performed the mandated activities. Claimant did not file comments on the draft proposed decsion.

B. State Controller's Office

The Controller maintains that the audit adjustments are correct and in accordance with the parameters and guidelines, as amended in 2003, and that this IRC should be denied. The Controller found that claimant's methodology to determine the mean time per position was not a valid statistical analysis because the statistical projections were based on employees who submitted time logs rather than employees or school sites randomly selected. Except for teachers/librarians in fiscal year 2001-2002, claimant's sample sizes were not statistically valid based on a 95 percent confidence level and a precision rate of +/-8 percent. The sample sizes, in addition to the non-random selection, prevented projecting the sample data to all school site employees. The Controller also found that claimant made several inconsistent and unsupportable adjustments to the data. Additionally, the Controller found that for the vast majority of school site staff, claimant did not provide documentation to support actual time that employees spent to perform mandated activities. Thus, the Controller allowed only the actual time that schoolsite employees documented on time logs.[14] The Controller filed comments concurring with the draft proposed decision specifically stating that: "The district did not comply with the parameters and guidelines requiring reimbursement claims to be based on actual salary and benefit costs incurred for the employees working on the mandated program. Further, the sampling methodology used by the district in claiming costs was not designed and implemented in a manner that supported actual costs incurred."[15]

IV. Discussion

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

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

[14] Exhibit A, Incorrect Reduction Claim, pages 70-75.

[15] Exhibit D, Controller's Comments on the Draft Proposed Decision filed September 8, 2014.

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.[16] 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."[17]

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.[18] 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.]' "[19]

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. [20] In addition, section 1185.2(c) of the Commission's regulations requires that any assertion 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.[21]

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

[17] *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.

[18] *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.

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

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

[21] 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.

A. The Parameters and Guidelines as Amended in 1991 Govern the Audit of these Reimbursement Claims.

The substantive issue in this IRC is whether the claimant complied with the documentation requirements of the parameters and guidelines in claiming salary and benefit costs of its employees performing the reimbursable activities.

The Controller assumes that the documentation requirements in the parameters and guidelines, as amended on May 29, 2003, apply to the audit of the 2001-2002 and 2002-2003 reimbursement claims for these costs.[22] That amendment was adopted following a request from the State Controller's Office, dated September 19, 2001, and pursuant to former section 1183.2 of the Commission's regulations,[23] to establish a period of reimbursement going back to July 1, 2000.[24] The parameters and guidelines amended in 2003 added a new requirement for claimants to support all costs claimed with contemporaneous source documents "created at or near the same time the actual cost was incurred." The 2003 amended parameters and guidelines were not in effect when the costs in this case were incurred.[25] Thus, the issue is whether the documentation requirements in the 2003 parameters and guidelines can be applied retroactively to costs incurred before the parameters and guidelines amendment was adopted. The Commission finds that the documentation requirements in the 2003 parameters and guidelines do not apply to the audit of the 2001-2002 and 2002-2003 claims.

Parameters and guidelines are regulatory in nature and are interpreted the same as regulations and statutes.[26] Despite the retroactive period of reimbursement for amendments to parameters and guidelines, an amendment cannot be applied retroactively if due process considerations prevent it.[27] If an amendment affects substantive rights or liabilities of the parties that change the legal consequences of past events, then the application of an amendment may be considered unlawfully retroactive under principles of due process.[28] A statutory change is substantive if it

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[22] See Exhibit B, Controller's Comments on the Incorrect Reduction Claim dated October 11, 2005, page 10.

[23] Former Government Code section 17557 did not specify the reimbursement period affected by an amendment to parameters and guidelines. However, the reimbursement period is now specified in section 17557(d) as of Statutes 2004, chapter 890.

[24] Exhibit B, Controller's Comments on the Incorrect Reduction Claim dated October 11, 2005, page 25. The 2003 parameters and guidelines are attached to the Controller's comments.

[25] There is a possibility that costs may have been incurred in fiscal year 2002-2003 between May 29, 2003 (when the Commission adopted the amendment) and June 30, 2003 (the end of the 2002-2003 fiscal year). However, there is no evidence in the record to support this possibility.

[26] *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 799.

[27] *City of Modesto v. National Med, Inc.* (2005) 128 Cal.App.4th 518, 527.

[28] *Department of Health Services v. Fontes* (1985) 169 Cal.App.3d 301, 304-305; *Tapia v. Superior Court* (1991) 53 Cal.3d 282; 287-292; *Murphy v. City of Alameda* (1993) 11 Cal.App.4th 906, 911-912.

imposes new, additional, or different liabilities based on past conduct.[29] In addition, due process requires that a claimant have reasonable notice of any substantive change that affects the substantive rights and liabilities of the parties.[30]

The court in *Clovis Unified School Dist. v. Chiang* found that the contemporaneous source document rule (CSDR) was an underground regulation and was not authorized in the parameters and guidelines, and determined which parameters and guidelines governed the audit of the programs at issue, consistent with these due process rules. In *Clovis*, the Controller requested that the court take judicial notice that the Commission adopted the contemporaneous source document rule by later amending the parameters and guidelines. The court denied the request and stated the following:

> We deny this request for judicial notice. This is because the central issue in the present appeal concerns the Controller's policy of using the CSDR *during the 1998 to 2003 fiscal years*, when the CSDR was an underground regulation. This issue is not resolved by the Commission's *subsequent* incorporation of the CSDR into its Intradistrict Attendance and Collective Bargaining Programs' P & G's. (Emphasis in original.)[31]

The court further determined that the parameters and guidelines that were in effect when the state-mandated costs were incurred are the parameters and guidelines that govern the audit.[32]

Therefore, the documentation requirements added to the parameters and guidelines in 2003 must be interpreted to operate prospectively to prevent a denial of due process. Before the amendment was adopted, claimants were not on notice of the new documentation requirements and cannot go back and recreate the documents.

Additionally, at the time the costs were incurred and the reimbursement claims were filed, Government Code section 17564(b) provided as follows:

> Claims for direct and indirect costs filed pursuant to Section 17561 shall be filed in the manner prescribed in the parameters and guidelines.[33]

As a result, the documentation requirements in the parameters and guidelines as amended in 1991 govern these reimbursement claims.

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[29] *City of Modesto v. National Med, Inc.* (2005) 128 Cal.App.4th 518, 527.

[30] *In. re Cindy B.* (1987) 192 Cal.App.3d 771, 783-784.

[31] *Clovis Unified School Dist., supra* 188 Cal.App.4th 794, 809, fn. 5.

[32] *Id.* at pages 812-813.

[33] Government Code sections 17564(b), as amended by Statutes 1999, chapter 643. Note that Statutes 2004, chapter 890 (A.B.2856) later added "and claiming instructions" to this provision, effective January 1, 2005.

B. The Controller's Reduction of Salaries and Benefits in Fiscal Years 2001-2002 and 2002-2003 is Correct as a Matter of Law Because the Claimant Did Not Comply with the Documentation Requirements in the Parameters and Guidelines.

The Commission finds that the Controller's reduction of salary and benefit costs is correct as a matter of law.

Claimants are required to file reimbursement claims in accordance with the parameters and guidelines.[34] 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, and to identify the supporting documentation required to be retained during the period subject to audit.[35]

Under the section on "Reimbursable Activities," the 1991 parameters and guidelines list the reimbursable personnel costs for emergency procedures:

> The salaries and related employee benefits of employees with assigned responsibility to prepare and implement district emergency and disaster plans and procedures. The salaries and related employee benefits of non-teacher district employees, including consultants, directly engaged in providing instruction to other employees and students of the district in earthquake and disaster procedures. The cost incurred by the district of employees attending these meetings to receive instruction.

Under "Claim Preparation," the 1991 parameters and guidelines list the documentation requirements:

> Attach a statement [to each claim] showing the ***actual increased costs*** incurred to comply with the mandate which summarizes these costs as follows: 1. Emergency Procedures; Salaries, employee benefits; Printing, postage and supplies. [Emphasis added.]
>
> [¶]…[¶]
>
> A listing to support the following reimbursable items ***shall be*** provided:
>
> 1. Emergency procedures
>
>   a. For those employees whose function is to prepare and implement emergency plans and to provide instruction, ***provide a listing of each employee***, describe their function, their hourly rate of pay and related employee benefit cost and the number of hours devoted to their function as they relate to this mandate. [Emphasis added.]
>
> [¶]…[¶]

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[34] Government Code sections 17561(d)(1); 17564(b); and 17571; *Clovis Unified School Dist., supra,* 188 Cal.App.4th 794, 812-813.

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

> For auditing purposes, ***all costs claimed may be traceable to source documents and/or worksheets that show evidence of the validity of such costs***. ***These documents must be kept on file*** by the school district submitting the claim for a period of no less than three years from the date of the final payment of the claim pursuant to this mandate, and made available on the request of the State controller [sic] or his agent. [Emphasis added.]

The applicable parameters and guidelines require actual costs to be claimed, and for the actual costs of employee salaries and benefits, a claimant is required to attach a "listing of each employee, describ[ing] their function, their hourly rate of pay and related employee benefit cost and the number of hours devoted to their function as they relate to this mandate."[36] In addition, the parameters and guidelines require that the costs claimed be traceable to source documents, which must be kept on file and made available to the Controller for auditing purposes.[37]

According to the audit, the district provided time logs for 115 district office employees, out of over 7216 total employees in its 2001-2002 reimbursement claim, and 45 time logs out of 9872 employees in its 2002-2003 reimbursement claim.[38] The Controller allowed the costs claimed for those employees that provided time and wage information. However, no documentation supporting the time spent on the program was provided for the remaining employees. Instead, the claimant calculated the mean time spent on the program for each employee who did not provide time information. The calculation was based on the 160 time logs submitted to the district.[39]

Claimant asserts that the method used to determine costs is valid and is federally approved. The claimant also contends that the Collective Negotiations Contract between the district's Board of Education and the San Diego Education Association, for the period between July 1, 2003 and June 30, 2006, is documentation that sufficiently shows that claimant incurred the mandated costs during the 2001-2002 and 2002-2003 fiscal years. The claimant states:

> The District's method of determining the actual costs of performing the mandated activities is federally approved [citing to OMB Circular A-87]. The time logs submitted were completely random, because the District did not play a role in determining which school sites were to submit a time log. The District performed a random moment sampling (RMS) test, which is in line with OMB circular A-87 and is used in determining worker effort. These statistical analyses of the time logs provided by the sites were used to determine the actual time spent by all school site personnel on the mandate.

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[36] Exhibit A, Incorrect Reduction Claim, page 17.

[37] Exhibit A, Incorrect Reduction Claim, page 18.

[38] Exhibit A, Incorrect Reduction Claim, page 75. The 7216 employees include principals, vice principals, teachers and librarians, but not secretaries and clerks that were included in the 2002-2003 claim. It is unclear how many police officers were involved.

[39] *Ibid*.

> There can be no doubt the District school site staff performed the reimbursable activities. Each school site annually reviews and prepares or updates an emergency preparedness plan, as required by the Collective Negotiations Contact [footnote omitted]. … Thus, the District has sufficient documentation to prove each school site performed activities of reviewing, preparing, and updating the emergency procedures required by the mandate.[40]

Claimant also cites to page 45 of the Collective Negotiations Contract, section 11.9, which states:

> During the first month of school, principals and supervisors will annually inform all unit members of the location of district Emergency Procedures relating to assault and/or battery, insults, upbraiding, threats, child abuse, molestations, natural disasters, and suicide threats. Each site supervisor shall discuss with unit members any changes in these procedures, as well as on-site work rules.[41]

The Commission finds that the Collective Negotiations Contract is not relvant to the audit and does not provide sufficient documentation supporting the time spent by the claimant's employees on the program. The contract, which became effective July 1, 2003, was not in effect during the fiscal years at issue in this case (2001-2002 and 2002-2003). In addition, the section quoted by the claimant simply requires principals and supervisors to inform staff of the location of the emergency plan and any changes contained in the plan. The contract is not evidence that the claimant's employees performed the mandated activities for the required *earthquake* emergency procedure systems.

Moreover, the personnel costs in the claims were not based on actual increased costs as required under the parameters and guidelines since no information on the actual time spent on the program has been provided. Rather, the claims were based on an approximation of actual costs in the form of a random moment sampling study. There is no authorization in the 1991 parameters and guidelines for a statistical sampling, a unit cost, or any other reimbursement method that estimates or averages time or costs. The parameters and guidelines require actual costs to be claimed, supported by a statement and documentation listing "each employee, describ[ing] their function, their hourly rate of pay and related employee benefit cost *and the number of hours devoted to their function as they relate to this mandate*." (Emphasis added.) Thus, the claimant did not comply with these documentation requirements.

Even if a random moment sampling were authorized by the parameters and guidelines, the record shows that the district's methodology did not conform to OMB Circular No. A-87.[42] According to the Circular, random moment sampling and other approved "substitute systems" for quantifying measures of employee effort must meet acceptable statistical sampling standards, including: "the sampling universe must include all of the employees whose salaries and wages

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[40] Exhibit A, Incorrect Reduction Claim, page 3.

[41] Exhibit A, Incorrect Reduction Claim, beginning on page 81.

[42] Exhibit A, Incorrect Reduction Claim, page 78.

are to be allocated based on sample results except as provided in subsection (c)."[43] But the record indicates that the sampling universe did *not* include all of the employees whose salaries and wages are to be allocated based on the sample results. Rather, claimant's cost projections were based solely on employees who submitted time logs, i.e., a self-selected sample rather than a randomly selected one. Therefore, the statistical methodology did not comply with OMB Circular No. A-87.

Accordingly, the Controller's reduction of salaries and benefits in fiscal years 2001-2002 and 2002-2003 is correct as a matter of law.

V. Conclusion

The Commission finds that the Controller's audit adjustment of $1,127,211 to claimant's reimbursement claims for fiscal years 2001-2002 and 2002-2003 is correct as a matter of law. Therefore, this IRC is denied.

[43] Subsection (c) states: "Less than full compliance with the statistical sampling standards noted in subsection (a) may be accepted by the cognizant agency if it concludes that the amounts to be allocated to federal awards will be minimal, or if it concludes that the system proposed by the governmental unit will result in lower costs to Federal awards than a system which complies with the standards." Exhibit A, Incorrect Reduction Claim, pages 78-79.

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RE: **Decision**

Emergency Procedures, Earthquake, and Disasters, 04-4241-I-01
Education Code Sections 35295, 35296, 35297, 40041.5 and 40042
Statutes 1984, Chapter 1659
Fiscal Years 2001-2002 and 2002-2003
San Diego Unified School 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 11, 2014

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Education Code Section 51225.3, as Added by Statutes 1983, Chapter 498 Fiscal Years 1998-1999, 1999-2000, 2000-2001, and 2001-2002 Clovis Unified School District, Claimant.	Case No.: CSM 05-4435-I-50 and 08-4435-I-52 *Graduation Requirements* STATEMENT OF DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5. ARTICLE 7 (*Adopted May 30, 2014*) (*Served June 4, 2014*)

STATEMENT OF DECISION

The Commission on State Mandates (Commission) heard and decided these consolidated incorrect reduction claims (IRCs) during a regularly scheduled hearing on May 30, 2014. Arthur Palkowitz appeared for the claimant; Michael Clear, Clovis Unified School District Superintendent Business Services, appeared for the claimant; and Jim Spano and Chris Ryan appeared for the Office of the State Controller (SCO).

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, sections 17500 et seq., and related case law.

The Commission adopted the proposed statement of decision to deny these IRCs at the hearing by a vote of 6 to 1.

Summary of the Findings

These IRCs challenge reductions made by the SCO to reimbursement claims filed by claimant, Clovis Unified School District for the *Graduation Requirements* program for fiscal years 1998-1999, 1999-2000, 2000-2001, and 2001-2002. Pursuant to the SCO's second revised audit issued April 30, 2007, reductions were made for claimed teacher salary, benefits, and related indirect costs in the amount of $216,502; and for materials, supplies, and related indirect costs in the amount of $317,955. The claimant seeks a determination from the Commission pursuant to Government Code section 17551(d) that the SCO incorrectly reduced the claims, and requests that the SCO reinstate the $534,457 reduced.

The Commission denies these IRCs. The parameters and guidelines require the claimant to show the increased costs for staffing and supplying the new science class mandated, and further requires "[d]ocumentation of increased units of science course enrollments due to the enactment of [the test claim statute] necessitating such an increase" to support the costs claimed. As determined by the SCO, the claimant did not provide documentation to demonstrate that the amounts claimed reflect the actual "increased units of science course enrollment due to the

enactment of" the test claim statute, as required by the parameters and guidelines. Thus, the SCO's decision to reject the methodology used by the claimant was reasonable and based on the plain language of the parameters and guidelines.

The Commission further finds that the SCO's application of the quarter load method to re-calculate the costs for teacher salaries and benefits, and for materials and supplies, in each fiscal year claimed is reasonable. Although the quarter load methodology was not identified in the governing parameters and guidelines for these reimbursement claims, the SCO properly determined that claimant did not comply with the parameters and guidelines by providing documentation sufficient to show the actual increased costs incurred as a direct result of the second science course mandated by the test claim statute. Claimant has still not filed documentation, either with the SCO or with the Commission as a part of this claim, to properly support its claim for reimbursement. Instead of reducing the claims to $0, the SCO used a reasonable methodology to provide reimbursement to claimant; a methodology that claimant used for claiming reimbursement for teacher salaries and benefits in fiscal years 2000-2001 and 2001-2002.

The quarter load calculation used by the SCO resulted in an *increase* of salary and benefit costs for fiscal years 1998-1999, 2000-2001, and 2001-2002, with no reduction taken for these fiscal years. Thus, there has been no reduction for teacher salaries and benefits for fiscal years 1998-1999, 2000-2001, and 2001-2002. The application of the quarter load method did result in a reduction of costs claimed for teacher salaries and benefits in fiscal year 1999-2000, and a reduction of costs claimed for materials and supplies in all four fiscal years claimed. Clovis has not argued that the SCO's quarter load methodology resulted in a math error or miscalculation, and there is no evidence in the record that a miscalculation occurred.

The SCO's audit decisions are entitled to deference, since it is the agency with the delegated authority and expertise to audit reimbursement claims. Thus, the Commission finds that the SCO's use of the quarter load method in the audit of these claims, and the resulting reduction to costs claimed for teacher salaries and benefits in fiscal year 1999-2000, and for materials and supplies in all four fiscal years, was reasonable and within the SCO's authority.

Accordingly, the Commission finds that the reduction of claimed costs in the total amount of $534,457 is reasonable; not arbitrary, capricious, or entirely lacking in evidentiary support; and, is therefore correct.

COMMISSION FINDINGS

Claimant

Clovis Unified School District

Chronology

10/22/04	SCO issued first audit report.
09/06/05	Claimant, Clovis Unified School District, filed an IRC for fiscal years 1998-1999, 2000-2001, and 2001-2002 (05-4435-I-50).[1]
09/16/05	Commission staff issued the Notice of Complete Filing.

[1] Exhibit A, IRC filed September 06, 2005.

09/30/05 SCO issued a revised audit report.

04/30/07 SCO issued a second revised audit report.

10/11/07 SCO Division of Audits filed comments on IRC 05-4435-I-50.[2]

10/18/07 SCO Division of Reporting and Accounting filed comments on the IRC 05-4435-I-50.[3]

08/04/08 Claimant filed a revised IRC for fiscal years 1998-1999, 2000-2001, and 2001-2002 (08-4435-I-52).[4]

08/26/08 Commission staff issued a Notice of Complete Revised Filing and Consolidation of IRCs (05-4435-I-50, 08-4435-I-52).

08/28/08 Commission staff issued a Notice of Corrected IRC Number.

07/13/11 SCO Division of Audits filed comments on the consolidated IRCs.[5]

04/07/14 Commission staff issued draft staff analysis and proposed statement of decision.[6]

04/28/14 SCO Division of Audits filed comments on the draft staff analysis and proposed statement of decision.[7]

04/28/14 Claimant filed comments on the draft staff analysis and proposed statement of decision.[8]

I. Background

These IRCs challenge reductions made by the SCO to reimbursement claims filed by Clovis for the *Graduation Requirements* program for fiscal years 1998-1999, 1999-2000, 2000-2001, and 2001-2002. Pursuant to the SCO's second revised audit issued April 30, 2007, reductions were made for claimed teacher salary, benefits, and related indirect costs in the amount of $216,502; materials, supplies, and related indirect costs in the amount of $317,955; and costs for contracted services claimed for construction projects at four high schools in the amount of $3,377,241. The claimant does not dispute the SCO's reduction of the claimed costs for the construction projects,[9] but continues to dispute the reductions for teacher salaries and benefits, materials and supplies, and their related indirect costs in the amount of $534,457.[10] The claimant seeks a

[2] Exhibit C, SCO Division of Audits Comments filed October 11, 2007.

[3] Exhibit D, SCO Division of Audits Comments filed October 18, 2007.

[4] Exhibit B, Claimant's Revised IRC filed August, 04, 2008.

[5] Exhibit E, SCO Division of Audits Comments filed July 13, 2011.

[6] Exhibit F, Draft Staff Analysis filed March 7, 2014.

[7] Exhibit G, SCO Division of Audits Comments filed April 28, 2014.

[8] Exhibit H, Claimant's Comments filed April 28, 2014.

[9] Exhibit B, Claimant's Revised IRC filed August 4, 2008, page 8.

[10] The revised IRC does not address the second revised audit report. Clovis did file comments on April 28, 2014 generally reasserting its claims in both the original IRC and the revised IRC.

determination from the Commission pursuant to Government Code section 17551(d) that the SCO incorrectly reduced the claims, and requests that the SCO reinstate the $534,457 reduced.

The *Graduation Requirements* Program

On January 22, 1987, the Commission adopted a statement of decision approving the *Graduation Requirements* test claim on Education Code section 51225.3, as added by Statutes 1983, chapter 498. The test claim statute increased the number of science courses required for high school graduation from one science course to two science courses in biological and physical sciences. The Commission determined that the test claim statute constitutes a reimbursable state-mandated program by requiring students, beginning with the 1986-87 school year, to complete at least two courses in science before receiving a high school diploma. The parameters and guidelines, as last amended in 1991, are relevant for these IRCs and authorize reimbursement for the "increased cost to school district[s] for staffing and supplying the new science classes mandated."[11]

Reductions to Salaries and Benefits

For fiscal years 1998-1999 and 1999-2000, Clovis claimed reimbursement for teacher salaries and benefits based on a formula to determine the incremental increase in teacher salary costs as a result of the mandate. The formula calculated the increase in the total number of high school science teachers between the 1985-1986 base year and the claim years, and reduced that amount by the percentage increase in high school enrollment for that same period. That number was then multiplied by the claim year's average annual salaries and benefits of a high school science teacher to determine the amount claimed for reimbursement. The SCO determined that the formula did not identify the courses taught; included salary and benefit costs of non-physical and biological science teachers; and did not deduct the percentage increase in science teachers related to factors other than the mandate, such as enrollment growth. In addition, the SCO's audit found that claimant claimed salary and benefit costs for non-mandated courses; six non-physical/biological science teachers and 22 middle school teachers in fiscal year 1998-1999, and one non-physical/biological science teacher in fiscal year 1999-2000.[12]

For fiscal years 2000-2001 and 2001-2002, claimant's reimbursement claim used a quarter class load method. This method divides one-fourth of the total number of grade 9-12 pupils by the average science course size to arrive at the additional science courses required for the mandate. That number is then divided by the number of daily courses taught per teacher to determine the increased science teachers required by the mandate. That number is then multiplied by the claim years' average science teacher salaries and benefits. Claimant did not identify any offsetting cost savings in its claims.

Before issuing the second revised audit report, the SCO issued audit reports in October 2004 and September 2005, reducing all costs claimed for science teacher salaries and benefits on several grounds including the fact that the district did not identify or report any offsetting cost

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Although the claimant has not specifically addressed the findings in the second revised audit, these IRCs remain pending and are still in dispute.

[11] Exhibit I, Parameters and Guidelines as amended January 24, 1991.

[12] Exhibit C, SCO Division of Audits, Comments on the IRC, Tab 3, p. 6.

savings or provide adequate supporting documentation. At the time these audit reports were released, a case challenging the offset issue in the *Graduation Requirements* program was pending.[13] Claimant was a party to the litigation and challenged the reduction of costs claimed for salaries and benefits in fiscal year 1997-1998. The court concluded that the Commission's decisions on IRCs, upholding the SCO's actions in several audits that reduced claims for teacher salary and benefits to $0 on the ground that school districts failed to identify cost savings as a result of the layoff authority found in Education Code section 44955, were invalid. The court ruled that Education Code section 44955 did not require school districts to offset new science course requirements by laying off teachers in non-science positions; it merely allowed school districts to exercise their discretion whether to lay off teachers.[14] Because the court ruled that school districts were not required to use section 44955 as an offset, the court invalidated that portion of the IRC decisions and the SCO's audit findings that precluded reimbursement by requiring the offset under section 44955. For purposes of remand back to the SCO for re-evaluation and to the Commission for determination, the court concluded that the SCO could properly require school districts to provide detailed documentation of offsetting savings directly resulting from their provision of the second science course.[15] The court further states on page 18 of its Ruling that:

> Such a documentation requirement has a firm legal basis in subdivision (e) of Government Code section 17556 and California Code of Regulations, title 2, section 1183.1(a)(9). Further, the documentation requirement reflects a reasonable expectation that savings to offset the science teachers' salaries may be generated when students taking the second science course do not increase the number of classes that they take overall. Thus, the Controller can properly require claimants to demonstrate that the second science course has not increased the number of classes provided during the school day and year along with the number of teachers required for the classes provided.

On remand, the SCO stated that the school districts failed to provide any documentation showing changes to the school day or school year as a result of the test claim statute. The SCO therefore presumed there were no changes to the school day or school year and that the district had offsetting cost savings for any science teachers hired to teach the mandated course. The SCO continued to deny the claimed amounts in full.

In its decisions on the IRCs that followed the SCOs determination to continue to deny reimbursement, the Commission determined that the SCO's presumptions were not supported by evidence, and conflicted with the court's decision that the test claim statute required an additional class that did not require a reallocation of resources.[16] Following that decision, the SCO reinstated all costs claimed, including those claimed by Clovis in fiscal year 1997-1998.

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[13] Exhibit I, *San Diego Unified School district v. Commission on State Mandates* (2004) Superior Court Case No. 03CS11401.

[14] *Id.* at p. 17.

[15] *Id.* at pp. 17-18.

[16] Item 19, Final Staff Analysis, Reevaluation of Reimbursement Claims on Remand from Superior Court Decision, adopted July 28, 2006.

Following the Commission's decisions on remand, the SCO reevaluated the reimbursement claims in this case and issued the second revised audit report on April 30, 2007. The SCO re-calculated the amounts eligible for reimbursement by applying the quarter class load method to teacher salary and benefit costs for all four fiscal years,[17] *which resulted in a reduction of direct salary and benefit costs in fiscal year 1999-2000 only*. The recalculation of costs for the other three fiscal years resulted in *increased* reimbursement to the claimant for the direct salary and benefit costs for those years. For fiscal year 1998-1999, the claimed teacher salary and benefit costs were $554.076, and the SCO adjusted the claim and allowed reimbursement for that year in the amount of $805,135 (an increase of $251,059). For fiscal year 2000-2001, the claimed salary and benefit costs were $955,872 and the SCO allowed reimbursement in the amount of $1,008,130 (an increase of $52,258). For fiscal year 2001-2002, the claimed salary and benefit costs were $1,022,501 and the SCO allowed reimbursement of $1,080,846 (an increase of $58,345). For the year that costs were reduced (fiscal year 1999-2000), the claimed salary and benefit costs were $1,482,352. The SCO allowed reimbursement of $916,328 (a reduction of $566,024), but adjusted that reduction of direct costs for salary and benefits by subtracting the increased allowances from the other three years, resulting in an overall reduction in direct salary and benefit costs of $204,362, plus related indirect costs of $12,140, for a total reduction of $216,502 for fiscal year 1999-2000[18].

Reduction to Materials and Supplies

The *San Diego* court ruling did not address reimbursement for materials and supplies, but the SCO reevaluated the reimbursement claims for materials and supplies in 2007, and recalculated the claims using the quarter load method. Like the claims for teacher salaries and benefits, the SCO determined that Clovis did not have documentation to support the amounts claimed for materials and supplies.

For fiscal years 1998-1999 and 1999-2000, claimant claimed reimbursement for materials and supplies based on a formula, similar to the one used for teacher salaries in the first two claim years. As determined by the SCO, the formula did not identify the courses taught and did not measure the cost of supplying the additional science course mandated by the state in the claim years. For fiscal years 2000-2001 and 2001-2002, claimant claimed that 50% of all high school science materials and supplies were attributable to the mandate, but did not provide documentation to substantiate the claimed percentage.

In its second revised audit, the SCO took the documentation that claimant provided and applied the quarter class load methodology to the costs claimed for materials and supplies, which resulted in a reduction of direct and related indirect costs claimed for materials and supplies in all four fiscal years of $317,955.

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[17] In 2008, the Commission amended the parameters and guidelines for the *Graduation Requirements* program by adopting the quarter class load methodology for teacher salary and benefit costs. The Commission's adoption of this RRM formula was upheld by the court in *Department of Finance v. Commission on State Mandates*, Sacramento County Superior Court, Case No. 34-2010-80000529 (2013).

[18] Exhibit C, SCO Division of Audits Comments filed on the IRC, Tab 3, p. 4.

II. Position of the Parties

A. Claimant's Position

Claimant contends that the SCO incorrectly reduced its reimbursement claims, and that its claims should be fully reimbursed for the full amounts reduced. Claimant argues that the SCO failed to complete the audit and provide final audit findings to the claimant before the statute of limitations and, thus, the audit is void. Claimant further argues that the standards applied by the SCO were "arbitrary, capricious, entirely lacking in evidentiary support and in conflict with the Superior Court decision, Commission Order, and documentation requirements of the Parameters & Guidelines when the mandate costs were incurred" as follows:

- The parameters and guidelines do not require claimants to provide documentation.
- Clovis used reasonable methods for calculating reimbursement for teacher salaries and benefits, and for materials and supplies.
- The SCO's use of the quarter load method is an unpublished standard that is not contained in the parameters and guidelines.

B. State Controller's Office's Position

The SCO contends that the audit, based on the second revised audit report, is correct and that this IRC should be denied. The SCO also contends that the audit was properly conducted within the statute of limitations.

III. Discussion

Government Code section 17561(b) authorizes the SCO to audit the claims filed by local agencies and school districts and to reduce any claim for reimbursement of state mandated costs that the SCO determines is excessive or unreasonable. Government Code section 12410 further requires the SCO to:

> [S]uperintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment.

Although the SCO is required to follow the parameters and guidelines when auditing a claim for mandate reimbursement, the SCO has broad discretion in determining how to audit claims. Government Code section 12410 provides in relevant part:

> Whenever, in [the Controller's] opinion, the audit provided for by [Government Code section 925 et seq.] is not adequate, the Controller *may make such field or other audit* of any claim or disbursement of state money *as may be appropriate to such determination*. (Italics added.)

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the SCO 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 statement of decision to the SCO and request that the costs in the claim be reinstated.

The Commission must determine in this case whether the SCO's audit decisions 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.[19] 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.]' "[20]

Thus, with respect to the SCO's authority and responsibility over state audits, the Commission exercises "very limited review 'out of deference to…the legislative delegation of administrative authority of the agency, and to the presumed expertise of the agency within its scope of authority.'"[21] The Commission "may not reweigh the evidence or substitute it's judgment for that of" the SCO.[22] The Commission must also review the SCO's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.[23]

In addition, the Commission must review questions of law *de novo*, without consideration of conclusions made by the SCO 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.[24] 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."[25]

A. The audit was conducted within the statute of limitations applicable to mandate reimbursement claims.

Claimant argues that the audit for the 1998-1999 and 1999-2000 reimbursement claims was completed beyond the statute of limitations provided by Government Code section 17558.5 and

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[19] *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.

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

[21] *Shapell Industries, Inc. v. Governing Board* (1991) 1 Cal.App.4th 218, at p. 230.

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

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

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

[25] *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.

is therefore void with respect to those claim years. The reimbursement claim for fiscal year 1998-1999 was filed December 27, 2000. The reimbursement claim for fiscal year 1999-2000 was filed on December 29, 2000. At the time these reimbursement claims were filed, Government Code section 17558.5 stated the following:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[26]

Claimant contends that funds were appropriated for this program for the 1998-1999 and 1999-2000 claim years and, thus, the first sentence of section 17558.5 applies. Claimant asserts that the first sentence requires the SCO "to complete" the audit no later than two years after the end of the calendar year that the reimbursement claim was filed. Applying claimant's argument in this case, then, would require the completion of the audit for the 1998-1999 and 1999-2000 claims no later than December 31, 2003, and December 31, 2002, respectively. The SCO did not complete its first audit of these claims until October 22, 2004.

The SCO asserts that the "subject to audit" language in section 17558.5 refers to the time the audit is initiated. In this case, the SCO states that the audit was initiated on November 1, 2002, and an audit entrance conference occurred on November 18, 2002, and that both dates are within two years after the end of the calendar year in which the claims were filed.

The Commission finds that audit of the 1998-1999 and 1999-2000 reimbursement claims was timely. The plain language of Government Code section 17558.5 does not require the SCO to "complete" the audit within any specified period of time. The plain language of the statute provides that reimbursement claims are "subject to audit" within two years after the end of the calendar year that the reimbursement claim was filed. The phrase "subject to audit" does not require the completion of the audit, but sets a time during which a claimant is on notice that an audit of a claim may occur. This reading is consistent with the plain language of the second sentence, which establishes a longer period of time to initiate the audit when no funds are appropriated for the program. In this case, the reimbursement claims filed in 2000 and 2001 were subject to audit at any time before December 31, 2002 and 2003. Since the audit began in November 2002, it was timely.

Moreover, section 17558.5 was amended in 2002 to establish, for the first time, a requirement to "complete" the audit two years after the audit is commenced. As amended, it reads:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject <u>to the initiation of an audit by the Controller no later than three years after the date the actual reimbursement claim is filed or last amended whichever is later</u>. However, if no funds are <u>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</u>

[26] Government Code section 17558.5 (Stats. 1995, ch. 945, (SB11)).

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.[27]

The 2002 amendment became effective on January 1, 2003, after the reimbursement claims were filed in 2000 and 2001 and, thus, does not apply to the audit in this case.[28] Based on the foregoing, the Commission finds that the audit of the reimbursement claims for fiscal years 1998-1999 and 1999-2000 is not barred by the statute of limitations.

B. The reduction made by the SCO for teacher salaries and benefits is consistent with the parameters and guidelines, reasonable, and is not arbitrary, capricious or entirely lacking in evidentiary support.

As stated in the Background, the only reimbursement claim for teacher salaries and benefits that was reduced by the SCO was the claim filed for fiscal year 1999-2000. There were no reductions in costs claimed for teacher salaries and benefits for fiscal years 1998-1999, 2000-2001, and 2001-2002, and, in fact, increased reimbursement was allowed by the SCO for those three fiscal years. Thus, there is no "incorrect reduction" to evaluate for fiscal years 1998-1999, 2000-2001, and 2001-2002. Nevertheless, Clovis continues to challenge the overall findings and adjustments made by the SCO, which rejected claimant's original methodology used for claiming salary and benefit costs in all fiscal years and, thus, these issues are addressed below.

Claimant first argues that the parameters and guidelines do not require documentation to support the claim for teacher salaries and benefits. Claimant is wrong. The parameters and guidelines at issue in this case provide that school districts may claim the "[i]ncreased cost to school district for staffing and supplying the new science classes mandated," and further requires "[d]ocumentation of increased units of science course enrollments due to the enactment of Education Code Section 51225.3 necessitating such an increase" to support the costs claimed.[29] Thus, the parameters and guidelines do require documentation to support the reimbursement claim for the increased costs claimed to comply with additional science course mandated by the state.

The Commission further finds the SCO correctly determined that Clovis did not provide documentation to demonstrate that the amounts claimed for teacher salaries and benefits reflect the actual "increased units of science course enrollment due to the enactment of" the test claim statute, as required by the parameters and guidelines. Instead, the reimbursement claims for 1998-1999 and 1999-2000 list the names of science teachers, aggregate salary amounts, and a comparison of the total number of science teachers in the base year (1985-1986) to the claim year. The documents supporting the claims for those years, however, do not show any correlation between the science teachers listed and the actual additional science classes taught in order to comply with the mandate. Although the state mandates schools to provide two science courses,

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[27] Government Code section 17558.5, (Amended by Stats. 2002, ch. 1128 (A.B. 2834) §14.5. Underline indicates changed text.

[28] Because this change in law affects the rights and liabilities of the parties, it may only be applied prospectively to reimbursement claims filed after January 1, 2003. (*Department of Health Services v. Fontes* (1985) 169 Cal.App.3d 301, 304-305; *Tapia v. Superior Court* (1991) 53 Cal.3d 282, 287-292; *Murphy v. City of Alameda* (1993) 11 Cal.App.4th 906, 911-912.)

[29] Exhibit I, Parameters and Guidelines, p.3.

including biological and physical sciences, in grades 9 to12 (with the test claim statute increasing the state requirement of one science course to two science courses) - state law, in Education Code section 51225.3 (a)(2), also allows school districts to offer, at their discretion, "other coursework as the governing board of the school district may by rule specify." By simply comparing the total number of science teachers in the base year to the total number of science teachers in the claim year, given the district's discretionary authority to offer more science courses than just the required biological and physical science courses, claimant does not identify the number of teachers employed to teach the mandated science class. Thus, there is no evidence that the costs claimed for teacher salaries and benefits are limited to those costs incurred for the mandated program here. In addition, the SCO's audit found that claimant claimed salary and benefit costs of six non-physical/biological science teachers in fiscal year 1998-1999 and 22 middle school teachers and one non-physical/biological science teacher in fiscal year 1999-2000.[30] Claimant has not filed evidence to rebut these findings.

Therefore, the SCO's decision to reject the methodology used by claimant in these fiscal years was reasonable and based on the plain language of the parameters and guidelines, which requires the claimant to show the increased costs for staffing the new science class mandated and further requires "[d]ocumentation of increased units of science course enrollments due to the enactment of [the test claim statute] necessitating such an increase" to support the costs claimed. The Commission further finds that the SCO's application of the quarter load method to re-calculate the costs for teacher salaries and benefits in each of the four fiscal years at issue is reasonable, and not arbitrary and capricious. Claimant is correct that the parameters and guidelines did not identify the quarter load method of claiming costs when the reimbursement claims were filed in this case. However, as stated above, the SCO properly determined that claimant did not comply with the parameters and guidelines by providing documentation sufficient to show the actual increased costs incurred for salaries and benefits as a direct result of the second science course mandated by the test claim statute. Claimant has still not filed documentation, either with the SCO or with the Commission as part of these IRCs, to properly support its claim for reimbursement. Instead of reducing the claims to $0, the SCO used a reasonable methodology to provide reimbursement to Clovis; a methodology that Clovis used in fiscal years 2000-2001 and 2001-2002. The quarter load calculation used by the SCO resulted in a reduction of direct costs for teachers' salaries and benefits in fiscal year 1999-2000 only, and in increased amounts allowed by the SCO in the other three fiscal years. Clovis has not argued that the SCO's quarter load methodology resulted in a math error or miscalculation, and there is no evidence in the record that a miscalculation occurred.

Moreover, the Commission amended the parameters and guidelines in 2008 by adopting the quarter load method as a reasonable reimbursement methodology (RRM) for claiming teacher salary and benefit costs as a result of the mandate. In its decision on the parameters and guidelines amendment, the Commission found that the formula uses each school district's actual numbers for enrollment, average science class size, and average teacher salary, and limits the costs claimed to the mandated science course taught in the claim year. Since the course has to be taken in one of the four years from grades 9-12, and it constitutes an additional class required to be provided by the school district, the methodology positively identifies the additional course by dividing total enrollment in grades 9-12 for the claim year by four. The Commission's decision

[30] Exhibit C, SCO Division of Audits Comments on the IRC, Tab 3, p. 6.

adopting the quarter load method recognized that school districts did not have detailed documentation of actual costs incurred to comply the mandate and, thus, the quarter load method, which uses information that schools have, was reasonable. In addition, the Commission's decision to adopt the quarter load method for this program was upheld by the court.[31]

As stated above, the Commission exercises very limited review of the SCO's audit decisions out of deference to the SCO, the agency delegated with the authority and expertise to audit reimbursement claims. Thus, the Commission finds that the SCO's use of the quarter load method in the audit of these claims, and the resulting reduction to costs claimed in fiscal year 1999-2000 only, was reasonable and within the SCO's authority.

Therefore, the Commission finds that there has been no reduction of salary and benefit costs for fiscal years 1998-1999, 2000-2001, and 2001-2002. The Commission further finds that the partial reduction of claimed costs of $216,502 for salary and benefits and related indirect costs in fiscal year 1999-2000, is reasonable, and not arbitrary, capricious, or entirely lacking in evidentiary support. The Commission therefore finds that the SCO's audit findings are not "incorrect."

C. The reduction made by the SCO for the materials and supplies and related indirect costs is consistent with the parameters and guidelines, reasonable, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

The parameters and guidelines at issue in this case provide that school districts may claim the "[i]ncreased cost to school district for . . . supplying the new science classes mandated," and further requires "[d]ocumentation of increased units of science course enrollments due to the enactment of Education Code Section 51225.3 necessitating such an increase" to support the costs claimed.[32]

For fiscal year 1998-1999 and 1999-2000, claimant claimed reimbursement for materials and supplies based on a formula, similar to the one used for teacher salaries in the first two claim years, that determined an incremental increase in materials and supplies as a result of the mandate. As determined by the SCO, the formula did not identify the courses taught and did not measure the cost of supplying the additional science course mandated by the state in the claim years.

For fiscal years 2000-2001 and 2001-2002, claimant's claim for reimbursement was based on a formula that attributed 50 percent of all high school science materials and supplies to the mandate. However, there is no evidence in the record to support an allegation that the mandate resulted in a 50 percent increase in costs for science materials and supplies. Although the state mandates schools to provide two science courses in grades 9 to12 (with the test claim statute increasing the state requirement of one science course to two science courses) - state law, in Education Code section 51225.3 (a)(2), also allows school districts to offer, at their discretion, "other coursework as the governing board of the school district may by rule specify." Thus, the actual total costs to a school district for science materials and supplies for a claim year may include costs for more than the state-mandated two science courses. In this respect, the 50

[31] *Department of Finance v. Commission on State Mandates*, Sacramento County Superior Court, Case No. 34-2010-80000529 (2013).

[32] Exhibit I, Parameters and Guidelines, page 3.

percent method proposed by claimant could result in reimbursement for materials and supplies for courses that are not mandated by the state.

Thus, the Commission finds that the SCO's decision to reject the methodology used by claimant in these fiscal years was reasonable and based on the plain language of the parameters and guidelines, which requires the claimant to show the increased costs for supplying the new science class mandated and further requires "[d]ocumentation of increased units of science course enrollments due to the enactment of [the test claim statute] necessitating such an increase" to support the costs claimed.

The Commission further finds that the SCO's application of the quarter load method to re-calculate the costs for science materials and supplies is reasonable. The method applied to materials and supplies is similar to the method applied for teacher salaries and benefits. It identifies the number of mandated classes taught in the claim year, and then multiplies that number by the average allocation for material and supply costs given to all science classes. Although the parameters and guidelines did not identify the quarter load method of claiming costs when the reimbursement claims were filed in this case, the SCO's use of the quarter load method to reimburse claimant for materials and supplies is reasonable here. As stated above, the SCO properly determined that claimant did not comply with the parameters and guidelines by providing documentation sufficient to show the actual increased costs were incurred as a direct result of the second science course mandated by the test claim statute. Claimant has still not filed documentation either with the SCO or with the Commission in support of this IRC to properly support its claim for reimbursement, and, thus, the claim was properly reduced by the SCO. The Commission finds that the SCO's use of the quarter load method in this case, and the resulting reductions to the costs claimed for materials and supplies, is reasonable, and not arbitrary or capricious.

Therefore, the Commission finds that the partial reduction of claimed costs for materials and supplies and related indirect costs in the amount of $317,955 is reasonable, and not arbitrary, capricious, or entirely lacking in evidentiary support.

IV. Conclusion

Pursuant to Government Code section 17551(d) and section 1185.7 of the Commission's regulations, the Commission concludes that the SCO's partial reduction of claimed costs for teacher salary and benefits, materials and supplies, and related indirect costs is reasonable, and not arbitrary, capricious, or entirely lacking in evidentiary support.

Accordingly, the Commission denies these consolidated incorrect reduction claims.

STATE OF CALIFORNIA EDMUND G. BROWN JR., Governor
COMMISSION ON STATE MANDATES
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Re: **Adopted Statement of Decision**
Incorrect Reduction Claim
Graduation Requirements, 05-4435-I-50 and 08-4435-I-52
Education Code Section 51225.3, Statutes 1983, Chapter 498
Fiscal Years: 1998-1999, 1999-2000, 2000-2001, and 2001-2002
Clovis Unified School District, Claimant

On May 30, 2014, the foregoing statement of decision of the Commission on State Mandates was adopted in the above-entitled matter.

Heather Halsey, Executive Director

Dated: June 4, 2014

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 Long Beach Community College District, Claimant.	Case No.: 05-4206-I-03 *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 the 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 at the hearing by a vote of six to zero.

Summary of the Findings

This analysis addresses an IRC filed by Long Beach Community College District (claimant) regarding reductions made by the Controller to reimbursement claims for costs incurred during fiscal years 2001-2002 and 2002-2003 under the *Health Fee Elimination* program. Over the two fiscal years in question, reductions totaling $217,409 were made based on alleged understated offsetting health fees authorized to be collected, and additional reductions totaling $156,987 were made based on disallowed indirect cost rates and unallowable services and supplies.

The Commission denies this IRC, finding that the Controller's audit of the 2001-2002 reimbursement claim was timely pursuant to Government Code section 17558.5; and that the Controller's reduction of costs for services and supplies beyond the scope of the mandate, the reduction of indirect costs based on the claimant's failure to obtain federal approval for its indirect cost rate proposals, and the reduction in reimbursement based on the claimant's

[1] Statutes 1993, chapter 8.

underreporting of health service fee revenue authorized by statute, are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support.

COMMISSION FINDINGS

I. Chronology

12/06/2002	Claimant filed its fiscal year 2001-2002 reimbursement claim. [2]
01/09/2004	Claimant signed and dated its 2002-2003 claim form.[3]
08/18/2004	An entrance conference for the audit was held.[4]
04/27/2005	Controller issued its final audit report.[5]
09/01/2005	Claimant filed this IRC.[6]
12/16/2008	Controller submitted comments on the IRC.[7]
08/10/2009	Claimant submitted rebuttal comments.[8]
08/01/2014	Commission staff issued the draft proposed decision.[9]
08/05/2014	Controller filed comments on the draft proposed decision.[10]
09/23/2014	Claimant filed comments on the draft proposed decision.[11]
10/03/2014	Commission staff issued a request for additional information from the Controller.[12]
10/13/2014	Controller filed additional information as requested.[13]

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

[2] Exhibit A, Incorrect Reduction Claim, page 19.

[3] Exhibit A, Incorrect Reduction Claim, page 85.

[4] Exhibit A, Incorrect Reduction Claim, page 19.

[5] Exhibit A, Incorrect Reduction Claim, page 19; 42.

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

[7] Exhibit B, Controller's Comments.

[8] Exhibit C, Claimant's Rebuttal Comments.

[9] Exhibit D, Draft Proposed Decision.

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

[11] Exhibit F, Claimant's Comments on Draft Proposed Decision.

[12] Exhibit G, Commission Request for Additional Information.

[13] Exhibit H, Controller's Response to Commission Request for Additional Information.

health service fee not to exceed $7.50 for each semester or $5 for each quarter or summer session, to fund these services.[14] In 1984, the Legislature repealed the community colleges' fee authority for health services.[15] However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, to reauthorize the fee at $7.50 for each semester (or $5 for quarter or summer semester).[16]

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.[17] 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.[18] 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.[19] 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.[20]

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 program to reflect amendments made by Statutes1987, chapter 1118.

The parameters and guidelines generally provide that eligible community college districts shall be reimbursed for the costs of providing a health services program, and that only services

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[14] 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.].

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

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

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

[18] 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).

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

[20] 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).

specified in the parameters and guidelines and provided by the community college in the 1986-1987 fiscal year may be claimed.

Controller's Audit and Summary of the Issues

The Controller reduced the reimbursement claims for costs allegedly incurred during fiscal years 2001-2002 and 2002-2003 under the *Health Fee Elimination* program, totaling $466,629. The following issues are in dispute:

- The statutory deadlines applicable to audits of reimbursement claims by the Controller;
- Reduction of costs for student health insurance based on the scope of reimbursement excluding student athletic costs.
- Reduction of indirect costs based on asserted faults in the development and application of indirect cost rates; and
- The amount of offsetting revenue to be applied from health service fee authority.

III. Positions of the Parties

Long Beach Community College District

The claimant asserts that the Controller incorrectly reduced costs claimed for fiscal years 2001-2002 and 2002-2003, totaling $368,371. Specifically, claimant asserts that reduction of $11,869 in athletic insurance costs was inappropriate, because the amounts claimed represented the district's basic and catastrophic coverage for the general student population, some of whom are also student athletes, but student athletes are also a part of the general student population for purposes of the general student population premium.[21] In addition, claimant asserts that the reduction of $139,093 in overstated indirect costs on the basis that "the district did not obtain federal approval for its [indirect cost rates,]" was incorrect. The claimant argues that "[c]ontrary to the Controller's ministerial preferences, there is no requirement in law that the district's indirect cost rate must be 'federally' approved," and the Controller did not make findings that the claimant's rate was excessive or unreasonable.[22] And, claimant asserts that a reduction of its total claim in the amount of $217,409, based on understated authorized health service fees, was incorrect, because the parameters and guidelines require claimants to state offsetting savings "experienced," and claimant did not experience offsetting savings for fees that it did not charge to students.[23] In addition, claimant asserts that the statute of limitations applicable to the Controller's audits of reimbursement claims barred auditing its fiscal year 2001-2002 reimbursement claim.

In its comments on the draft proposed decision, the claimant argues that the Commission's findings on unallowable student health insurance costs are not supported; that the Controller's claiming instructions on indirect cost rates are not legally enforceable; that the data used by the Controller to calculate offsetting revenues is not from a source approved by the Commission; and

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

[22] Exhibit A, Incorrect Reduction Claim, page 12.

[23] Exhibit A, Incorrect Reduction Claim, page 14-18.

that the 2002 and 2004 amendments to Government Code section 17558.5 are not relevant, but only the code section as it read when the claims were filed.[24]

State Controller's Office

The Controller asserts that "athletic insurance is not an authorized expenditure" within the scope of the *Health Fee Elimination* mandate, and that "[t]he district did not provide any additional information supporting the allowability of insurance costs claimed."[25]

The Controller further asserts that the claimant overstated its indirect costs, because claimant did not obtain federal approval for its indirect cost rate proposals, as required by the Controller's claiming instructions.[26] The Controller asserts that "[s]ince the Claimant did not have a current approved ICRP (via the OMB Circular A-21 method), the auditors utilized the FAM-29C and determined that the allowable rate was much less than claimed."[27]

In addition, the Controller found that the claimant understated its authorized health service fees for the audit period in the amount of $217,409. Using enrollment and exemption data, the Controller recalculated the health fees that the claimant was authorized to collect, and reduced the claim by the amount not stated as offsetting revenues.[28] The Controller argues that "[t]he relevant amount [of offsetting savings] is not the amount charged, nor the amount collected, rather it is the amount authorized."[29]

Finally, the Controller argues that the claimant "incorrectly applies the 1996 version of [the statute of limitations.]" The Controller explains that the prior version of section 17558.5 provided that a reimbursement claim is "subject to audit" for two years after the end of the calendar year in which the claim is filed, meaning that the claimant's 2001-2002 claim, filed December 2, 2002, would be "subject to audit" through December 31, 2004. The Controller asserts that the audit in dispute in this IRC was initiated no later than August 18, 2004, "when the entrance conference was held," and therefore the audit was proper. In addition, the Controller argues that the amendments to section 17558.5, which took effect January 1, 2003, expanded the statute of limitations, and that "[u]nless a statute expressly provides to the contrary, any enlargement of a statute of limitations provision applies to matters pending but not already barred." The amended statute provides that an audit must be initiated no later than *three* years after the claim is filed or last amended. The Controller argues that the expansion of the statute of limitations pursuant to section 17558.5, as amended by Statutes 2002, chapter 1128 (AB 2834) applies to the audit in dispute in this IRC, and therefore the audit was proper.[30]

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[24] Exhibit F, Claimant Comments on Draft Proposed Decision.

[25] Exhibit A, Incorrect Reduction Claim, page 50 [Controller's Audit Report, page 6].

[26] Exhibit A, Incorrect Reduction Claim, page 51 [Controller's Audit Report, page 7].

[27] Exhibit B, Controller's Comments on IRC, page 2.

[28] Exhibit A, Incorrect Reduction Claim, page 52 [Controller's Audit Report, page 8].

[29] Exhibit B, Controller's Comments on IRC, page 2.

[30] Exhibit B, Controller's Comments on IRC, pages 2-3.

On August 5, 2014, the Controller filed comments on the draft proposed decision, concurring with the conclusion and recommendation. [31] Then, in response to Commission staff's request for additional information, the Controller filed additional comments, on October 13, 2014, including evidence, as requested, to substantiate the reduction of insurance costs claimed, as discussed below.[32]

IV. Discussion

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

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

The Commission must review questions of law, including interpretation of the parameters and guidelines, *de novo*, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[33] 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."[34]

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.[35] 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.]

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[31] Exhibit E, Controller's Comments on Draft Proposed Decision.

[32] Exhibit H, Controller's Response to Commission Request for Additional Information.

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

[34] *County of Sonoma, supra,* 84 Cal.App.4th 1264, 1281, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

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

> When 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.]' "[36]

The Commission must review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.[37] In addition, section 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[38]

A. The Statutory Deadlines Found in Government Code Section 17558.5 do not Bar the Controller's Audit of the Claimant's 2001-2002 Reimbursement Claim.

The statutory deadlines applicable to the Controller's audit of mandate reimbursement claims are provided in Government Code 17558.5. Section 17558.5 was amended twice between the time the subject claims were filed and time the final audit report was issued, and the parties take opposing views on what version of the statute to apply and the meaning given to the statutory language.

At the time claimant incurred the mandated costs in fiscal year 2001-2002 and filed its reimbursement claim on December 6, 2002, Government Code section 17558.5, as added in 1995, stated the following:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[39]

Claimant asserts that "the first year of the two claims audited, FY 2001-02, is beyond the statute of limitations for audit when the Controller completed its audit on April 27, 2005."[40] The claimant reasons that its fiscal year 2001-2002 reimbursement claim, filed on December 6, 2002, was "subject to audit" until December 31, 2004. The claimant interprets "subject to audit" to require the *completion* of an audit within the two year period, and therefore concludes that

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

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

[38] 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.

[39] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)). Former Government Code section 17558.5 was originally added by the Legislature by Statutes 1993, chapter 906, effective January 1, 1994. The 1993 statute became inoperative on July 1, 1996, and was repealed on January 1, 1997 by its own terms.

[40] Exhibit A, Incorrect Reduction Claim, pages 18-19.

pursuant to "the unmistakable language of Section 17558.5," the Controller's issuance of a final audit report on April 27, 2005 was beyond the statute of limitations.[41]

The Controller argues that the claimant inappropriately relies on "the 1996 version of this statute," but that "[e]ven under this inappropriate version, [the claimant's] conclusion is based on an erroneous interpretation that attempts to rewrite that section, adding a deadline for completion of the audit where none exists." The Controller argues that "[a]lthough there may be a dispute as to what constitutes the initiation of an audit, it is clear that the audit was initiated no later than August 18, 2004, when the entrance conference was held," and that "[t]herefore, the audit of the fiscal year 2000-01 [reimbursement claim] was proper, even under the 1996 version of Section 17558.5."[42] Alternatively, the Controller argues that a 2002 amendment to section 17558.5, which became effective on January 1, 2003, enlarges the statute of limitations to initiate an audit to three years, and that the later enacted statute applies here to grant the Controller additional time to initiate the audit, because the audit period for the 2001-2002 claim was still open. In addition, a 2004 amendment to section 17558.5 also applies, requiring that an audit be completed within two years of the date commenced.[43]

The Commission finds that the audit of the 2001-2002 reimbursement claim was timely under Government Code section 17558.5, as added by Statutes 1995, chapter 945. In addition, when applying the 2002 and 2004 amendments to section 17558.5 the audit is also timely.

The plain language of Government Code section 17558.5, as added in 1995, provides that reimbursement claims are "subject to audit" no later than two years after the end of the calendar year that the reimbursement claim was filed. The phrase "subject to audit" does not require the completion of the audit, but sets a time during which a claimant is on notice that an audit of a claim may occur.[44] This reading is consistent with the plain language of the second sentence, which provides that when no funds are appropriated for the program, "the time for the Controller *to initiate an audit* shall commence to run from the date of initial payment of the claim."[45]

The claimant criticizes the above reasoning, which was included in the draft proposed decision, that the 1995 statute specifies the time by which an audit must be initiated, but not when it must be completed.[46] A common law requirement may be implied that the audit must be completed within a reasonable time, once commenced, but here less than nine months elapsed between the entrance conference and the issuance of the final audit report, and therefore even under the 1995 version of the statute that the claimant urges, the audit was completed within a reasonable period of time.

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[41] Exhibit A, Incorrect Reduction Claim, pages 19-23.

[42] Exhibit B, Controller's Comments on IRC, page 2.

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

[44] *City of Oakland v. Public Employees' Retirement System* (2002) 95 Cal.App.4th 29, at p. 45 [The court held that PERS' duties to its members override the general procedural interest in limiting claims to three or four years: "[t]here is no requirement that a particular type of claim have a statute of limitation."].

[45] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)).

[46] Exhibit F, Claimant's Comments on the Draft Proposed Decision, September 23, 2014.

This interpretation is also consistent with the Legislature's 2002 amendment to Government Code section 17558.5, clarifying that "subject to audit" means "subject to the initiation of an audit," as follows in underline and strikeout:

> 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 ~~two~~ three years after the ~~end of the calendar year in which 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 ~~made~~ filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[47]

And finally, section 17558.5 was amended again in 2004 to establish, for the first time, the requirement to "complete" an audit two years after the audit is commenced. As amended and effective beginning January 1, 2005, the section provides as follows in underline and strikeout:

> 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.[48]

Each of these amendments must be analyzed, with respect to both the earliest claim filed, and the completion of the audit, because an expansion or contraction of a statute of limitations generally applies to pending claims (here, a pending audit) unless a party's rights would be unconstitutionally impaired.

In *Douglas Aircraft,*[49] cited in the Controller's comments, the Court stated the general rule as follows:

> The extension of the statutory period within which an action must be brought is generally held to be valid if made before the cause of action is barred. (*Weldon v. Rogers*, 151 Cal. 432.) The party claiming to be adversely affected is deemed to suffer no injury where he was under an obligation to pay before the period was lengthened. This is on the theory that the legislation affects only the remedy and not a right. (*Mudd v. McColgan*, 30 Cal.2d 463; *Davis & McMillan v. Industrial Acc. Com.*, 198 Cal. 631; 31 Cal.Jur.2d 434.) An enlargement of the limitation period by the Legislature has been held to be proper in cases where the period had not run against a corporation for additional franchise taxes (*Edison Calif. Stores, Inc. v. McColgan*, 30 Cal.2d 472), against an individual for personal income taxes

[47] Statutes 2002, chapter 1128 (AB 2834).

[48] Statutes 2004, chapter 890.

[49] *Douglas Aircraft Co. v. Cranston* (1962) 58 Cal.2d 462.

(*Mudd v. McColgan*, *supra*, 30 Cal.2d 463), and against a judgment debtor (*Weldon v. Rogers*, *supra*, 151 Cal. 432). It has been held that unless the statute expressly provides to the contrary any such enlargement applies to matters pending but not already barred. (*Mudd v. McColgan*, *supra*, 30 Cal.2d 463.)[50]

In *Mudd v. McColgan*, relied upon in *Douglas Aircraft*, the Court explained:

> It is settled law of this state that an amendment which enlarges a period of limitation applies to pending matters where not otherwise expressly excepted. Such legislation affects the remedy and is applicable to matters not already barred, without retroactive effect. Because the operation is prospective rather than retrospective, there is no impairment of vested rights. [Citations.] Moreover, a party has *no vested right in the running of a statute of limitation prior to its expiration*. He is deemed to suffer no injury if, at the time of an amendment extending the period of limitation for recovery, he is under obligation to pay. In *Campbell v. Holt*, 115 U.S. 620, at page 628, it was said that statutes shortening the period or making it longer have always been held to be within the legislative power until the bar was complete.[51]

And in *Liptak v. Diane Apartments, Inc.*,[52] the Second District Court of Appeal, relying in part on *Mudd*, *supra*, reasoned:

> A party does not have a vested right in the time for the commencement of an action. (*Mill and Lumber Co. v. Olmstead* (1890) 85 Cal. 80, 84-85.) Nor does he have a vested right in the running of the statute of limitations prior to its expiration. (*Mudd v. McColgan* (1947) 30 Cal.2d 463, 468; *Weldon v. Rogers* (1907) 151 Cal. 432, 434.) *A change in the statute of limitations merely effects a change in procedure and the Legislature may shorten the period, however, a reasonable time must be permitted for a party affected to avail himself of the remedy before the statute takes effect.* (*Rosefield Packing Co. v. Superior Court* (1935) 4 Cal.2d 120, 122; *Davis & McMillan v. Industrial Acc. Com.* (1926) 198 Cal. 631, 637; *Mill and Lumber Co. v. Olmstead*, *supra*, 85 Cal. at p. 84.)[53]

Therefore, an expansion of a statute of limitations applies to matters pending but not already barred, based in part on the theory that a party has no vested right in the running of a statutory period prior to its expiration.[54] In addition, a contraction of a statute of limitations will generally apply to pending claims or matters as long as the party affected has a reasonable time to assert the claim.[55] However, the courts have also found that where an amended statute of limitations relinquishes a right previously held *by the state or one of its agencies*, a reasonable time to avail

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[50] *Id*, at page 465.

[51] *Mudd v. McColgan* (1947) 30 Cal.2d 463, 468 [emphasis added].

[52] 109 Cal.App.3d 762.

[53] *Id*, at page 773.

[54] *Mudd v. McColgan* (1947) 30 Cal.2d 463, 468

[55] *Liptak v. Diane Apartments, Inc.* 109 Cal.App.3d 762, 773 [citing *Rosefield Packing Co. v. Superior Court* (1935) 4 Cal.2d 120, 122].

itself of the right is not required. In *California Employment Stabilization Commission v. Payne*, the Court stated the following:

> Accordingly, the power of the Legislature to lessen a statute of limitations is subject to the restriction that an existing right cannot be cut off summarily without giving a reasonable time after the act becomes effective to exercise such right. (See *Davis & McMillan v. Ind. Acc. Comm.*, 198 Cal. 631, 637.) This principle, however, does not apply where the state gives up a right previously possessed by it or by one of its agencies. Except where such an agency is given powers by the Constitution, it derives its authority from the Legislature, which may add to or take away from those powers and therefore a statute which adversely affects only the right of the state is not invalid merely because it operates to cut off an existing remedy of an agency of the state.[56]

Therefore the amendments to section 17558.5 discussed above, first expanding the time to initiate an audit (and clarifying the meaning of "subject to audit"),[57] and then imposing a two year deadline for completion of an audit,[58] must be applied and analyzed as of their effective dates. As explained above, the claimant has no "vested right in the running of the statute of limitations prior to its expiration,"[59] and the Controller's authority to audit can be impaired by the Legislature, as it was by the 2004 amendment to section 17558.5, without consideration of whether the agency has a reasonable time in which to avail itself of the "right."[60]

Here, the reimbursement claim filed for fiscal year 2001-2002 was (at the time it was filed) subject to audit "no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended;"[61] in this case, before December 31, 2004, for a reimbursement claim filed in December of 2002. Based on the interpretation urged by the Controller, which is consistent with the clarifying change made in the 2002 amendment, effective January 1, 2003, an audit *initiated* before December 31, 2004 would be timely.

Moreover, the amendment to section 17558.5 became effective January 1, 2003 (i.e., effective before the time the audit would have been barred), and provided that the period during which the claim is "subject to the *initiation* of an audit" extends to December 6, 2005, based on the filing date of the claim.[62] Here, an audit entrance conference was held on August 18, 2004, and the audit was completed April 27, 2005, well within the two-year time period required by section

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[56] (1948) 31 Cal.2d 210, 215-216.

[57] Statutes 2002, chapter 1128 (AB 2834).

[58] Statutes 2004, ch. 890 (AB 2856).

[59] *Liptak*, *supra*, 109 Cal.App.3d 762, 773 [citing *Mudd*, *supra*, 30 Cal.2d 463, 468].

[60] *California Employment Stabilization Commission v. Payne*, (1948) 1931 Cal.2d 210, 215-216.

[61] Government Code section 17558.5 (as added, Stats. 1995, ch. 945 (SB 11)).

[62] See Government Code section 17558.5 (as amended, Stats. 2002, ch. 1128 (AB 2834)) [Audit must be initiated no later than *three years after reimbursement claim filed or last amended*].

17558.5, as amended in 2004, and indeed even before the period "subject to the initiation of an audit" had expired.[63]

The claimant continues to argue, in its comments on the draft proposed decision, that section 17558.5 must be applied as it read at the time the claims were filed,[64] despite the expansion of the statutory deadline by the 2002 and 2004 amendments. The claimant continues to argue that "these amendments are not relevant…"[65] There is no support in law for the claimant's position. As explained above, a party has no vested right in the running of a statute of limitations, until it has expired.[66] The law clearly permits the expansion or contraction of a statute of limitations even as it applies to pending claims,[67] and therefore the above analysis is not altered.

Based on the foregoing, the Commission finds that the audit of the claimant's reimbursement claims is not barred by the statute of limitations in Government Code section 17558.5.

B. The Controller's Reduction for Insurance Premiums is Consistent with the Parameters and Guidelines and Correct as a Matter of Law.

The Controller reduced amounts claimed for "services and supplies" by $9,257 for fiscal year 2001-2002, and $8,637 for fiscal year 2002-2003, on the grounds that athletic insurance costs are beyond the scope of the mandate, and certain costs were "claimed twice."[68] The total reduction for services and supplies for both fiscal years is $17,894.[69] The claimant does not dispute the "duplicated charges of $6,025 for services and supplies for both fiscal years."[70]

However, in its IRC filing, claimant asserts that the total amount includes "$11,869 in "overclaimed athletic insurance costs," for both fiscal years,[71] which claimant disputes, arguing:

> The District pays two types of student insurance premiums. The basic and catastrophic coverage for the general student population, and a separate premium amount for intercollegiate athletics. The Controller's adjustment improperly disallows a portion of the general population premium as somehow being related to intercollegiate athletics. The audit report does not describe how the disallowance was calculated. Regardless the reduction is inappropriate since

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[63] See, *California Employment Stabilization Commission v. Payne* (1948) 1931 Cal.2d 210, 215-216, where the court found that when state gives up a right previously possessed by it or one of its agencies, the restriction in the new law becomes effective immediately upon the operative date of the change in law for all pending claims.

[64] Exhibit F, Claimant Comments on Draft Proposed Decision, pages 1-2.

[65] Exhibit F, Claimant Comments on Draft Proposed Decision, pages 1-2.

[66] *Mudd v. McColgan* (1947) 30 Cal.2d 463, 468.

[67] *Mudd v. McColgan* (1947) 30 Cal.2d 463, 468; *Liptak v. Diane Apartments, Inc.* 109 Cal.App.3d 762, 773

[68] Exhibit A, Incorrect Reduction Claim, page 50.

[69] *Ibid*.

[70] Exhibit A, Incorrect Reduction Claim, pages 11-12.

[71] Exhibit A, Incorrect Reduction Claim, pages 11-12.

> student athletes are part of the student population for purpose of the general student population insurance premium. The insurance premiums for athletes pertains to coverage while participating in intercollegiate sports, not while they are attending class or on campus in their capacity [sic] as a member of the general student population.[72]

The Controller asserts that claimant "overclaimed insurance premiums for student basic and catastrophic coverage by $11,869, because it included unallowable premiums paid for athletic insurance." The Controller explains that the parameters and guidelines provide for reimbursement for the cost of insurance for "(1) on campus accident, (2) voluntary, and (3) insurance inquiry/claim administration." However, the Controller notes that "Education Code Section 76355(d) (formerly Section 72246(2)) states that athletic insurance is not an authorized expenditure for health services."[73]

What was initially unclear from the record was whether the parties were talking about health insurance premiums for "(1) on campus accident, (2) voluntary, and (3) insurance inquiry/claim administration" which premiums include coverage of student athletes as members of the student body, or whether the costs claimed were in fact for "athletic insurance." If the former, then the costs are reimbursable because Education Code section 76355 provides that "no student shall be denied a service supported by student health fees on account of participation in athletic programs"[74] and student athletes are not exempt from the requirement to pay the student health fee. Student athletes are entitled to the same services as other students. However, if the latter, the cost is not a reimbursable type of insurance based on the plain language of the parameters and guidelines, and the disputed adjustment would therefore be a proper reduction.[75]

Adding to the confusion is claimant's statement in a letter to the Controller's Audit Bureau that it "is still investigating the athletic insurance costs to determine if the amounts reported in the claim related to basic insurance costs for students who also were covered by athletic insurance."[76] And later, in rebuttal comments, claimant asserted that the reductions were based on "the erroneous conclusion...that premiums for athletic insurance are not reimbursable." Claimant states: "the athletic insurance premiums claimed are part of the excess costs that make up the District's claims, and as such, were not paid for with the student [health] fees from the fund."[77] It appears from these comments that claimant is arguing a mandate issue that was already decided in the test claim and parameters and guidelines; that athletic insurance should be reimbursable.

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[72] Exhibit A, Incorrect Reduction Claim, pages 11-12.

[73] Exhibit B, Controller's Comments, pages13.

[74] 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)].

[75] Exhibit A, Incorrect Reduction Claim [Parameters and Guidelines, pages 30-33].

[76] Exhibit A, Incorrect Reduction Claim [Controller's audit report, page 50].

[77] Exhibit C, Claimant's Rebuttal Comments, page 5.

However, that is not what the adopted parameters and guidelines provide. The only insurance costs authorized for reimbursement under this program are "(1) on campus accident, (2) voluntary, and (3) insurance inquiry/claim administration."[78] The test claim decision and parameters and guidelines are final decisions of the Commission and they bind the parties. The Controller is required to follow the parameters and guidelines.[79]

As the analysis above indicates, athletic insurance is not reimbursable, as a matter of law. However, the evidentiary basis of the Controller's audit adjustment is not reflected in the reimbursement claims or the audit report, and therefore on October 3, 2014, a request for additional information was issued, asking the Controller to provide evidence that the adjustment is based on amounts claimed that can be isolated and identified as athletic insurance premiums, which are not reimbursable.[80] On October 13, 2014, the Controller responded, and provided evidence that Controller's audit staff contacted the claimant's insurance company to determine the amounts of premiums claimed that were attributed to "Basic Student Coverage," and those amounts claimed in excess, which the Controller attributed to unallowable athletic insurance:

> Based on this information, we prepared a worksheet titled "Audit Review of Student Insurance Costs" showing the difference between the claimed and audited amounts for "Basic Student Coverage." The audit finding is the difference between the claimed amounts of $56,276 and $57,964, and the audited amounts of $50,419 and $51,952 for FY 2001-02 and FY 2002-03 respectively.[81]

The worksheet, which is included in the record, explains the Controller's audit adjustment, and the declaration attached states that "[a]ny attached copies of records are true copies of records, as provided by Long Beach Community College District or retained at our place of business."[82] Based on this additional evidence, the Commission finds that the Controller has demonstrated the basis of the audit adjustment.

Based on the foregoing, the Commission finds that the reductions for insurance premiums are consistent with the parameters and guidelines and correct as a matter of law.

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

The Controller reduced indirect costs claimed by $70,710 for fiscal year 2001-2002, and $68,383 for fiscal year 2002-2003, on the ground that claimant did not utilize a federally approved indirect cost rate.[83] Claimant argues that "[c]ontrary to the Controller's ministerial preferences, there is no requirement in law that the district's indirect cost rate must be 'federally' approved,

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[78] Exhibit A, Incorrect Reduction Claim [Parameters and Guidelines, page 32].

[79] Government Code 17558.

[80] Exhibit G, Commission Request for Additional Information.

[81] Exhibit H, Controller's Response to Commission Request for Additional Information, page 7.

[82] Exhibit H, Controller's Response, pages 14; 4.

[83] Exhibit A, Incorrect Reduction Claim, page 51.

and further the Controller has never specified the federal agencies which have the authority to approve indirect cost rates."

The parameters and guidelines specify as follows: "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions."[84] Thus, Commission finds that the claimants are required to adhere to the Controller's claiming instructions. The Commission further finds that the claimant had notice of the claiming instructions; and that the claimant here did not follow the claiming instructions. Therefore, the Controller recalculated indirect costs in accordance with the only other option available, the state FAM-29C method, and reduced the claim accordingly. The reduction was correct as a matter of law, and the Controller's use of the alternative state method 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-29C.*

The claimant argues that "[n]o particular indirect cost rate calculation is required by law," and that the parameters and guidelines "do not require that indirect costs be claimed in the manner described by the Controller."[85] The claimant argues that the word "may" is permissive, and that therefore the parameters and guidelines do not require that indirect costs be claimed in the manner described by the Controller.[86]

The 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.*"[87] 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 Controller's claiming instructions.

The claiming instructions specific to the *Health Fee Elimination* mandate, revised in September 1997[88] 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." In addition, the School Mandated Cost Manual, revised each year, and containing instructions applicable to all school and community college mandated programs,[89] provides as follows:

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[84] Exhibit A, Incorrect Reduction Claim, page 34 (page 6 of the parameters and guidelines as amended May 25, 1989).

[85] Exhibit A, Incorrect Reduction Claim, pages 12-13.

[86] Exhibit A, Incorrect Reduction Claim, page 13.

[87] Exhibit A, Incorrect Reduction Claim, page 34.

[88] Exhibit B, Controller's Comments, pages 29-40 [emphasis added].

[89] Exhibit I, School Mandated Cost Manual Excerpt, 2001-2002, page 11; Community College Mandated Cost Manual Excerpt, 2002-2003, page 7.

> A college has the option of using a federally approved rate, utilizing the cost accounting principles from Office of Management and Budget Circular A-21 "Cost Principles for Educational Institutions," or the Controller's methodology outlined in the following paragraphs. If the federal rate is used, it must be from the same fiscal year in which the costs were incurred.[90]

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 later the Mandated Cost Manual for Community Colleges), and the manual provides ample notice to claimants of how they may claim indirect costs. Claimant's assertion that "[n]either applicable law nor the Parameters and Guidelines made compliance with the Controller's claiming instructions a condition of reimbursement"[91] is therefore in error. The parameters and guidelines, which were duly adopted at a Commission hearing, require compliance with the claiming instructions.

Claimant also argues that "the Controller's claiming instructions were never adopted as law, or regulations pursuant to the Administrative Procedure Act," and therefore, claimant argues, "the claiming instructions are merely a statement of the ministerial interests of the Controller and not law."[92] In *Clovis Unified*, 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.[93] Here, claimant alleges 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.[94]

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

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[90] Exhibit I, School Mandated Cost Manual Excerpt, page 17. See also, Community College Mandated Cost Manual Excerpt, 2002-2003, page 16.

[91] Exhibit C, Claimant Rebuttal Comments, page 7.

[92] Exhibit A, Incorrect Reduction Claim, page 13.

[93] *Clovis Unified School District v. State Controller* (2010) 188 Cal.App.4th 794, 807.

[94] Exhibit I, School Mandated Cost Manual Excerpt, 2001-2002, page 11; Community College Mandated Cost Manual Excerpt, 2002-2003, page 7.

recalculation of costs, applying the Form FAM-29C calculation to provide an indirect cost rate, is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.

In the audit of the 2001-2002 and 2002-2003 reimbursement claims, the Controller concluded that the claimed indirect costs were based on a rate not federally approved, and that the Controller's calculated rates did not support the indirect cost rates claimed.[95] Indirect costs of $149,291 were claimed for fiscal year 2001-2002, against direct costs of $417,010; and $148,836 for fiscal year 2002-2003, against direct costs of $437,679. Those indirect costs amount to rates of approximately 35.8 percent and 34 percent, respectively.

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.

The Controller, concluding that the rate was not approved, and therefore not supported consistently with the parameters and guidelines and the claiming instructions, recalculated the indirect cost rate using the alternative state procedure, the "FAM-29C method," outlined in the School Mandated Cost Manual.[96] Applying the FAM-29C methodology, the Controller reduced the claimed indirect costs to $75,424 (an 18.23% rate) for fiscal year 2001-2002 and $77,522 (a 17.96% rate) for fiscal year 2002-2003.[97]

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 [*sic*]."[98]

However, the Commission finds that 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. 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."[99] 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.

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

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[95] Exhibit A, Incorrect Reduction Claim, page 51.

[96] See Exhibit B, Controller's Comments, page 16.

[97] Exhibit A, Incorrect Reduction Claim, pages 48; 51.

[98] Exhibit A, Incorrect Reduction Claim, page 14.

[99] Exhibit A, Incorrect Reduction Claim, page 12.

D. The Controller's Reduction for Understated Offsetting Revenues Pursuant to the Health Fee Rule is Correct as a Matter of Law.

The Controller reduced the reimbursement claims by $217,409 for the two years at issue.[100] These reductions were made on the basis of the fee authority available to claimant, multiplied by the number of students subject to the fee, less the amount of offsetting revenue claimed.

Claimant disputed the reduction in its IRC filing, arguing that the relevant Education Code provisions permit, but do not require, a community college district to levy a health services fee, and that the parameters and guidelines require a community college district to deduct from its reimbursement claims "[a]ny offsetting savings that the claimant experiences as a direct result of this statute…" Claimant argued that "[i]n order for the district to 'experience' these 'offsetting savings' the district must actually have collected these fees." Claimant concluded that "[s]tudent fees actually collected must be used to offset costs, but not student fees that could have been collected and were not."[101]

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

After the claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge 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.[102] (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

[100] Exhibit A, Incorrect Reduction Claim, page 14.

[101] Exhibit A, Incorrect Reduction Claim, pages 14-15.

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

> calculation produces an increase of one dollar ($1) above the existing fee, the fee may be increased by one dollar ($1).[103]

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.[104] The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered.[105] Here, the Controller asserts that claimant had the authority to increase its health fee in accordance with the notices periodically issued by the Chancellor, stating that the Implicit Price Deflator Index had increased enough to support a one dollar increase in student health fees. The Controller argues that the claimant was required to claim offsetting fees in the amount authorized.[106] Claimant argues that "the Controller cannot rely on the Chancellor's notice as a basis to adjust the claim for 'collectible' student health services fees,"[107] because the fees levied on students are raised by action of the governing board of the community college district. But the *authority* to impose the health service fees increases automatically with the Implicit Price Deflator, as noticed by the Chancellor. Accordingly, the court in *Clovis Unified* upheld the Controller's use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. In making its decision the court 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.[108]

The court also notes that, "this basic principle flows from common sense as well. As the Controller succinctly puts it, 'Claimants can choose not to require these fees, but not at the state's expense.'"[109] Additionally, in responding to claimant's argument that, "since the Health

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[103] 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)].

[104] 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.

[105] See, e.g., Exhibit A, Incorrect Reduction Claim [Letter from Chancellor, pages 69-70].

[106] See Exhibit B, Controller's Comments, pages 16-18; Exhibit A, Incorrect Reduction Claim, pages 69-70.

[107] Exhibit A, Incorrect Reduction Claim, pages 17-18.

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

[109] *Ibid.*

Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission's P&G's",[110] 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*.[111] (Italics added.)

Thus, pursuant to the court's decision in *Clovis Unified*, the Health Fee Rule used by the Controller to adjust reimbursement claims filed by claimant for the *Health Fee Elimination* program is valid. Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.[112] In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.[113] 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.[114] Although the claimant to this IRC was not a party to the *Clovis* action, the claimant is in privity with the petitioners in *Clovis*. "A party is adequately represented for purposes of the privity rule if his or her interests are so similar to a party's interest that the latter was the former's virtual representative in the earlier action."[115]

The claimant, in its comments filed 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, relying on the Commission's October 27, 2011 decision on seven consolidated Health Fee IRCs, the claimant argues that the only approved source of enrollment data is "specific Community College Chancellor's MIS data."[116] For this audit, however, the claimant argues that a different methodology was used. From the Controller's final audit report: "At the district's recommendation, we recalculated authorized health fee revenues using the Student Headcount by Enrollment Status for Long Beach Community College District report available from the

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

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

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

[113] 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.

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

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

[116] Exhibit F, Claimant's Comments on Draft Proposed Decision, page 9.

California Community Colleges Chancellor's Office (CCCCO) Web site, as well as district-prepared reports indicating the number of students who received fee waivers."[117]

The claimant is correct in that in the earlier decision on seven consolidated *Health Fee Elimination* IRCs, the Commission found that the "Community College Chancellor's MIS data" was a "reasonable and reliable source" for enrollment data, and use of such data was not arbitrary or capricious.[118] The claimant here points out that more recent audits have used "enrollment data from the CCCCO,"[119] but that for this audit, the enrollment data was derived from another report available from the CCCCO. However, the Commission did not determine that the MIS data was the *only* reasonable and reliable source for the data. The claimant has not raised a specific objection to the data being used, other than that it is not the "MIS" data. Indeed the audit report indicated that "[t]he district was unable to retrieve student attendance data from its computer system," and the audit staff therefore used the "Student Headcount by Enrollment Status" report and "district-prepared reports" for the number of students exempt from the fee "[a]t the district's recommendation."[120] The Commission finds that the Controller's recalculation of fee authority based on the Health Fee Rule, and utilizing the enrollment and exemption information available was not arbitrary, capricious, or entirely lacking in evidentiary support. The claimant's concerns do not alter the above analysis.

Based on the foregoing the Commission finds that the Controller's reduction of reimbursement to the extent of the district's fee authority is correct as a matter of law.

V. Conclusion

Pursuant to Government Code section 17551(d), the Commission concludes that the reductions to the following costs are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support:

- Reduction for fiscal years 2001-2002 and 2002-2003 totaling $11,869 for athletic insurance costs that are beyond the scope of the mandate.
- Reductions of indirect costs claimed of $70,710 for fiscal year 2001-2002, and $68,383 for fiscal year 2002-2003, based on the 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 to calculate indirect costs authorized by the parameters and guidelines and claiming instructions.
- Reduction for fiscal years 2001-2002 and 2002-2003 totaling $217,409 based on understated offsetting health fee authority.

Based on the foregoing, the Commission denies this IRC.

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[117] Exhibit F, Claimant's Comments on Draft Proposed Decision, pages 9-10 [quoting from Controller's Final Audit Report, page 8].

[118] Statement of Decision, Health Fee Elimination, 09-4206-I-19, page 35.

[119] Exhibit F, Claimant's Comments on Draft Proposed Decision, page 9.

[120] Exhibit A, Incorrect Reduction Claim, page 52.

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RE: **Decision**

Health Fee Elimination, 05-4206-I-03
Education Code Section 76355
Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118
Fiscal Years 2001-2002 and 2002-2003
Long Beach Community College District, Claimant

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

Dated: December 10, 2014

Heather Halsey, Executive Director

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Education Code Section 76355 Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1) and Statutes 1987, Chapter 1118 (AB 2336) Fiscal Years 1999-2000, 2000-2001, 2001-2002 and 2002-2003 San Mateo Community College District and San Bernardino Community College District, Claimants.	Case Nos.: 05-4206-I-04 and 05-4206-I-08 *Health Fee Elimination* STATEMENT OF DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5. ARTICLE 7 (*Adopted January 24, 2014*) (*Served January 31, 2014*)

STATEMENT OF DECISION

The Commission on State Mandates (Commission) heard these consolidated incorrect reduction claims (IRCs) during a regularly scheduled hearing on December 6, 2013. Mr. Keith B. Petersen appeared for the claimants, and Mr. Jim Spano and Mr. Shawn Silva appeared for 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.

At the December 6, 2013 hearing the Commission partially approved the incorrect reduction claims as specified herein. Specifically, the Commission made findings which modified the staff analysis and directed staff to prepare a revised statement of decision, to reflect the decision of the Commission, for approval at the January, 24, 2014 hearing. The Commission's December 6, 2013 findings, which modified the proposed statement of decision, are as follows:

1. A vote of 7 to 0 to strike the "arbitrary and capricious" language from the finding regarding the Controller's application of the Health Fee Rule to San Bernardino's reimbursement claim; and
2. A vote of 6 to 1, finding that the Controller's reductions of salaries and benefits for two employees of San Mateo were supported by some evidence and thus were not arbitrary and capricious.

Staff modified the statement of decision to reflect the Commission's findings at the December 6, 2013 hearing and presented this revised proposed statement of decision to the Commission at the January 24, 2014 hearing. The Commission adopted this statement of decision on consent.

Summary of the Findings

These IRCs were filed in response to audits conducted by the Controller, in which reimbursement was reduced to the claimant districts on several discrete bases. The analysis below addresses the IRCs filed by two community college districts disputing adjustments made by the Controller, pursuant to audits of the districts' cost claims filed under the *Health Fee Elimination* mandate (CSM-4206). The executive director has consolidated these claims pursuant to section 1185.4 of the Commission's regulations.[1]

The Commission partially approves these IRCs, finding that some of the reductions were appropriate, and some were incorrect. The Commission therefore remands the matter to the Controller with instructions to reinstate the incorrect reductions as specified below consistent with this statement of decision.

Pursuant to Government Code section 17551(d) and section 1185.7 of the Commission's regulations, the Commission finds that the following reductions by the Controller's Office are incorrect and that the costs, as specified, should be reinstated:

- Reduction of San Bernardino's reimbursement claims based on understated health fee revenues, in the amount of $150,031, should be reinstated pending reevaluation of the total number of students enrolled less those exempt from the fee. On remand, the Controller should reexamine the health fees authorized based on the total number of *enrolled students less those exempt from the fee*. If the District is unable to assist the Controller and provide documentation of the number of exempt students for whom fees cannot legally be charged, the Controller may apply the Health Fee Rule using any reasonable source available to obtain enrollment and exemption information.
- Disallowance of costs for hepatitis and influenza immunizations, and outside lab services was arbitrary, capricious, or entirely lacking in evidentiary support; costs claimed for these services should be reinstated in the full amount reduced.

The Commission further finds that the following reductions were supported by the law, the parameters and guidelines, the claiming instructions, and the record:

- Reduction of San Mateo's reimbursement claims, on the basis of understated health fee revenues, in the amount of $70,603.
- The reduction of indirect costs claimed by San Mateo, in the amount of $112,243, based on the district's incorrect application of its approved 30% indirect cost rate to direct costs other than the distribution base of salaries and benefits.
- The reduction of indirect costs claimed by San Bernardino, in the amount of $281,494, based on the district's failure to comply with the claiming instructions in the development of its indirect cost rate, and the Controller's reasonable use of an alternative method to calculate indirect costs.
- The disallowance of salaries and benefits for Ernest Rodriguez and Dee Howard, based on an absence of employee time records or other documentation as required by the parameters and guidelines.

[1] California Code of Regulations, title 2, section 1185.4 (Register 2010, No. 44).

- The reduction of benefits claimed by San Mateo, in the amount of $88,633, based on the district's failure to support its claimed benefit amounts.
- The reduction of costs claimed for "other outgoing expenses" by San Mateo, in the amount of $41,375, based on the district's failure to support claimed expenses.
- The reduction of health insurance costs and other overstated services and supplies in San Bernardino's reimbursement claims, in the amounts of $37,348 for fiscal year 2001-2001, and $38,322 for fiscal year 2002-2003, based on the documentation submitted by the Controller.
- The reduction of health services costs for pap smears and marriage therapy, on the basis of San Bernardino's reimbursement claims failing to substantiate that these services were provided in the base year.

I. Background

Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts to charge almost all students a general fee (health service fee) for the purpose of voluntarily providing health supervision and services, direct and indirect medical and hospitalization services, and operation of student health centers.[2] Statutes 1984, chapter 1 repealed the community colleges' fee authority for health services.[3] However, it also included a provision to reauthorize the fee, which was to become operative on January 1, 1988.[4]

In addition to temporarily repealing community college districts' authority to levy a health services fee, Statutes1984, chapter 1 required any district which provided health services during the 1983-1984 fiscal year, for which it was 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.[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.

Statutes1987, chapter 1118 amended former Education Code section 72246,[6] which was to become operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5.[7] As a result, beginning in 1988 all community college districts were required to maintain the same level of health services they

[2] 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.

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

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

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

[6] In 1993, former Education Code section 72246 was renumbered to Education Code section 76355. (Stats. 1993, ch. 8).

[7] Statutes 1987, chapter 1118.

provided in the 1987-1988 fiscal year each year thereafter. In addition, the community college districts regained a limited fee authority for the provision of the required health services.[8]

Commission Decisions

At the November 20, 1986 Commission hearing, the Commission determined that Statutes 1984, chapter 1, which required community college districts to maintain health services while repealing community college districts' fee authority for those services, imposed a reimbursable state-mandated new program upon community college districts.[9] On August 27, 1987, the Commission adopted parameters and guidelines for the *Health Fee Elimination* program.

At the May 25, 1989 Commission hearing, the Commission adopted amendments to the parameters and guidelines for the *Health Fee Elimination* program to reflect amendments made by Statutes 1987, chapter 1118.[10] The 1989 parameters and guidelines reflected a change in eligible claimants for the *Health Fee Elimination* program, (those districts that provided health services in the 1986-87 fiscal year, and would be required to continue to do so) and the reestablishment of community college districts' fee authority for the *Health Fee Elimination* program.

At the October 27, 2011 Commission hearing, the Commission adopted a decision regarding seven consolidated IRCs under the *Health Fee Elimination* program, which addressed some of the same substantive issues present in these consolidated IRCs.

This decision addresses the following issues:

- The statute of limitations applicable to audits of reimbursement claims by the Controller;
- The appropriate extent of offsetting revenue available from health service fees, pursuant to the *Clovis Unified* decision;
- Disallowances found against both districts based on asserted faults in the development and application of indirect cost rates;
- Disallowance of salaries and benefits against San Mateo based on asserted insufficient documentation of hours and duties;
- Disallowance of other outgoing expenses against San Mateo based on asserted insufficient documentation;
- Disallowance of discrete health services against San Bernardino based on an asserted failure to substantiate services provided in the base year;
- Disallowance of costs for student health insurance against San Bernardino based on the scope of reimbursement excluding student athletic costs.

II. Procedural History

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

[9] Statement of decision, *Health Fee Elimination* (CSM 4206, adopted January 22, 1987). Reference to 1984 legislation refers to Statutes 1984, 2nd Extraordinary Session 1984, chapter 1.

[10] Amendments to parameters and guidelines, *Health Fee Elimination* (CSM 4206, adopted May 25, 1989). Reference to 1987 legislation refers to Statutes 1987, chapter 1118.

San Mateo filed timely reimbursement claims for fiscal years 1999-2000,[11] 2000-2001,[12] and 2001-2002.[13] On October 28, 2004, the Controller issued a draft audit report addressing these three fiscal years.[14] On November 15, 2004, San Mateo issued a letter to the Controller responding to the draft audit report findings, disputing the Controller's adjustments and disallowance of costs.[15] On January 7, 2005, the Controller issued its final audit report, finding that $1,017,386 in claimed costs, of $1,259,226 total costs claimed in the relevant audit period, were unallowable.[16] On September 1, 2005, San Mateo filed IRC 05-4206-I-04.[17]

San Bernardino filed timely reimbursement claims for fiscal years 2001-2002,[18] and 2002-2003.[19] On September 30, 2004, the Controller issued a draft audit report addressing these two fiscal years. On October 13, 2004, San Bernardino issued a letter to the Controller responding to the draft audit report, disputing the Controller's findings regarding the overstatement of health services provided in the base year the development and application of indirect cost rates, and the reporting of health fee revenues, and disputing the Controller's calculation of the appropriate reductions.[20] On November 10, 2004, the Controller issued its final audit report, concluding that $610,323 in claimed costs, of $1,130,569 total costs claimed in the relevant audit period, were unallowable.[21] On September 13, 2005, San Bernardino filed IRC 05-4206-I-08.[22]

The Controller submitted written comments, dated December 31, 2007, on the San Bernardino IRC, reiterating the audit findings and asserting that its adjustments were appropriate. On April 24, 2008, the Controller submitted written comments on the San Mateo IRC, stressing the proper application of the statute of limitations, and restating its contention that the audit adjustments were proper. On July 13, 2009, San Mateo submitted rebuttal comments in response to the Controller's comments on its IRC, renewing its objections to the lack of explanation of the reasons for disallowance of specific costs, and to the application of an average benefit rate where actual benefit costs were available; reiterating its disagreement with the Controller's adjustment on the basis of health fees authorized; restating its claim that the indirect cost rate proposal had been improperly rejected; and continuing to challenge the statute of limitations asserted by the Controller.

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[11] Exhibit A, San Mateo IRC, at p. 105.

[12] Exhibit A, San Mateo IRC, at p. 90.

[13] Exhibit A, San Mateo IRC, at p. 75.

[14] Exhibit A, San Mateo IRC, at p. 67.

[15] Exhibit A, San Mateo IRC, at pp. 67-68.

[16] Exhibit A, San Mateo IRC, at p. 45.

[17] Exhibit A, San Mateo IRC, at p. 1.

[18] Exhibit B, San Bernardino IRC, at p. 74.

[19] Exhibit B, San Bernardino IRC, at p. 95.

[20] Exhibit B, San Bernardino IRC, at pp. 61-63.

[21] Exhibit B, San Bernardino IRC, at p. 45.

[22] Exhibit B, San Bernardino IRC, at p. 1.

On September 21, 2010, after the filing of the IRCs, the Third District Court of Appeal issued its opinion in *Clovis Unified*,[23] which specifically addressed two of the key disputed issues. The court found that community college districts were required to offset costs claimed for the *Health Fee Elimination* program by the health service fees that community college districts were *authorized* to charge, rather than, as the claimants have argued, the fees actually collected. In addition, the court held that the contemporaneous source document rule (CSDR) was, as applied to the audits of several mandated programs, an unenforceable underground regulation. The scope and effect of the *Clovis Unified* decision is addressed below, where relevant.

On August 2, 2013, Commission staff issued a draft staff analysis for these consolidated incorrect reduction claims.[24] On August 21, 2013, the claimants requested an extension of time to file comments and a postponement of the hearing, which was granted for good cause.[25] On October 21, 2013, the claimants filed comments on the draft staff analysis.[26] On October 22, 2013, the Controller filed late comments on the draft staff analysis.[27]

On December 6, 2013, the Commission heard and partially approved the claim, adopting the staff analysis as modified by the Commission and directing Commission staff to prepare the statement of decision for adoption at the January 24, 2014 hearing.

III. Positions of the Parties

San Mateo Community College District

San Mateo argues that the Controller inappropriately reduced reported costs of salaries and benefits, and other indirect costs claimed.[28] San Mateo argues that the Controller reduced "outgoing expense costs" without explaining the distinction between "expenses" and "costs," and that "the district was not on notice of any particular reporting or audit standard with respect to journal voucher transactions."[29] San Mateo also takes issue with the Controller's finding that "the district improperly applied its claimed indirect cost rate to costs beyond those approved by the U.S. Department of Health and Human Services (DHHS)."[30] San Mateo argues that by reducing claims on the basis of fees collectible, but not collected, the Controller improperly disallowed a portion of the districts' reimbursable costs.[31] Finally, San Mateo disputes the application of the statute of limitations to allow audits of the subject fiscal years.[32]

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[23] *Clovis Unified School Dist. v. Chiang* (*Clovis*) (Cal. Ct. App. 3d Dist. 2010) 188 Cal.App.4th 794.

[24] Exhibit F, Draft Staff Analysis.

[25] Exhibit G, Claimant Request for Extension.

[26] Exhibit H, Claimants' Comments on Draft Staff Analysis.

[27] Exhibit I, Controller's Comments on Draft Staff Analysis.

[28] Exhibit A, San Mateo IRC, at p. 13.

[29] Exhibit A, San Mateo IRC, at p. 15.

[30] Exhibit A, San Mateo IRC, at pp. 17-18.

[31] Exhibit A, San Mateo IRC, at pp. 19-23.

[32] Exhibit A, San Mateo IRC, at pp. 23-26.

In its rebuttal comments San Mateo maintains that the Controller has the burden of proof in showing that the district's claimed costs were not allowable, and that therefore several discrete costs that were disallowed were improperly reduced. San Mateo also argues that the application of an average benefit rate is inappropriate where actual benefit costs are available. San Mateo renews its contention regarding the health fee authority, and restates its challenge to the statute of limitations for audits asserted by the Controller.[33]

In its comments on the draft staff analysis, San Mateo maintains that staff's interpretation of the statute of limitations for audits remains incorrect; that the Controller's application of the Health Fee Rule is not supported; and that staff's analysis regarding indirect cost rates is not supported. Finally, the district states that staff correctly analyzed and recommended reinstatement of disallowed employee salaries and benefits, and concedes several other issues.[34]

San Bernardino Community College District

San Bernardino disputes the disallowance of costs for certain health services, arguing that "[t]he Controller established FY 1997-98 as an alternative base year, contrary to the Education Code and the parameters and guidelines."[35] San Bernardino further argues that the Controller improperly disallowed costs related to insurance premiums for the general student population, and "does not describe how the disallowance was calculated."[36] San Bernardino also disputes the Controller's finding that indirect costs were overstated because the indirect cost rate proposal was not federally approved. The district argues that there is no requirement of federal approval.[37] Finally, San Bernardino argues that the proper measure of offsetting revenues should be the health fees collected, not the amount of fees authorized.[38]

In comments on the draft staff analysis, the District disagreed with staff's analysis of the Controller's application of the Health Fee Rule, as noted above, and disagreed with staff's analysis of indirect cost rates. The district concurred with staff's recommendation that all disallowed health services should be reinstated, a finding that has been revised in the final analysis.[39]

State Controller's Office

San Mateo Audit and IRC

The final audit report concluded that $793,165 in salaries and benefits were unallowable, because "the district did not provide documentation supporting the validity of the distribution made to the mandate."[40] The Controller maintains that San Mateo "was unable to support that

[33] Exhibit E, San Mateo Rebuttal Comments, at pp. 1-4.

[34] Exhibit H, Claimants' Comments on Draft Staff Analysis, at pp. 2-12.

[35] Exhibit B, San Bernardino IRC, at p. 12-13.

[36] Exhibit B, San Bernardino IRC, at p. 19.

[37] Exhibit B, San Bernardino IRC, at pp. 20-22.

[38] Exhibit B, San Bernardino IRC, at pp. 23-27.

[39] Exhibit H, Claimants' Comments on Draft Staff Analysis, at pp 12-13.

[40] Exhibit A, San Mateo IRC, at p. 52.

salary costs claimed for several employees were directly attributable to the mandate." The Controller argues that San Mateo did not provide any documentation showing that the disallowed employees were tasked to the mandated activities. The Controller further maintains that it has calculated an appropriate benefit rate to apply to San Mateo's claim.

The audit report also disallowed $41,375 in "other outgoing expenses," finding that "the district did not provide any documentation supporting the validity of the costs claimed."[41] Additionally, the audit report concluded that "the district improperly applied its claimed indirect cost rate to costs beyond those approved by the U.S. Department of Health and Human Services," and thus "overstated indirect costs by $112,243."[42] And finally, by claiming health fees received rather than health fees collectible, the Controller concluded that San Mateo "understated offsetting health fee revenues by $70,603."[43] Finally, the Controller argues that the statute of limitations for audits under section 17558.5 permitted the Controller to audit fiscal years 1999-2000 and 2000-2001.[44]

San Bernardino Audit and IRC

The final audit report concluded that San Bernardino "overstated health services costs by $103,128 for the audit period…because the services were not provided in FY 1986-87."[45] The Controller also concluded that "[t]he district overstated service and supply costs by $75,670 because it claimed ineligible athletic insurance costs of $72,554 and did not support costs of $3,116."[46] In addition, the Controller concluded that San Bernardino overstated indirect costs by $281,494, because the district "claimed indirect costs based on an indirect cost rate proposal prepared for each year by an outside consultant…[and] did not obtain federal approval for its rate."[47] And finally, the Controller concluded that San Bernardino "understated authorized health fee revenue by $150,031" by claiming "actual rather than authorized health fee revenues."[48]

Response to Draft Staff Analysis

In comments on the draft staff analysis, the Controller focuses primarily on staff's conclusions with respect to indirect cost rates, the recommended reinstatement of disallowed salaries and benefits for San Mateo, and the recommended reinstatement of disallowed health services not substantiated in the base year for San Bernardino. The Controller argues that the draft staff analysis "misapprehends the application of an indirect cost rate," and explains that a rate established on the basis of direct salaries and wages including fringe benefits is meant to be applied only to direct salaries and wages in order to arrive at the indirect costs for the entire

[41] Exhibit A, San Mateo IRC, at p. 54.

[42] Exhibit A, San Mateo IRC, at p. 54.

[43] Exhibit A, San Mateo IRC, at pp. 56-58.

[44] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 1-3.

[45] Exhibit B, San Bernardino IRC, at p. 53.

[46] Exhibit B, San Bernardino IRC, at p. 55.

[47] Exhibit B, San Bernardino IRC, at pp. 55-57.

[48] Exhibit B, San Bernardino IRC, at p. 57.

program.[49] The Controller argues that the simplified method of claiming indirect costs uses salaries and wages as a measurement, or formula, and the rate is not meant to be applied to all direct costs. In addition, the Controller argues that the disallowed salaries and benefits for San Mateo employees was based on a lack of documentation, and was not inconsistent with salaries allowed for other employees, for whom more documentation corroborating their salaries was submitted.[50] Finally, the Controller argues that it did not disallow costs for health services on the basis of an alternate base year. The Controller argues that audit staff considered the 1997-98 claim information not to rule out services not provided in the base year, but to substantiate services provided in the base year.[51] In addition, the Controller argues that Commission staff's reading of the health services provided in the base year and listed in the parameters and guidelines is too broad, and that the Controller's audit staff "appropriately relied on the explicit list of reimbursable services in the Parameters & Guidelines" to deny health services claimed by San Bernardino.[52]

IV. Discussion

Government Code section 17561(b) authorizes the Controller to audit the claims filed by local agencies and school districts and to reduce any claim for reimbursement of state mandated costs that the Controller determines is excessive or unreasonable. Government Code section 12410 further requires the Controller to:

> [S]uperintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment.

Although the Controller's Office is required to follow the parameters and guidelines when auditing a claim for mandate reimbursement, the Controller has broad discretion in determining how to audit claims. Government Code section 12410 provides in relevant part:

> Whenever, in [the Controller's] opinion, the audit provided for by [Government Code section 925 et seq.] is not adequate, the Controller *may make such field or other audit* of any claim or disbursement of state money *as may be appropriate to such determination*. (Italics added.)

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 statement of decision to the Controller and request that the costs in the claim be reinstated.

The Commission must determine in this case whether the Controller's audit decisions 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 with

[49] Exhibit I, Controller's Comments on Draft Staff Analysis, at pp. 2-3.

[50] Exhibit I, Controller's Comments on Draft Staff Analysis, at pp. 3-4.

[51] Exhibit I, Controller's Comments on Draft Staff Analysis, at pp. 4-8.

[52] Exhibit I, Controller's Comments on Draft Staff Analysis, at p. 8.

respect to an adjudicatory decision in which an evidentiary hearing is not required.[53] 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.]' "[54]

Thus, with respect to the Controller's authority and responsibility over state audits, the Commission exercises "very limited review 'out of deference to…the legislative delegation of administrative authority of the agency, and to the presumed expertise of the agency within its scope of authority.'"[55]

The Commission must review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.[56] As more fully discussed in the analysis below, the parameters and guidelines governing these reimbursement claims require that costs claimed be supported by documentation maintained by the claimant.

In addition, the Commission must review questions of law *de novo*, without consideration of conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[57] 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."[58]

A. Statute of Limitations and Document Retention Requirements Applicable to Audits of Mandate Reimbursement Claims

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[53] *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.

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

[55] *Shapell Industries, Inc. v. Governing Board* (1991) 1 Cal.App.4th 218, at p. 230.

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

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

[58] *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.

San Mateo asserts that the statute of limitations applicable to audits of mandate reimbursement claims bars the Controller's audits of the claims filed for fiscal years 1999-2000 and 2000-2001. San Mateo disputes also the document retention requirements asserted by the Controller.

1. *The audit of community college district claims beginning in 1999-2000 is not barred by the statute of limitations found in Government Code section 17558.5.*

San Mateo asserts that "the first two years of the three claim years audited, fiscal years 1999-00 and 2000-01, were beyond the statute of limitations for an audit when the Controller issued its audit report on January 7, 2005."[59] Statutes 1995, chapter 945 (operative July 1, 1996), effective at the time of the two earliest claims, provided as follows:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[60]

San Mateo contends that this code section provides for two standards: "if no funds are appropriated," the Controller may initiate an audit for two years from the initial date of payment of the claim; but if the claims for a program are being paid (San Mateo calls this a "funded program") the claims are subject to audit no later than two years after the end of the calendar year in which the reimbursement claim is filed. San Mateo contends that "subject to audit" means subject to the completion of an audit, rather than the initiation of an audit, and that the 2002 amendment of section 17558.5, which changed "subject to audit" to "subject to the initiation of an audit," is more than a mere clarifying change, and the claims filed prior to the effective date of the 2002 amendment should not be held to the enlarged standard.[61] San Mateo contends that the relevant periods for which those claims would be *subject to audit* expired December 31, 2003 for the 1999-00 claim, filed January 10, 2001; and December 31, 2004 for the 2000-2001 claim, filed January 10, 2002. Thus, San Mateo reasons that the January 7, 2005 audit report was *completed* outside the period subject to audit.

The Controller argues that San Mateo's conclusion "is based on an erroneous interpretation that attempts to rewrite that section, adding a deadline for completion of the audit where none exists."[62] The Controller argues that section 17558.5 does not require an audit to be completed within two years; "subject to audit," the Controller holds, means subject to *initiation* of an audit. The Controller asserts that the audit in this case was initiated as of the entrance conference conducted on January 2, 2003, "well before the earliest deadline [cited by San Mateo] of December 31, 2003."[63]

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[59] Exhibit A, San Mateo IRC, at pp. 23-24.

[60] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)); Exhibit A, San Mateo IRC, at p. 25.

[61] Exhibit H, Claimants' Comments on Draft Staff Analysis, at pp. 2-4.

[62] Exhibit C, Controller's Comments on San Mateo IRC, at p. 2.

[63] Exhibit C, Controller's Comments on San Mateo IRC, at p. 3.

In addition, the Controller argues that Government Code section 17558.5, *as later amended by Statutes 2002, chapter 1128* (AB 2834), provides the proper statute of limitations, because "[u]nless a statute expressly provides to the contrary, any enlargement of a statute of limitations provision applies to matters pending but not already barred."[64] The Controller reasons that the amendment made by AB 2834 became effective January 1, 2003, and even under San Mateo's interpretation the earliest claim (fiscal year 1999-2000) would not have been barred until December 31, 2003. Therefore, the Controller reasons, the expanded statute of limitations is applicable, providing that a reimbursement claim "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."[65] Therefore, because the 2003 version of section 17558.5 would require an audit to be initiated "not later than" January 10, 2004 (three years after the earlier claim was filed), and the audit in issue was initiated January 2, 2003, the statute of limitations does not bar the audit.

The Commission finds that the audit of community college district claims beginning in 1999-2000 is not barred by the statute of limitations found in Government Code section 17558.5. The audits of reimbursement claims filed January 10, 2001 and January 10, 2002, respectively, were initiated "no later than January 2, 2003, when the entrance conference was held."[66] The only reading of these facts and of section 17558.5 that could bar the audits would be to hold that section 17558.5 requires an audit to be *completed* within two years, in which case the final audit report issued January 7, 2005 would be barred. This is the interpretation urged by San Mateo, but this reading of the code is not supported. Based only upon the plain language of the former section, the reimbursement claims in issue would be "subject to audit" until the end of the calendar year 2003, for a claim filed in January of 2001. However, "[u]nless a statute expressly provides to the contrary, any enlargement of a statute of limitations provision applies to matters pending but not already barred."[67] Therefore, the 2002 statute that enlarged the statute of limitations effective January 1, 2003, would control, and the enlargement of the statute would apply to the subject claims.

Based on the foregoing, the Commission finds that the audit of San Mateo's reimbursement claims is not barred by the statute of limitations.

2. Document retention requirements cited by the Controller are consistent with the parameters and guidelines, and are not dependent on the period subject to audit.

San Mateo asserts, with respect to the disallowance of employee salaries and benefits, discussed below under section D, that "[o]ne of the stated reasons for the disallowance was that claimants must retain source documentation on file 'for a period of no less than three years from the date of the final payment of the claim.'" San Mateo argues that "[n]o legal citation was provided for this assertion."[68]

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[64] Exhibit C, Controller's Comments on San Mateo IRC, at p. 3 [citing *Douglas Aircraft Co. v. Cranston* (1962) 58 Cal.2d 462, at p. 465.].

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

[66] Exhibit C, Controller's Comments on San Mateo IRC, at p. 3.

[67] *Douglas Aircraft Co. v. Cranston* (1962) 58 Cal.2d 462, at p. 465.

[68] Exhibit A, San Mateo IRC, at p. 13.

The Controller counters that document retention was not a stated reason for the disallowance of costs.[69] However, the Controller also points to the parameters and guidelines of the *Health Fee Elimination* mandate, which state:

> For auditing purposes, all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs…*These documents must be kept on file by the agency submitting the claim for a period of no less than three years from the date of the final payment of the claim pursuant to this mandate*, and made available on the request of the State Controller or his agent.

Thus, at the time the subject reimbursement claims were filed, the parameters and guidelines expressly provided for retention of documents to "no less than three years from the date of the final payment of the claim." The three year period is provided in the parameters and guidelines for all of the subject claim years, and is controlling.[70] The parameters and guidelines were adopted in the normal course of Commission hearings, and constitute a final decision of the Commission.[71] San Mateo's assertion that the document retention period "appears to be a ministerial preference of the Controller's" is clearly in error.

Based on the foregoing, the Commission finds that source documents are required to be retained for a minimum of three years after final payment of the claim.

B. Understated Offsetting Revenues in the Reimbursement Claims of Both Districts: *Clovis Unified* and the Health Fee Rule Support a Reduction of Reimbursement to the Extent of Fees Authorized Under Law.

The Controller reduced the reimbursement claims filed by San Mateo by $13,175 for fiscal year 1999-2000, and $57,428 for fiscal year 2001-2002.[72] San Bernardino's reimbursement claims were reduced by $97,642 for fiscal year 2000-2001, and $52,389 for fiscal year 2001-2002.[73] These reductions were made on the basis of the fee authority available to the districts, multiplied by the number of students subject to the fee, less any amount of offsetting revenue already claimed.

Both San Mateo and San Bernardino disputed the Controller's findings that offsetting revenues from student health fees had been understated in the relevant claim years. Both districts argued that the parameters and guidelines only require a claimant to declare offsetting revenues that the claimant "experiences," and that while the fee amount that districts were authorized to impose may have increased for the applicable period, nothing in the Education Code made the increase

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[69] Exhibit C, Controller's Comments on San Mateo IRC, at p. 15.

[70] Exhibit A, San Mateo IRC, at pp. 37-38.

[71] *CSBA v. State of California* (2009) 171 Cal.App.4th 1183, at p. 1201 ["Once the Commission's decisions are final, whether after judicial review or without judicial review, they are binding, just as are judicial decisions."].

[72] Exhibit A, San Mateo IRC, at p. 56.

[73] Exhibit B, San Bernardino IRC, at p. 57.

of those fees mandatory. The claimants argue that the issue is the difference between fees collected and fees collectible.[74]

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

> Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.[75] (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).

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.[76] Both San Mateo and San Bernardino argue that the actual increase of the fee imposed upon students requires action of the community college district governing board,[77] and that "the issue is one of student health fees revenue actually received, rather than student health fees which might be collected."[78] But the *authority* to impose the fee increases without any legislative action by a community college district, or any other entity (state or local), and the

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[74] Exhibit A, San Mateo IRC, at pp. 20-23; Exhibit B, San Bernardino IRC, at pp. 23-27.

[75] *Clovis Unified School Dist. v. Chiang*, *supra*, 188 Cal.App.4th at page 811.

[76] 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.

[77] Exhibit A, San Mateo IRC, at p. 69. See also Exhibit B, San Bernardino IRC, at pp. 25-27.

[78] Exhibit A, San Mateo IRC, at pp. 22-23; Exhibit B, San Bernardino IRC, at pp. 26-27.

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.[79]

The court also notes that, "this basic principle flows from common sense as well. As the Controller succinctly puts it, 'Claimants can choose not to require these fees, but not at the state's expense.'"[80] 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."[81] 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*.[82] (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 the Districts for the *Health Fee Elimination* program is valid. The Commission is bound by the court's decision in *Clovis Unified*, and bound to apply the Health Fee Rule set forth by the court.

In comments submitted on the draft staff analysis, the claimants acknowledge the Health Fee Rule, but maintain that the Controller has misapplied the rule to reach the audit reductions made. The claimants argue: "[t]here is no evidence on the record for this incorrect reduction claim that the Controller has properly applied the Health Fee Rule to either District's annual claims, therefore the Commission's ultimate conclusion that the adjustments here are not arbitrary or lacking in evidentiary support is unfounded." The claimants argue that the application of the Health Fee rule "involves two factual elements: *the number of exempt students and the specific enrollment statistics for each semester*." The determination of exempt students can be found in the plain language of Education Code section 76355, which provides that community college districts are authorized to charge *all students the health service fee, except*: (1) students who depend exclusively upon prayer for healing in accordance with the teachings of a bona fide religious sect, denomination, or organization; (2) students who are attending a community college under an approved apprenticeship training program; and until January 1, 2006, (3) low-income students.[83] With respect to enrollment information, the claimants argue that the Commission's earlier decision on seven consolidated Health Fee Elimination IRCs provided for obtaining enrollment information from the "Community College Chancellor's MIS data." The

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

[80] *Ibid.*

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

[82] *Clovis Unified School Dist. v. Chiang*, *supra*, 188 Cal.App.4th at page 812.

[83] Statutes 2005, chapter 320, repealed the exemption for low-income students from Education Code section 76355.

claimants argue that there is no evidence that the approved data has been utilized in the Controller's audit adjustments.

In its audit of San Mateo, the Controller appears to have utilized the enrollment and exemption figures reported *by the claimant*, and San Mateo has not sought to dispute those figures. The audit report reveals that the District reported the fees *collected*, rather than *collectible*, for 13,175 students in the summer semester of fiscal year 1999-2000, at which time the District was authorized to charge a fee of $8.00 per student, but charged only $7.00 per student. The Controller found that this one dollar discrepancy resulted in an understatement of $13,175. A similar result was found for fiscal year 2001-2002, during which the District was authorized to increase the fee from $8.00 to $9.00 for the summer semester, and from $11.00 to $12.00 for the fall and spring semesters. The Controller found that the one dollar difference between the fees authorized and the fees charged, multiplied by the claimant's reported number of students enrolled and not exempted from the fee for the three semesters, resulted in an understatement of $70,603.[84] Thus, with respect to San Mateo, the record supports a finding that the audit adjustment made was based on enrollment and exemption information reported by the district, and the understatement of fee revenues was exactly one dollar per student per semester.[85]

Based on the foregoing, the Commission finds that the Controller correctly reduced the reimbursement claims of San Mateo to the full extent of student health fees authorized by law.

However, with respect to San Bernardino, the reimbursement claims in the record appear to state only the total amount of fees collected and the number of students charged the fees, in accordance with the District's theory that only fees *collected*, rather than fees *collectible*, should be considered offsetting.[86] San Bernardino interpreted the offsetting revenue that it was required to declare to be limited to fees "experienced," and as a result the Controller's audit report indicates substantially higher enrollment figures than those reported in the District's reimbursement claims.[87] In the audit report, the Controller states that in order to calculate the fees that should have been charged (i.e., the *full extent* of San Bernardino's "fee authority" under law), "enrollment information was obtained from the term unit report, and the student waiver information was obtained from the Board of Governors Grant (BOGG) report."[88] The claimant has not alleged specifically how the Controller's fee calculation is incorrect, or whether information from "the term unit report" is different from "specific enrollment statistics for each semester," but it is not clear from the record that the Controller has considered all exempt students in making its calculation of the fees authorized. The BOGG report, pursuant to Code of Regulations, title 5, sections 58611 and 58620, contains data on low-income students who qualify for a fee waiver to attend a community college.[89] The report is not required to contain

[84] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 148-149.

[85] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 148-149.

[86] Exhibit B, San Bernardino IRC, at pp. 77-78.

[87] Exhibit B, San Bernardino IRC, at p. 26. Compare Exhibit D, SCO Comments on San Bernardino IRC, pp. 165-166 with Exhibit D, p. 145.

[88] Exhibit D, Controller's Comments on San Bernardino IRC, at p. 145.

[89] Code of Regulations, title 5, sections 58611; 58620.

data on students attending an apprenticeship training program or students who depend on prayer for healing, which are exempt categories under section 76355.[90] Because the exemption from the health fee applies also to these students, the BOGG report is not sufficient in itself to establish the number of students exempt from the fee pursuant to the plain language of the test claim statute.

In the earlier decision on seven consolidated Health Fee Elimination IRCs, the Commission found that the "Community College Chancellor's MIS data" was a "reasonable and reliable source" for enrollment data, and use of such data was not arbitrary or capricious.[91] The claimant here points out that more recent audits have used "enrollment data from the CCCCO."[92] However, the Commission did not determine that the MIS data was the *only* reasonable and reliable source for the data, and the "term unit report" may be equally reasonable. What is certain, however, is that *Clovis Unified, supra*, permits the Controller to adjust reimbursement to the full extent of fee authority provided under law; here, the adjustment based on enrollment less only those exemptions reported in the BOGG report may have exceeded the fee authority provided under section 76355.

Based on the record, the Commission finds that the Controller's reduction of costs for San Bernardino does not demonstrate that *all exempt students* have been excluded from the fee calculation. Therefore, the Commission remands the issue with respect to San Bernardino's reimbursement claims to the Controller, with instructions to reexamine the health fees authorized based on the total number of *enrolled students less those exempt from the fee*. If the District is unable to assist the Controller and provide documentation of the number of exempt students for whom fees cannot legally be charged, the Controller may apply the Health Fee Rule using any reasonable source available to obtain enrollment and exemption information.

C. Application of an Indirect Cost Rate Proposal in the Reimbursement Claims of Both Districts

The Controller reduced indirect costs claimed by San Mateo by $30,417 for fiscal year 1999-2000, $32,728 for fiscal year 2000-2001, and $49,098 for fiscal year 2001-2002, on grounds that the indirect cost rate was applied to direct costs beyond the scope of the distribution base employed to develop the rate.[93] The Controller also reduced the indirect costs claimed by San Bernardino by $122,795 for fiscal year 2001-2002, and $158,699 for fiscal year 2002-2003, on grounds that San Bernardino did not utilize a federally approved indirect cost rate.[94]

The districts dispute the Controller's findings that the indirect cost rate proposal was incorrectly applied, and was required to be federally approved, charging that the Controller's conclusions were without basis in the law.

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[90] *Ibid*. See also Education Code section 76355.

[91] Statement of Decision, Health Fee Elimination, 09-4206-I-19, at p. 35.

[92] Exhibit H, Claimants' Comments on Draft Staff Analysis, at p. 6.

[93] Exhibit A, San Mateo IRC, at p. 55.

[94] Exhibit B, San Bernardino IRC, at p. 56.

1. *The parameters and guidelines expressly reference the Controller's claiming instructions, which in turn provide for an indirect cost rate to be developed in accordance with federal OMB guidelines.*

Both districts argue that claimants are not required to adhere to the claiming instructions.[95] The parameters and guidelines plainly state that "indirect costs *may be claimed in the manner described by the State Controller*." The districts argue that the word "may" is permissive, and that therefore the parameters and guidelines do not require that indirect costs be claimed in the manner described by the Controller.[96] In addition, San Bernardino argues that "[n]either state law nor the parameters and guidelines made compliance with the Controller's claiming instructions a condition of reimbursement."[97] The districts' argument is unsound: 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 Controller's claiming instructions. This interpretation is urged by the Controller.[98]

The claiming instructions specific to the *Health Fee Elimination* mandate, included in the submissions of both claimants and of the Controller,[99] do not discuss specific rules or guidelines for claiming indirect costs with respect to this mandate. However, the School Mandated Cost Manual[100] provides *general instructions* for school districts and community college districts seeking to claim indirect costs, and those instructions provide guidance to claimants for *all mandates*, absent specific provision 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, available on the Controller's web site.[101] The Mandated Cost Manual contains general instructions for claiming under all mandates, with the suggestion that claimants refer to the parameters and guidelines and specific claiming instructions, as follows:

> *This manual is issued to assist claimants in preparing mandated cost claims for submission to the State Controller's Office (SCO). The information contained in this manual is based on the State of California's statutes, regulations, and the parameters and guidelines (P's & G's) adopted by the Commission on State*

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[95] Exhibit A, San Mateo IRC, at pp. 16-17; Exhibit B, San Bernardino IRC, at pp. 21-22.

[96] See Exhibit A, San Mateo IRC, at pp. 16-17; Exhibit B, San Bernardino IRC, at pp. 21-22.

[97] Exhibit B, San Bernardino IRC, at p. 22.

[98] See, e.g., Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 20-21.

[99] Exhibit A, San Mateo IRC, at pp. 40-42; Exhibit B, San Bernardino IRC, at pp. 40-42; Exhibit C, Controller's Comments on San Mateo IRC, at pp. 35-46; Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 34-45.

[100] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 30-33; Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 29-32.

[101] See, e.g., Exhibit X, Community College Mandated Cost Manual General Instructions Revised 09/03

> *Mandates (CSM). Since each mandate is unique, it is imperative that claimants refer to the claiming instructions and P's & G's of each program for updated data on established policies, procedures, eligible reimbursable activities, and revised forms.*[102]

The Controller submitted copies of the Mandated Cost Manual addressing indirect cost rates, revised September 2002, in response to both IRCs.[103] The Controller also submitted an excerpt of the School Mandated Cost Manual revised September 1997, which contained the program-specific instructions for the *Health Fee Elimination* Mandate.[104] This last submission suggests that all community college claiming instructions were, at or near the relevant time period, published in the School Mandated Cost Manual. Therefore, 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. San Bernardino's assertion that "[n]either State law or the parameters and guidelines made compliance with the Controller's claiming instructions a condition of reimbursement" is therefore clearly in error.[105]

Both districts also argue that because the claiming instructions "were never adopted as law, or regulations pursuant to the Administrative Procedure Act, the claiming instructions are merely a statement of the ministerial interests of the Controller and not law."[106] In *Clovis Unified*, discussed above, 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.[107] Here, the districts imply 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. The Commission's parameters and guidelines are a final, binding document,[108] and provide notice of the options for claiming indirect costs, pursuant to duly issued claiming instructions, which are general and apply to all programs. Moreover, the Commission is not the venue in which to challenge the Controller's claiming instructions on the ground that those instructions may constitute an underground regulation. Until the courts declare otherwise, the Commission will presume that, where reasonable and consistent with the parameters and guidelines, the Controller's claiming instructions are valid and enforceable.

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[102] Exhibit X, Community College Mandated Cost Manual Foreword, Revised 07/12.

[103] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 30-33; Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 29-32.

[104] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 35-46; Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 34-45.

[105] Exhibit B, San Bernardino IRC, at p. 22.

[106] See, e.g., Exhibit A, San Mateo IRC, at p. 16.

[107] *Clovis Unified*, *supra*, 188 Cal.App.4th, at p. 807.

[108] *CSBA v. State*, *supra*, 171 Cal.App.4th 1183, at p. 1201.

Based on the foregoing, the Commission finds that the parameters and guidelines expressly reference the claiming instructions, which clearly provide one of two options for indirect cost rates is to be developed in accordance with OMB guidelines, including seeking federal approval.

2. San Mateo did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rate, and the Controller's reduction was not arbitrary, capricious, or entirely lacking in evidentiary support.

In its audit of San Mateo's reimbursement claims for the period of July 1, 1999 through June 30, 2002, the Controller concluded that San Mateo "improperly applied its claimed indirect cost rate to costs beyond those approved by the U.S. Department of Health and Human Services." The Controller concluded that the indirect cost rate was *developed* using "a base consisting of 'Direct Salaries and Wages including all fringe benefits,'" but improperly applied, the Controller asserts, to "direct services and supplies, other operating expenses, and capital outlay costs.[109] The Controller asserted that "*if the district wishes to apply its indirect cost rate to a distribution base other than salaries and wages*, the district's approved A-21 rate must be based on modified total direct costs."[110]

San Mateo counters that federal approval of an indirect cost rate proposal is merely a "ministerial preference," and not based on any requirement in law.[111] San Mateo asserts that the Controller accepted its 30 percent indirect cost rate but "did not accept application of the rate to costs other than salary and benefits because the rate was calculated using only salary and benefit costs."[112] San Mateo asserts that "no accounting rationale or legal basis"[113] supports the Controller's reduction. San Mateo further argues that "cost accounting principles allow indirect cost rates to be established based on a variety of bases…without regard for the scope of the distribution base except that the source of the rate has to be representative of the 'distribution base.'"[114] In other words, the District argues that an indirect cost rate does not necessarily have to be developed on the basis of the same direct costs to which it will be applied, as long as the basis is "representative of" the direct costs to which it will be applied.

The Controller counters, in comments on the IRC, that "during the audit period, the district improperly applied its indirect cost rate to direct services and supplies, other operating expenses, and capital outlay costs." The Controller argues that the 30% rate was developed and approved on a distribution base of salaries and wages including fringe benefits, but "the auditor determined that the district (in determining applicable mandate indirect costs) did not apply the rate to the same base that was used in developing the rate, i.e., salaries and wages including all fringe benefits." Finally, the Controller argues that "regardless of which methodology the district uses to claim indirect costs in its mandate reimbursement claim, the district must bear the responsibility to calculate the indirect cost rate accurately and apply the rate properly based upon

[109] Exhibit A, San Mateo IRC, at pp. 54-55.

[110] Exhibit A, San Mateo IRC, at p. 56.

[111] Exhibit A, San Mateo IRC, at p. 16.

[112] Exhibit A, San Mateo IRC, at pp. 14-15.

[113] Exhibit A, San Mateo IRC, at pp. 15-16.

[114] Exhibit A, San Mateo IRC, at pp. 16-17.

the criteria it used to create the rate" and "the district applied its indirect cost rate to costs beyond those that were included in the distribution base."[115] The Commission finds, as discussed below, that the Controller's interpretation is consistent with the OMB guidelines, and that San Mateo failed to apply its approved indirect cost rate properly.

The claiming instructions referenced in the parameters and guidelines reveal that while federal approval of an indirect cost rate is not strictly required, it is one of two options for developing an indirect cost rate. The claiming instructions provide, in pertinent part:

> A college has the option of using a federally approved rate, utilizing the cost accounting principles from Office of Management and Budget Circular A-21 "Cost Principles for Educational Institutions," or the Controller's methodology outlined in the following paragraphs. If the federal rate is used, it must be from the same fiscal year in which the costs were incurred.[116]

The plain language of the above-cited paragraph provides that either a district can use a federally approved rate, incorporating the accounting principles of the OMB Circular A-21; or, the district can use the alternative state procedure.[117] The OMB Circular A-21, an excerpt of which the Controller submitted along with its comments on San Mateo's IRC, provides two options for the development of an indirect cost rate for facilities and administrative costs (referred to as F&A in the text). The first option is a simplified rate based on "salaries and wages," and the second is labeled a "modified total direct cost base." The 30% rate employed by the claimant is developed using a salaries and wages cost base.[118] The Controller explains, in comments on the draft staff analysis,[119] that a salaries and wages base rate developed in accordance with the steps described is to be applied "to direct salaries and wages for individual agreements to determine the amount of F&A costs allocable to such agreements."[120] The rate is calculated using *all* "facilities and administrative" costs (F&A), divided by salaries and wages, including fringe benefits, attributable to the programs or contracts.[121] Then the rate is negotiated and approved by DHHS, and can be applied in future years to the salaries and benefits attributable to a other programs, which will yield an indirect cost allocation appropriate to that program covering *all indirect costs*, not just the indirect costs related to salaries and benefits.

Here, the claimant has an approved rate of 30%, developed using a distribution base *only* of salaries and benefits. That approved rate cannot properly be applied more broadly than the direct cost distribution base used to develop it. Application of the approved rate *only* to salaries and benefits of other programs or subsequent years is intended to provide a calculation of indirect

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[115] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 18; 20-21.

[116] Exhibit C, Controller's Comments on San Mateo IRC, at p. 30.

[117] Exhibit C, Controller's Comments on San Mateo IRC, at p. 31.

[118] Exhibit I, Controller's Comments on Draft Staff Analysis, at p. 58.

[119] Exhibit I, Controller's Comments on Draft Staff Analysis, at pp. 2-3; 16-17.

[120] Exhibit C, Controller's Comments on San Mateo IRC, at p. 59.

[121] Exhibit C, Controller's Comments on San Mateo IRC, at p. 59.

costs for the *entire mandated program*.[122] In its audit of San Mateo's claim, the Controller reduced indirect costs claimed by a total of $112,243 for the three audit years, finding that the district "improperly applied the indirect cost rate to direct services and supplies, other operating expenses, and capital outlay costs."[123] As discussed above, San Mateo was required, if it chose to utilize a federally approved rate, to apply that rate consistently with the manner in which the rate was developed, and San Mateo did not do so. Consequently, a reduction in reimbursement was called for.

Based on the foregoing, the Commission finds that San Mateo's application of the indirect cost rate to direct costs *other than salaries and wages* was inconsistent with the parameters and guidelines and the claiming instructions, and yielded a total indirect cost calculation significantly higher than permitted. The federally approved rate that the District chose to use (30%) was calculated to reimburse for all indirect costs on the basis of direct salaries and benefits, and should have been applied only to direct salaries and benefits in order to yield an indirect cost calculation for the entire mandated program. Therefore, the Commission finds that the Controller's reduction of indirect costs was not arbitrary, capricious, or without evidentiary support.

3. *San Bernardino did not comply with the requirements of the claiming instructions in developing and applying its indirect cost rates, and therefore an adjustment to indirect costs claimed was not arbitrary, capricious, or entirely lacking in evidentiary support.*

In the audit of San Bernardino's reimbursement claims for the period of July 1, 2001 through June 30, 2003, the Controller concluded that the district's claimed indirect costs were based on a rate not federally approved, and that the costs were highly disproportionate to the Controller's calculations. San Bernardino claimed indirect costs of $210,961 for fiscal year 2001-2002, against direct costs of $467,227; and $249,766 for fiscal year 2002-2003, against direct costs of $522,176.[124] Those claimed costs represent indirect costs at a rate of approximately 45 percent for 2001-2002 and 48 percent for 2002-2003. The Controller reduced the claimed indirect costs to $88,166 (an 18.87% rate) for fiscal year 2001-2002 and $91,067 (a 17.44% rate) for fiscal year 2002-2003.[125]

The Controller maintains that the claiming instructions required the district to use either a federally approved rate "prepared in accordance with OMB Circular A-21, or the SCO's alternate methodology using Form FAM-29C."[126] The Controller argues that the district claimed

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[122] Exhibit I, Controller's Comments on Draft Staff Analysis, at p. 58 [In the draft staff analysis, staff misunderstood the correct application of a salaries and benefits indirect cost rate, and incorrectly concluded that the Controller had improperly reduced indirect costs for other items to zero. The Controller's comments clarified that an indirect cost rate developed on the basis of salaries and benefits is only intended to be applied to salaries and benefits, and that it does account for *all* indirect costs when properly applied.]

[123] Exhibit C, Controller's Comments on San Mateo IRC, at p. 18.

[124] Exhibit B, San Bernardino IRC, at p. 56.

[125] *Ibid.*

[126] Exhibit B, San Bernardino IRC, at pp. 55-56.

its indirect costs "based on an indirect cost rate proposal (ICRP) prepared for each fiscal year by an outside consultant using OMB Circular simplified indirect cost rate methodology." The Controller continues: "However, the district did not obtain federal approval for its rate." The Controller calculated indirect cost rates using the alternative method allowed by the claiming instructions, and found that "the calculated indirect cost rates did not support the indirect cost rates claimed."[127]

San Bernardino counters that "there is no requirement in law that the claimant's indirect cost rate must be 'federally' approved," and that "[n]o particular indirect cost rate calculation is required by law." San Bernardino argues that the Controller's claiming instructions "were never adopted as law, or regulations pursuant to the Administrative Procedure Act," and are therefore "merely a statement of the ministerial interests of the Controller and not law."[128] San Bernardino stands on its assertion that there is no requirement that a rate be federally approved, arguing that "the District has computed its ICRPs utilizing cost accounting principles from the Office of Management and Budget Circular A-21, and the Controller has disallowed it without a determination of whether the product of the District's calculation would, or would not, be excessive, unreasonable, or inconsistent with cost accounting principles."[129] In addition, San Bernardino asserts that "[n]either the Commission nor the Controller has ever specified the federal agencies which have the authority to approve indirect cost rates."[130]

As discussed above, the Commission's duly adopted parameters and guidelines require compliance with the Controller's claiming instructions, and the claiming instructions are presumed to be valid and enforceable. Those claiming instructions reveal that while federal approval of an indirect cost rate is not strictly required, it is an element of one of two options for developing an indirect cost rate. There is no third option in the claiming instructions to develop an indirect cost rate in accordance with the OMB Circular without seeking federal approval. Furthermore, the OMB Circular A-21, which San Bernardino claims to have followed, states that "[c]ost negotiation cognizance is assigned to the Department of Health and Human Services…[or the Department of Defense, depending on which provides more funding to the educational agency]…In cases where neither HHS or DOD provides Federal funding to an educational institution, the cognizant agency assignment *shall default to HHS*."[131] Therefore, while the Commission and the Controller may not have directly identified the responsible agency, the OMB guidelines explicitly direct claimants to HHS for approval of their federally recognized rates.

Based on the foregoing, San Bernardino's application of an indirect cost rate prepared without federal approval was inconsistent with the parameters and guidelines and the claiming instructions, and therefore an adjustment to indirect costs claimed was not arbitrary, capricious, or entirely lacking in evidentiary support.

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[127] Exhibit B, San Bernardino IRC, at p. 55.

[128] Exhibit B, San Bernardino IRC, at pp. 20-21.

[129] Exhibit B, San Bernardino IRC, at p. 22.

[130] Exhibit B, San Bernardino IRC, at p. 20.

[131] Exhibit C, Controller's Comments on San Mateo IRC, at p. 59 [emphasis added].

4. The Controller's decision to apply the alternative method described in the claiming instructions to San Bernardino's reimbursement claim was not arbitrary, capricious, or entirely lacking in evidentiary support.

In its audit of San Bernardino's reimbursement claim, the Controller, concluding that the rate was not approved and therefore not supported consistently with the parameters and guidelines and the claiming instructions, recalculated the indirect cost rate using the alternative state procedure, the "FAM-29C method," outlined in the School Mandated Cost Manual.[132] San Bernardino asserts that the difference between its claimed rate and the audited rate is "the determination of which of those cost elements are direct costs and which are indirect costs." San Bernardino continues, "[i]ndeed, federally 'approved' rates which the Controller will accept without further action, are 'negotiated' rates calculated by the district and submitted for approval, 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."[133] San Bernardino 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." San Bernardino 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."[134]

San Bernardino argues that this substitution of methods was arbitrary. But, based on the above analysis, San Bernardino failed to comply with the requirements of the claiming instructions with respect to the OMB method of calculating indirect cost rates. San Bernardino does not assert that the rate calculated was arbitrary; only that it was arbitrary to substitute the state method outlined in the claiming instructions for the claimant's preferred but incorrectly executed method.

However, in comments submitted on the draft staff analysis, the claimant acknowledges that "the Controller staff have readily available from the Community College Chancellor's Office sufficient information (the CCFS-311) to calculate any district's indirect cost rates using the Controller's FAM 29-C method." Therefore, given that the claimant concedes that "the Controller staff have readily available" the information sufficient to calculate indirect costs using the FAM 29-C method provided in the claiming instructions, and the claimant has made no effort to introduce a federally approved rate under the OMB guidelines, the Controller's decision to substitute the state method is not unreasonable.

Finally, San Bernardino concedes that the difference between the claimed and audited methods turns on what costs are considered direct or indirect, and that "the process is not an exact science." The Commission does not have evidence in the record suggesting a finding that the Controller's reductions to San Bernardino's claim were unreasonable; the determination of which costs are direct and which are indirect is not sufficiently explained in the record, nor are any specific delineations made. If the claimant wishes to have the Commission reinstate costs

[132] See Exhibit D, Controller's Comments on San Bernardino IRC, at p. 29.

[133] Exhibit B, San Bernardino IRC, at p. 21.

[134] Exhibit B, San Bernardino IRC, at p. 22.

adjusted by the Controller, the claimant must carry the burden of establishing what adjustments were unreasonable and why.[135]

Based on the foregoing, the Commission finds that the Controller's reduction was based on an alternative method authorized by the claiming instructions for calculating indirect costs, and is therefore not arbitrary, capricious, or entirely lacking in evidentiary support.

D. Disallowance of Salaries and Application of Audited Benefit Rates for San Mateo's Reimbursement Claims.

The Controller reduced the reimbursement claims filed by San Mateo for salaries and benefits by $281,607 for fiscal year 1999-2000, $246,609 for fiscal year 2000-2001, and $264,949 for fiscal year 2001-2002, on grounds that "the district did not provide documentation supporting the validity of the distribution made to the mandate."[136]

San Mateo disputes the Controller's disallowance of certain employee salaries and the application of an "audited" benefit rate to the remaining employees, based on the Controller's conclusion that San Mateo did not adequately support the claimed costs.

1. The Controller's audit adjustment was not arbitrary, capricious, or entirely lacking in evidentiary support.

San Mateo argues that the Controller is attempting to enforce an auditing standard, with respect to the documentation required, that is not consistent with the parameters and guidelines.[137] The Controller does not specifically describe an auditing standard, but states that "the district did not provide documentation supporting the validity of the distribution made to the mandate."[138] The Controller also notes the absence of "time logs, time studies, or other corroborating documentation" supporting the claimed salaries and benefits.[139]

The parameters and guidelines in effect for the Health Fee Elimination mandate provide that in order to claim employee salaries and benefits, a claimant must demonstrate the following:

> Identify the employee(s), show the classifications of the employee(s) involved, describe the mandated functions performed and specify the actual number of hours devoted to each function, the productive hourly rate, and the related

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[135] Government Code 17558.7 ["If the Controller reduces a claim approved by the commission, the claimant may file with the commission an incorrect reduction claim pursuant to regulations adopted by the commission."]; Code of Regulations, title 2, section 1185 [An incorrect reduction claim shall contain: "(2) A written detailed narrative that describes the alleged incorrect reduction(s). The narrative shall include a comprehensive description of the reduced or disallowed area(s) of cost(s). ¶ (3) If the narrative describing the alleged incorrect reduction(s) involves more than discussion of statutes or regulations or legal argument and utilizes assertions or representations of fact, such assertions or representations shall be supported by testimonial or documentary evidence and shall be submitted with the claim."].

[136] Exhibit A, San Mateo IRC, at p. 52.

[137] Exhibit A, San Mateo IRC, at p. 12.

[138] Exhibit C, Controller's Comments on San Mateo IRC, at p. 14.

[139] *Ibid.*

benefits. The average number of hours devoted to each function may be claimed if supported by a documented time study.[140]

In its reimbursement claims for fiscal years 1999-2000, 2000-2001, and 2001-2002, San Mateo stated its salary and benefit costs for the mandate, certified under penalty of perjury, on the Controller's claim forms.[141] The claim forms submitted to the Commission along with San Mateo's IRC showed only the *total* salaries and benefits for the audit years,[142] but the district asserts that "salary and benefits were reported in the District general ledger in the normal course of financial accounting," and that it "has also provided employee names, positions (job titles), hours worked, salary and benefit amounts, and a description of the tasks performed as they relate to this mandate, and in some cases declarations."[143] In addition, the Controller's comments filed on the IRC included worksheets and schedules that show disallowed salaries and benefits identified by employee and classification, suggesting that somewhat more detailed information was submitted to the Controller prior to the final audit.[144] The Controller's comments on the IRC also included emails between the district's chief financial officer and the Controller's audit manager discussing the accounts from which the disputed employees were paid and their job descriptions.[145]

The Controller's audit report provides the totals of salaries and benefits disallowed,[146] and the "schedule of allowable salaries and benefits" submitted in the Controller's comments on the IRC identifies employees whose time spent on mandated activities was not verified to the satisfaction of the Controller.[147] In emails exchanged between the district and the Controller's audit manager, the Controller asked for more information regarding certain employees whose activities were not clearly attributable to the mandate, while salaries for persons identified as nurses and doctors, for example, were allowed without question.[148] In response to these emails, San Mateo submitted additional documentation and explanation to the Controller showing that the district omitted from its reimbursement claim certain costs charged to accounts outside the health services department. For example, a letter to the Controller explains that "[f]or Ernest Rodriguez, in March 2002, he took on a teacher assignment which is reflected in the account code… 201000. This was not charged to the claim."[149] Similarly, the letter shows that Dee Howard, who is identified as "Full-time Faculty" in the Controller's schedules,[150] worked as

[140] Exhibit A, Test Claim, at p. 37.

[141] Exhibit A, San Mateo IRC, at pp. 75; 89; 90; 104; 105; 119.

[142] Exhibit A, San Mateo IRC, at pp. 89; 104; 119.

[143] Exhibit A, San Mateo IRC, at p. 13.

[144] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 52-54.

[145] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 48-50.

[146] Exhibit A, San Mateo IRC, at p. 52.

[147] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 52-54.

[148] Costs were allowed for persons named as nurses without question.

[149] Exhibit E, San Mateo Rebuttal Comments, at pp. 23-25.

[150] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 52-54.

a counselor in departments other than "Health Services," and therefore only the portion of her wages attributed to the health services account was claimed.[151] Similarly, the letter states that Gloria D'Ambra, identified as an office assistant, earned overtime pay in fiscal year 1999-2000, which was not charged to the claim.[152] Additional documentation was submitted along with this letter, including employee earnings reports for several persons, detailing the accounts from which employees were paid, and the portions of total salary attributable to each account.

Ultimately the Controller accepted this type of documentation for some employees, including "$5762 of salary expense for Donna Elliot," which San Mateo had explained was incorrectly charged to account 543000, instead of 643000. The Controller also allowed the costs for Gloria D'Ambra based on the amounts reported as non-overtime wages charged to account code 643000; overtime wages charged to account code 649001 were not claimed, and the Controller accepted the omission of those amounts from the claim.[153] The Controller therefore accepted the earnings reports and other documentation to support the validity of salaries claimed for two persons identified as "office assistant." But for Dee Howard and Ernest Rodriguez, each of whom had a portion of their salary charged to "code 643000," the Controller ultimately disallowed salaries "in the absence of time records supporting the hours worked performing mandate activities at the Health Center."[154]

The Controller maintains that "the audit determined that the claimant was unable to support that salary costs claimed for several employees were directly attributable to the mandate." The Controller asserts that the district provided information regarding salaries, but "no documentation supporting the validity of the distribution of those costs to the performance of mandated activities."[155] San Mateo argues that its August 31, 2004 letter to the Controller's audit manager, issued prior to the final audit report, "clearly distinguishes between claimed costs, which relate to the mandate, and those costs that were not claimed and did not relate to the mandate."[156]

The documents in the record pertaining to this IRC do not show "the actual number of hours devoted to each [mandated] function," as required by the parameters and guidelines., but the Controller has apparently allowed salary and benefit costs for some employees on the basis of job titles,[157] and in some cases on the basis of earnings reports that show an employee's salary paid from an account recognized to be related to the provision of health services.[158] In the case

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[151] Exhibit E, San Mateo Rebuttal Comments, at pp. 23-25.

[152] Exhibit E, San Mateo Rebuttal Comments, at pp. 27-30.

[153] Account code 643000 appears, in context, to be accepted by the Controller as related to the health services department.

[154] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 48-49.

[155] Exhibit C, Controller's Comments on San Mateo IRC, at p. 2.

[156] Exhibit E, San Mateo Rebuttal Comments, at pp. 5; 23-24.

[157] See Exhibit C, Controller's Comments on San Mateo IRC, at pp. 52-54 [allowable salaries for nurses and doctors].

[158] See Exhibit C, Controller's Comments on San Mateo IRC, at pp. 48-50 [allowable salaries for and office assistants, apparently on the basis of employee earnings reports].

of those employees, the Controller did not insist on hours worked toward the mandate, even for the non-overtime wages paid to Gloria D'Ambra, a health services center office assistant. In contrast, and without any explanation of its differential treatment, the Controller disallowed salary and benefit costs for employees that San Mateo (under penalty of perjury) claimed worked at least a portion of their salaried time for the health services department. The Controller made this disallowance citing an absence of employee time records supporting the hours worked performing mandated activities. Although the documents in the record do not substantiate actual hours performing mandated activities for Dee Howard and Ernest Rodriguez, the same type of documents were accepted by the Controller to substantiate omitting from the reimbursement claim overtime hours worked by Gloria D'Ambra; and the same documents were accepted by the Controller as evidence that D'Ambra and Donna Elliot, identified as office assistants, were both engaged in mandate-related activities at the health services department. In other words, if the account codes to which the salaries of D'Ambra and Elliot were charged are sufficient to substantiate costs for their salaries, disallowing costs for Howard and Rodriguez on the basis of the same documentation is potentially inconsistent.

In comments submitted on the draft staff analysis, the claimant concurs with the above discussion, and maintains that the inconsistent application of evidence warrants reinstatement of costs.[159] However, the Controller, in its comments, disputes the above analysis. The Controller submits 45 pages of additional documentation regarding salaries and benefits allowed and disallowed, some of which has been submitted previously, and argues that "[w]e considered and accepted the additional supporting documentation for certain employees of the district in lieu of timesheets or other records supporting hours charged for Health Fee Elimination activities."[160] Nevertheless, Controller's audit staff determined that the job description "full time faculty" was inconsistent with the mandate and "indicated that they [Howard and Rodriguez] were primarily instructors." Therefore, because "the district did not provide any additional information for us to consider other than the employee earnings reports and a statement in the letter dated August 31, 2004…indicating that these two employees were Counselors in one of the district's Health Centers," the Controller concluded that "the documentation provided supported only that salary and benefit costs…came out of the budget for Health Services," and the "costs claimed were unsupported and unallowable."[161]

However, the Controller appears to rely largely on the title "full-time faculty" to justify its audit adjustment, despite protestations that "additional supporting documentation for certain employees" was considered.[162] In the comments on the draft staff analysis, the Controller states that "additional documentation provided for district employee Arlene Wiltberger indicated that she was *regularly assigned as a faculty member* for the district (Tab 8, page 15); however, it also supported the extent to which she worked as a Counselor in the College of San Mateo's Health Center."[163] The Controller describes this additional documentation as including "Personnel

[159] Exhibit H, Claimants' Comments on Draft Staff Analysis, at p. 12.

[160] Exhibit I, Controller's Comments on Draft Staff Analysis, at pp. 18; 64-108.

[161] Exhibit I, Controller's Comments on Draft Staff Analysis, at p. 19.

[162] Exhibit I, Controller's Comments on Draft Staff Analysis, at p. 72 ["Does not appear OK because of job description."].

[163] Exhibit I, Controller's Comments on Draft Staff Analysis, at p. 18.

Action Forms, Academic/Administrative Salary Orders, and an Approval of Personnel Actions Form."[164] The record does not contain such documentation for Dee Howard and Ernest Rodriguez, but as discussed above, employee earnings reports indicate that these employees were faculty tasked to Counseling activities in the Health Center as well. In addition, the letter referenced by the Controller "dated August 31, 2004, from Kathy Blackwood, Chief Fiscal Officer," indicated that these two employees were Counselors.[165]

The Commission has no reason to presume the employee earnings records and other documentation in the record are inaccurate or unreliable with respect to the distribution of hours, and the District represented to the Controller's audit staff that the two employees in question were assigned to work in the Health Center as counselors during the audit years. Moreover, the disqualification of Ernest Rodriguez and Dee Howard on the basis of being labeled "full time faculty" is not meaningfully distinguished from the acceptance of a letter stating that Arlene Wiltberger was "*regularly assigned as a faculty member* for the district (Tab 8, page 15),"[166] but also assigned to the Health Center. All of the information and documents were submitted as supporting documentation for San Mateo's reimbursement claim, filed under penalty of perjury.

However, 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. Thus, with respect to this issue, the Commission's review is limited to determining whether the Controller's audit decision was arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency, in the case of an adjudicatory decision for which the agency is not required to hold an evidentiary hearing.[167] 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.]' "[168]

Thus, with respect to the Controller's authority and responsibility over state audits, the Commission exercises "very limited review 'out of deference to…the legislative delegation of

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[164] *Ibid.*

[165] Exhibit I, Controller's Comments on Draft Staff Analysis, at pp. 19; 101-102.

[166] Exhibit I, Controller's Comments on Draft Staff Analysis, at p. 18.

[167] *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.

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

administrative authority of the agency, and to the presumed expertise of the agency within its scope of authority.'"[169] The Commission "may not reweigh the evidence or substitute it's judgment for that of" the Controller[170]. 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.[171]

Here, the Controller has explained that the evidence available to substantiate costs was sufficient for some employees, but not for others. The Controller has detailed its efforts to work with the claimant, and its acceptance of less-thorough documentation than that required by the plain language of the parameters and guidelines.

Based on the foregoing, the Commission finds that the Controller's disallowance of salaries and benefits for Dee Howard and Ernest Rodriguez was not arbitrary, capricious, or entirely lacking in evidentiary support, and the audit adjustment is correct.

2. There is no evidence in the record to support the benefits claimed by San Mateo and, thus, the Controller's audited benefit rate is not arbitrary, capricious, or entirely lacking in evidentiary support.

San Mateo disputes the application of an "audited" benefit rate. San Mateo asserts that "[t]he Controller calculated a benefit rate to be applied to the salaries to determine the total allowable salary and employee benefits for each employee." The resulting rates were between 16.62719 percent and 17.66762 percent for the three years subject to audit. San Mateo objects to this calculation, arguing that "[t]he Controller has not indicated why it was necessary to calculate an average benefit rate when the District reported actual benefit costs in its general ledger, that is, why an average rate is better than actual benefit costs." San Mateo also asserts that the claiming instructions provide for a "default" benefit rate of 21 percent, which can be added to hourly payroll costs.[172]

The Controller maintains that the 21 percent rate asserted by the district applies to the *Collective Bargaining* program, and is not applicable to these claiming instructions.[173] Accordingly, the claiming instructions submitted to the Commission by both parties contain no default benefit rate applicable to this mandate.[174]

The Controller also argues that the district disputes the audited rate "but fails to provide any alternative." The Controller maintains that San Mateo "failed to provide any documentation supporting actual benefit amounts paid to each employee, so the auditor calculated a benefit rate by dividing total benefits claimed by total salaries claimed."[175] San Mateo makes reference to its

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[169] *Shapell Industries, Inc. v. Governing Board* (1991) 1 Cal.App.4th 218, at p. 230.

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

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

[172] Exhibit A, San Mateo IRC, at p. 12.

[173] Exhibit C, Controller's Comments on San Mateo IRC, at p. 14.

[174] See Exhibit A, San Mateo IRC, at pp. 40-42; Exhibit C, Controller's Comments on San Mateo IRC, at pp. 35-37.

[175] Exhibit C, Controller's Comments on San Mateo IRC, at p. 2.

"general ledger," but no such document is found in the record, and the existence of "actual benefit costs," assertedly provided to the Controller, cannot be verified.[176]

There is no evidence in the record of actual benefit amounts paid to each employee, only the benefit totals included in San Mateo's worksheets.[177] The only benefit amounts in the record are the audited benefit amounts in the Controller's "schedule of allowable salaries and benefits."[178] Absent any documentation substantiating the benefit amounts claimed, the Controller's reductions cannot be evaluated; however, neither can the district's claims be supported.

Based on the foregoing, the Controller's audited benefit rate is not arbitrary, capricious, or entirely lacking in evidentiary support. In comments submitted on the draft staff analysis the claimant concedes this issue.[179]

E. Disallowance of Other Outgoing Expenses Claimed by San Mateo: Controller's Reduction was not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

In its audit of San Mateo's reimbursement claims the Controller identified unallowable costs for "other outgoing expenses" for fiscal year 2001-2002, in the amount of $41,375, "recorded on three separate journal transactions." The Controller found that these transactions were not supported by documentation, "e.g., in invoices or other source documentation." The district did not respond to that finding prior to issuance of the final audit report.[180]

San Mateo disputes the disallowance of "other outgoing expense costs," and challenges the Controller to explain what is meant by these terms. San Mateo argues that "the Controller should provide the derivation of "outgoing expense costs," which is not described in generally accepted accounting principles." The district argues that "there is no documentation standard for which the district was on notice that requires journal voucher transactions to comply with any documentation standard other than the financial reporting standards mandated by the state for community colleges."[181]

The Controller counters that "expenses" and "costs" are synonymous, and that the district "makes no mention whatsoever as to the factual nature of the finding nor does it offer any documentation that supports the three journal voucher entries."[182] In rebuttal comments, San Mateo maintains that the Controller "does not state why these costs are not mandate-related, excessive, or unreasonable."[183]

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[176] Exhibit A, San Mateo IRC, at p. 12.

[177] Exhibit A, San Mateo IRC, at pp. 89; 104; 119.

[178] Exhibit C, Controller's Comments on San Mateo IRC, at pp. 52-54.

[179] Exhibit H, Claimants' Comments on Draft Staff Analysis, at p. 12.

[180] Exhibit A, San Mateo IRC, at p. 54.

[181] Exhibit A, San Mateo IRC, at p. 15.

[182] Exhibit C, Controller's Comments on San Mateo IRC, at p. 17.

[183] Exhibit E, San Mateo Rebuttal Comments, at p. 8.

As discussed above, the parameters and guidelines requires that all costs claimed must be traceable to source documents that show evidence of the validity of such costs. Those documents, in turn are required to be certified under penalty of perjury, but certification alone cannot substitute for probative value. It is not necessary, under the parameters and guidelines, and consistent with *Clovis Unified*, as discussed above, that claimants produce unimpeachable proof of costs incurred, produced at or near the time the costs were incurred so as to reinforce the reliability of those documents. However, the documentation must show some evidence that costs are related to the mandate, and the term "other outgoing expenses," even if claimed and certified to be related to the mandate, is not sufficient to show the validity of the costs. The record indicates that the Controller offered the district an opportunity to substantiate these costs, and the district declined to do so, instead asserting that the burden should be on the Controller to show that the costs are not mandate-related. A claimant's certification that costs are related to the mandate is not sufficient in itself to substantiate the costs.

Based on the foregoing, the Commission finds that the Controller's finding regarding "other outgoing expenses" was not arbitrary, capricious, or entirely lacking in evidentiary support, and a reduction of San Mateo's claim in the amount of $41,375 is therefore supported. In comments submitted on the draft staff analysis the claimant concedes this issue.[184]

F. Disallowance of Health Services Not Substantiated in the Base Year in the Reimbursement Claims of San Bernardino

The scope of allowable health services costs for this test claim is defined and limited by the so-called "maintenance of effort" requirement: community college districts are required by the test claim statute to continue providing health services "at the level provided" during the base year, 1986-87. The parameters and guidelines and claiming instructions provide a long list of services that may be eligible for reimbursement in the claim year to the extent those services were provided in the base year. The analysis below determines that the list is illustrative, not exhaustive, and a too-narrow reading of the "maintenance of effort" requirement is not warranted. The analysis below also concludes that the Controller's reductions for two of the disallowed services were plainly inconsistent with the record, reduction for one of the disallowed services was incorrect because it was based on a too-narrow reading of the test claim statute and parameters and guidelines, and reductions for two other disallowed services were correctly made, based on the record. Finally, the analysis below approves of the Controller's proportional reductions for the correctly disallowed services.

San Bernardino claimed a total of $545,964 in health services direct costs for fiscal year 2001-2002, and $622,237 in health services direct costs for fiscal year 2002-2003.[185] The Controller reduced health services costs claimed by San Bernardino in amounts of $41,389 for fiscal year 2001-2002, and $61,739 for fiscal year 2002-2003, on grounds that the district claimed costs for services not provided in the base year, fiscal year 1986-87. The Controller found that "flu shots, hepatitis shots, pap smears, and outside laboratory services for San Bernardino Valley College, and flu shots, hepatitis shots, outside laboratory services, and marriage therapy for Crafton Hills College," were services not provided in fiscal year 1986-87, and therefore were not

[184] Exhibit H, Claimants' Comments on Draft Staff Analysis, at p. 12.

[185] Exhibit D, SCO Comments on San Bernardino IRC, at pp. 16-17.

reimbursable.[186] San Bernardino asserts that the Controller incorrectly reduced reimbursement for health services costs claimed, because the *Controller could not show* that services claimed were not provided in the base year, and the Controller interpreted the maintenance of effort requirement too narrowly. In addition, San Bernardino argues that the Controller improperly compared the audit years to the District's reimbursement claim from the 1997-98 fiscal year, thus establishing an alternate base year in violation of the statute; and that the Controller improperly measured the maintenance of effort requirement with reference to individual campuses, rather than the District as a whole. Finally, San Bernardino argues that the Controller's method of reducing health services costs on the basis of a proportional valuation of services disallowed was arbitrary and capricious.[187]

1. *Costs for flu shots were incorrectly disallowed, and should be reinstated in the full amount reduced, because the District indicated in its claim forms that it provided influenza immunizations in the base year.*

The parameters and guidelines provide a long list of services, which are stated to be "reimbursable to the extent they were provided by the community college district in fiscal year 1986-87." The claiming instructions contain the same list of services, and provide a form with columns for the reimbursement year and the 1986-87 fiscal year (the base year). Claimants are required to mark in those columns the services provided in the claim year, and the services provided in the base year; only those services marked in both columns are reimbursable. Those forms, as a part of the reimbursement claim, are submitted under penalty of perjury.

The parameters and guidelines provide for reimbursement of "Immunizations," including "Diptheria/Tetanus," "Measles/Rubella," and "Influenza."[188] The claim forms, accordingly, provide columns in which claimants are expected to indicate whether those services were provided in the base year, and in the claim year, and if the services are indicated in both the claim year and the base year, they are reimbursable, consistently with the parameters and guidelines.[189]

Here, San Bernardino indicated in its 2001-2002 and 2002-2003 claim forms that immunizations for "Influenza" were provided in both the base year and the claim years.[190] The Controller determined that "flu shots" were not provided in the base year and therefore reduced the claimant's reimbursement in accordance with the number of flu shots provided as a percentage of total health services provided in the claim years.

The Commission takes official notice that "influenza immunizations" are commonly known also as "flu shots,"[191] and that the claimant therefore correctly indicated in the claim forms that "flu

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[186] Exhibit B, San Bernardino IRC, at p. 53.

[187] *Id*, at pp. 11-13.

[188] Exhibit B, San Bernardino IRC, at p. 33-34.

[189] Exhibit B, San Bernardino IRC, at pp. 92-94.

[190] Exhibit B, San Bernardino IRC, at pp. 93; 101.

[191] Code of Regulations, title 2, section 1187.5 ["Official notice may be taken in the manner and of such information as is described in Government Code Section 11515."]; Government Code section 11515 ["[O]fficial notice may be taken, either before or after submission of the case for

shots" were provided in the base year.[192] Accordingly, the Controller now concedes that reimbursement is required for "flu shots."[193]

Based on the foregoing, the Commission finds that costs for flu shots were incorrectly disallowed and must be reinstated in the full amount reduced.

2. Costs for outside labs were incorrectly disallowed, and should be reinstated in the full amount reduced, because outside labs were provided in the base year, and inadvertently omitted from the reimbursement claims for the audit years.

The parameters and guidelines provide that "outside labs" are reimbursable, to the extent that these services were provided in the base year.[194] Accordingly, the claim forms provide an opportunity for a community college district to certify whether "outside labs" were provided in the base year (1986-87), and in the claim year; only services that were provided in both the base year and the claim year are allowable.[195]

San Bernardino indicated in its 2001-2002 and 2002-2003 reimbursement claims that "outside labs" were provided in the claim years, but not in the base year.[196] The Controller's audit report indicates that "in an attempt to determine if the health services in question were reported in prior-year mandated cost claims, we asked district personnel to provide the earliest mandated cost claims available." The Controller was "given a copy of [San Bernardino's] FY 1997-98 Health Fee Elimination cost claim." In reviewing that claim, the Controller "observed that the health services in question were not listed."[197] Accordingly the Controller reduced reimbursement for "outside labs," in accordance with the number of outside labs provided as a percentage of total health services provided in the claim years.[198]

However, the record of this IRC indicates that "outside labs" *were provided in the base year* in prior reimbursement claims.[199] Therefore the omission of "outside labs" in the 2001-02 and 2002-03 claims was likely in error. Accordingly, the Controller now concedes that reimbursement is required for "outside labs," stating that "we subsequently re-reviewed the district's FY 1997-98 claim…[and] noted that the district's FY 1997-98 claim does indicate that the district provided outside laboratory services during the 1986-87 base year." Therefore, the

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decision, of any generally accepted technical or scientific matter within the agency's special field, and of any fact which may be judicially noticed by the courts of this State."]; Evidence Code 451 ["Judicial notice shall be taken of…¶… [f]acts and propositions of generalized knowledge that are so universally known that they cannot reasonably be the subject of dispute."]

[192] Exhibit B, San Bernardino IRC, at pp. 93; 101.

[193] Exhibit I, SCO Comments on Draft Staff Analysis, at pp. 4-5.

[194] Exhibit B, San Bernardino IRC, at p. 33-34.

[195] See, e.g., Exhibit B, San Bernardino IRC, at pp. 92-94.

[196] Exhibit B, San Bernardino IRC, at pp. 93; 101.

[197] Exhibit B, San Bernardino IRC, at p. 54.

[198] Exhibit D, SCO Comments on San Bernardino IRC, at pp. 16-17.

[199] Exhibit I, SCO Comments on Draft Staff Analysis, at p. 110.

Controller stated "for this reason only, the SCO agrees to allow claimed costs attributable to outside laboratory services."[200] The Controller states that it will publish a revised final audit report accounting for the incorrect reduction.

Based on the foregoing, the Commission finds that costs for outside labs were incorrectly disallowed and that those costs must be reinstated in the full amount reduced.

3. Costs for pap smears were correctly disallowed, in accordance with the District's certification that these services were not provided in the base year.

The parameters and guidelines provide that "pap smears" are reimbursable, to the extent that these services were provided in the base year.[201] Accordingly, the claim forms provide an opportunity for a community college district to certify whether "pap smears" were provided in the base year (1986-87), and in the claim year; only services that were provided in both the base year and the claim year are allowable.[202]

San Bernardino certified in its reimbursement claims for fiscal years 2001-2002 and 2002-2003 that pap smears were a service provided in the claim years, but not in the base year.[203] However, the District nevertheless included costs for pap smears in its total reimbursement claim.[204] The Controller reduced reimbursement for pap smears, in accordance with the District's certification that these costs were not provided in the base year.[205]

Based on the foregoing, the Commission finds that costs for pap smears were correctly disallowed, and in accordance with the parameters and guidelines and claiming instructions, for claim years 2001-2002 and 2002-2003.

4. Costs for hepatitis shots were incorrectly disallowed, and should be reinstated in the full amount reduced, because the District certified that immunization services were provided in the base year.

San Bernardino argues that the Controller is interpreting the scope of reimbursable activities pursuant to the maintenance of effort requirement too narrowly, and that the District's claim forms "accurately reflect that immunization services were available in FY 1986-87." San Bernardino asserts that "Hepatitis B vaccinations and flu shots are just a part of the whole scope of services which may comprise immunization services."[206] Based on the analysis below, the Commission agrees that the scope of reimbursable services under the parameters and guidelines and claiming instructions should be viewed in terms of classes of services, rather than focusing on distinctions within those classes, particularly with respect to services that can be classified within a fairly narrow scope, such as immunizations.

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[200] Exhibit I, SCO Comments on Draft Staff Analysis, at p. 21.

[201] Exhibit B, San Bernardino IRC, at p. 33-34.

[202] See, e.g., Exhibit B, San Bernardino IRC, at pp. 92-94.

[203] Exhibit B, San Bernardino IRC, at pp. 93; 101.

[204] Exhibit D, SCO Comments on San Bernardino IRC, at pp. 16-17.

[205] Exhibit B, San Bernardino IRC, at p. 53.

[206] Exhibit B, San Bernardino IRC, at p. 17.

In the test claim statement of decision, the Commission found that the statute imposed a "maintenance of effort" requirement on community college districts requiring them to continue to provide health services "at the level provided" in the base year, while suspending authority until January 1, 1988 to levy health service fees previously allowed.[207] The statute was amended in 1987 to expressly reinstate the suspended fee authority with a cap indexed to inflation, and to provide that community colleges must continue to maintain services, now at the level provided in fiscal year 1986-87.[208] The parameters and guidelines were amended in 1989 to reflect the later statute and the maintenance of effort requirement based on the 1986-87 fiscal year.[209]

The parameters and guidelines provide a long list of services, which are stated to be "reimbursable to the extent they were provided by the community college district in fiscal year 1986-87," but the origin of the list is not apparent from the record, or discussed in the staff analysis accompanying the parameters and guidelines.[210] The list includes some services that are stated in general terms, such as "Birth Control," and "Dental Services," while others are couched in terms of varying specificity, such as "Antacids," "Antidiarrheal," and "Aspirin, Tylenol, etc." Government Code section 17558, at all times relevant to this IRC, required that "claiming instructions shall be derived from the statute or executive order creating the mandate and the parameters and guidelines adopted by the commission…"[211] Accordingly, the claiming instructions contain the same list of services adopted in the parameters and guidelines (though the origin of the list is uncertain), with columns for the current reimbursement year and the 1986-87 fiscal year. Claimants are required to mark in those columns the services provided in the current claim year, and the services provided in the base year; only those services marked in both columns are reimbursable. Those forms, as a part of the reimbursement claim, are submitted under penalty of perjury.

Neither the claim forms, nor the parameters and guidelines expressly name hepatitis immunizations as one of the reimbursable services within the scope of the mandate. There is no place on the claim form for a district to indicate that it provided hepatitis immunizations in the base year. Accordingly, San Bernardino did not indicate on the claim forms that it provided hepatitis immunizations in the base year.[212] San Bernardino nevertheless included costs for hepatitis immunizations in its total direct cost claim, and now argues that hepatitis immunizations are "just a part of the whole scope of services which may comprise immunization services."[213]

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[207] Exhibit X, Test Claim Decision CSM-4206.

[208] Education Code section 72246 (Stats. 1987, ch. 1118).

[209] See Health Fee Elimination Parameters and Guidelines, Exhibit A, San Mateo IRC, at p. 32.

[210] Exhibit X, Commission Hearing Binder for Item 6, Parameters and Guidelines, August 27, 1987.

[211] Government Code section 17558 (Added, Stats. 1995, ch. 945 (SB 11); amended, Stats. 1996, ch. 45 (SB 19)).

[212] See Exhibit B, San Bernardino IRC, at pp. 93; 101.

[213] Exhibit B, San Bernardino IRC, at p. 17.

The Controller, relying on the claim forms and the list contained within the parameters and guidelines, disallowed costs for "hepatitis shots," and adjusted San Bernardino's reimbursement claim in accordance with the number of hepatitis shots provided as a percentage of total health services provided in the claim years. San Bernardino argues that services provided in the base year should be viewed in terms of classes of services, rather than focusing on distinctions within those classes. For example, San Bernardino argues that the Controller disallowed "Hepatitis B shots," finding that hepatitis vaccinations were not provided in the base year.[214] But San Bernardino argues that "*immunization services* were available in FY 1986-87," and points to the services listed in the claiming instructions, which include "Immunizations." Hepatitis vaccinations, the claimant argues, "are just a part of the whole scope of services which may comprise immunization services."[215]

The Commission agrees with claimant's interpretation, particularly with respect to services that can be classified within a fairly narrow scope, such as immunizations. The maintenance of effort requirement of the test claim statute cannot be read so narrowly as to limit the provision of reimbursable health services to the state of medical technology and knowledge available in 1986-1987 since this would lead to absurd results.[216] The narrow reading of maintenance of effort as applied by the Controller here could endanger student health, especially with respect to services such as immunizations.

Lending further support to the reasoning above is a letter dated March 16, 1984, approximately seven weeks after the enactment of the test claim statute, and signed by Gerald C. Hayward, then Chancellor of the California Community Colleges. This letter shows that the maintenance of effort requirement was interpreted by the Chancellor's Office in terms of the scale of a district's health services program, rather than a requirement that the exact services provided in the base year be continued in the next. The letter was written to "respond to numerous requests for this agency to interpret the student fee portions of [the test claim statute," and states, with respect to the "maintenance of effort requirement," as follows:

> We interpret the words "maintain health services at the same level provided during the 1983-84 fiscal year" to mean the actual level of services provided. However, because of the difficulty of quantifying such a concept, we believe that the law would allow districts to substitute dollars spent as a proxy…[217]

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[214] Exhibit B, San Bernardino IRC, at p. 12.

[215] Exhibit B, San Bernardino IRC, at p. 17.

[216] See *Lopez v. Superior Court* (2010) 50 Cal.4th 1055 ["If the language is susceptible of multiple interpretations, the court looks to a variety of extrinsic aids, including the ostensible objects to be achieved, the evils to be remedied, the legislative history, public policy, contemporaneous administrative construction, and the statutory scheme of which the statute is a part. After considering these extrinsic aids, we must select the construction that comports most closely with the apparent intent of the Legislature, with a view to promoting rather than defeating the general purpose of the statute, and avoid an interpretation that would lead to absurd consequences." (internal citations and quotations omitted)].

[217] Exhibit X, Letter from Chancellor of California Community Colleges.

As the administrative agency responsible for overseeing the community college system, the interpretation of the Chancellor of the California Community Colleges office is entitled to great weight; the courts have long held that "[a]n agency interpretation of the meaning and legal effect of a statute is entitled to consideration and respect by the courts."[218] The general approach to the concept of *health services provided in the base year* is also consistent with the parameters and guidelines, which describes many of the services in general terms, such as "dental services," "lab reports," and "birth control." The list does not provide specific dental services or lab reports that are reimbursable, nor limit birth control to any specific methods or treatments. The list does provide expressly for certain immunizations, including "influenza," "measles/rubella," and "diphtheria/tetanus,"[219] but given the general nature of many of the other items listed in the parameters and guidelines, and the fact that there is no indication in the record of where the list came from, or whether it represents all of the services provided by all community college districts in the base year, it is reasonable to conclude that the Commission intended, when it adopted the parameters and guidelines, that immunizations named in the parameters and guidelines would be illustrative in nature, as suggested by the claimant, rather than exhaustive, as suggested by the Controller.[220]

The Controller argues, in comments submitted on the draft staff analysis, that basing a Commission decision on a policy argument is "beyond the scope of the Commission's authority." However, the Commission does have the authority to interpret the parameters and guidelines, and the requirements of the test claim statute using the canons of statutory construction. The "maintenance of effort requirement" is not, by its terms, or in accordance with earlier Commission findings, limited to discrete medical procedures or services that were provided in the base year. The test claim statute has been interpreted by the agency responsible for oversight of the community colleges to require that a community college district maintain a health services program *on the same scale* as it did in 1986-87. And, "the difficulty of quantifying such a concept," as pointed out by the Chancellor, most likely explains the list of services found in the parameters and guidelines: the list of services adopted by the Commission in the parameters and guidelines appears, from the record, to have been first proposed by the test claimant, Rio Hondo Community College District, but there is no other explanation of the origin of the list. Thus, the Commission finds that the parameters and guidelines are *illustrative* of the

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

[219] Exhibit B, San Bernardino IRC, at p. 34.

[220] In comments on the draft staff analysis, (Exhibit I, page 122) the Controller submitted an email referencing a phone conversation with a person alleged to be a nurse at San Bernardino Valley College in 1986-87, who recalled that the college provided "immunizations (Tb [illegible] tests, Tetanus/Dyptheria [sic], Measles/Mumps/Rubella)" in the base year. This new item of evidence (albeit highly suspect hearsay) does not indicate that influenza immunizations were provided in the base year, which is inconsistent with the claim forms in the record and inconsistent with the Controller's concession at page 4 of Exhibit I. Furthermore, the statement above is inconsistent with the claim forms indicating that tetanus and measles immunizations *were not* provided in the base year. Nevertheless, the Commission agrees with the claimant's interpretation of immunization services as constituting a class of services, rather than a menu of services limited by the list originating in the parameters and guidelines, and the analysis is unchanged.

types of services provided in the base year which are subject to the maintenance of effort requirement.

Based on the foregoing, the Commission finds that costs for hepatitis immunizations were incorrectly disallowed, and should be reinstated in the full amount reduced.

5. Costs for marriage therapy were correctly disallowed, based on the District's failure to substantiate services provided in the base year.

The parameters and guidelines, and the claiming instructions, provide for reimbursement for a number of different types of counseling services, including "Stress Counseling," "Crisis Intervention," "Child Abuse Reporting and Counseling," "Substance Abuse Identification and Counseling," and "Eating Disorders," among other things. However, neither the claim forms, nor the parameters and guidelines, expressly name marriage therapy as one of the reimbursable services within the scope of the mandate. There is no place on the claim form for a district to indicate that it provided marriage therapy in the base year, and, accordingly, San Bernardino did not indicate on the claim forms that it provided marriage therapy in the base year.[221] Nevertheless, San Bernardino included costs for marriage therapy in its total direct cost claim.

The Controller, relying on the claim forms and the parameters and guidelines, disallowed costs for marriage therapy and adjusted San Bernardino's reimbursement claim in accordance with the units of service of marriage therapy provided as a percentage of total health services provided in the claim years.[222]

As discussed above, the maintenance of effort requirement need not be read so narrowly as to constrain minor modifications within a class of services provided by a community college district's health services program in the base year, based on advances in medicine and current health concerns. However, no argument is advanced that marriage therapy is derivative of, related to, or otherwise part and parcel of any services provided in the base year. The District has made no attempt to substantiate the provision of marriage therapy services in the base year, or to argue the inclusion of marriage therapy within any of the enumerated services. In addition, the Controller has stated that "[t]hroughout the audit fieldwork and up until October 22, 2004 (the date of this response), the district did not provide us with any documentation to substantiate its assertion that the health services in question were provided at the San Bernardino Valley College and/or Crafton Hills College in FY 1986-87."

Based on the foregoing, the Commission finds that costs for marriage therapy were properly disallowed in accordance with the parameters and guidelines and claiming instructions.

6. The Controller did not establish an alternate base year for substantiation of the maintenance of effort requirement, or require proof that health services were rendered *in the base year in order to substantiate reimbursement in the claim years.*

San Bernardino argues that the inventory of available services for the audit years "was compared to the health services inventory for FY 1997-98," and the services listed in the inventory for the audit years but not also listed in fiscal year 1997-1998 were "assumed to be 'new services not offered in 86/87.'" San Bernardino argues that this comparison "established FY 1997-98 as an

[221] See Exhibit B, San Bernardino IRC, at pp. 93; 101.

[222] Exhibit D, SCO Comments on San Bernardino IRC, at pp. 16-17.

alternative base year, contrary to the Education Code and the parameters and guidelines."[223] In addition, San Bernardino argues that "[t]he Controller is endeavoring to compare the student health services rendered during the fiscal years claimed (audit years) to those services *rendered* during the 1986-87 fiscal year." San Bernardino maintains that "[t]he statutory requirement is that at least the same level of services be provided…[and that] [t]here is no basis in law or fact which requires the entire variety of health care services available each year to actually have been utilized, which is to say rendered, each year in order to prove that the same services are provided."

San Bernardino is correct that the Controller may not establish an alternate base year; the services provided in 1986-87 are mandated under the plain language of the test claim decision and the parameters and guidelines, and to the extent those services are not offset by student health fees, costs to provide those services are reimbursable.[224] However, the Controller explains in its comments on the draft staff analysis that it "never attempted to use the 1997-98 inventory as a restrictive document, rather it was used as an attempt to prove that a service was rendered in the reviewed year and reimbursed, which provides some evidence that it was available in the base year."[225] The Controller's explanation is persuasive: the Controller was not attempting to establish an alternate base year, but rather attempting to *include* additional reimbursable services by comparing the district's more recent certifications of services provided in the base year with earlier certifications of the services provided in the base year, to determine if the district might have left certain services out inadvertently.[226]

Moreover, San Bernardino's reasoning with respect to the distinction between services *rendered* and services *available* is sound, but it is not clear that the Controller's audit adjustments in any way relied upon an interpretation of services "provided." The district's interpretation of services *provided* being equivalent to services *available* is consistent with the purpose and intent of the maintenance of effort requirement, and the Controller agrees that "the term 'provided,' as used in the parameters and guidelines, is synonymous to 'available.'" However, the Controller argues that the distinction is "irrelevant to analyzing the factual accuracy of the audit finding."[227]

The record of this IRC indicates that the Controller has accepted the claim forms as evidence that a service was *provided* in the base year. For example, with respect to "outside labs," which were apparently left out of the reimbursement claims that are the subject of this IRC (2001-02 and 2002-03), the Controller was satisfied that these services were provided in the base year after comparing the claim years to the 1997-98 reimbursement claims filed. The Controller concluded that the omission in 2001-02 and 2002-03 was inadvertent. There is no indication that the services that the claimant alleged in the claim forms were limited to those *rendered*, or that the

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[223] Exhibit B, San Bernardino IRC, at p. 13.

[224] See Exhibit B, San Bernardino IRC, at p. 33.

[225] Exhibit I, Controller's Comments on Draft Staff Analysis, at p. 7.

[226] Note, as discussed above, that "outside labs" were left out of the audit year claims, but claimed in the 1997-98 fiscal year, and for that reason the Controller found that those services were reimbursable.

[227] Exhibit I, Controller's Comments on Draft Staff Analysis, at p. 20.

claim forms were rejected because claimant's broad interpretation of services *provided* was employed to complete the forms.

Based on the foregoing, the Commission finds that the Controller did not establish an alternate base year for substantiation of the maintenance of effort requirement, or require proof that health services were *rendered* in the base year in order to substantiate reimbursement in the claim years.

7. The Controller's method of adjusting costs for overstated health services was not arbitrary or capricious, in light of the absence of cost information provided by the district for the specific services disallowed.

San Bernardino argues that the "audit report does not explain how the adjustments were calculated." San Bernardino argues that "it appears that the Controller generated the disallowance by first assigning some type of numeric unit of service provided for each health service activity listed in the audit year health service inventories." Then, "a percentage of the total services was assigned based on the number of units of service for that particular service divided by the total number of services for the audit year." San Bernardino argues that "this method assumes that the cost of each type of service is the same, that is, for example, the cost of a cardiogram is the same as the cost of an eye exam." San Bernardino argues that "the percentage amounts for each of the 'new' activities in the audit years (flu shots, Hepatitis B shots, outside lab services, and pap smears) were added to determine a total percentage for each year of unallowable new services." Then, the percentage of unallowable services was multiplied by total services costs to determine a dollar amount of the disallowance.[228]

The Controller explains the disallowance calculation in its audit report and comments on the IRC, stating that "the district did not maintain information identifying the costs of the [disallowed services]." The Controller continued: "Consequently, the SCO calculated the fiscal year audit adjustments by applying the percentage of new units of services provided annually by colleges to total health services costs, net of SCO insurance adjustments."[229] In comments on the draft staff analysis, the Controller further explained that "the district did not present any documentation or alternative methodology to identify the costs attributable to the unallowable services." The Controller states that in the absence of any documentation of the actual costs attributable to the unallowable health services, it "concluded that it is reasonable to identify unallowable costs based on a percentage of unallowable services provided to total services provided."[230]

The Commission finds that absent any documentation identifying costs attributable to the disallowed services, the Controller's method of calculating the adjustments for pap smears and marriage therapy was not arbitrary, capricious, or entirely lacking in evidentiary support.

G. Controller's Reduction Based on Disallowance of Insurance Premiums Claimed by San Bernardino was not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

[228] Exhibit B, San Bernardino IRC, at pp. 11-12.

[229] Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 16-17.

[230] Exhibit I, Controller's Comments on Draft Staff Analysis, at pp. 23-24.

The Controller reduced amounts claimed by San Bernardino for "services and supplies" in amounts of $37,348 for fiscal year 2001-2002, and $38,322 for fiscal year 2002-2003, on grounds that athletic insurance costs are beyond the scope of the mandate.[231]

San Bernardino disputes the disallowance of "overstated services and supplies," arguing that the Controller inappropriately disallowed costs for student insurance premiums.

The Controller explains that the district carried three types of insurance coverage in fiscal years 2001-2002 and 2002-2003: basic coverage for students as well as athletes, super catastrophic coverage for athletes, and catastrophic coverage for students. The Controller asserts that the disallowed costs are only the "intercollegiate athletes' portion of the basic coverage and the intercollegiate athletes' portion of the super catastrophic coverage," along with a small amount of costs that the Controller finds unsupported. The maintenance of effort requirement, pursuant to section 76355, applies only to those health services for which community college districts are permitted to charge a fee; and because section 76355(d) prohibits expenditures of health fees on athletic-related costs, the costs of athletic insurance are not mandated, and must be disallowed.[232]

The Controller submitted a worksheet detailing the disallowed portions of insurance, showing that only the portions of basic coverage and catastrophic coverage attributable to intercollegiate athletes were disallowed.[233] The amounts disallowed were $37,348 for fiscal year 2001-2002, and $35,206 for fiscal year 2002-2003,[234] and in addition $3,116 in "unsupported costs."[235]

San Bernardino argues that "the adjustment is inappropriate since student athletes are part of the student population for purpose of the general student population insurance premium." San Bernardino reasons that the athletic insurance premiums "[pertain] to coverage while participating in intercollegiate sports, not while they are attending class or on campus in their capacity [as] a member of the general student population."[236]

San Bernardino has not disputed the Controller's argument that costs related to athletics are not included within the maintenance of effort requirement, nor submitted any documentation in answer to the Controller's worksheet attributing the disallowed costs to portions of insurance premiums applicable to collegiate athletic programs. San Bernardino's assertion that intercollegiate athletes are covered by the college's general student population insurance premiums "while they are attending class" is logically true and correct, but the idea that the disallowed costs extend to any portion of the general student population premiums is not substantiated by any documentation in the record.

The Controller's documentation clearly supports the disallowance, and nothing in the record supports the additional $3,116 that the Controller found was "unsupported." Based on the foregoing, the Commission finds that the disallowance of costs related to insurance premiums for

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[231] Exhibit B, San Bernardino IRC, at p. 55.

[232] Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 17-19.

[233] Exhibit D, Controller's Comments on San Bernardino IRC, at pp. 79-82.

[234] Ibid.

[235] Exhibit B, San Bernardino IRC, at p. 55.

[236] Exhibit B, San Bernardino IRC, at pp. 16-17.

intercollegiate athletes not arbitrary, capricious, or entirely lacking in evidentiary support. In comments submitted on the draft staff analysis the claimant concedes this issue.[237]

V. Conclusion

Pursuant to Government Code section 17551(d) and section 1185.7 of the Commission's regulations, the Commission finds that the following reductions by the Controller's Office are incorrect and that the costs, as specified, should be reinstated:

- Reduction of San Bernardino's reimbursement claims based on understated health fee revenues, in the amount of $150,031, should be reinstated pending reevaluation based on the total number of students enrolled less those exempt from the fee. On remand, the Controller should reexamine the health fees authorized based on the total number of *enrolled students less those exempt from the fee*. If San Bernardino is unable to assist the Controller and provide documentation of the number of exempt students for whom fees cannot legally be charged, the Controller may apply the Health Fee Rule using any reasonable source available to obtain enrollment and exemption information.
- Disallowance of costs for hepatitis and influenza immunizations, and outside lab services was arbitrary, capricious, or entirely lacking in evidentiary support; costs claimed for these services should be reinstated in the full amount reduced.

The Commission further finds that the following reductions were reasonable and supported by the law, the parameters and guidelines, the claiming instructions, and the record:

- Reduction of San Mateo's reimbursement claims, on the basis of understated health fee revenues, in the amount of $70,603.
- The reduction of indirect costs claimed by San Mateo, in the amount of $112,243, based on the district's incorrect application of its approved 30% indirect cost rate to direct costs other than the distribution base of salaries and benefits.
- The reduction of indirect costs claimed by San Bernardino, in the amount of $281,494, based on the district's failure to comply with the claiming instructions in the development of its indirect cost rate, and the Controller's reasonable use of an alternative method to calculate indirect costs.
- The disallowance of salaries and benefits for Ernest Rodriguez and Dee Howard, based on an absence of employee time records or other documentation as required by the parameters and guidelines.
- The reduction of benefits claimed by San Mateo, in the amount of $88,633, based on the district's failure to support its claimed benefit amounts.
- The reduction of costs claimed for "other outgoing expenses" by San Mateo, in the amount of $41,375, based on the district's failure to support claimed expenses.
- The reduction of health insurance costs and other overstated services and supplies in San Bernardino's reimbursement claims, in the amounts of $37,348 for fiscal year 2001-

[237] Exhibit H, Claimants' Comments on Draft Staff Analysis, at p. 13.

2001, and $38,322 for fiscal year 2002-2003, based on the documentation submitted by the Controller.

- The reduction of health services costs for pap smears and marriage therapy, on the basis of San Bernardino's reimbursement claims failing to substantiate that these services were provided in the base year.

The Commission hereby remands the subject claims to the Controller, with instructions to reinstate the incorrect reductions specified above consistent with these findings.

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RE: **Adopted Statement of Decision**

Health Fee Elimination, 05-4206-I-04 and 05-4206-I-08
Education Code Section 76355
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.); Statutes 1987, Chapter 1118
Fiscal Years 1999-2000, 2000-2001, 2001-2002, and 2002-2003
San Mateo County Community College District and San Bernardino Community College District, Claimants

On January 24, 2014, the foregoing statement of decision of the Commission on State Mandates was adopted in the above-entitled matter.

Heather Halsey, Executive Director

Dated: January 31, 2014

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.) (AB 1) and Statutes 1987, Chapter 1118 (AB 2336) Fiscal Years 1999-2000, 2000-2001, and 2001-2002 State Center Community College District, Claimant.	Case No.: 05-4206-I-05 *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 11, 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 the 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 six to zero.

Summary of the Findings

This analysis addresses reductions made by the Controller to State Center Community College District's (claimant's) reimbursement claims for fiscal years 1999-2000 through 2001-2002 under the *Health Fee Elimination* program. Over the three fiscal years in question, reductions totaling $385,753 were made based on understated offsetting health fee authority, and additional reductions totaling $415,502 were made based on disallowed indirect costs rates.

The Commission denies this IRC, finding that the Controller's audit of the 1999-2000 and 2000-2001 reimbursement claims was timely pursuant to Government Code section 17558.5 . The Commission further finds that the reduction of indirect costs based on the claimant's failure to obtain federal approval for its indirect cost rate proposals, and the Controller's reduction of costs based on the claimant's underreporting of health service fee revenue authorized by statute, are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support.

[1] Statutes 1993, chapter 8.

COMMISSION FINDINGS

I. Chronology

01/13/2001	Claimant, State Center Community College District, filed its fiscal year 1999-2000 reimbursement claim.[2]
12/27/2001	Claimant filed its fiscal year 2000-2001 reimbursement claim.[3]
12/20/2002	Claimant signed and dated its fiscal year 2001-2002 reimbursement claim.[4]
05/12/2003	An entrance conference for the audit of all three fiscal years was held.[5]
09/17/2004	The Controller issued a final audit report.[6]
09/01/2005	Claimant filed this IRC.[7]
02/8/2008	The Controller filed comments on the IRC.[8]
09/09/2014	Commission staff issued a draft proposed decision.[9]
09/22/2014	Claimant filed comments on the draft proposed decision.[10]
09/30/2014	The 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 health service fee not to exceed $7.50 for each semester or $5 for each quarter or summer session, to fund these services.[12] In 1984, the Legislature repealed the community colleges' fee

[2] Exhibit A, Incorrect Reduction Claim, page 19.

[3] *Ibid*.

[4] Exhibit A, Incorrect Reduction Claim, page 96.

[5] Exhibit A, Incorrect Reduction Claim, page 19.

[6] Exhibit A, Incorrect Reduction Claim, pages 19; 42.

[7] Exhibit A, Incorrect Reduction Claim, page 1.

[8] Exhibit B, Controller's Comments.

[9] Exhibit C, Draft Proposed Decision.

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

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

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

authority for health services.[13] However, the Legislature also reenacted section 72246, to become operative on January 1, 1988, to reauthorize the fee, at $7.50 for each semester (or $5 for quarter or summer semester).[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 health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.[15] As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987,[16] 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.[17] 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.[18] As a result, beginning January 1, 1988 all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services. In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.[19]

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

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

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

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

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

[16] Statutes 1987, chapter 1118.

[17] 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).

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

[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)

The Controller's Audit and Summary of the Issues

Over the three fiscal years in question (1999-2000, 2000-2001, and 2001-2002), reductions totaling $385,753 were made based on alleged understated offsetting health fees authorized to be collected and additional reductions totaling $415,502 were made based on disallowed indirect costs rates.

This IRC addresses the following issues:

- The statutory deadlines applicable to audits of reimbursement claims by the Controller pursuant to Government Code section 17558.5;
- 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.

III. Positions of the Parties

State Center Community College District

Claimant asserts that the Controller incorrectly reduced costs claimed for fiscal years 1999-2000 through 2001-2002, totaling $801,255. Specifically, claimant asserts that the reduction of $415,502 on grounds that "the district did not obtain federal approval for its [indirect cost rates,]" was incorrect. Claimant argues that "[c]ontrary to the Controller's ministerial preferences, there is no requirement in law that the district's indirect cost rate must be 'federally' approved," and the Controller did not make findings that claimant's rate was excessive or unreasonable.[20] And, claimant asserts that a reduction of its total claim in the amount of $385,753, based on understated authorized health service fees was incorrect, because the parameters and guidelines require claimants to state offsetting savings "experienced," and claimant did not experience offsetting savings for fees that it did not charge to students.[21] In addition, claimant asserts that the statute of limitations applicable to the Controller's audits of reimbursement claims barred auditing its fiscal year 1999-2000 and 2000-2001 reimbursement claims.[22]

Claimant does not dispute the Controller's findings with respect to unallowable services and supplies and unallowable salary costs.[23]

In comments on the draft proposed decision, the claimant reiterates its view that the applicable statute of limitations, with respect to the 1999-2000 and 2000-2001 fiscal year reimbursement claims, required the Controller to complete the audit on or before December 31, 2003, and that the audit is therefore not timely with respect to those fiscal years.

[20] Exhibit A, Incorrect Reduction Claim, page 14.

[21] Exhibit A, Incorrect Reduction Claim, pages 15-19.

[22] Exhibit A, Incorrect Reduction Claim, pages 19-23.

[23] Exhibit A, Incorrect Reduction Claim, pages 11; 50-51.

State Controller's Office

The Controller asserts that claimant overstated its indirect costs, because claimant did not obtain federal approval for its indirect cost rate proposals, as required by the Controller's claiming instructions. The Controller explains that the auditors "calculated indirect cost rates using the alternate methodology" provided in the claiming instructions, which "did not support the rates that the district claimed."[24] In addition, the Controller states that it "is not responsible for identifying the district's responsible federal agency" authorized to approve indirect cost rates.[25]

The Controller further found that claimant understated its health service fee authority for the audit period in the amount of $385,753. Using enrollment and exemption data, the Controller recalculated the health fees that claimant was authorized to collect, and reduced the claim by the amount not stated as offsetting revenues.[26] The Controller argues that "[t]he relevant amount [of offsetting savings] is not the amount charged, nor the amount collected, rather, it is the amount authorized."[27]

Finally, the Controller argues that claimant "incorrectly applies the 1996 version of [the statute of limitations.]" The Controller explains that the prior version of section 17558.5 provided that a reimbursement claim is "subject to audit" for two years after the end of the calendar year in which the claim is filed, meaning that claimant's 1999-2000 claim, filed January 13, 2001, would be "subject to audit" through December 31, 2003. The Controller asserts that the audit in dispute in this IRC was initiated no later than "when the entrance conference was held,"[28] which claimant asserts was on May 12, 2003.[29] The Controller argues that there is no support for the theory that "subject to audit" requires the Controller to issue a final audit report before the two year period expires.[30] Moreover, the Controller argues that as of January 1, 2003 section 17558.5 was amended to provide that a reimbursement claim "is subject to the initiation of an audit by the Controller no later than three years after the reimbursement claim is filed or last amended, whichever is later…" The Controller argues that "the phrase 'initiation of an audit' implies the first step taken by the Controller," in this case, the entrance conference.[31]

On September 30, 2014, the Controller submitted written comments expressing support of staff's conclusions in the draft proposed decision.[32]

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[24] Exhibit B, Controller's Comments on IRC, pages 12-13.

[25] Exhibit B, Controller's Comments on IRC, page 14.

[26] Exhibit B, Controller's Comments on IRC, page 15; 18.

[27] Exhibit B, Controller's Comments on IRC, page 2.

[28] Exhibit B, Controller's Comments on IRC, page 2.

[29] Exhibit A, Incorrect Reduction Claim, page 19.

[30] Exhibit B, Controller's Comments on IRC, page 20.

[31] *Ibid.*

[32] Exhibit E, Controller's Comments on 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.

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the SCO has incorrectly reduced payments to a 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 SCO 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.[33] 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."[34]

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.[35] 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.]' "[36]

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

[34] *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.

[35] *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.

[36] *American Bd. of Cosmetic Surgery, Inc, supra,* 162 Cal.App.4th 534, 547-548.

The Commission must review the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with claimant. [37] In addition, section 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[38]

A. The Statutory Deadlines Found in Government Code Section 17558.5 do not Bar the Controller's Audit of Claimant's 1999-2000 and 2000-2001 Reimbursement Claims.

Claimant asserts that "the audit adjustments for Fiscal Year 1999-00 and 2000-01 are barred by the statute of limitations…" in Government Code section 17558.5.[39] Claimant submitted the reimbursement claims for fiscal years 1999-2000 and 2000-2001 on January 13, 2001, and December 27, 2001.[40] At that time, Government Code section 17558.5, as added in 1995, stated the following:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller *no later than two years after the end of the calendar year* in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[41] (Emphasis added.)

Since the 1999-2000 and 2000-2001 reimbursement claims were submitted on January 13, 2001, and December 27, 2001, those claims were "subject to audit" by the plain language of the statute until December 31, 2003. The audit was initiated no later than May 12, 2003, when an audit entrance conference was held, less than two years after the end of the calendar year in which they were filed. Therefore, the initiation of the audit was timely.

Claimant, however, interprets "subject to audit" to require the *completion* of an audit within the two year period, and therefore concludes that an audit report issuing September 17, 2004 is not timely, and "[t]he audit findings are therefore void for those two claims."[42] The Controller argues that "the Legislature modified the previous language to clarify its intent." The Controller states that the plain language of "subject to" does not require the Controller to issue its final audit

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

[38] 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.

[39] Exhibit A, Incorrect Reduction Claim, page 17.

[40] Exhibit A, Incorrect Reduction Claim, page 19.

[41] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)).

[42] Exhibit A, Incorrect Reduction Claim, pages 19-23.

report before the two years expires; rather, the Controller "exercised its authority to audit the district's claims by conducting the audit entrance conference within the statute of limitations."[43]

As amended by Statutes 2002, chapter 1128 (AB 2834), effective January 1, 2003, section 17558.5 stated the following:

> 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 ~~two~~ three years after the ~~end of the calendar year in which~~ 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 ~~made~~ filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[44]

Effective January 1, 2003, section 17558.5 clarified that when funds are appropriated, the claim is subject "to *the initiation of an audit*…" for the statutory period. The 2002 statute also changed the requirement to initiate the audit from *two years after the end of the calendar year* in which the reimbursement claim is filed or last amended, to *three years after the date that the actual reimbursement claim is filed* or last amended. Any enlargement of the statutory period that is made by a statutory amendment that becomes effective after a reimbursement claim is filed, but the audit period is still pending and not already barred, applies to those claims already filed. In *Douglas Aircraft*, the court stated the general rule as follows:

> The extension of the statutory period within which an action must be brought is generally held to be valid if made before the cause of action is barred. (*Weldon v. Rogers*, 151 Cal. 432.) The party claiming to be adversely affected is deemed to suffer no injury where he was under an obligation to pay before the period was lengthened. This is on the theory that the legislation affects only the remedy and not a right. (*Mudd v. McColgan*, 30 Cal.2d 463; *Davis & McMillan v. Industrial Acc. Com.*, 198 Cal. 631; 31 Cal.Jur.2d 434.) An enlargement of the limitation period by the Legislature has been held to be proper in cases where the period had not run against a corporation for additional franchise taxes (*Edison Calif. Stores, Inc. v. McColgan*, 30 Cal.2d 472), against an individual for personal income taxes (*Mudd v. McColgan, supra*, 30 Cal.2d 463), and against a judgment debtor (*Weldon v. Rogers, supra*, 151 Cal. 432). It has been held that unless the statute expressly provides to the contrary any such enlargement applies to matters pending but not already barred. (*Mudd v. McColgan, supra*, 30 Cal.2d 463.)[45]

Based only upon the plain language of the 1995 version of section 17558.5, the reimbursement claims in issue would be "subject to audit" until the end of the calendar year 2003, for the reimbursement claims filed in 2001. Based on the plain language as amended in 2002 (effective January 1, 2003), the reimbursement claims in issue would be "subject to the initiation of an audit" until three years after the claims were filed, or January 13, 2004, for the 1999-2000

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[43] Exhibit B, Controller's Comments on IRC, pages 19-20.

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

[45] *Douglas Aircraft Co. v. Cranston* (1962) 58 Cal.2d 462, 465.

reimbursement claim. Because an entrance conference was held May 12, 2003, the audit was initiated prior to the running of the statutory period. And, because the 2002 statute expanded the statutory period while it was still pending, the Controller receives the benefit of the additional time.

The only reading of these facts and of section 17558.5 that could bar the subject audits would be to hold that section 17558.5 requires an audit to be *completed* within two years of filing, in which case the final audit report issued September 17, 2004 would be barred for the 1999-2000 and 2000-2001 reimbursement claims. This is the interpretation urged by the claimant, but this reading of the code is not supported by the plain language of the statute, and would ignore the expansion of the limitation period effected by the 2002 amendment to the statute, in direct conflict with *Douglas Aircraft, supra*. At the time the first two claims were filed, section 17558.5 did not expressly fix the time in which an audit must be completed. Nevertheless, the Controller was still required under common law to complete the audit within a reasonable period of time. Under appropriate circumstances, the defense of laches may operate to bar an audit by a public agency if there is evidence of unreasonable delay by the agency and resulting prejudice to the claimant.[46] In this case, the audit was completed when the final audit report was issued on September 17, 2004, approximately 16 months after the audit was initiated. Thus, there is no evidence of an unreasonable delay in the completion of the audit.

In its comments on the draft proposed decision, the claimant continues to argue that "the FY 1999-00 (filed January 13, 2001) and FY 2000-01 (filed December 27, 2001) annual claims were beyond the statute of limitations for completion of the audit (December 31, 2003) when the Controller completed its audit on September 17, 2004." The claimant continues: "The Commission cites no cases contradicting the practical requirement that completion is measured by the date of the audit report."[47]

The claimant's comments do not alter the above analysis. The 1995 version of the statute, as shown above, does not require an audit to be completed within a certain time, and if interpreted as a whole, there is no reason to read "subject to audit" in the first sentence differently from "the time for the Controller to initiate an audit" in the second sentence. Moreover, the 2002 amendment supports that construction, providing that a claim is "subject to the initiation of an audit" for a specified time from the date the claim is filed (expanded to three years). And, even if the 2002 amendment were interpreted as a substantive amendment, rather than a clarifying change, the amendment applies as of its effective date to any actions (here, potential audits) pending but not already barred. Once initiated, the 2002 version of section 17558.5 does not provide for a specific time frame to complete an audit, but a reasonableness test could be applied. Here, there is no basis to find that the completion of the audit was not reasonable, based on an entrance conference of May 12, 2003 and a final audit report issued September 17, 2004, approximately sixteen months elapsing between.

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[46] *Cedar-Sinai Medical Center v. Shewry* (2006) 137 Cal.App.4th 964, 985-986. In that case, the court determined that the hospital failed to establish an unreasonable delay in audits conduct by Department of Health Services, since the Department conducted audits two years or less after the end of the fiscal period that it was auditing, which was less than the three-year period permitted by statute.

[47] Exhibit D, Claimant's Comments on Draft Proposed Decision, pages 1-2.

Based on the foregoing, the Commission finds that the audit of the subject reimbursement claims is timely and not barred by the statutory deadlines in Government Code section 17558.5.

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

The Controller reduced indirect costs claimed by a total of $415,502 for all three fiscal years, on grounds that claimant did not utilize a federally approved indirect cost rate.[48] Claimant disputes that federal approval is required, and challenges the Controller's substitution of the alternative state method and the resulting disallowance.

The Commission finds that the parameters and guidelines require claimants to adhere to the claiming instructions when claiming indirect costs, and that the claimant here did not do so. Therefore, the reduction was correct as a matter of law. The Commission further finds that the Controller's use of the other 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 guidelines or by using the state Form FAM-29C.*

The claimant argues that "[n]o particular indirect cost rate calculation is required by law," and that the parameters and guidelines "do not require that indirect costs be claimed in the manner described by the Controller." Claimant recognizes that the parameters and guidelines plainly state that "indirect costs *may be claimed in the manner described by the State Controller*," but claimant argues that the word "may" is permissive, and that therefore the parameters and guidelines do not require that indirect costs be claimed in the manner described by the Controller.[49]

Claimant's argument is unsound: the parameters and guidelines provide that "[i]ndirect costs may be claimed in the manner described by the State Controller in his claiming instructions."[50] 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 Controller's claiming instructions.[51]

The claiming instructions specific to the *Health Fee Elimination* mandate, revised in September 1997[52] 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

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

[49] Exhibit A, Incorrect Reduction Claim, pages 11-12.

[50] Exhibit B, Controller's Comments, page 40 [Parameters and Guidelines, Adopted August 27, 1987].

[51] Exhibit B, Controller's Comments, page 14.

[52] Exhibit F, Health Fee Elimination Claiming Instructions.

Manual for Schools." In addition, the School Mandated Cost Manual, revised each year, and containing instructions applicable to all school and community college mandated programs,[53] provides as follows:

> A college has the option of using a federally approved rate, utilizing the cost accounting principles from Office of Management and Budget Circular A-21 "Cost Principles for Educational Institutions," or the Controller's methodology outlined in the following paragraphs. If the federal rate is used, it must be from the same fiscal year in which the costs were incurred.
>
> The Controller allows the following methodology for use by community colleges in computing an indirect cost rate for state mandates. The objective of this computation is to determine an equitable rate for use in allocating administrative support to personnel that performed the mandated cost activities claimed by the community college. This methodology assumes that administrative services are provided to all activities of the institution in relation to the direct costs incurred in the performance of those activities. Form FAM-29C has been developed to assist the community college in computing an indirect cost rate for state mandates.[54]

Claimant argues that "[c]ontrary to the Controller's ministerial preferences, there is no requirement in law that the district's indirect cost rate must be 'federally' approved, and neither the Commission nor the Controller has ever specified the federal agencies which have the authority to approve indirect cost rates."[55]

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 later the Mandated Cost Manual for Community Colleges), and the manual provides ample notice to claimants as to how they may properly claim indirect costs. Claimant's assertion that "[n]either applicable law nor the Parameters and Guidelines made compliance with the Controller's claiming instructions a condition of reimbursement"[56] is therefore in error. The parameters and guidelines, which were duly adopted at a Commission hearing, require compliance with the claiming instructions.

Claimant also argues that "the Controller's claiming instructions were never adopted as law, or regulations pursuant to the Administrative Procedure Act," and therefore, claimant argues, "the claiming instructions are merely a statement of the ministerial interests of the Controller and not law."[57] In *Clovis Unified*, 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.[58] Here, claimant

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[53] Exhibit F, School Mandated Cost Manual Excerpt 1999-2000, page 4.

[54] Exhibit F, School Mandated Cost Manual Excerpt, 1999-2000, Revised October 1998, page 11.

[55] Exhibit A, Incorrect Reduction Claim, at page 11.

[56] Exhibit C, Claimant Rebuttal Comments, page 7.

[57] Exhibit A, Incorrect Reduction Claim, page 13.

[58] *Clovis Unified School District v. State Controller* (2010) 188 Cal.App.4th 794, 807.

alleges, somewhat indirectly, the same fault in the claiming instructions with respect to 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 the claimant did not challenge the parameters and guidelines or the claiming instructions when they were adopted.[59]

Based on the foregoing, the Commission finds that the parameters and guidelines expressly require claimants to claim indirect costs in the manner described in the Controller's claiming instructions, which in turn provide that an indirect cost rate may be developed in accordance with federal OMB guidelines or by using the state Form FAM-29C; and that the 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 and applying its indirect cost rates. Therefore, the Controller's reduction and recalculation of costs based on applying the Form FAM-29C calculation to provide an indirect cost rate is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.*

In the audit of claimant's 1999-2000 through 2001-2002 reimbursement claims, the Controller concluded that the claimed indirect costs were based on a rate that was not federally approved, and that the Controller's calculated rates did not support the indirect cost rates claimed.[60] Claimant filed indirect cost rates of 38.74 percent, 37.73 percent, and 35.06 percent for the three audit years. The Controller reduced the claimed indirect cost rates, based on the alternative state method, to 14.07 percent, 14.38 percent, and 13.86 percent.[61]

The Controller maintains that the claimant "should obtain federal approval when it prepares ICRPs using OMB Circular A-21."[62] In addition, the Controller states that it is "not responsible for identifying the district's responsible federal agency." The Controller cites OMB Circular A-21:

> [Cognizant agency responsibility] is assigned to the Department of Health and Human Services (HHS) or the Department of Defense's Office of Naval Research (DOD), normally depending on which of the two agencies (HHS or DOD) provides more funds to the educational institution for the most recent three years... In cases where neither HHS nor DOD provides Federal funding to an educational institution, the cognizant agency assignment shall default to HHS.[63]

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[59] Exhibit F, School Mandated Cost Manual Excerpt, 1999-2000; School Mandated Cost Manual Excerpt, 2000-2001; School Mandated Cost Manual Excerpt, 2001-2002.

[60] Exhibit A, Incorrect Reduction Claim, page 52 [Controller's Audit Report].

[61] *Ibid.*

[62] *Ibid.*

[63] Exhibit B, Controller's Comments, page 14.

As discussed above, the Commission's duly adopted parameters and guidelines require compliance with the Controller's claiming instructions. Thus, the Commission finds that the claimant did not comply with the parameters and guidelines and claiming instructions and the reduction is correct as a matter of law.

Therefore, the Controller, concluding that the rate was not approved, and therefore not supported consistently with the parameters and guidelines and the claiming instructions, recalculated the indirect cost rate using the alternative state procedure, the "FAM-29C method," outlined in the Schools Mandated Cost Manual.[64] 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 [*sic*]."[65] In addition, claimant argues that "there is no mention of the Controller's FAM-29C method in the parameters and guidelines adopted for *this* mandate program."[66]

Claimant's argument is not persuasive. The absence of a direct "mention of the Controller's FAM-29C method in the parameters and guidelines adopted for this mandate program" is not dispositive. As discussed above, the parameters and guidelines require claimants to comply with the Controller's claiming instructions, and the claiming instructions applicable to all mandated programs state that community colleges may use either the OMB method (with federal approval) or the FAM-29C method.[67] The Commission finds that 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.

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."[68] 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.

In its comments on the draft proposed decision, claimant continues to argue that the claiming instructions are an unenforceable underground regulation, and that therefore the Controller's recalculation and reduction of indirect costs on the basis of the claimant's failure to abide by the claiming instructions is arbitrary, capricious, and entirely lacking in evidentiary support.[69] The claimant's comments do not alter the above analysis.

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

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[64] See Exhibit B, Controller's Comments, page 15.

[65] Exhibit A, Incorrect Reduction Claim, page 14.

[66] Exhibit C, Claimant Rebuttal Comments, page 6.

[67] See Exhibit B, Controller's Comments, pages 23-26.

[68] Exhibit A, Incorrect Reduction Claim, page 12.

[69] Exhibit D, Claimant's Comments on Draft Proposed Decision, pages 5-9.

C. The Controller's Reduction for Understated Offsetting Revenues Pursuant to the Health Fee Rule is Correct as a Matter of Law.

The Controller reduced the reimbursement claims filed by claimant in the amount of $385,753 for the three years at issue.[70] These reductions were made on the basis of the fee authority available to claimant, multiplied by the number of students subject to the fee, less the amount of offsetting revenue claimed.

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

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

After claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge 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.[72]

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

[70] Exhibit A, Incorrect Reduction Claim, page 15.

[71] Exhibit A, Incorrect Reduction Claim, page 16.

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

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

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.[73] The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered.[74] Here, the Controller asserts that claimant had the authority to increase its fee in accordance with the notices periodically issued by the Chancellor of the California Community Colleges, stating that the Implicit Price Deflator Index had increased enough to support a one dollar increase in student health fees.[75] The Controller argues that the claimant was required to claim offsetting fees in the amount authorized. Claimant argues that the actual increase of the fee imposed upon students requires action of the community college district governing board, and that "the Controller cannot rely on the Chancellor's notice as a basis to adjust the claim for 'collectible' student health services fees,"[76] because the fees levied on students are raised by action of the governing board of the community college district. But the *authority* to impose the health service fees increases with the Implicit Price Deflator, as noticed by the Chancellor, and without any legislative action by a community college district, or any other entity (state or local). Moreover, 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.[77]

The court also notes that, "this basic principle flows from common sense as well. As the Controller succinctly puts it, 'Claimants can choose not to require these fees, but not at the state's expense.'"[78] Additionally, in responding to the community college districts' argument

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[73] 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.

[74] See, e.g., Exhibit A, Incorrect Reduction Claim [Letter from Chancellor, page 66].

[75] See Exhibit B, Controller's Comments, at page 17; Exhibit A, Incorrect Reduction Claim, pages 66-67.

[76] Exhibit A, Incorrect Reduction Claim, pages 17-18.

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

[78] *Ibid.*

that, "since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission's P&G's,"[79] 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*.[80] (Italics added.)

Thus, pursuant to the court's decision in *Clovis Unified*, the Health Fee Rule used by the Controller to adjust reimbursement claims filed by claimants for the *Health Fee Elimination* program is valid. Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.[81] In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.[82] 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.[83] 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.[84]

In its comments on the draft proposed decision, the claimant "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."[85] However, the claimant argues that the sources for enrollment data used by the Controller have not been approved by the Commission, and therefore the calculations and reduction are arbitrary and lacking in evidentiary support.[86] The claimant cites to the Commission's October 27, 2011

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

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

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

[82] 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.

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

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

[85] Exhibit D, Claimant's Comments on Draft Proposed Decision, page 10.

[86] Exhibit D, Claimant's Comments on Draft Proposed Decision, page 11.

decision on seven consolidated Health Fee Elimination IRCs. In that decision, the Commission found that the "Chancellor's Office MIS is a reasonable and reliable source for enrollment data of community college districts, and the Controller's use of the MIS for enrollment data for auditing the Districts' claims is not arbitrary or capricious." [87] Based on the findings of that prior decision, the claimant here argues that it was improper to instead use student enrollment and exemption data provided by the "district's Institutional Research Office."[88]

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, and the claimant has not presented any evidence or argument that its own Institutional Research Office is or was incapable of producing reliable evidence from which to calculate offsetting revenues.

Based on the foregoing, the Commission finds that the Controller's reduction of reimbursement to the extent of the fee authority found in Education Code section 76355 is correct as a matter of law.

V. Conclusion

Pursuant to Government Code section 17551(d) and section 1185.7 of the Commission's regulations, the Commission concludes that the reductions to the following costs are correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support:

- The reduction of $415,502 in indirect costs claimed, based on the 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 to calculate indirect costs authorized by the parameters and guidelines and claiming instructions.
- The reduction of $385,753based on understated health fee revenues.

Based on the foregoing, the Commission denies this IRC.

[87] Adopted Decision, *Health Fee Elimination*, 09-4206-I-19, page 25.

[88] Exhibit D, Claimant's Comments on Draft Proposed Decision, page 10.

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 2000-2001, 2001-2002 and 2002-2003 El Camino Community College District, Claimant.	Case No.: 05-4206-I-11 *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 11, 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. Mr. Keith Petersen appeared on behalf of the claimant. Mr. Jim Spano and Mr. Jim Venneman appeared for the State Controller's Office (SCO).

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 at the hearing by a vote of 6 to 0.

Summary of the Findings

This decision addresses the IRC filed by El Camino Community College District (claimant) regarding reductions totaling $399,891 made by the SCO to reimbursement claims for fiscal years 2000-2001, 2001-2002, and 2002-2003 under the *Health Fee Elimination* program.

The following issues are in dispute:

- The statutory deadline applicable to audits of reimbursement claims by the SCO for fiscal years 2000-2001 and 2001-2002;
- Reduction of costs claimed in fiscal years 2000-2001, 2001-2002, and 2002-2003 based on claimant's development and application of indirect cost rates; and
- The amount of offsetting revenue to be applied from health service fee authority.

[1] Statutes 1993, chapter 8.

The Commission finds that the audit was timely. The Commission further finds that:

- Claimant did not comply with the parameters and guidelines and the SCO's claiming instructions in preparing its indirect cost rate without federal approval and, thus, the SCO's recalculation of indirect costs using another authorized method, and the resultant reduction of $188,652, is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.
- The SCO's reduction of the claimant's reimbursement claims, on the basis of understated health fee revenues of $195,333, is correct as a matter of law 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.

COMMISSION FINDINGS

I. Chronology

01/14/2002	Claimant filed a reimbursement claim for fiscal year 2000-2001.[2]
12/30/2002	Claimant filed a reimbursement claim for fiscal year 2001-2002.[3]
12/02/2004	SCO contacted claimant to schedule an entrance conference.[4]
01/05/2005	The entrance conference was held.[5]
10/05/2005	SCO issued the final audit report for fiscal years 2000-2001, 2001-2002, and 2002-2003.
03/27/2006	Claimant filed an IRC for fiscal years 2000-2001, 2001-2002, and 2002-2003.
04/03/2006	Commission staff deemed the IRC complete and issued a notice of complete filing and schedule for comments.
11/24/2008	SCO submitted comments on IRC.
08/11/2009	Claimant filed rebuttal comments.
08/01/2014	Commission staff issued the draft proposed decision.
08/05/2014	SCO filed comments on the draft proposed decision.[6]
09/26/2014	Claimant filed comments on the draft proposed decision.[7]

[2] Exhibit A, IRC, at p. 17; Exhibit B, SCO's Comments on IRC, Tab 2, "State Controller's Office (SCO) Analysis and Response," at p. 14.

[3] *Ibid*.

[4] Exhibit A, IRC, Exhibit G, Declaration of Pamela Fees, at p. 1; Exhibit B, SCO's Comments on IRC, Tab 2, State Controller's Office (SCO) Analysis and Response, at p. 15.

[5] Exhibit B, SCO's Comments on IRC, Tab 2, State Controller's Office (SCO) Analysis and Response, at p. 14.

[6] Exhibit E, SCO, Division of Audits Comments filed August 5, 2014.

[7] Exhibit F, Claimant Comments filed September 26, 2014.

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.[8] In 1984, the Legislature repealed the community colleges' fee authority for health services.[9] 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.[10]

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.[11] 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,[12] 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.[13] 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.[14] As a result, beginning January 1, 1988 all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services. In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.[15]

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[8] 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.

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

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

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

[12] Statutes 1987, chapter 1118.

[13] 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).

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

[15] 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 upon community college districts. On August 27, 1987, the Commission adopted parameters and guidelines for the *Health Fee Elimination* program. On May 25, 1989, the Commission adopted amendments to the parameters and guidelines for the *Health Fee Elimination* program to reflect amendments made by Statutes1987, chapter 1118.

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

The SCO's Audit and Summary of the Issues

The SCO reduced claimant's reimbursement claims filed for fiscal years 2000-2001, 2001-2002, and 2002-2003 by $399,891 on the ground that the claimant did not properly calculate indirect costs and did not deduct the full amount of offsetting fee revenues authorized by statute. The following issues are in dispute:

- The statutory deadline applicable to audits of reimbursement claims by the SCO for fiscal years 2000-2001 and 2001-2002;
- Reduction of indirect costs calculated and claimed in fiscal years 2000-2001, 2001-2002, and 2002-2003 and the SCO's application of an alternative indirect cost rate calculation; and
- The amount of offsetting revenue to be applied from health service authority.

III. Positions of the Parties

El Camino Community College District

Claimant argued in its initial IRC filing that the SCO incorrectly reduced reported indirect costs claimed and adjusted for uncollected offsetting revenues,[16] and that the proper measure of offsetting revenues should be the health fees collected, not the amount of fees authorized.[17] Claimant argues that the SCO inappropriately reduced "indirect cost rates and costs in the amount of $188,652 for [fiscal years 2000-2001, 2001-2002, and 2002-2003] because "the district did not obtain federal approval for its [indirect cost rate proposals (IRCPs)]."[18] Claimant contends that "there is no requirement in law that the claimant's indirect cost rate must be 'federally' approved, and the Commission has never specified the federal agencies which have the authority to approve indirect cost rates."[19] Finally, claimant disputes the application of the statute of limitations to allow audits of its reimbursement claims for fiscal years 2000-2001 and 2001-2002.[20]

[16] Exhibit A, IRC, at pp. 9-25.

[17] *Id*. at pp. 11-16.

[18] *Id*. at 9.

[19] *Ibid*.

[20] *Id*. at pp. 17-25.

In its rebuttal comments, claimant maintains that the SCO has the burden of proof in showing that the district's claimed costs were not allowable, and that therefore costs that were disallowed were improperly reduced. Claimant renews its argument that the district did not need to obtain federal approval of its indirect cost rates, and restates its challenge to the statute of limitations for audits asserted by the SCO. Claimant also, in its rebuttal comments, renewed its contention regarding the health fee authority.[21]

In its comments on the draft proposed decision, claimant reasserts its statute of limitations challenge by arguing that the 2002 and 2004 amendments to Government Code section 17558.5 are not relevant to the audit of its claims for fiscal years 2000-2001 and 2001-2002 and that section 17558.5 must be applied as it read when the claims were filed.[22] Claimant further argues that the SCO's claiming instructions alone on indirect cost rates are not legally enforceable because they are not regulations and do not derive from the test claim or the parameters and guidelines for the *Health Fee Elimination* program.[23]

Finally, the claimant now agrees that the Health Fee Rule must be applied, pursuant to *Clovis Unified*, yet argues that the data used by the SCO to calculate offsetting revenues is not from a source approved by the Commission and so it arbitrary, capricious and entirely lacking in evidentiary support.

State Controller's Office

The SCO concluded that claimant overstated indirect costs by $188,652 for the audit period, because the "district claimed indirect costs based on an indirect cost rate proposals (ICRPs) prepared for each fiscal year by an outside consultant…[but] did not obtain federal approval for its ICRPs."[24] The SCO also concluded that claimant "understated authorized health fee revenue by $195,333" by claiming actual, rather than authorized, health fee revenues.[25] Finally, the SCO argues that the statute of limitations for audits under section 17558.5 permitted the SCO to audit fiscal years 2000-2001 and 2001-2002.[26]

On August 5, 2014, the SCO filed comments concurring with the draft proposed decision.[27]

IV. Discussion

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

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[21] Exhibit C, Claimant Rebuttal Comments, at pp. 1-4.

[22] Exhibit F, Claimant Comments on Draft Proposed Decision.

[23] *Id*., at pp. 8-9.

[24] Exhibit B, SCO's Comments on IRC, Exhibit D, SCO Final Audit Report dated October 5, 2005, at p. 6.

[25] *Id*., at p. 8.

[26] Exhibit B, SCO's Comments on IRC, Tab 2, State Controller's Office (SCO) Analysis and Response, at pp. 13-17.

[27] Exhibit E, Controller's Comments on Draft Proposed Decision.

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the SCO has incorrectly reduced payments to the local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9 of the Commission's regulations requires the Commission to send the decision to the SCO 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 SCO 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.[28] 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."[29]

With regard to the SCO'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.[30] 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.]' "[31]

The Commission must also review the SCO's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant. [32] 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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[28] *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

[29] *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.

[30] *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.

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

[32] *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.[33]

A. The Audit of the Fiscal Year 2000-2001 and 2001-2002 Reimbursement Claims Was Not Barred by the Statutory Deadline Found in Government Code Section 17558.5.

The claimant asserts that the statute of limitations applicable to audits of mandate reimbursement claims bars the SCO's audit of the claim filed for fiscal years 2000-2001 and 2001-2002.

The time to audit a reimbursement claim is provided in Government Code section 17558.5. At the time the reimbursement claims in this case were filed in 2002, Government Code section 17558.5, as added in 1995, stated the following:

> A reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter is subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended. However, if no funds are appropriated for the program for the fiscal year for which the claim is made, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[34]

The plain language of Government Code section 17558.5, as added in 1995, provides that reimbursement claims are "subject to audit" no later than two years after the end of the calendar year that the reimbursement claim was filed. The phrase "subject to audit" does not require the completion of the audit, but sets a time during which a claimant is on notice that an audit of a claim may occur.[35] This reading is consistent with the plain language of the second sentence, which provides that when no funds are appropriated for the program, "the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim."

This interpretation is also consistent with the Legislature's 2002 amendment to Government Code section 17558.5, effective January 1, 2003, clarifying that "subject to audit" means "subject to the initiation of an audit," as follows in underline and strikeout:

> 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 ~~two~~ three years after the ~~end of the calendar year in which the~~ date that

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[33] 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.

[34] Government Code section 17558.5 (Stats. 1995, ch. 945, (SB11)). Former Government Code section 17558.5 was originally added by the Legislature by Statutes 1993, chapter 906, effective January 1, 1994. The 1993 statute became inoperative on July 1, 1996, and was repealed on January 1, 1997 by its own terms.

[35] City of Oakland v. Public Employees' Retirement System (2002) 95 Cal.App.4th 29, at p. 45 [The court held that PERS' duties to its members override the general procedural interest in limiting claims to three or four years: "[t]here is no requirement that a particular type of claim have a statute of limitation."].

> 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 ~~made~~ filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim.[36]

And finally, Government Code section 17558.5 was amended again in 2004 to establish the requirement to "complete" the audit two years after the audit is commenced. As amended and effective beginning January 1, 2005, it reads as follows in underline and strikeout:

> 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.[37]

The parties disagree about which version of section 17558.5 applies in this case. The claimant argues that Government Code section 17558.5, as amended by Statutes 1995, chapter 945 (operative July 1, 1996) applies in this case, requiring that a reimbursement claim "is subject to audit by the Controller no later than two years after the end of the calendar year in which the reimbursement claim is filed or last amended..."[38] The claimant asserts that "subject to audit" requires the SCO "to complete" the audit no later than two years after the end of the calendar year that the reimbursement claim was filed. In this case, the claimant contends that the audit of the reimbursement claims for fiscal years 2000-2001 and 2001-2002, which were respectively filed on January 14, 2002, and December 30, 2002, were subject to audit and had to be completed by December 31, 2004. Claimant reasons that since the final audit report was issued on October 5, 2005, ten months after the deadline, the audit of these reimbursement claims is barred.

The SCO contends that the audit of the reimbursement claims is timely, but makes two different arguments to support its position. First, in the SCO's "Analysis and Response to the Incorrect Reduction Claim, the SCO relies on the 1995 version of Government Code section 17558.5, arguing "subject to audit" means subject to the initiation of an audit, and does not require that the audit be completed within "two-years after the end of the calendar year in which the reimbursement claim is filed." The SCO further asserts that the reimbursement claims in this case, both filed in 2002, were subject to audit through December 31, 2004, and that the audit was timely initiated on December 2, 2004, when the SCO contacted the claimant by phone to request an entrance conference. The entrance conference was conducted on January 5, 2005. These comments state the following:

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[36] Statutes 2002, chapter 1128.

[37] Statutes 2004, chapter 313.

[38] Government Code section 17558.5 (Stats. 1995, ch. 945 (SB 11)); Exhibit A, IRC, at p. 19; Exhibit F, Claimant Comments on Draft Proposed Decision, at pages 1-2.

> Government Code section 17558.5 subdivision (a), effective July 1, 1996, states that a district's reimbursement claim is subject to audit no later than two years after the end of the calendar year in which the claim is filed or last amended. The district filed its FY 2000-01 claim on January 14, 2002, and filed its 2001-02 claim on December 30, 2002. Thus, both claims were subject to audit through December 31, 2004. The SCO initiated the audit on December 2, 2004, and conducted an audit entrance conference on January 5, 2005, at the district's request. Therefore, the SCO initiated an audit within the period in which both claims were subject to audit.[39]

However, in a letter prepared by the SCO's staff counsel, the SCO argues that Government Code section 17558.5, *as later amended by Statutes 2002, chapter 1128* (AB 2834), provides the proper statute of limitations, because "[u]nless a statute expressly provides to the contrary, any enlargement of a statute of limitations provision applies to matters pending but not already barred." [40] The SCO reasons, the expanded statute of limitations is applicable, providing that a reimbursement claim "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." Therefore, the audit of the 2000-2001 claim had to be initiated by January 14, 2005, and the audit of the 2001-2002 claim had to be initiated by December 30, 2005. The letter further states that the audit in this case was timely initiated "no later than January 5, 2005," the date of the entrance conference.

Although the claimant asserts that the date the audit was initiated is not relevant to the analysis of Government Code section 17558.5 since the statute requires the audit to be completed by the deadline, the claimant factually disputes the SCO's assertions about when the audit was "initiated." The claimant argues that an audit is initiated when the entrance conference is held, and that the SCO's position, that the audit was initiated *before* the entrance conference, is new and conflicts with prior positions of the SCO.[41] The claimant also disagrees with the SCO's factual assertion that the claimant requested that the entrance conference be delayed until January 5, 2005, due to the unavailability of district staff. In this respect, the claimant has filed a declaration from Pamela Fees, Business Manager for El Camino Community College District, describing the communication with the SCO that began with a phone call on December 2, 2004.[42] Ms. Fees declares that the district was available to meet on December 9, 2004, but was told that the SCO was not available on that date and that the SCO requested the conference be conducted on January 5, 2005. Ms. Fees also declares that she was asked by the SCO's Office to prepare a letter stating that the entrance conference was postponed until January 5, 2005. The letter was mailed on December 8, 2004. On December 9, 2004, Ms. Fees received a letter faxed by the SCO's audit manager stating that the delay of the entrance conference date was due to the

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[39] Exhibit B, SCO's Comments on IRC, Tab 2, "State Controller's Office (SCO) Analysis and Response," at pp. 13-14.

[40] Exhibit B, SCO's Comments on IRC, letter by Shawn D. Silva, Staff Counsel, State Controller's Office, at p. 2. (Citing, *Douglas Aircraft Co. v. Cranston* (1962) 58 Cal.2d 462, 465; 43 Cal.Jur.3d, Limitation of Actions § 8.)

[41] Exhibit A, IRC, at pp. 22-23; Exhibit C, claimant's rebuttal comments, at p. 10.

[42] Exhibit A, IRC, at claimant's exhibit G.

unavailability of District staff. Ms. Fees declares that this statement is in "direct contradiction of all previous district communication and correspondence."

For the reasons below, the Commission finds that the audit of the 2000-2001 and 2001-2002 reimbursement claims was timely.

At the time the reimbursement claims were filed in 2002, the reimbursement claims in issue were "subject to audit," pursuant to the 1995 version of section 17558.5, two years after the end of the calendar year that the reimbursement claims were filed, or by December 31, 2004. Although the parties dispute whether "subject to audit" in the 1995 version of section 17558.5 requires the SCO to initiate the audit or complete the audit by December 31, 2004, that issue does not need to be decided in this case. Under either interpretation, the audit of the 2000-2001 and 2001-2002 reimbursement claims remained pending until at least December 31, 2004.

Effective January 1, 2003 (a full year before the December 31, 2004 deadline), section 17558.5 was amended to enlarge the time period in which the SCO is required to initiate the audit to three years after the date the actual reimbursement claim is filed or last amended. Pursuant to the *Douglas Aircraft* case, "[u]nless a statute expressly provides to the contrary, any enlargement of a statute of limitations provision applies to matters pending but not already barred."[43] The Court in *Douglas Aircraft* stated the general rule as follows:

> The extension of the statutory period within which an action must be brought is generally held to be valid if made before the cause of action is barred. (*Weldon v. Rogers*, 151 Cal. 432.) The party claiming to be adversely affected is deemed to suffer no injury where he was under an obligation to pay before the period was lengthened. This is on the theory that the legislation affects only the remedy and not a right. (*Mudd v. McColgan*, 30 Cal.2d 463; *Davis & McMillan v. Industrial Acc. Com.*, 198 Cal. 631; 31 Cal.Jur.2d 434.) An enlargement of the limitation period by the Legislature has been held to be proper in cases where the period had not run against a corporation for additional franchise taxes (*Edison Calif. Stores, Inc. v. McColgan*, 30 Cal.2d 472), against an individual for personal income taxes (*Mudd v. McColgan*, *supra*, 30 Cal.2d 463), and against a judgment debtor (*Weldon v. Rogers*, *supra*, 151 Cal. 432). It has been held that unless the statute expressly provides to the contrary any such enlargement applies to matters pending but not already barred. (*Mudd v. McColgan*, *supra*, 30 Cal.2d 463.)[44]

In *Mudd v. McColgan*, relied upon in *Douglas Aircraft*, the Court explained:

> It is settled law of this state that an amendment which enlarges a period of limitation applies to pending matters where not otherwise expressly excepted. Such legislation affects the remedy and is applicable to matters not already barred, without retroactive effect. Because the operation is prospective rather than retrospective, there is no impairment of vested rights. [Citations.] Moreover, a party has *no vested right in the running of a statute of limitation prior to its expiration*. He is deemed to suffer no injury if, at the time of an

[43] *Douglas Aircraft Co. v. Cranston* (1962) 58 Cal.2d 462, at p. 465.

[44] *Id*, at page 465.

> amendment extending the period of limitation for recovery, he is under obligation to pay. In *Campbell v. Holt*, 115 U.S. 620, at page 628, it was said that statutes shortening the period or making it longer have always been held to be within the legislative power until the bar was complete.[45]

And in *Liptak v. Diane Apartments, Inc.*, the Second District Court of Appeal, relying in part on *Mudd, supra*, reasoned:

> A party does not have a vested right in the time for the commencement of an action. (*Mill and Lumber Co. v. Olmstead* (1890) 85 Cal. 80, 84-85.) Nor does he have a vested right in the running of the statute of limitations prior to its expiration. (*Mudd v. McColgan* (1947) 30 Cal.2d 463, 468; *Weldon v. Rogers* (1907) 151 Cal. 432, 434.) *A change in the statute of limitations merely effects a change in procedure and the Legislature may shorten the period, however, a reasonable time must be permitted for a party affected to avail himself of the remedy before the statute takes effect.* (*Rosefield Packing Co. v. Superior Court* (1935) 4 Cal.2d 120, 122; *Davis & McMillan v. Industrial Acc. Com.* (1926) 198 Cal. 631, 637; *Mill and Lumber Co. v. Olmstead*, *supra*, 85 Cal. at p. 84.)[46]

Therefore, an expansion of a statute of limitations applies to matters pending but not already barred, based in part on the theory that a party has no vested right in the running of a statutory period prior to its expiration.[47]

In this case, the 2002 amendment to section 17558.5 became effective on January 1, 2003, when the audit period for both reimbursement claims was still pending and not yet barred under the prior statute. The 2002 statute, which enlarged the time to initiate the audit to three years after the date the actual reimbursement claim is filed or last amended, would control, and gives the SCO additional time to initiate the audit. The SCO therefore had until January 14, 2005 to initiate the audit of the 2000-2001 reimbursement claim, and had until December 30, 2005, to initiate the 2001-2002 reimbursement claim. Since the audit was initiated "no later than January 5, 2005," when the entrance conference was held, the audit was timely initiated.

The Commission further finds that the audit was timely completed. Before Government Code section 17558.5 was amended effective January 1, 2005, the SCO had to complete an audit within a reasonable period of time,[48] but did not have a statutory deadline for the completion of an audit. Effective January 1, 2005, when the audit period was still pending in this case, the rule changed to require that "an audit shall be completed not later than two years after the date that the audit is commenced;" which in this case would be no later than January 5, 2007. The courts have held that where the state gives up a right previously possessed by it or one of its agencies (like the SCO's unspecified time to complete an audit before January 1, 2005), the restriction in

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[45] *Mudd v. McColgan* (1947) 30 Cal.2d 463, 468 [emphasis added].

[46] (1980) 109 Cal.App.3d 762, 773.

[47] *Mudd v. McColgan* (1947) 30 Cal.2d 463, 468.

[48] Under appropriate circumstances, the defense of laches may operate to bar a claim by a public agency if there is evidence of unreasonable delay by the agency and resulting prejudice to the claimant. (*Cedar-Sinai Medical Center v. Shewry* (2006) 137 Cal.App.4th 964, 985-986.)

the new law becomes effective immediately upon the operative date of the change in law for all pending claims. In *California Employment Stabilization Commission v. Payne* (1948) 1931 Cal.2d 210, 215-216, the court stated the following:

> Accordingly, the power of the Legislature to lessen a statute of limitations is subject to the restriction that an existing right cannot be cut off summarily without giving a reasonable time after the act becomes effective to exercise such right. (See *Davis & McMillan v. Ind. Acc. Comm.*, 198 Cal. 631, 637, 246 P. 1046, 46 A.L.R. 1095.) This principle, however, does not apply where the state gives up a right previously possessed by it or by one of its agencies. Except where such an agency is given powers by the Constitution, it derives its authority from the Legislature, which may add to or take away from those powers and therefore a statute which adversely affects only the right of the state is not invalid merely because it operates to cut off an existing remedy of an agency of the state. The case of Superior Oil Co. v. Superior Court, 6 Cal.2d 113, 56 P.2d 950, is distinguishable since the court was there concerned with the operation of a statute which applied to private persons as well as the state. This distinction was not noted in *Calif. Emp. Stab. Comm. v. Chichester etc. Co.*, 75 Cal.App.2d 899, 172 P.2d 100, which relied on the Superior Oil case and assumed without discussion that the same rule would apply where the state alone would be adversely affected. It was held in the *Chichester* case that the amendment of section 45.2 in 1943 could not operate to deprive the commission of the right to sue on existing causes of action until a reasonable time had passed after the statute became effective. The commission was created by, and derives its powers from, the Legislature, and it does not have rights which are superior to the legislative will. By the enactment in 1939 of section 45.2, the three-year limitation contained in section 338 was rendered inapplicable, and the commission was given the right without limit as to time to enforce contributions where no return had been filed. Thereafter in 1943 the Legislature determined that it was unwise and perhaps unfair to allow the commission an unlimited time within which to enforce contributions where there was no intent to evade the act, and as to those cases, the three-year limitation was restored and the right of action was cut off if the period had run. This the Legislature had the power to do insofar as the constitutional requirement of due process is concerned, and the holding to the contrary in the *Chichester* case, 75 Cal.App.2d 899, 172 P.2d 100, is disapproved.

Here, the audit was completed when the final audit report was issued on October 5, 2005, well before the two year deadline of January 5, 2007, to complete the audit.

Based on the foregoing, the Commission finds that the audit of the District's reimbursement claim for fiscal years 2000-2001 and 2001-2002 is not barred by the statutory deadline in section 17588.5.

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

The parameters and guidelines state that "indirect costs may be claimed in the manner described by the State Controller in his claiming instructions."[49] The SCO's claiming instructions provide two options for claiming indirect costs, the OMB Circular A-21 or the state's methodology in FAM-29C. In its audit of claims for fiscal years 2000-2001, 2001-2002, and 2002-2003 the SCO found that the claimant used the OMB Circular A-21 methodology, but did not obtain federal approval of its indirect cost rate for these years, as required by the parameters and guidelines and claiming instructions.[50] Thus, the SCO applied the alternative Form FAM-29C methodology to calculate indirect costs.[51] Applying these rates to total direct costs for the three fiscal years subject to audit resulted in a reduction in indirect costs of $188,652.[52]

As discussed below, the Commission finds that the claimant did not comply with the parameters and guidelines and SCO's claiming instructions in preparing its indirect cost rate, so the SCO's reduction and recalculation of these costs is correct as a matter of law and 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 SCO's claiming instructions, which in turn provide for an indirect cost rate to be developed in accordance with federal OMB Circular A-21 guidelines or by using the state Form FAM-29C.*

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.[53] The reimbursement claims filed by the claimants are, likewise, required as a matter of law to be filed in accordance with the parameters and guidelines.[54] The parameters and guidelines for the *Health Fee Elimination* program provide that "*indirect costs may be claimed in the manner described by the State Controller in his claiming instructions*."[55]

Claimant argues that it is not required to adhere to the claiming instructions.[56] Claimant also argues that the word "may" is permissive, and that therefore the parameters and guidelines do not require that indirect costs be claimed in the manner described by the SCO.[57] In addition,

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[49] Exhibit A, Incorrect Reduction Claim, at p. 38.

[50] Exhibit B, SCO's Comments on IRC, Tab 2, SCO's Analysis and Response to the IRC, at pp. 5-8.

[51] Exhibit B, SCO's Comments on IRC, Exhibit D, SCO Final Audit Report dated October 5, 2005, at p. 6.

[52] *Ibid*.

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

[54] Government Code sections 17561(d)(1); 17564(b); and 17571.

[55] Exhibit A, IRC, p. 10.

[56] Exhibit A, IRC, p. 10.

[57] *Ibid.*

claimant argues that "[n]either state law nor the parameters and guidelines made compliance with the Controller's claiming instructions a condition of reimbursement."[58]

Claimant is incorrect. The parameters and guidelines plainly 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 must adhere to the SCO's claiming instructions.

The claiming instructions specific to the *Health Fee Elimination* mandate, revised September of 1997,[59] 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."

In addition, the School Mandated Cost Manual, revised each year, and containing instructions applicable to all school and community college mandated programs,[60] provides as follows:

> A college has the option of using a *federally approved* rate, utilizing the cost accounting principles from Office of Management and Budget Circular A-21 "Cost Principles for Educational Institutions," or the Controller's methodology outlined in the following paragraphs. If the federal rate is used, it must be from the same fiscal year in which the costs were incurred.[61]

The reference in the parameters and guidelines to the SCO's claiming instructions necessarily includes the general provisions of the School Mandated Cost Manual (and later the Mandated Cost Manual for Community Colleges), and the manual provides ample notice to claimants as to how they may properly claim indirect costs. Claimant's assertion that "[n]either State law or the parameters and guidelines made compliance with the SCO's claiming instructions a condition of reimbursement"[62] is therefore not correct.[63]

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

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[58] *Id.*at p. 11.

[59] Exhibit B, Controller's Comments, at pp. 40.

[60] Exhibit G, School Mandated Cost Manual Excerpt, revised 09/01, at page 7; School Mandated Cost Manual Excerpt, revised 09/02, at page 7; School Mandated Cost Manual Excerpt, revised 09/03, at page 10.

[61] Exhibit G, School Mandated Cost Manual Excerpt, revised 09/01, at page 7 [as revised 09/02 and 09/03, the manuals continue to provide similarly].

[62] Exhibit A, IRC, at p. 11.

[63] Government Code section 17564(b) was amended by Statutes 2004, chapter 890, to require: "Claims for direct and indirect costs filed pursuant to Section 17561 shall be filed in the manner prescribed in the parameters and guidelines and claiming instructions."

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.[64]

Claimant also argues that because the claiming instructions "were never adopted as law, or regulations pursuant to the Administrative Procedure Act, the claiming instructions are merely a statement of the ministerial interests of the SCO and not law."[65] In the *Clovis* case, [66] the SCO'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.[67] 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.

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.[68]

Therefore, the Commission finds that the parameters and guidelines expressly require claimants to claim indirect costs in the manner described in the SCO's the claiming instructions, which in turn provide that an indirect cost rate may be developed in accordance with federal OMB guidelines, requiring federal approval, or by using the state Form FAM-29C; and that the 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 and applying its indirect cost rate. Therefore, the SCO's reduction and recalculation of costs, applying the Form FAM-29C calculation to provide an indirect cost rate, is correct as a matter of law and is not arbitrary, capricious, or entirely lacking in evidentiary support.*

The claiming instructions specify that, to use the OMB Circular A-21 option, a claimant must obtain federal approval, which the claimant here did not do. Thus, because claimant did not obtain federal approval, the claimant did not comply with the requirements of the parameters and guidelines and claiming instructions in developing and applying its indirect cost rate. Therefore, the SCO's adjustment for overstated indirect costs is correct as a matter of law.

In its audit of claimant's reimbursement claims, the SCO, concluding that the rate was not approved and therefore not supported by the parameters and guidelines and the claiming

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[64] Exhibit G, OMB Circular A-21.

[65] Exhibit A, IRC, p. 10.

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

[67] *Id.* at page 807.

[68] Exhibit I, School Mandated Cost Manual Excerpt, 2001-2002, page 11; Community College Mandated Cost Manual Excerpt, 2002-2003, page 7.

instructions, recalculated the indirect cost rate using the alternative state procedure, the "FAM-29C method," outlined in the School Mandated Cost Manual.[69]

Claimant asserts that "the difference in the claimed and audited methods is in the determination of which of those cost elements are direct costs and which are indirect costs." Claimant continues:

> 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 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.[70]

Claimant argues that the SCO "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 SCO's decision to recalculate indirect costs by its own method "is an arbitrary choice of the SCO, not a 'finding' enforceable by fact or law."[71]

The Commission finds that the SCO's use of the FAM-29C method for calculating indirect costs is not arbitrary or capricious. The FAM-29C method is expressly authorized by the claiming instructions. Although claimant argues that this substitution of methods was arbitrary, based on the above analysis, claimant failed to comply with the requirements of the parameters and guidelines and claiming instructions with respect to the OMB method of calculating indirect cost rates that it used. Claimant does not assert that the rate calculated was arbitrary; only that it was arbitrary to substitute the state method outlined in the claiming instructions for the claimant's preferred but incorrectly executed method.

Based on the foregoing, the Commission finds that the SCO's reduction and recalculation of costs based on applying the Form FAM-29C calculation to provide an indirect cost rate is correct as a matter of law and was not arbitrary, capricious, or entirely lacking in evidentiary support.

C. The SCO's Audit Reduction for Understated Offsetting Revenues Pursuant to the Health Fee Rule is Correct as a Matter of Law.

The SCO reduced the reimbursement claims by $8,807 for fiscal year 2000-2001, $111,710 for fiscal year 2001-2002, and $74,816 for fiscal year 2002-2003 on the ground that the authorized, but uncollected, health service fees should have been deducted as offsetting revenue.[72] The claimant reported and deducted only the amounts collected rather than the fee revenue authorized by statute.

Though claimant now agrees that the Health Fee Rule applies, claimant argued, in its original IRC filing and rebuttal comments that the parameters and guidelines only require a claimant to

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[69] Exhibit B, Controller's Comments on the IRC, tab 2, pp. 6-7.

[70] Exhibit A, IRC, page 9.

[71] Exhibit A, IRC, page 11.

[72] Exhibit B, SCO's Comments on IRC, Exhibit D, SCO Final Audit Report dated October 5, 2005, at pp. 8-11.

declare offsetting revenues that the claimant "experiences," and that while the fee amount that claimant was authorized to impose may have increased for the applicable period, nothing in the Education Code made the increase of those fees mandatory.[73] Claimants argue that the issue is the difference between fees collected and fees collectible.[74]

After claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the issue of whether the SCO properly reduced reimbursement claims for state-mandated health services required by 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 (i.e., the "Health Fee Rule). 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.[75] (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).[76]

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.[77] The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered.

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[73] Exhibit A, IRC, at p. 15.

[74] *Id*. at pp. 15-16.

[75] *Clovis Unified School Dist. v. Chiang*, *supra*, 188 Cal.App.4th at page 811.

[76] 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)].

[77] 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

Claimant argued in the IRC that the actual increase of the fee imposed upon students requires action of the community college district,[78] and that "[t]his issue is one of student health fees revenue actually received, rather than student health fees which might be collected."[79] But the court in *Clovis Unified* upheld, as a matter of law, the SCO's use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. In making its decision the court noted that 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.[80]

The court also noted that, "this basic principle flows from common sense as well. As the SCO succinctly puts it, 'Claimants can choose not to require these fees, but not at the state's expense.'"[81] 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."[82] 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*.[83] (Italics added.)

The claimant here was a party to the *Clovis* case and is bound by the decision therein under principles of collateral estoppel.[84] 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.[85] The issue decided by the court is identical to the issue in this IRC.

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

[78] Exhibit A, IRC, at p. 15.

[79] *Ibid*.

[80] *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 812.

[81] *Ibid.*

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

[83] *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th at page 812.

[84] 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.

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

Thus, pursuant to the court's decision in *Clovis*, the Health Fee Rule used by the SCO 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.[86]

In its comments filed on the draft proposed decision, claimant "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."[87] However, claimant argues that the draft proposed decision is inconsistent with the Commission's October 27, 2011 decision on seven consolidated Health Fee IRCs. Claimant argues that, based upon the Commission's prior decision, the only approved source of enrollment data is "specific Community College Chancellor's MIS data to obtain enrollment amounts."[88] For this audit, however, the claimant argues that the SCO was incorrect to use a different methodology. The SCO's final audit report states: "[The SCO] recalculated the authorized health fees the district was authorized to collect using the district's Student Enrollment Reports and the [Board of Governors Grants] Detail Reports dated January 2005 through March 2005."[89]

Claimant is correct that an in earlier decision on seven consolidated Health Fee Elimination IRCs, the Commission found that the "Community College Chancellor's MIS data" was a "reasonable and reliable source" for enrollment data, and use of such data was not arbitrary or capricious.[90] Claimant argues that this earlier finding requires that the SCO's audit of the claims at issue here must also use MIS enrollment data from the CCCCO, not any other source.[91] However, claimant does not assert that the data used by the SCO was incorrect and the Commission did not determine that the MIS data was the *only* reasonable and reliable source for the data. Additionally, claimant has not raised a specific objection to the data being used, other than that it is not the "MIS" data. Therefore, the Commission finds that the SCO's recalculation of fee authority based on the Health Fee Rule, and utilizing enrollment and exemption information available was not arbitrary, capricious, or entirely lacking in evidentiary support.

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

V. Conclusion

Pursuant to Government Code section 17551(d), the Commission concludes that the SCO's reduction of claimed costs for indirect costs is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

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

[87] Exhibit F, Claimant's Comments on Draft Proposed Decision, at p. 12.

[88] *Ibid*.

[89] Exhibit F, Claimant's Comments on Draft Proposed Decision, at p. 13 [quoting from Controller's Final Audit Report, page 11].

[90] Statement of Decision, Health Fee Elimination, 09-4206-I-19, at p. 35.

[91] Exhibit F, Claimant's Comments on Draft Proposed Decision, at p. 13.

The Commission finds that the audit was timely. The Commission further finds that:

- Claimant did not comply with the parameters and guidelines and the SCO's claiming instructions in preparing its indirect cost rate without federal approval and, thus, the SCO's recalculation of indirect costs using another authorized method, and the resultant reduction of $188,652, is correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.
- The SCO's reduction of the claimant's reimbursement claims, on the basis of understated health fee revenues, of $195,333, is correct as a matter of law 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.

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RE: **Decision**

Health Fee Elimination, 05-4206-I-11
Education Code Section 76355
Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118
Fiscal Years 2000-2001, 2001-2002, and 2002-2003
El Camino 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 11, 2014

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

[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

[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

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[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 Education Code [section] 76355.[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
COMMISSION ON STATE MANDATES
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SACRAMENTO, CA 95814
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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

BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM ON: Education Code Section 49079 Statutes 1989, Chapter 1306; Statutes 1993, Chapter 1257 Fiscal Years 2001-2002 and 2002-2003 San Diego Unified School District, Claimant.	Case No.: 05-4452-I-01 *Notification to Teachers: Pupils Subject to Suspension or Expulsion* DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5. ARTICLE 7 (*Adopted September 26, 2014*) (*Served September 29, 2014*)

DECISION

The Commission on State Mandates (Commission) heard and decided this incorrect reduction claim (IRC) during a regularly scheduled hearing on September 26, 2014. Martha Alvarez, representative for San Diego Unified School District, appeared on behalf of the claimant. Jim Spano and Ken Howell appeared on behalf of the State Controller's Office (SCO).

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

This IRC filed by San Diego Unified School District (claimant) challenges reductions made by the SCO to the District's reimbursement claims for costs incurred in fiscal years 2001-2002 and 2002-2003 for the *Notification to Teachers: Pupils Subject to Suspension or Expulsion* program, CSM-4452. Following an audit, the SCO reduced the claims in the amount of $166,791 in fiscal year 2001-2002 and $187,255 in fiscal year 2002-2003 on the grounds that the district claimed employee time that was not supported by actual time records or a valid "documented" time study.

The Commission denies this IRC and finds that the reductions made by the SCO for salaries and benefits are consistent with the parameters and guidelines, reasonable, and not arbitrary and capricious or entirely lacking in evidentiary support.

The parameters and guidelines authorize reimbursement for salary and benefit costs of an employee performing the mandated activities, but require the claimant to either specify the actual number of hours an employee devoted to the mandated activities or the average number of hours spent on the program if supported by a "documented" time study. The parameters and guidelines further require claimants to maintain supporting documentation to evidence the validity of the costs claimed.

Claimant admits that it does not have any documentation to support the actual costs incurred by the schools at issue in this case. However, claimant used cost data from other schools within the district that did collect and maintain source documentation to calculate the average costs incurred for 37 schools in fiscal year 2001-2002 and 57 schools in fiscal year 2002-2003 that did not collect or maintain source documentation. Although Section VI B. 1. of the parameters and guidelines provides that claimants may utilize time studies to support claims for reimbursement, the time studies must be documented to show the average time spent by the employee performing the mandated activities. Here, claimant did not comply with these requirements. Moreover, claimant admits that there is no district policy on this mandated program and that each school within the district performs the mandate differently. Thus, claimant's use of data from other schools within the district to calculate an average cost for those schools that did not maintain any documentation of the costs, does not provide sufficient evidence of the validity of the costs actually incurred by these schools.

The Commission further finds that the record supports the SCO's contention that claimant's extrapolation of data from reporting schools to schools that did not collect and maintain source documentation to support the costs claimed raises valid questions regarding whether the data accurately reflects the undocumented costs from those schools. As the administrative agency responsible for auditing mandate reimbursement claims, the interpretation of the SCO is entitled to great weight. The Commission may not reweigh the evidence or substitute its judgment for that of the SCO.

Finally, the Commission finds that claimant's assertion that its "time study" qualifies as a reasonable reimbursement methodology, is not supported by the law. Government Code section 17518.5 defines reasonable reimbursement methodology (RRM) to mean a formula for reimbursing local agencies and school districts for costs mandated by the state. The RRM may be based on a general allocation formula, uniform cost allowance, or other approximations of local costs mandated by the state. The RRM, however, must be adopted by the Commission pursuant to Government Code section 17557, following a request, an opportunity for comment by the parties, a public hearing, and the adoption of a decision on the matter. The parties have not submitted a request to include an RRM in the parameters and guidelines for this program, and the Commission has not adopted one. The mandates process does not allow a party, on its own, to use a formula for claiming reimbursement of state-mandated costs.

Accordingly, the Commission denies this IRC.

COMMISSION FINDINGS

Chronology

01/19/1995	The Commission approved the *Notification to Teachers: Pupils Subject to Suspension or Expulsion* test claim.
07/20/1995	The Commission adopted parameters and guidelines.[1]
06/30/2005	SCO issued final audit for fiscal years 2001-2002 and 2002-2003.

[1] Exhibit E, Parameters and Guidelines adopted July 20, 1995. Note that the parameters and guidelines have since been amended twice: once on August 1, 2008 and again on May 27, 2010. However, the amended parameters and guidelines are not relevant to this IRC.

06/26/2006	Claimant filed an IRC for fiscal years 2001-2002 and 2002-2003.[2]
07/06/2006	Commission staff deemed the IRC filing complete and issued a notice of complete incorrect reduction claim filing and schedule for comments.
11/21/2007	SCO filed comments on the IRC.[3]
05/16/2014	Commission staff issued draft proposed decision and notice of hearing for July 25, 2014.[4]
06/04/2014	SCO filed comments on the draft proposed decision.[5]
07/23/14	Claimant requested postponement of the hearing.
07/24/14	Commission staff issued a notice approving the request to postpone the hearing to September 26, 2014 for good cause.

I. Introduction

This IRC challenges reductions made by the SCO to reimbursement claims for costs claimed for fiscal years 2001-2002 and 2002-2003 for the *Notification to Teachers: Pupils Subject to Suspension or Expulsion* program, CSM-4452. Following an audit, the SCO reduced the claims by $166,791for fiscal year 2001-2002 and $187,255 for fiscal year 2002-2003[6] on the grounds that the claimed employee time was not supported by actual time records or a valid time study.

Claimant seeks a determination from the Commission pursuant to Government Code section 17551(d) that the SCO incorrectly reduced the claim, and requests that the SCO reinstate the $354,046 reduced.

Summary of the Program

Under the *Notification to Teachers: Pupils Subject to Suspension or Expulsion* program, school districts are eligible to claim reimbursement for the costs to perform the following activities:

> (1) From records maintained in the ordinary course of business or received from law enforcement agencies, identify pupils who have, during the previous three years, engaged in, or are reasonably suspected to have engaged in, any of the acts described in any of the subdivisions of Education Code section 48900, except subdivision (h).
>
> (2) Provide this information to teachers on a routine and timely basis.

[2] Exhibit A, IRC.

[3] Exhibit B, State Controller's Office, Comments on IRC.

[4] Exhibit C, Draft Proposed Decision.

[5] Exhibit D, SCO Comments on Draft Proposed Decision.

[6] For the 2002-2003 claim, the IRC shows a disputed amount that differs from the amount noted in the conclusion of the IRC. The difference represents audit adjustments in the amount of $5,485 related to costs funded from restricted fund sources. (See Exhibit B, Controller's Comments on the IRC, attachment Exhibit I, Audit Report dated June 2005.) The claimant has not disputed that adjustment.

(3) Maintain the information regarding the identified pupils for a period of three years, and adopt a cost effective method to assembly, maintain and disseminate the information to teachers.[7]

Parameters and guidelines for the program were adopted in 1995.[8] Section VI B. of the parameters and guidelines provide instructions on supporting documentation for claiming reimbursement for employee salaries and benefits, and requires the claimant to either specify the actual number of hours an employee devoted to the mandated activities or the average number of hours spent on the program if supported by a "documented time study" as follows:

B. Supporting Documentation

Claimed costs should be supported by the following information:

1. Employee Salaries and Benefits

Identify the employee(s) and their job classification, describe the mandated functions performed, and specify the actual number of hours devoted to each function, the productive hourly rate, and the related benefits. The average number of hours devoted to each function may be claimed if supported by a documented time study.

Section VII of the parameters and guidelines requires supporting data to be kept by the claimant, which evidences the validity of the costs claimed as follows:

For auditing purposes, all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs. Pursuant to Government Code section 17558.5, these documents must be kept on file by the agency submitting the claim for a period of no less than four years after the end of the calendar year in which the reimbursement claim is filed, and made available on the request of the SCO.

The SCO's Audit

As determined in the SCO's audit in this case, claimant submitted contemporaneous time logs or activity reports prepared by school site employees that performed the mandated activities showing the actual time spent on the program, and claimed reimbursement for the salary and benefit costs for these employees based on these time logs for several schools. These costs are not in dispute.

The disputed costs stem from claimed reimbursement for the salary and benefit costs for employees of schools that did *not* maintain actual time logs or maintain other documentation supporting the time spent on the program. For these employees, claimant reported an average time spent on each reimbursable activity for each student suspended from school. The average

[7] Exhibit E, Statement of Decision on the *Notification to Teachers: Pupils Subject to Suspension or Expulsion* test claim adopted January 19, 1995.

[8] Exhibit E, Parameters and Guidelines adopted on July 25, 1995. Although the parameters and guidelines for the *Notification to Teachers: Pupils Subject to Suspension or Expulsion* (CSM-4452) program were subsequently amended and consolidated with a later claim, the amended and consolidated parameters and guidelines are not applicable to this IRC.

time was calculated based on the time logs prepared and submitted by other employees at different schools within the district that documented their time for this program. For fiscal year 2001-2002, claimant used the average times to calculate the costs for employees at 37 schools that did not have actual time logs. Claimant explains the costs claimed as follows:

> For fiscal year 2001-2002, the District has time logs from 66 schools totaling $236,587. These schools reported a total of 6,451 suspensions that qualified for the teacher notification program, which breaks down to $36.67 per student. In their audit, the SCO accepted these activity reports as reasonable reimbursement. The District extrapolated costs for 37 additional schools totaling $157,270. The additional 37 schools had a total of 4,681 suspensions that qualified for the teacher notification program, which breaks down to $33.60 per student, approximately $3.00 less than the supported costs accepted by the SCO. The District argues that this is a reasonable estimate of the actual costs for these 37 schools.[9]

For fiscal year 2002-2003, claimant used the average times to calculate the costs for employees at 57 schools that did not have actual time logs. Claimant explains the costs claimed as follows:

> For fiscal year 2002-2003, the District has time logs from 83 schools totaling $224,356. These schools reported a total of 6,327 suspensions that qualified for the teacher notification program, which breaks down to $35.46 per student. In their audit, the SCO accepted these time logs as reasonable reimbursement. The District extrapolated costs for 57 additional schools totaling $181,006. The additional 57 schools had a total of 5,307 suspensions that qualified for the teacher notification program, which breaks down to $34.11 per student, $1.35 less than the supported costs accepted by the SCO. The District contends this is a reasonable estimate of the actual costs for these 57 schools.[10]

The SCO denied the reimbursement claims submitted on behalf of these schools on the grounds that the claims were not supported by actual time records or a valid time study.

II. Positions of the Parties

A. Claimant, San Diego Unified School District

Claimant argues that the SCO incorrectly reduced costs of salaries, benefits, and related indirect costs claimed in fiscal years 2001-2002 and 2002-2003 in the amount of $354,046. Claimant seeks a determination from the Commission pursuant to Government Code section 17551(d) that the SCO incorrectly reduced the claim, and requests that the SCO reinstate the full amount reduced.

Although claimant admits that it did not provide actual time records to support some of its reimbursement claims, claimant argues that the parameters and guidelines governing these reimbursement claims allow it to use '"the average number hours devoted to each function' as long as it is 'supported by a documented time study.'"[11] Claimant asserts that its reimbursement

[9] Exhibit A, IRC, at pp. 4-5.

[10] *Ibid.*

[11] Exhibit A, IRC, at p. 4.

claims are supported by a time study which "used an average derived from contemporaneous activity reports submitted by school site staff members who performed the [reimbursable] activities to calculate an average rate per mandated activity, per student suspended."[12] Claimant contends that its extrapolation of actual time records to determine salaries and benefits that are not supported by actual time records is a valid time study.[13] Claimant contends that the averages developed by the time study are "conservative" and not excessive for the following reasons:

- The total hours submitted by each school were divided by the total number of qualifying students suspended at that school regardless of whether the staff turned in time for all students. In cases where school site employees did not turn in all of their contemporaneous activity logs for the year, the average time per student is driven down below the actual average time.
- To be conservative, data with the highest hours reported was eliminated when calculating the average time per student. San Diego made this adjustment to the average so that it would be more representative of the typical reimbursement situation.
- The per student cost for extrapolated schools was less than the per student audited costs supported by contemporaneous activity reports.

Claimant further asserts that, in addition to supporting its claims with a time study, Government Code section 17518.5 allows it to unilaterally develop and implement its own reasonable reimbursement methodology to support its claimed costs.[14] Claimant asserts that its time study qualifies as a reasonable reimbursement methodology.[15]

B. State Controller's Office

The final audit report concluded that $354,046 in salaries, benefits, and related indirect costs were unallowable, because "the District failed to provide documentation to support salary and benefits costs based on actual time records or an average number of hours supported by a documented time study, and indirect costs for these disallowed claimed costs."[16] The SCO asserts that its audit was appropriate and the IRC should be denied for the following reasons:

- Government Code section 17518.5 does not allow a local government to unilaterally develop and implement a reasonable reimbursement methodology.
- Claimant failed to provide any evidence that employees performed activities that were not accounted for on contemporaneous activity logs. There is no evidence that the non-reporting schools performed all of the mandated activities, performed the activities in the same manner as those schools that submitted time records, or performed the activities

[12] *Ibid*.

[13] *Ibid.*

[14] Exhibit A, IRC, at pp. 4 and 7.

[15] *Ibid*.

[16] Exhibit B, State Controller's Office, Comments on the IRC, at p. 124.

with the same frequency as those schools that submitted time records. Claimant admits that it does not have a district-wide policy or procedure governing this program.

- Claimant's method of calculating average times was inconsistent between fiscal years. For fiscal year 2001-2001, the district calculated average times based on time logs completed by employees in certain positions, rather than on all employees who performed each mandated activity. For the activity of identifying students, claimant used only time reported by principals and vice principals. For the activities of information maintenance and notifying teachers, claimant used only time reported by school clerks, school secretaries, and similar positions. In 2002-2003, however, claimant calculated time based on all employees who submitted time logs. In that year, claimant also excluded the "max school" that reported the highest number of hours for each activity, but not the highest hours per student.
- Claimant's methodologies for both fiscal years do not constitute valid statistical analyses. The projections were based on employees that submitted time logs, rather than on randomly selected employees. Claimant provided no documentation to show that the employees used in the calculations were representative of the population.
- The time logs that were submitted indicate that time studies are not appropriate for these activities because the times reported per student varied significantly.
- Reimbursement claims submitted by large school districts indicate that the costs claimed by the claimant were excessive and unreasonable. For fiscal year 2001-2002, claimant's average claimed cost per pupil was $2.87, while the average claimed cost per pupil by 17 other populous school districts in the state was $0.62 per pupil. For fiscal year 2002-2003, claimant's average claimed cost per pupil was $2.95, while the average claimed cost for the 17 other districts in the state was $0.81 per pupil.

On June 4, 2014, the SCO submitted comments concurring with the recommendation in the draft proposed decision that the IRC should be denied.

V. Discussion

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

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the SCO has incorrectly reduced payments to the local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9 of the Commission's regulations requires the Commission to send the decision to the SCO 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 SCO 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.[17] The

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

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."[18]

With regard to the Controller's audit decisions, the Commission must determine in whether the SCO's audit decisions 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.[19] 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.]' "[20]

The Commission must also review the SCO's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.[21] In addition, section 1185.2(c) of the Commission's regulations requires that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.[22]

A. The reductions made by the SCO for salaries and benefits are consistent with the parameters and guidelines, reasonable, and not arbitrary and capricious or entirely lacking in evidentiary support.

The SCO reduced salaries, benefits, and other indirect costs claimed by $166,791 for fiscal year 2001-2002 and $192,740 for fiscal year 2002-2003, on grounds that claimant failed to provide

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[18] *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.

[19] *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.

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

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

[22] 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.

documentation to support salary and benefits costs based on actual time records or an average number of hours supported by a documented time study.[23]

Claimant admits that it does not have any documentation to support the actual costs incurred by the schools at issue in this case.[24] However, claimant used cost data from other schools in the district that did collect and maintain source documentation to calculate the average costs incurred for 37 schools in fiscal year 2001-2002 and 57 schools in fiscal year 2002-2003 that did not collect or maintain any source documentation.

The Commission finds that the SCO correctly reduced these claims. Although Section VI B. 1. of the parameters and guidelines provides that claimants may utilize time studies to support a claim for reimbursement, the time study must be documented showing the employee's average times spent on the program. In addition, Section VII of the parameters and guidelines requires the claimant to maintain supporting source documentation of the costs incurred to show evidence of the validity of the claim. Here, claimant did not comply with these requirements.

Moreover, claimant admits that there is no district policy on this mandated program and that each school within the district performs the mandate differently. Thus, claimant's use of data from other schools within the district to calculate an average cost for those schools that did not maintain any documentation of the costs, does not provide sufficient evidence of the validity of the costs actually incurred by the schools that did not maintain any documentation.

In addition, the record supports the SCO's contention that claimant's extrapolation of data from reporting schools to schools that did not collect and maintain any source documentation raises valid questions whether the data accurately reflects the undocumented costs from other schools. The SCO contends that claimant's costs claimed are unallowable for the following reasons:

- Claimant's procedures for performing mandates activities do not lend themselves to time studies because claimant does not have uniform district-wide procedures for the mandated activities.
- Claimant based its projections on employees who submitted time logs rather than on statistically valid random sample of all employees performing each mandated activity and claimant failed to provide documentation showing that the employees used were representative of the population performing each mandated activity.
- Claimant did not provide any evidence that non-reporting schools: (1) performed all the mandated activities; (2) performed the activities in the same manner as those schools that submitted time records; and (3) performed the activities with the same frequency as those schools that submitted time records.

Claimant has not submitted evidence to rebut these findings.

As the administrative agency responsible for auditing mandate reimbursement claims, the interpretation of the SCO is entitled to great weight; the courts have long held that "[a]n agency interpretation of the meaning and legal effect of a statute is entitled to consideration and respect

[23] Exhibit B, State Controller's Office, Comments on the IRC, at p. 124.

[24] Exhibit A, IRC, at p. 4.

by the courts."[25] The Commission "may not reweigh the evidence or substitute it's judgment for that of" the SCO.[26]

Based on the foregoing, the Commission finds claimant did not comply with the parameters and guidelines for claiming reimbursement for the costs of salaries and benefits, and therefore the SCO's disallowance of salaries, benefits, and related indirect costs in the amount of $166,791 for fiscal year 2001-2002 and $192,740 for fiscal year 2002-2003, was not arbitrary, capricious, or entirely lacking in evidentiary support.

B. San Diego's time study does not constitute a valid reasonable reimbursement methodology, as defined by Government Code section 17518.5.

Claimant asserts that Government Code section 17518.5 "allows and even encourages the use of a reasonable reimbursement methodology."[27] Claimant further asserts that the "time study" used to support its undocumented reimbursement claims, qualifies as a reasonable reimbursement methodology.[28]

Claimant is wrong. Government Code section 17518.5 defines reasonable reimbursement methodology (RRM) to mean a formula for reimbursing local agencies and school districts for costs mandated by the state. The RRM may be based on a general allocation formula, uniform cost allowance, or other approximations of local costs mandated by the state. The RRM, however, must be adopted by the Commission pursuant to Government Code section 17557, following a request, an opportunity for comment by the parties, a public hearing, and the adoption of a decision on the matter.[29] The parties have not submitted a request to include an RRM in the parameters and guidelines for this program, and the Commission has not adopted one. The mandates process does not allow a party, on its own, to use a formula for claiming reimbursement of state-mandated costs.

Based on the above discussion, the Commission finds claimant's time study does not qualify as an RRM within the meaning of Government Code section 17518.5.

VI. Conclusion

Pursuant to Government Code section 17551(d), the Commission finds that the SCO's reductions of salaries, benefits, and related indirect costs of $166,791 for fiscal year 2001-2002 and $192,740 for fiscal year 2002-2003 are consistent with the parameters and guidelines, reasonable, and not arbitrary and capricious or entirely lacking in evidentiary support.

Accordingly, the Commission denies this IRC.

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[25] *Shapell Industries, supra,* 1 Cal.App.4th 218, at p. 230.

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

[27] Exhibit A, San Diego IRC, at p. 6, citing Government Code section 17518.5 as added by Statutes of 2004, chapter 890.

[28] *Ibid.*

[29] California Code of Regulations, Title 2, 1183.10-1183.13, as effective on July 1, 2014.