KERN COMMUNITY COLLEGE DISTRICT

Revised Audit Report

HEALTH FEE ELIMINATION PROGRAM

Chapter 1, Statutes of 1984, 2nd Extraordinary Session, and Chapter 1118, Statutes of 1987

July 1, 2003, through June 30, 2007

JOHN CHIANG
California State Controller

August 2010

JOHN CHIANG
California State Controller

August 20, 2010

Stuart Witt, President
Board of Trustees
Kern Community College District
2100 Chester Avenue
Bakersfield, CA 93301

Dear Mr. Witt:

The State Controller's Office audited the costs claimed by the Kern Community College District for the legislatively mandated Health Fee Elimination Program (Chapter 1, Statutes of 1984, 2nd Extraordinary Session, and Chapter 1118, Statutes of 1987) for the period of July 1, 2003, through June 30, 2007.

This revised final report supersedes our previous report dated June 30, 2009. We revised Finding 2 to correct errors in the allowable indirect cost rate calculations for fiscal year (FY) 2004-05, FY 2005-06, and FY 2006-07. As a result, allowable costs increased by $51,199 for the audit period.

The district claimed $1,088,894 ($1,099,894 less an $11,000 penalty for filing late claims) for the mandated program. Our audit disclosed that $326,012 is allowable and $762,882 is unallowable. The costs are unallowable because the district understated services and supplies, overstated indirect costs rates, and understated authorized health service fees. The State made no payment to the district. Allowable costs claimed exceed the amount paid by $326,012.

The district previously filed an Incorrect Reduction Claim (IRC) on September 9, 2009. The district may file an amended IRC with the Commission on State Mandates (CSM) based on this revised final audit report. The IRC must be filed within three years following the date that we notify you of a claim reduction. You may obtain IRC information at CSM's Web site link at www.csm.ca.gov/docs/IRCForm.pdf.

If you have any questions, please contact Jim L. Spano, Chief, Mandated Cost Audits Bureau, at (916) 323-5849.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/sk

cc: Joyce Coleman, Dean of Students
Bakersfield College
Steven D. Schultz, Vice President of Student Services
Porterville College
Tom Burke, Chief Financial Officer
Kern Community College District
Christine Atalig, Auditor
Fiscal Services Unit
California Community Colleges Chancellor's Office
Thomas Todd, Principal Program Budget Analyst
Education Systems Unit
Department of Finance
Jay Lal, Manager
Division of Accounting and Reporting
State Controller's Office

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Revised Audit Report

Summary

The State Controller's Office (SCO) audited the costs claimed by the Kern Community College District for the legislatively mandated Health Fee Elimination Program (Chapter 1, Statutes of 1984, 2nd Extraordinary Session, and Chapter 1118, Statutes of 1987) for the period of July 1, 2003, through June 30, 2007.

The district claimed $1,088,894 ($1,099,894 less an $11,000 penalty for filing late claims) for the mandated program. Our audit disclosed that $326,012 is allowable and $762,882 is unallowable. The costs are unallowable because the district understated services and supplies, overstated indirect cost rates, and understated authorized health service fees. The State made no payment to the district. Allowable costs claimed exceed the amount paid by $326,012.

Background

Chapter 1, Statutes of 1984, 2nd Extraordinary Session (E.S.) repealed Education Code section 72246 which authorized community college districts to charge a health fee for providing health supervision and services, providing medical and hospitalization services, and operating student health centers. This statute also required that health services for which a community college district charged a fee during fiscal year (FY) 1983-84 had to be maintained at that level in FY 1984-85 and every year thereafter. The provisions of this statute would automatically sunset on December 31, 1987, reinstating the community college districts' authority to charge a health service fee as specified.

Chapter 1118, Statutes of 1987, amended Education Code section 72246 (subsequently renumbered as section 76355 by Chapter 8, Statues of 1993). The law requires any community college district that provided health services in FY 1986-87 to maintain health services at the level provided during that year for FY 1987-88 and for each fiscal year thereafter.

On November 20, 1986, the Commission on State Mandates (CSM) determined that Chapter 1, Statutes of 1984, 2nd E.S. imposed a "new program" upon community college districts by requiring specified community college districts that provided health services in FY 1983-84 to maintain health services at the level provided during that year for FY 1984-85 and for each fiscal year thereafter. This maintenance-of-effort requirement applied to all community college districts that levied a health service fee in FY 1983-84.

On April 27, 1989, the CSM determined that Chapter 1118, Statutes of 1987, amended this maintenance-of-effort requirement to apply to all community college districts that provided health services in FY 1986-87, requiring them to maintain that level in FY 1987-88 and for each fiscal year thereafter.

The program's parameters and guidelines establish the state mandate and define reimbursement criteria. CSM adopted the parameters and guidelines on August 27, 1987, and amended them on May 25, 1989. In compliance with Government Code section 17558, the SCO issues claiming instructions to assist school districts in claiming mandated program reimbursable costs.

Objective, Scope, and Methodology

We conducted the audit to determine whether costs claimed represent increased costs resulting from the Health Fee Elimination Program for the period of July 1, 2003, through June 30, 2007.

Our audit scope included, but was not limited to, determining whether costs claimed were supported by appropriate source documents, were not funded by another source, and were not unreasonable and/or excessive.

We conducted this performance audit under the authority of Government Code sections 12410, 17558.5, and 17561. We did not audit the district's financial statements. Except for the issue described below, we conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We were unable to assess fraud risk because the district did not respond to our inquiries regarding fraud assessment. The district did not respond to our inquiries, based on its consultant's advice. Accordingly, we increased our substantive testing; however, these measures would not necessarily identify fraud or abuse that may have occurred.

We limited our review of the district's internal controls to gaining an understanding of the transaction flow and claim preparation process as necessary to develop appropriate auditing procedures.

We asked the district's representative to submit a written representation letter regarding the district's accounting procedures, financial records, and mandated cost claiming procedures as recommended by generally accepted government auditing standards. However, the district declined our request.

Conclusion

Our audit disclosed instances of noncompliance with the requirements outlined above. These instances are described in the accompanying Revised Summary of Program Costs (Schedule 1) and in the Revised Findings and Recommendations section of this report.

For the audit period, the Kern Community College District claimed $1,088,894 ($1,099,894 less an $11,000 penalty for filing late claims) for costs of the Health Fee Elimination Program. Our audit disclosed that $326,012 is allowable and $762,882 is unallowable. The State made no payment to the district. The State will pay allowable costs claimed that exceed the amount paid, totaling $326,012, contingent upon available appropriations.

Views of Responsible Official

We issued a draft audit report on April 24, 2009. Tom Burke, Chief Financial Officer, responded by letter dated May 18, 2009 (Attachment), agreeing with Finding 1 and disagreeing with Findings 2 and 3.

We issued a final audit report on June 30, 2009. Subsequently, we revised Finding 2 to recalculate the allowable indirect cost rates for FY 2004-05, FY 2005-06, and FY 2006-07. As a result, we revised the Finding 2 audit adjustment from $167,604 to $79,213. We advised Mr. Burke of the revisions on August 12, 2010.

Restricted Use

This report is solely for the information and use of the Kern Community College District, the Kern County Office of Education, the California Department of Education, the California Community Colleges Chancellor's Office, the California Department of Finance, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

August 20, 2010

Revised Schedule 1—
Summary of Program Costs
July 1, 2003, through June 30, 2007

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference [1]
July 1, 2003, through June 30, 2004				
Direct costs:				
Salaries and benefits	$ 197,775	$ 197,775	$ —	
Services and supplies	94,707	210,773	116,066	Finding 1
Total direct costs	292,482	408,548	116,066	
Indirect costs	115,325	99,931	(15,394)	Finding 1, 2
Total direct and indirect costs	407,807	508,479	100,672	
Less authorized health service fees	(285,084)	(429,075)	(143,991)	Finding 3
Less late filing penalty	(1,000)	(1,000)	—	
Total program costs	$ 121,723	78,404	$ (43,319)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ 78,404		
July 1, 2004, through June 30, 2005				
Direct costs:				
Salaries and benefits	$ 217,009	$ 217,009	$ —	
Services and supplies	246,130	232,352	(13,778)	Finding 1
Total direct costs	463,139	449,361	(13,778)	
Indirect costs	198,640	177,855	(20,785)	Finding 1, 2
Total direct and indirect costs	661,779	627,216	(34,563)	
Less authorized health service fees	(258,054)	(414,479)	(156,425)	Finding 3
Total program costs	$ 403,725	212,737	$ (190,988)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ 212,737		
July 1, 2005, through June 30, 2006				
Direct costs:				
Salaries and benefits	$ 240,352	$ 240,352	$ —	
Services and supplies	100,198	205,556	105,358	Finding 1
Total direct costs	340,550	445,908	105,358	
Indirect costs	135,914	175,777	39,863	Finding 1, 2
Total direct and indirect costs	476,464	621,685	145,221	
Less authorized health service fees	(132,111)	(586,814)	(454,703)	Finding 3
Total program costs	$ 344,353	34,871	$ (309,482)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ 34,871		

Revised Schedule 1 (continued)

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference [1]
July 1, 2006, through June 30, 2007				
Direct costs:				
Salaries and benefits	$ 206,732	$ 206,732	$ —	
Services and supplies	315,630	315,630	—	
Total direct costs	522,362	522,362	—	
Indirect costs	221,117	220,125	(992)	Finding 2
Total direct and indirect costs	743,479	742,487	(992)	
Less authorized health service fees	(514,386)	(904,491)	(390,105)	Finding 3
Less late filing penalty	(10,000)	(10,000)	—	
Audit adjustments that exceed cost claimed	—	172,004	172,004	
Total program costs	$ 219,093	—	$ (219,093)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ —		
Summary: July 1, 2003, through June 30, 2007				
Direct costs:				
Salaries and benefits	$ 861,868	$ 861,868	$ —	
Services and supplies	756,665	964,311	207,646	
Total direct costs	1,618,533	1,826,179	207,646	
Indirect costs	670,996	673,688	2,692	
Total direct and indirect costs	2,289,529	2,499,867	210,338	
Less authorized health service fees	(1,189,635)	(2,334,859)	(1,145,224)	
Less late filing penalty	(11,000)	(11,000)	—	
Audit adjustments that exceed cost claimed	—	172,004	172,004	
Total program costs	$ 1,088,894	326,012	$ (762,882)	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		$ 326,012		

[1] See the Revised Findings and Recommendations section.

Revised Findings and Recommendations

FINDING 1—Misstated services and supplies

The district understated allowable services and supplies by $207,646 for the audit period. The related indirect costs total $81,904.

The understatement occurred because:

- For fiscal year (FY) 2003-04 and FY 2005-06, the district did not claim student insurance costs. We allowed such costs based on documentation provided by the district.
- For FY 2004-05, the district claimed $13,778 that was recorded in its books as "Out-indirect Cost (Expense)." The district did not provide support for this expenditure.

The following table summarizes the audit adjustment:

	Fiscal Year			
	2003-04	2004-05	2005-06	Total
Unclaimed student insurance	$ 116,066	$ —	$ 105,358	$ 221,424
Nonreimbursable costs	—	(13,778)	—	(13,778)
Total services and supplies	116,066	(13,778)	105,358	207,646
Indirect costs	45,765	(5,909)	42,048	81,904
Audit adjustment	$ 161,831	$ (19,687)	$ 147,406	$ 289,550

For services and supplies, the parameters and guidelines state that the district may claim expenditures that can be identified as direct costs of the mandated program. They also state that all costs claimed must be traceable to source documents and/or worksheets that show evidence of the validity of such costs.

Recommendation

We recommend that the district claim actual mandate-related costs that are supported by its accounting records and source documentation.

District's Response

The District does not dispute this finding.

SCO's Comment

Our finding and recommendation remain unchanged.

FINDING 2—Unallowable indirect costs

The district claimed unallowable indirect costs totaling $79,213 because it overstated allowable indirect cost rates.

For the audit period, the district prepared its indirect cost rate proposal (ICRP) using the SCO's FAM-29C methodology. However, the district did not correctly compute the FAM-29C rate.

We calculated indirect cost rates based on the SCO's claiming instructions applicable to each year by using the information contained in the California Colleges Annual Financial and Budget Report, Expenditure by Activity (CCFS-311). Our calculations revealed that, for all four fiscal years, the district overstated the indirect cost rates.

The following table summarizes the claimed and allowable indirect cost rates and the resulting audit adjustments:

	Fiscal Year				
	2003-04	2004-05	2005-06	2006-07	Total
Allowable indirect cost rate	24.46%	39.58%	39.42%	42.14%	
Less claimed indirect cost rate	(39.43)%	(42.89)%	(39.91)%	(42.33)%	
Overstated indirect cost rate	(14.97)%	(3.31)%	(0.49)%	(0.19)%	
Allowable direct costs claimed	× $408,548	× $449,416	× $445,908	× $522,362	
Audit adjustment	$ (61,160)	$ (14,876)	$ (2,185)	$ (992)	$ (79,213)

The parameters and guidelines state, "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." For FY 2003-04, the SCO's claiming instructions state:

> 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 [FAM-29C] methodology. . . .

For FY 2004-05 forward, the SCO's claiming instructions state:

> A CCD [community college district] may claim indirect costs using the Controller's methodology (FAM-29C). . . . If specifically allowed by a mandated program's [parameters and guidelines], a district may alternately choose to claim indirect costs using either (1) a federally approved rate prepared in accordance with Office of Management and Budget (OMB) Circular A-21, *Cost Principles for Educational Institutions:* or (2) a flat 7% rate.

Recommendation

We recommend that the district claim indirect costs based on indirect cost rates computed in accordance with the SCO's claiming instructions.

District's Response

The draft audit report concludes that the District overstated indirect costs by $167,604 for the four-year audit period. The draft audit report states that for FY 2003-04 the District developed an indirect cost rate proposal based on OMB Circular A-21 that was not federally approved as required by the Controller's claiming instructions. In fact, the District used the FAM-29C method for all four fiscal years and used the same source document as the auditor, the CCFS-311, except that each year the District used the prior year CCFS-311 and the auditor used the current year CCFS-311.

The draft audit report asserts that the District "did not correctly compute the FAM-29C rate." The District's calculation of the indirect cost rates was not "incorrect." Rather, it differed from the audited rates because the District included the CCFS-311 capital costs rather than annual financial statement depreciation expense for the first three fiscal years.

There were also differences in how certain other groups of costs were categorized as either direct or indirect for all four fiscal years.

Fiscal Year	As Claimed	Claimed Source	As Audited	Audit Report Source
2003-04	39.43%	CCFS-311	24.46%	CCFS-311 w/out depreciation
2004-05	42.89%	CCFS-311	34.28%	CCFS-311 with depreciation
2005-06	39.91%	CCFS-311	33.28%	CCFS-311 with depreciation
2006-07 (amended)	42.33%	CCFS-311 with depreciation	35.02%	CCFS-311 with depreciation

CHOICE OF METHODS

FY 2003-04

Contrary to the statement in the draft audit report, the District did not utilize a federal indirect cost rate in accordance with OMB A-21 for FY 2003-04. The District used the Controller's FAM-29C method based on the CCFS-311, including capital costs. The auditor also used the FAM-29C method, but without the capital costs, consistent with the Controller's audit policy at that time. There were also differences in how certain other groups of costs were categorized as either direct or indirect.

FY 2004-05 and FY 2005-06

The District used the Controller's FAM-29C method based on the CCFS-311, including capital costs. The auditor also used the FAM-29C method, but deleted these capital costs and substituted depreciation expense as stated on the District's annual financial statements. This use of depreciation was a result of a change in the Controller's audit policy. Claimants were not on notice of this new method of treating depreciation costs at the time the FY 2004-05 and FY 2005-06 annual claims were filed. The audit report uses this new method retroactively to FY 2004-05. There were also differences in how certain other groups of costs were categorized as either direct or indirect.

FY 2006-07

After the release of the preliminary audit findings, in February 2009, the District submitted an amended FY 2006-07 claim. The District used the same FAM-29C method based on the CCFS-311 as did the auditor. The District deleted the capital costs stated in the CCFS-311 and substituted the depreciation expense as reported in the District's annual financial statements, consistent with the Controller's new audit policy. The remaining difference in the rate claimed by the District in the amended FY 2006-07 claim and the audited rate is a result of how certain other groups of costs were categorized as either direct or indirect.

The Parameters and Guidelines for the Health Fee Elimination program (as last amended on May 25, 1989), which are the legally enforceable standards for claiming costs, state: "Indirect costs *may be claimed* in the manner described by the Controller in his claiming instructions." (Emphasis added) Therefore, the Parameters and Guidelines *do not require* that indirect costs be claimed in the manner described by the Controller. Since the Controller's claiming instructions were never adopted as rules or regulations, they have no force of law.

The burden is on the Controller to show that the indirect cost rate used by the claimant is excessive or unreasonable, which is the only mandated cost audit standard in statute (Government Code Section 17651(d)(2)). The District's calculated rates vary only by about three percent (39.43%-42.89%). The audited rates vary significantly (24.46%-35.02%). For the four fiscal years audited, the Controller's policy regarding capital costs and depreciation expense changed without statutory or regulatory bases. If the Controller wishes to enforce different audit standards for mandated cost reimbursement other than Section 17561, the Controller should comply with the Administrative Procedure Act.

PRIOR YEAR CCFS-311

The draft audit report did not disclose that the audit used the current audit year CCFS-311 for the calculation of the indirect cost rate. The District used the prior year CCFS-311. The CCFS-311 is prepared based on annual costs from the prior fiscal year for use in the current budget year. When the audit utilizes a different CCFS-311 than the District, this constitutes an undisclosed audit adjustment. The audit report does not state an enforceable requirement to use the most current CCFS-311.

As a practical example of the baselessness of the Controller's position on prior year CCFS-311 reports, note that the federally approved indirect cost rates which the Controller accepts are approved for periods of two to four years. This means the data from which the rates were calculated can be from three to five years prior to the last year in which the federal rate is used.

Since the Parameters and Guidelines *do not require* that indirect costs be claimed in the manner described by the Controller, and the Controller's claiming instructions were never adopted as rules or regulations, the choice of which CCFS-311 to use is based on factual relevance only. The later CCFS-311 and financial statement depreciation expense used by the Controller is not always available to claimants at the time the claim is due to the state. The draft audit report

> has stated no legal basis to disallow the indirect cost rate calculation method used by the District and has not shown a factual basis to reject the rates as unreasonable or excessive.

SCO's Comment

Subsequent to our final audit report issued June 30, 2009, we revised the allowable indirect cost rates for FY 2004-05, FY 2005-06, and FY 2006-07. Our original calculations excluded allowable depreciation expense. As a result, we revised the total audit adjustment from $167,604 to $79,213. Our recommendation is unchanged. The revised calculations do not affect issues that the district discussed in its draft audit report response or the remainder of our comments below.

FY 2003-04

We agree that the district prepared its FY 2003-04 indirect cost rates using the SCO's FAM-29C methodology. Consequently, we updated the finding to clarify the methodology used by the district.

FY 2004-05 and FY 2005-06

For FY 2004-05 and FY 2005-06, the district claims that "claimants were not on notice of this new method of treating depreciation costs at the time the FY 2004-05 and FY 2005-06 annual claims were filed." The parameters and guidelines state, "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." The claiming instructions for FY 2004-05 and FY 2005-06 both state, in reference to the FAM-29C method of calculating indirect costs, that "indirect cost rate computation(s) include any depreciation or use allowance applicable to district buildings and equipment."

FY 2006-07

We agree with the district that it used FAM-29C method based on the CCFS-311. However, the district did not allocate direct and indirect costs as specified in the SCO's claiming instructions.

Parameters and Guidelines

The parameters and guidelines (sections VI) state, "Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions." The district interprets "may be claimed" in compliance with the claiming instructions as voluntary. Instead, "may be claimed" permits the district to claim indirect costs. However, if the district chooses to claim indirect costs, then the district must comply with the SCO's claiming instructions.

The district contends that "The burden is on the Controller to show that the indirect cost rate used by the claimant is excessive or unreasonable, which is the only mandated cost audit standard in statute. . . ." Government Code section 17558.5 required the district to file a reimbursement claim for actual mandate-related costs. Government Code section 17561, subdivision (d)(2), allows the SCO to audit the district's

records to verify actual mandate-related costs and reduce any claim that the SCO determines to be excessive or unreasonable. In addition, section 12410 states, "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." Therefore, the district's contention is invalid.

Nevertheless, the SCO did, in fact, conclude that the district's indirect cost rates for FY 2003-04 through FY 2006-07 were excessive. "Excessive" is defined as "exceeding what is usual, proper, necessary, or normal. . . . Excessive implies an amount or degree too great to be reasonable or acceptable. . . .[1] The SCO calculated indirect cost rates using the FAM-29C methodology allowed in the claiming instructions. This method did not support the rates that the district claimed; thus, the rates claimed were excessive.

[1] Merriam-Webster's Collegiate Dictionary, Tenth Edition, © 2001.

Prior Year CCFS-311

The district states, "The CCFS-311 is prepared based on annual costs from the prior fiscal year for use in the current budget year." Although this is how the district used its data, there are no mandate-related authoritative criteria supporting this methodology. Government Code section 17558.5 requires the district to file a reimbursement claim for actual mandate-related costs. In addition, the parameters and guidelines require the district to report actual costs. For each fiscal year, "actual costs" are costs of the current fiscal year, not costs from a prior fiscal year.

FINDING 3—Understated authorized health service fees

The district understated authorized health service fees by $1,145,224. The district reported actual health service fees that it collected rather than authorized health service fees.

Mandated costs do not include costs that are reimbursable from authorized health service fees. Government Code section 17514 states that "costs mandated by the state" means any increased costs that a school district is required to incur. To the extent community college districts can charge a fee, they are not required to incur a cost. In addition, Government Code section 17556 states that the Commission on State Mandates shall not find costs mandated by the State if the school district has the authority to levy fees to pay for the mandated program or increased level of service.

Education Code section 76355, subdivision (c), states that health fees are authorized for all students except those who: (1) depend exclusively on prayer for healing; (2) are attending a community college under an approved apprenticeship training program; or (3) demonstrate financial need. The California Community Colleges Chancellor's Office (CCCCO) identified the fees authorized by Education Code section 76355, subdivision (a). For FY 2003-04, the authorized fees were $12 per semester and $9 per summer session. For FY 2004-05, the authorized fees were $13 per semester and $10 per summer session. For FY

2005-06, the authorized fees were $14 per semester and $11 per summer session. For FY 2006-07, the authorized fees were $15 per semester and $12 per summer session. Effective January 1, 2006, Education Code section 76355, subdivision (c), no longer excludes students who have a financial need.

We obtained student enrollment and Board of Governors Grant (BOGG) recipient data from the CCCCO. The CCCCO identified enrollment and BOGG recipient data from its management information system (MIS) based on student data that the district reported. The CCCCO identified the district's enrollment based on the CCCCO's MIS data element STD 7, codes A through G. The CCCCO eliminated any duplicate students based on their social security numbers. From the district enrollment, the CCCCO identified the number of BOGG recipients based on MIS data element SF21, all codes with first letter of B or F.

The following table shows the authorized health service fees calculation and audit adjustment:

	Summer Session	Semester Fall	Semester Spring	Total
Fiscal Year 2003-04				
Student enrollment	9,766	24,997	27,277	
Less BOGG waivers	(3,259)	(10,180)	(10,533)	
Less apprenticeship waivers	—	(358)	(327)	
Subtotal	6,507	14,459	16,417	
Authorized health service fee rate	× $ (9)	× $(12)	× $(12)	
Authorized student health fees	$ (58,563)	$ (173,508)	$ (197,004)	$ (429,075)
Less authorized health service fees claimed				285,084
Audit adjustment, FY 2003-04				(143,991)
Fiscal Year 2004-05				
Student enrollment	10,101	24,631	25,319	
Less BOGG waivers	(3,653)	(11,061)	(11,384)	
Less apprenticeship waivers	—	(302)	(280)	
Subtotal	6,448	13,268	13,655	
Authorized health service fee rate	× $(10)	× $(13)	× $(13)	
Authorized student health fees	$ (64,480)	$ (172,484)	$ (177,515)	(414,479)
Less authorized health service fees claimed				258,054
Audit adjustment, FY 2004-05				(156,425)
Fiscal Year 2005-06				
Student enrollment	10,269	24,108	24,454	
Less BOGG waivers	(3,877)	(11,173)	—	
Less apprenticeship waivers	—	(235)	(261)	
Subtotal	6,392	12,700	24,193	
Authorized health service fee rate	× $(11)	× $(14)	× $(14)	
Authorized student health fees	$ (70,312)	$ (177,800)	$ (338,702)	(586,814)
Less authorized health service fees claimed				132,111
Audit adjustment, FY 2005-06				(454,703)

	Summer Session	Semester Fall	Semester Spring	Total
Fiscal Year 2006-07				
Student enrollment	11,013	25,669	26,344	
Less apprenticeship waivers	—	(267)	(257)	
Subtotal	11,013	25,402	26,087	
Authorized health service fee rate	× $(12)	× $(15)	× $(15)	
Authorized student health fees	$ (132,156)	$ (381,030)	$ (391,305)	(904,491)
Less authorized health service fees claimed				514,386
Audit adjustment, FY 2006-07				(390,105)
Total audit adjustment				$ (1,145,224)

Recommendation

We recommend that the district deduct authorized health service fees from mandate-related costs claimed. To properly calculate authorized health service fees, we recommend that the district identify the number of enrolled students based on CCCCO data element STD 7, codes A through G. We also recommend that the district identify the number of apprenticeship program enrollees based on data elements SB 23, code 1, and STD 7, codes A through G.

In addition, we recommend that the district maintain documentation that identifies the number of students excluded from the health service fee based on Education Code section 76355, subdivision (c)(1). If the district excludes any students from receiving health services, the district should maintain contemporaneous documentation of a district policy that excludes those students and documentation identifying the number of students excluded.

District's Response

> The draft audit report states that student health service fee revenues offsets were understated by $1,145,224 for the four-year audit period. The difference between the claimed amount and the audited amount is that the District utilized actual revenues received rather than a calculation of the student health service fees potentially collectible. The auditor calculated "authorized health fee revenues," that is, the student fees collectible based on the highest student health serve fee chargeable to all eligible students, rather than the full-time or part-time student health service fee actually charged by the District to the students not exempted by state law (e.g., BOGG waiver students) or District policy.
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> The audit utilizes student enrollment information from the State Community College Chancellor's data base. These statistics are not available to claimants at the time the claims are prepared nor does the audit report substantiate this source as either uniquely accurate or superior to enrollment data maintained by the claimant. As a separate issue, the audit also included in the calculation of collectible fees the enrollment of Cerro Coso College and District Learning Centers that do not have a student health service program and whose students do not pay a student health service fee. However, since the District did not calculate student health service fee revenue based on student enrollment, this is a Controller's audit adjustment rationale and not a District annual claim issue.

COLLECTIBLE STUDENT HEALTH SERVICE FEES

The District asserts that the "collectible method" of determining the student health service fee revenue offset is not supported by law or fact.

"Authorized" Fee Amount

There is no "authorized" student health service fee amount other than the amounts stated in Education Code Section 76355. The draft audit report alleges that claimants must compute the total student health fees collectible based on the highest "authorized" rate. The draft audit report does not provide the statutory basis for the calculation of the "authorized" rate, nor the source of the legal basis for any state entity to "authorize" student health services rates absent rulemaking or compliance with the Administrative Procedure Act by the "authorizing" state agency.

Education Code Section 76355

Education Code Section 76355, subdivision (a), state that "[t]he governing board of a district maintaining a community college *may require* community college students to pay a fee. . . for health supervision and services. . ." There is no requirement that community colleges levy these fees. The permissive nature of the provision is further illustrated in subdivision (b), which states: "*If*, pursuant to this section, a fee is required, the governing board of the district shall decide the amount of the fee, if any, that a part-time student is required to pay. *The governing board may decide whether the fee shall be mandatory or optional*." (Emphasis supplied in both instances) Therefore, districts have the option of charging a fee to some or all of its students.

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The draft audit report relies upon Government Code Section 17514 for the conclusion that "[t]o the extent community college districts can charge a fee, they are not required to incur a cost." First, charging a fee has no relationship to whether costs are incurred to provide the student health services program. Second, Government Code Section 17514, as added by Chapter 1459, Statutes of 1984, actually states:

> "Costs mandated by the state" means any increased costs which a local agency or school district is required to incur after July 1, 1980, as a result of any statute enacted on or after January 1, 1975, or any executive order implementing any statute enacted on or after January 1, 1975, which mandates a new program or higher level of service of an existing program within the meaning of Section 6 of Article XIII B of the California Constitution.

The operating cost of the student health service program is not determined by the fees collected. There is nothing in the language of the statute regarding the authority to charge a fee, or any nexus of fee revenues to increased cost, or any language that describes the legal effect of fees collected.

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costs mandated by the State if the school district has the authority to levy fees to pay for the mandated program or increased level of service." Government Code Section 17556 as amended by Statutes of 2004, Chapter 895, actually states:

> The commission shall not find costs mandated by the state, as defined in Section 17514, in any claim submitted by a local agency or school district, if after a hearing, the commission finds that: . . .
>
> (d) The local agency or school district ahs the authority to levy service charges, fees, or assessments sufficient to pay for the mandated program or increased level of service.

The draft audit report misrepresents the law. Government Code Section 17556 prohibits the Commission on State Mandates from finding costs subject to reimbursement, which means approving a test claim activity for reimbursement, where the authority exists to levy fees in an amount sufficient to offset the entire mandated costs. Here, the Commission has already approved the test claim and made a finding of a new program or higher level of service for which the claimants do not have the ability to levy a fee in an amount sufficient to offset the entire mandated costs.

Parameters and Guidelines

The Parameters and Guidelines, as last amended on May 25, 1989, states, in relevant part:

> "*Any* offsetting savings that eh claimant experiences as a direct result of this statute must be deducted from the costs claimed. In addition, reimbursement for this mandate received from any source, e.g., federal, state, etc., shall be identified and deducted from this claim. This shall include the amount of [student fees] as authorized by Education Code Section 72246(a) [1]."

[1] Former Education Code Section 72246 was repealed by Chapter 8, Statutes of 1993, Section 29, and was replaced by Education Code Section 76355.

The use of the term "*any* offsetting savings" further illustrates the permissive nature of the fees. Student fees actually collected must be sued to offset costs, but not student fees that could have been collected and were not, because uncollected fees are "offsetting savings" that were not "experienced." The Parameters and Guidelines do not allow the Controller to reduce claimed costs by revenues never received by the claimants and such an offset is contrary to the generally accepted accounting principle that requires revenues and costs to be properly matched.

STUDENTS NOT PAYING HEALTH SERVICES FEES

The District has three colleges and several Learning Centers. Cerro Coso College and the Learning Centers do not collect student health service fees because no such services are provided at those locations. Cerro Coso College (Ridgecrest) and the Learning Centers (Mammoth Lakes) are located several hours from either the Porterville or Bakersfield college campuses where the student health service programs are located.

The collection of student health service fees is controlled by Education Code Section 76355, but also requires independent action by the district governing board. Section 76355, at subdivision (e) requires that "[a]ny community college district that provided health services in the 1986-87 fiscal year shall maintain health services, at the level provided during the 1986-87 fiscal year, and each fiscal year thereafter." Kern Community College District is subject to this requirement. However, Section 75355 does not require community college district governing boards to provide a student health services program at every district location. The District did not provide such a program at Cerro Coso College or the Learning Centers and did not collect a student health services fee at those locations. Therefore, there are no collected or collectible fees from Cerro Coso College or the Learning Centers.

Legal requirements and the facts aside, the audit process is subject to generally accepted accounting principles and procedures that, amount other things, require revenues and expenses to be "matched." If the enrollment of Cerro Coso College and the Learning Centers is included in the calculation of collectible fees, the audit is applying revenues with no corresponding matching expenses.

In sum, there is no legal compulsion or factual circumstance to support the position that the Cerro Coso College and Learning Centers student enrollment should be included in the mandated cost claim, and to do so would be contrary to accounting principles.

Public Records Request

The District request that the Controller provide the District any and all written instructions, memorandums, or other writings in effect and applicable during the claiming period to Finding 2 (indirect cost rate calculation standards) and Finding 3 (calculation of the student health services fees offset).

Government Code section 6253, subdivision (c), requires the state agency that is the subject of the request, within 10 days from receipt of a request for a copy of records, to determine whether the request, in whole or in part, seeks copies of disclosable public records in your possession and promptly notify the requesting party of that determination and the reasons therefor. Also, as required, when so notifying the District, please state the estimated date and time when the records will be made available.

The District requests that the final audit report comply with the appropriate application of the Parameters and Guidelines regarding allowable activity costs and the Government Code sections concerning audits of mandate claims.

SCO's Comment

Our finding and recommendation remain unchanged.

The district states, "The audit utilizes student enrollment information from the State Community College Chancellor's data base. These statistics are not available to district at the time the claims are prepared nor does the audit report substantiate this source as either uniquely accurate or superior to enrollment data maintained by the claimant. . . ." This is the district's own data. In addition, the district implies that the

SCO used data that is somehow different from "enrollment data maintained by the claimant." Our audit used data retrieved from the California Community Colleges Chancellor's Office (CCCCO). The CCCCO data is extracted directly from enrollment information that the district submitted. Districts are required to submit this data to the CCCCO within one month after each term ends; thus, the district has its fiscal year enrollment data available approximately seven months before its mandated program claims are due to the State.

COLLECTIBLE STUDENT HEALTH SERVICE FEES

"Authorized" Fee Amount

We agree that community college districts may choose not to levy a health service fee or to levy a fee less than the authorized amount. Regardless of the district's decision to levy or not levy the authorized health service fee, Education Code section 76355, subdivision (a), provides districts the *authority* to levy a fee. The CCCCO notifies districts when the authorized rate increases pursuant to Education Code section 76355, subdivision (a)(2). Therefore, the Administrative Procedures Act is irrelevant.

Education Code Section 76355

Education Code section 76355 (specifically, subdivision (a)) authorizes the health service fee rate. The statutory section also provides the basis for calculating the authorized rate applicable to each fiscal year. The statutory section states:

> 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.
>
> 2. The governing board of each community college district may increase this fee by the same percentage increase as the Implicit Price Deflator for the 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 ($1).

Government Code Section 17514

Government Code section 17514 states, "'Costs mandated by the state' means any increased costs which a local agency or school district is *required* [emphasis added] to incur. . . ." The district ignores the direct correlation that if the district has authority to collect fees attributable to health service expenses, then it is not required to incur a cost. Therefore, those health service expenses do not meet the statutory definition of mandated costs.

Government Code Section 17556

The district argues that the statutory language applies only when the fee authority is sufficient to offset the "entire" mandated costs. The CSM recognized that the Health Fee Elimination Program's costs are not uniform between districts. Districts provided different levels of service in FY 1986-87 (the "base year"). Furthermore, districts provided these services at varying costs. As a result, the fee authority may be sufficient to pay for some district's mandated program costs, while it may be insufficient to pay the "entire" costs of other districts. Meanwhile, Education Code section 76355 (formerly section 72246) established a uniform health service fee assessment for students statewide. Therefore, the CSM adopted parameters and guidelines that clearly recognize an available funding source by identifying the health service fees as offsetting reimbursements. To the extent that districts have authority to charge a fee, they are not required to incur a cost.

Two court cases addressed the issue of fee authority[2]. Both cases concluded that "costs" as used in the constitutional provision, exclude "expenses that are recoverable from sources other than taxes." In both cases, the source other than taxes was fee authority.

[2] County of Fresno v. California (1991) 53 CAL. 3d 482; Connell v. Santa Margarita (1997) 59 Cal. App. 4th 382.

Parameters and Guidelines

The district incorrectly interprets the parameters and guidelines' requirement regarding authorized health service fees. The CSM clearly recognized the availability of another funding source by including the fees as offsetting savings in the parameters and guidelines. The CSM's staff analysis of May 25, 1989, states the following regarding the proposed parameters and guidelines amendments that the CSM adopted that day:

> Staff amended Item "VIII. Offsetting Savings and Other Reimbursements" to reflect the reinstatement of [the] fee authority.
>
> In response to that amendment, the [Department of Finance (DOF)] has proposed the addition of the following language to Item VIII. to clarify the impact of the fee authority on claimants' reimbursable costs:
>
> "If a claimant does not levy the fee authorized by Education Code Section 72246 (a), it shall deduct an amount equal to what it would have received had the fee been levied."
>
> Staff concurs with the DOF proposed language which does not substantively change the scope of Item VIII.

Thus, CSM intended that claimants deduct authorized health service fees from mandate-reimbursable costs claimed. Furthermore, the staff analysis included an attached letter from CCCCO dated April 3, 1989. In that letter, the CCCCO concurred with the DOF and the CSM regarding authorized health service fees.

The CSM did not revise the proposed parameters and guidelines amendments further, as the CSM's staff concluded that DOF's proposed language did not substantively change the scope of staff's proposed language. The CSM's meeting minutes of May 25, 1989, show that the CSM adopted the proposed parameters and guidelines on consent, with no additional discussion. Therefore, no community college districts objected and there was no change to the CSM's interpretation regarding authorized health service fees.

The district states that "such an offset is contrary to the generally accepted accounting principle that requires revenues and costs to be properly matched." This statement is presented out of context; generally accepted accounting principles are not controlling criteria in identifying authorized health fee revenues attributable to the Health Fee Elimination mandated program. If a district voluntarily assesses less than the authorized health service fees, or fails to collect fees assessed, is it the district's responsibility to "match" health service expenditures with other district revenue sources.

STUDENTS NOT PAYING HEALTH SERVICE FEES

On October 31, 2006, the California Community Colleges Chancellor's Office issued a legal opinion titled "Student Fee Handbook: Legal Opinion M 06-11," which represents a summary of advice regarding community college student fees. Chapter 3, "Fees for Services," addressed the student health fee per Education Code section 76355, which authorizes a community college to charge a fee for "health supervision and health services." Specifically, the opinion states:

> . . . we believe that the health fee may be charged to students who take only online classes or who attend classes at sites away from where the health services center is physically located. The health fee is not designated as a "use" fee. . . the fact that their classes may not be physically proximate to a student health center does not remove the fee obligation. Additionally, even though students may take online classes or be enrolled in classes that are offered at sites away from the student health center, that does not necessarily mean that such students will not travel to the health center or otherwise receive student health services.

The district states that "there is no legal compulsion or factual circumstance to support the position that Cerro Coso College and Learning Centers' student enrollment should be included in the mandated cost claim and to do so would be contrary to accounting principles." Again, the generally accepted accounting principles are not controlling criteria in identifying authorized health fee revenues attributable to the Health Fee Elimination mandated program. The district had the ability to collect health fees from students at Cerro Cost College and Learning Centers, even if no health centers were present. Furthermore, as noted in the district's response, student health service programs are located at the Porterville and Bakersfield college campuses.

OTHER ISSUE—
Public records request

The district's response included a public records request. The district's response and SCO's comment are as follows:

District's Response

> The District requests that the Controller provide the District any and all written instructions, memorandums, or other writings in effect and applicable during the claiming period to Finding 2 (indirect cost rate calculation standards) and Finding 3 (calculation of the student health services fees offset).

SCO's Comment

SCO has made available to the district the requested records via letter and attachments dated June 19, 2009.

Attachment—
District's Response to
Draft Audit Report

KCCD
KERN COMMUNITY COLLEGE DISTRICT

OFFICE OF THE CHANCELLOR
2100 CHESTER AVENUE
BAKERSFIELD, CA 93301-4099
(661) 336-5104

May 18, 2009

Mr. Jim L. Spano, Chief
Mandated Costs Audits Bureau
Division of Audits
California State Controller
P.O. Box 942850
Sacramento, CA 94250-5874

Re: Chapter 1, Statutes of 1984, 2nd Ex. Session
Health Fee Elimination
Annual Claim Fiscal Years: 2003-04, 2004-05, 2005-06, and 2006-07

Dear Mr. Spano:

This letter is the response of the Kern Community College District to the draft audit report for the above referenced program and fiscal years transmitted by the letter from Jeffrey Brownfield, Chief, Division of Audits, State Controller's Office, dated April 24, 2009, and received by the District on May 1, 2009.

Finding 1 - Misstated services and supplies

The District does not dispute this finding.

Finding 2 - Unallowable indirect costs

The draft audit report concludes that the District overstated indirect costs by $167,604 for the four-year audit period. The draft audit report states that for FY 2003-04 the District developed an indirect cost rate proposal based on OMB Circular A-21 that was not federally approved as required by the Controller's claiming instructions. In fact, the District used the FAM-29C method for all four fiscal years and used the same source document as the auditor, the CCFS-311, except that each year the District used the prior year CCFS-311 and the auditor used the current year CCFS-311.

The draft audit report asserts that the District "did not correctly compute the FAM-29C rate." The District's calculation of the indirect cost rates was not "incorrect." Rather, it differed from the audited rates because the District included the CCFS-311 capital costs rather than annual financial statement depreciation expense for the first three fiscal years.

There were also differences in how certain other groups of costs were categorized as either direct or indirect for all four fiscal years.

Indirect Cost Rates Claimed and Audited

Fiscal Year	As Claimed	Claimed Source	As Audited	Audit Report Source
2003-04	39.43%	CCFS-311	24.46%	CCFS-311 w/out depreciation
2004-05	42.89%	CCFS-311	34.28%	CCFS-311 with depreciation
2005-06	39.91%	CCFS-311	33.28%	CCFS-311 with depreciation
2006-07 (amended)	42.33%	CCFS-311 with depreciation	35.02%	CCFS-311 with depreciation

CHOICE OF METHODS

FY 2003-04

Contrary to the statement in the draft audit report, the District did not utilize a federal indirect cost rate in accordance with OMB A-21 for FY 2003-04. The District used the Controller's FAM-29C method based on the CCFS-311, including capital costs. The auditor also used the FAM-29C method, but without the capital costs, consistent with the Controller's audit policy at that time. There were also differences in how certain other groups of costs were categorized as either direct or indirect.

FY 2004-05 and FY 2005-06

The District used the Controller's FAM-29C method based on the CCFS-311, including capital costs. The auditor also used the FAM-29C method, but deleted these capital costs and substituted depreciation expense as stated on the District's annual financial statements. This use of depreciation was a result of a change in the Controller's audit policy. Claimants were not on notice of this new method of treating depreciation costs at the time the FY 2004-05 and FY 2005-06 annual claims were filed. The audit report uses this new method retroactively to FY 2004-05. There were also differences in how certain other groups of costs were categorized as either direct or indirect.

FY 2006-07

After the release of the preliminary audit findings, in February 2009, the District submitted an amended FY 2006-07 claim. The District used the same FAM-29C method based on the CCFS-311 as did the auditor. The District deleted the capital costs stated in the CCFS-311 and substituted the depreciation expense as reported in the District's annual financial statements, consistent with the Controller's new audit policy. The remaining difference in the rate claimed by the District in the amended FY 2006-07 claim and the audited rate is a result of how certain other groups of costs were categorized as either direct or indirect.

The Parameters and Guidelines for the Health Fee Elimination program (as last amended on May 25, 1989), which are the legally enforceable standards for claiming costs, state: "Indirect costs *may be claimed* in the manner described by the Controller in his claiming instructions." (Emphasis added) Therefore, the Parameters and Guidelines *do not require* that indirect costs be claimed in the manner described by the Controller. Since the Controller's claiming instructions were never adopted as rules or regulations, they have no force of law.

The burden is on the Controller to show that the indirect cost rate used by the claimant is excessive or unreasonable, which is the only mandated cost audit standard in statute (Government Code Section 17651(d)(2)). The District's calculated rates vary only by about three percent (39.43%-42.89%). The audited rates vary significantly (24.46% - 35.02%). For the four fiscal years audited, the Controller's policy regarding capital costs and depreciation expense changed without statutory or regulatory bases. If the Controller wishes to enforce different audit standards for mandated cost reimbursement other than Section 17561, the Controller should comply with the Administrative Procedure Act.

PRIOR YEAR CCFS-311

The draft audit report did not disclose that the audit used the current audit year CCFS-311 for the calculation of the indirect cost rate. The District used the prior year CCFS-311. The CCFS-311 is prepared based on annual costs from the prior fiscal year for use in the current budget year. When the audit utilizes a different CCFS-311 than the District, this constitutes an undisclosed audit adjustment. The audit report does not state an enforceable requirement to use the most current CCFS-311.

As a practical example of the baselessness of the Controller's position on prior year CCFS-311 reports, note that the federally approved indirect cost rates which the Controller accepts are approved for periods of two to four years. This means the data from which the rates were calculated can be from three to five years prior to the last year in which the federal rate is used.

Since the Parameters and Guidelines *do not require* that indirect costs be claimed in the manner described by the Controller, and the Controller's claiming instructions were never adopted as rules or regulations, the choice of which CCFS-311 to use is based on factual relevance only. The later CCFS-311 and financial statement depreciation expense used by the Controller is not always available to claimants at the time the claim is due to the state. The draft audit report has stated no legal basis to disallow the indirect cost rate calculation method used by the District and has not shown a factual basis to reject the rates as unreasonable or excessive.

Finding 3 - Understated authorized health fee service fees

The draft audit report states that student health service fee revenue offsets were understated by $1,145,224 for the four-year audit period. The difference between the

claimed amount and the audited amount is that the District utilized actual revenues received rather than a calculation of the student health service fees potentially collectible. The auditor calculated "authorized health fee revenues," that is, the student fees collectible based on the highest student health service fee chargeable to all eligible students, rather than the full-time or part-time student health service fee actually charged by the District to the students not exempted by state law (e.g., BOGG waiver students) or District policy.

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COLLECTIBLE STUDENT HEALTH SERVICE FEES

The District asserts that the "collectible method" of determining the student health service fee revenue offset is not supported by law or fact.

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Legal requirements and the facts aside, the audit process is subject to generally accepted accounting principles and procedures that, among other things, require revenues and expenses to be "matched." If the enrollment of Cerro Coso College and the Learning Centers is included in the calculation of collectible fees, the audit is applying revenues with no corresponding matching expenses.

In sum, there is no legal compulsion or factual circumstance to support the position that the Cerro Coso College and Learning Centers student enrollment should be included in the mandated cost claim, and to do so would be contrary to accounting principles.

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O O O

The District requests that the final audit report comply with the appropriate application of the Parameters and Guidelines regarding allowable activity costs and the Goverment Code sections concerning audits of mandate claims.

Sincerely,

Thomas J. Burke, Chief Financial Officer
Kern Community College District

State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874

http://www.sco.ca.gov

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