Date of Hearing: April 23, 2025

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Juan Carrillo, Chair
AB 964 (Hadwick) – As Amended March 27, 2025

**SUBJECT**: Commission on State Mandates: state mandates.

**SUMMARY**: Authorizes local agencies to offset any reduced reimbursements from any unpaid reimbursement claims or to remit funds to the State Controller's Office (SCO). Specifically, **this bill**:

1) Requires the SCO to notify the claimant in writing within 30 days of any adjustment to a claim for reimbursement that results from an audit or review, instead of 30 days after the issuance or remittance advice.

2) Specifies that the SCO shall allow a local agency or school district, at the sole discretion of the local agency or school district, to do wither of the following:

   a) Offset any reduced reimbursement, identified in an audit or review by the SCO, from any unpaid reimbursement claims, whether appropriated or not, to the extent sufficient unpaid reimbursement claims are available.

   b) Remit funds to the Controller.

3) Makes other technical changes.

**EXISTING LAW**:

1) Provides that a reimbursement claim for actual costs filed by a local agency or school district 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 [Government Code (GC) § 17558.5].

2) Specifies that the SCO may conduct a field review of any claim after the claim has been submitted, prior to the reimbursement of the claim (GC § 17558.5).

3) Provides that the SCO shall notify the claimant in writing within 30 days after issuance of a remittance advice of any adjustment to a claim for reimbursement that results from an audit or review. The notification shall specify the claim components adjusted, the amounts adjusted, interest charges on claims adjusted to reduce the overall reimbursement to the local agency or school district, and the reason for the adjustment. Remittance advices and other notices of payment action shall not constitute notice of adjustment from an audit or review (GC § 17558.5).

4) Specifies that the interest rate charged by the Controller on reduced claims shall be set at the Pooled Money Investment Account rate and shall be imposed on the dollar amount of the

overpaid claim from the time the claim was paid until overpayment is satisfied (GC § 17558.5).

**FISCAL EFFECT**: This bill is keyed fiscal.

**COMMENTS**:

1) **State Mandates.** In 1979, the voters amended the California Constitution, requiring the state to reimburse local governments for the cost of new programs or higher levels of service mandated by the Legislature, the Governor, or any state agency (Section 6 of Article XIII B). However, not all mandates are reimbursable. The Constitution also creates specific exceptions when the state does not have to reimburse local governments for the new program or higher level of service:

   a) The local agency affected requests the mandate.

   b) The mandate defines a new crime or changes an existing definition of a crime.

   c) The Legislature enacted the mandate prior to 1975.

   d) The mandate concerns constitutional requirements to provide the public access to public meetings and records.

   The Legislature established the State Mandates Commission (Commission) in 1984 as a quasi-judicial body to mediate disputes between the state and local agencies over what constitutes a reimbursable mandate. The Commission is tasked with resolving the complex legal questions associated with determinations of state mandated costs. The Commission's membership includes the following:

   a) The Director of the Department of Finance.

   b) The State Treasurer.

   c) The State Controller.

   d) The Director of the Office of Land Use and Climate Innovation (formerly the Office of Planning and Research).

   e) Two local government members (a city councilmember, member of a county board of supervisors, or a governing board member of a school district), appointed by the Governor.

   f) One public member with experience in public finance, appointed by the Governor.

   When the Legislature created the Commission, it also created additional circumstances under which the state does not have to reimburse local agencies for state-mandated local programs, including when:

a) The mandate has been declared existing law or regulation by action of the courts.

b) The mandate is federally-mandated.

c) The local agency has the authority to levy service charges, fees, or assessments sufficient to pay for the mandated program or increased level of service.

d) There is offsetting savings from an appropriation or another bill.

e) The mandate is necessary to implement a ballot measure approved by the voters.

2) **Proposition 1A.** Proposition 1A, passed by voters in 2004, generally required the state to pay all outstanding non-education mandate costs each year or else suspend the mandate's requirements, halting the practice of delaying payments indefinitely while still requiring local agencies to provide the mandated services. Proposition 1A allowed those delayed payments to be paid over a term of years. Local agencies worked with the state to secure the final repayment for pre-2004 mandate debt in the 2015-16 state budget. That debt, which at one time totaled more than $1 billion, is now fully paid.

3) **Submitting Test Claims.** When a local agency wants to claim a state law or executive order increases costs, it submits a test claim to the Commission outlining the increased costs or level of service. The Commission hears the claim and decides whether it is a reimbursable state mandate. If the Commission determines that the requirement in question is a reimbursable mandate, it calculates the amount the state must pay local agencies based on actual costs or another Reasonable Reimbursement Methodology (RRM) the Commission develops.

   Under the 1984 legislation, local agencies did not have a statute of limitations that limited the time they had to submit a test claim. In 2002, AB 3000 (Committee on Budget), Chapter 1124, Statutes of 2002, imposed a three-year statute of limitations. Later, AB 2856 (Laird), Chapter 890, Statutes of 2004, reduced the statute of limitations to one year from the effective date of the statute, or the date the local agency first incurred costs. Section 1181.1of the California Code of Regulations requires local governments to file test claims with the Commission, which must be filed no later than 12 months following the effective date of a statute or executive order, or within 12 months of *first* incurring increased costs as a result of a statute or executive order, whichever is later.

4) **Reimbursement Process.** If the Commission determines there are costs mandated by the state, it shall determine the amount to be subvened to local agencies and school districts for reimbursement. The Commission is then required to adopt "Parameters and Guidelines" that list the specific activities that are reimbursable. Once the Commission has adopted Parameters and Guidelines, local governments can submit claims for reimbursement based on the actual costs of the required activities. Alternatively, the Commission can adopt a RRM. The Legislature created the RRM process in 2004 with the intent to streamline the documentation and reporting process for mandates. An RRM allows local governments to be reimbursed based on general allocation formulas or other approximations of costs, rather than detailed documentation of actual costs.

After the Commission adopts parameters and guidelines, those parameters and guidelines are sent to the SCO. The SCO then has 90 days to issue claiming instructions. The claiming instructions tell local governments how to file for reimbursement for the mandated activities with the SCO. Local governments then have 120 days to file their initial reimbursement claims with the SCO. Following the receipt of the initial reimbursement claims, the Commission estimates the statewide costs and sends the statewide cost estimate to the Legislature. Typically, within one year of local governments submitting claims for reimbursement, the Commission prepares a statewide cost estimate based on the claims or the RRM. After the cost estimate is prepared, mandates are considered for funding in the state budget. As noted earlier, Proposition 1A (2004) requires the Legislature to fund, suspend, or repeal non-education-related mandates. Suspending mandates relieves local governments of performing the mandate for one year, while repealing a mandate permanently eliminates it.

If the amount the Legislature appropriates is insufficient to pay all of the reimbursement claims filed and approved for reimbursement, the Controller will prorate the claims. If the funds to cover the remaining deficiency are not appropriated in the Budget Act, the Controller shall report this information to the legislative budget committees and the Commission.

5) **School Reimbursements.** In 2012-13, the state created two education mandates block grants—one for all active K-12 mandates and one for all active community college mandates. The block grants are an alternative mechanism for local educational agencies (LEAs) to seek mandate reimbursement. Instead of submitting detailed claims on an ongoing basis listing how much was spent on each mandated activity or using specific RRMs for specific mandates, LEAs can choose to receive funding for all mandated activities through the block grants. As of 2015-16, almost all LEAs were participating in the block grants. (Those LEAs not opting to participate in the block grants continue to submit claims to the Controller for reimbursement at a later date.)

6) **SCO Audits and Reductions.** State law authorizes the SCO to audit any mandate claim within three years of reimbursement, and an audit must be complete within two years of when the audit commenced. However, if no funds are appropriated or no payment is made to a claimant for the mandate for the fiscal year for which the claim is filed, the time for the Controller to initiate an audit must commence to run from the date of initial payment of the claim. When auditing a claim or RRM, the SCO reviews whether the local government's claim for reimbursement follows the Parameters and Guidelines set out by the Commission. The SCO also verifies the information provided by the local government is accurate and sufficient to support the reimbursement. If the local government claimed reimbursement for activities not included in the Parameters and Guidelines or did not provide sufficient evidence for the claim, the SCO may reduce the reimbursement and may charge interest when the claim was already paid. The SCO is required to notify the claimant in writing within 30 days after the issuance of a remittance advice of any adjustment to a claim for reimbursement.

As detailed by a Legislative Analyst's Office review in 2016, "Last year, the SCO issued roughly 130 audit reports related to mandate claims. Each audit report included an average of five local government reimbursement claims for particular mandates. Overall, this reflects an audit of roughly 1 percent of claims. In the 1 percent, or roughly 650 claims, audited, the SCO identified errors in 60 percent of them. As a result, reimbursements to local governments were reduced by $170 million. While those claims audited were reduced by a significant amount, these reductions reflect a small share of the state's mandate payments overall. Moreover, this error rate likely does not reflect the error rate across all claims as SCO targets audits based on the risk factors discussed above. (Notably, reductions to community college claims reflected over half of the total adjustments.) Each audit report, which typically is performed by one auditor, requires six months to one year to complete."

If a local government believes the SCO incorrectly reduced its reimbursement, the local government may appeal the decision to the Commission. To overturn a reduction, the Commission must find that the SCO's reduction was arbitrary, capricious, or did not have sufficient evidence to support a reduction. For example, Sacramento County filed an IRC on November 25, 2024 for Fiscal Years 2016-2019 on the Child Abduction and Recovery Program. According to the filing, "On February 23, 2022, the State Controller's Office (SCO) issued its final audit report on the County of Sacramento District Attorney's Office (DA's Office) claims for costs incurred based on the legislatively created Child Abduction and Recovery Program (Chapter 1399, Statutes of 1976; Chapter 162, Statutes of 1992; and Chapter 988, Statues of 1996) for the period of July 1, 2016, through June 30, 2019... The SCO incorrectly reduced the County's claim of $1,885,876 by $465,094. The County requests the Commission of State Mandates to reverse the audit findings and to award the County the correct claim in the amount of $1,885,876." The next tentative hearing date for the IRC is September 26, 2025.

7) **Bill Summary.** This bill requires the Controller to notify a claimant in writing within 30 days of any adjustment that results from an audit or review, instead of 30 days after the issuance or remittance advice. This bill also requires the Controller to allow a local agency or school district, at the sole discretion of the local agency or school district, to offset any reduced reimbursement, as prescribed, or to remit funds to the Controller. The State Association of County Auditors is the sponsor of this bill.

8) **Author's Statement.** According to the author, "The State of California owes cities, counties, special districts, schools and community colleges over $1.8 billion in unpaid reimbursable state mandate claims. Even after a reimbursement is issued, an audit or review may reduce the reimbursement amount paid. The local government then must pay that reduced amount, plus interest, back to the State. These repayments must occur even if the local government has other outstanding claims owed to them. For small, rural counties with tight budgets, repaying even a fraction of what little reimbursement they are owed can cripple their financial health. Assembly Bill 964 provides financial relief to local governments facing a massive back log of unpaid claims. By allowing a local government to offset any reduced reimbursement from other unpaid reimbursement claims, local governments can hold on to critical funding for their under resourced communities."

9) **Policy Considerations.** The Committee may wish to consider the following:

   a) **When to Pay.** The state mandates reimbursement process is very complex and often takes years for local agencies to receive reimbursements for mandates they are already performing. The SCO is required to submit a report annually to the Legislature summarizing the total amount of claims paid per fiscal year and the amount, if any, of mandate deficiencies or surpluses. In the October 31, 2024, letter sent to the Legislature, the SCO detailed that the state liabilities due to schools and other local agencies is approximately $1.4 billion dollars with an estimated accrued interest of approximately $228 million for a total of approximately $1.6 billion. According to a coalition of local government associations, "Over the years, the state has accrued a significant backlog of funds owed to local governments for work performed to carry out state-mandated projects. According to the State Controller's Office, as of October 2024 the state owes local governments collectively $883.3 million, including estimated accrued interest. This nearly $1 billion figure includes funds owed for claims for active state-mandated programs, unpaid claims from prior fiscal years, and outstanding 'incorrect reduction' claims filed with the Commission on State Mandates."

The SCO is unable to pay these amounts without an appropriation from the State and the amounts are accruing interest as stated in the SCO's letter. However, the authority to make an appropriation ultimately rests with the State. While this bill likely does not force the State to make any additional appropriations to pay for the stated backlog of claims, it would essentially allow local agencies to receive funds absent a budget appropriation. The Committee may wish to consider if the authority of when to pay reimbursement claims should reside with the State.

b) **Is Additionally Clarity Needed?** As written, this bill specifies that the SCO must allow a local agency or school district, at the sole discretion of the local agency or school district, to offset any reduced reimbursement from any unpaid reimbursement claims, whether appropriated or not, to the extent sufficient unpaid reimbursement claims are available or to remit funds to the SCO. However, it is not clear who makes the determination of whether such funds are available.

   Additionally, it is not immediately clear which funds from unpaid reimbursement claims can be used to offset a reduction. Should this bill specify that only the unpaid amounts attributed to a particular agency can be used as this bill would allow?

10) **Committee Amendments.** In order to respond to the policy consideration in b) above, the Committee may wish to amend this bill as follows:

    (d) The Controller shall allow a local agency or school district, at the sole discretion of the local agency or school district, to do either of the following:
    (1) Offset any reduced reimbursement identified in subdivision (c) from any unpaid reimbursement claims **attributed to that local agency or school district**, whether appropriated or not, to the extent sufficient unpaid reimbursement claims are **determined by the Controller to exist** ~~**available**~~.
    (2) Remit funds to the Controller.

11) **Arguments in Support.** According to the State Association of County Auditors, sponsor of this bill, "For decades, local agencies have been assessing the new duties assigned to them by State laws and, if eligible, filing claims for reimbursement for the services rendered. However, if a subsequent State audit disallows the contested amounts on the claim, current law leaves open the possibility that agencies would be required to repay the funds that had likely been budgeted or even spent by the agency.

    "Assembly Bill 964 would allow the State and local agencies to address the balance of these disallowed claims by utilizing past due amounts currently owed the local agencies rather than withholding funds from current or future claims and harming critical services provided. This would allow the State to be made whole for the contested amount due, while relieving local agencies the burden of clawing back funds that are needed for critical services.

"AB 964 does not relieve the agency of the obligation to repay the subject funds; rather it provides a fair mechanism to correct the issue with significantly less harm to local agency services by utilizing funding that is owed to that agency."

12) **Arguments in Opposition.** None on file.

13) **Double-Referral.** This bill is double-referred to the Assembly Committee on Education.

**REGISTERED SUPPORT / OPPOSITION**:

**Support**

State Association of County Auditors [SPONSOR]
California Association of School Business Officials
California Special Districts Association
California State Association of Counties
Fresno County
League of California Cities
Rural County Representatives of California
Sacramento County
Urban Counties of California

**Opposition**

None on file

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