



# The Florida Senate

Interim Project Report 2003-139

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Committee on Regulated Industries

Senator James E. "Jim" King, Jr., President

## FEE EQUITY - EXAMINING THE FAIRNESS OF FLORIDA'S REGULATORY FEE STRUCTURE

### SUMMARY

The State of Florida funds its annual \$50 billion General Appropriations Act through a combination of general and dedicated revenues spread across hundreds of separate trust accounts and participating public and private entities. Fully sixty percent of the FY 2003 budget is composed of trust funds, that is, funds dedicated for the achievement of a specific purpose within a defined jurisdictional framework. Despite a succession of annual budget reprioritization exercises and institutionalized performance initiatives the budget remains a complex aggregation of fee and revenue structures, many with their own seasonal or policy variations. Governmental regulatory actions frequently attempt to capture the cost of that regulation in a self-contained fashion. The report discusses a number of the difficulties associated with making some governmental functions pay for themselves and recommends a more disciplined and regularized review of dedicated revenue structures that support these functions.

with General Revenue. Another remedy is to have one account borrow with interest from another account sufficient funds to cover its costs.

During the 2002 Legislative Session, Senate Bill 692 (SB 692) relating to Fee Equity Measures, was filed. The bill required that all costs of providing a service for which a fee is charged or of regulating professionals be borne *solely* by those receiving the service or regulation. The bill required the fees imposed to be reasonable, to account for differences in the services or professions being regulated, and to require the responsible agencies to operate efficiently. To accomplish this goal, the bill required agencies to annually examine whether such regulation could be privatized<sup>1</sup> and, where the agency best serves the public, established criteria for setting the fees. Where the direct and indirect costs were not covered by fees, the bill required the agency to go to the Legislative Budget Commission, or, if rejected, to the Legislature for an increase in the fee. The bill was never heard by a committee during regular session.

### BACKGROUND

The State of Florida manages an annual operating budget in excess of \$50 billion along with separate fiduciary accounts approaching almost another \$120 billion. Within these sums are scores of separate revenue raising and spending streams, each naming a specific object of jurisdiction. Regulatory fees pose unique sets of issues for the institutions and persons affected by government action through its police power or commerce regulating functions. Fees charged for services and for regulation of businesses and professions are set in statute either as a flat fee, a fee cap, or authorization is given to an agency or board to charge a fee to "cover the cost of such service." Many fees are capped and require legislation to change the cap. Recently some fees charged have been inadequate to cover the true cost of regulation. One remedy to cover the cost of regulations is to supplement the costs

### METHODOLOGY

A work group was formed with staff of the Senate Committees on Appropriations – General Government, Government Oversight and Productivity, Finance and Taxation, Regulated Industries and staff from the Office of Programs and Policy Analysis and the Office of the Auditor General. The group discussed the issues addressed in SB 692 and other ways to improve the process of making Florida's fee structure more equitable and reflective of the true cost of providing services.

<sup>1</sup> There are important distinctions to be made among the terms privatization, outsourcing, and franchising. This report uses the term generically to apply to the indirect, rather than the direct, delivery of a governmentally determined service or purpose.

Staff also reviewed reports from other agencies and states that addressed this issue.

## FINDINGS

Florida's state government provides a huge array of services, regulation, and protection to its citizens. Professional regulatory functions, for example, are dispersed over a number of agencies, many of which are subject-matter specific. The Department of Education regulates teachers, the Department of Law Enforcement certifies all law enforcement officers; but there is also a separate professional regulation agency for primarily private sector entities and professions. Funding for these regulatory operations comes from general and dedicated trust funds. Trust funds are accounts to which specified fees are deposited for an exclusive use and benefit. Concerns have recently been raised when the fees collected do not completely cover the cost of the benefits provided. Concerns have also been raised at some seemingly disparate treatment among those regulated.

A review to determine whether fees cover costs may not address all the perceived problems. The work group identified numerous issues that would need to be addressed in a review such as one suggested in SB 692. These issues include review of the underlying policy, definitions of terms, and cost allocation. These issues, as well as others, are discussed below.

The statutes are the narrative statement of policies determined necessary by the Legislature. Their execution is effected principally through the state agencies created for those named purposes. It is critical, then, that the functions each agency discharges matches its statutory responsibility. The corresponding costs of providing the regulation or service should be identifiable and relate back to the agency function. Identifying and defining certain terms and the revenue sources is a function of the prescribed policy. Generally, the fees set forth in the statute are to pay for certain costs accrued for the regulation of a profession or provision of a service. Because of policy considerations, the fees may not entirely cover the cost of regulating the profession or providing the service. Or on the other hand, the fees may more than adequately cover the cost of regulating the profession or providing the service, but the overages are designated to fund additional activities elsewhere in the agency or in the overall budget. Finally, fees may be set to cover the cost of regulating a profession or providing a service based upon average costs, not specific costs.

Policy is established on a case-by-case basis as fees are set and applied to each profession or service.

A portion of the policy statement may be derived from the definitions that are assigned to particular terms. Such terms would include taxes, user charges or fees and other miscellaneous revenues. Moreover, the distinction between these terms can become blurred. The courts have been the ultimate determiner of the definitions; however, the U.S. Census Bureau's Governments Division has developed a scheme that was utilized in a 1999 National Conference of State Legislatures report "Appropriate Role of User Charges in State and Local Finance." The following are examples of definitions for the terms:

**Taxes** – are compulsory contributions exacted by a government for public purposes, other than for employee and employer assessments and contributions to finance retirement and social insurance systems and for special assessments to pay for capital improvements. These include personal and corporate income taxes, franchise, gross receipts, sales and use, excise, property, and utility taxes. They do not include taxes to fund unemployment insurance, workers' compensation, worker or employer pension contributions, and Social Security and Medicare taxes.

**Current charges** - are charges imposed for provided current services or for the sale of products in connection with general government activities, excluding utility service charges. This definition, because of its emphasis on current consumption of services, excludes impact fees that are used to fund capital projects. Current charges include tuition at state colleges and universities, tolls and transportation charges, parks and recreation fees, solid waste charges, and other fees for the use of government services.

**User charges** - are the equivalent of the operating portion of the state budget, not the capital portion of the budget. In other words, user charges pay for current consumption of goods and services and do not include fees for capital costs.

**Miscellaneous general revenue** - includes all the general revenue of governments from their own sources, including interest revenue necessary to pay the interest expenditure on private activity bonds. Examples include lottery revenue, funds from sales of state property, royalties from mining

or timber activities and state lands, development impact fees, and interest earnings.

General revenue from own sources, includes all government revenue except that classified as intergovernmental, liquor store, utility, or insurance trust revenue. It is the sum of taxes, current charges, and miscellaneous revenue described above. This category excludes federal aid.

It should be noted that there is very little practical difference between a tax and a fee. Legal distinctions between taxes and fees are very important, however, because many states have constitutional or statutory restrictions on the ability of local governments to levy taxes – restrictions that usually do not apply to fees. The absence of a definition of “fee” or “tax” in the Florida Statutes itself may contribute to this semantic and budgetary confusion as to what is owed, what the rate should be, and who should pay.

Prescribing that all costs of providing a service or of regulating professions be covered requires that all costs be defined and allocated. Usually each agency implements some method of allocation to track its costs. However, questions arise such as how to allocate to each program general and administrative costs. These costs may include costs for planning and budgeting, accounting, human resources, communications, and information technology. Generally, administrative expenses for specific programs are charged pursuant to a plan. For the charges to be legitimate, the work is required to directly benefit the specific program charged. Or, with documentation, a direct charge can be made in lieu of assessing the program for indirect administrative support. In each instance, an equitable basis must be determined for any charge.

The language for cost recovery varies in the statutes between the agencies. For instance there may be different definitions of cost, different cost recovery exceptions or inclusions, and there may be fees or charge caps. Examples from the statutes illustrate this point:

- Caps set without regard to cost.
- Caps set with waiver or exemption criteria.
- Monies directed to a trust fund for a specific purpose.
- A reasonable, cost-efficient fee with out mention of caps.

- The agency is allowed to set a fee to offset costs of administration of the certification process.
- Ranges of not less than X nor more than Y per year.
- Charging a reasonable fee for purpose of administering the chapter.
- Charging a reasonable amount based on the cost of such extensive use of IT resources or labor costs of the personnel providing the service that is actually incurred by the agency attributable to the agency for the clerical and supervisory assistance or both.
- Charge to defray the cost of the program if general revenue funds are not provided for this purpose.
- Establish a schedule of fees to pay one-half of the costs incurred by the department in administering this act, but not to exceed X amount.

Government accounting has some unique treatment of certain specialized areas that are different than the generally accepted accounting principles (GAAP) and have been established by the Government Accounting Standards Board (GSAB). (Otherwise, GAAP is the same for all.) While the accounting standards are the same, the allocation of costs may be specialized for each agency. Functions are assigned codes, and while some codes may be the same for all agencies, others may be specific to a particular agency and program within the agency. Thus, the costs that are captured in an allocation process may be unique to a program and administered by a particular agency.

There are other issues that relate to cost allocation. State agencies perform a broad spectrum of services that can directly benefit a particular entity and at the same time benefiting the public as a whole. There currently appears to be no guidance for treatment of certain costs that may be considered capital expenses, such as equipment and software, when utilized across a broad spectrum of services and professions regulated. When trust funds are utilized, additional issues arise. For instance, a statute may authorize collection of a fee to be deposited into a designated trust fund but does not specify a particular activity.

Sources of funding are varied and may include federal, regional, and local sources in addition to taxes, fees and fines. Accompanying such funding may be a requirement that the funds may only be spent on specific costs or that a certain cost allocation be followed. In these instances, agencies are limited in what the funds are used for and how they are accounted.

The use of the funds is also relevant. Revenues can be placed in the general revenue fund or in a specific fund, such as a trust fund, designed to cover regulatory or other costs. Some states impose fees on regulated industries that are intended to cover the cost of the regulatory agencies that oversee them; the Department of Business and Professional Regulation, for example. Courts generally have considered these charges to be fees if revenues are not used to fund other government activities. However, if these fees generate excess revenues for general government purposes beyond what is necessary to cover regulatory costs, they frequently are considered taxes by the courts.

In addition to legal constraints on state and local taxes, fees also appear to have gained in political popularity with both state and local lawmakers and voters. Some taxpayers perceive taxes as compulsory payments for services from which they do not necessarily benefit. Fees, on the other hand, are perceived as payments for services received by the payer. Finally, fees do not seem to have the political stigma of taxes.

SB 692 contemplated an annual review by each agency to examine the fees they charge for services and for regulatory oversight. The burden of such a review could outweigh the benefits. For instance, approximately 35 chapters provide for the regulation of professions, pari-mutuels, alcoholic beverages and tobacco, hotels and restaurants, land sales, condominiums and mobile homes and has at least 29 different professions for which is allocates costs. Article III, Section 19 of the Florida Constitution provides for the automatic termination every four years of trust funds. Section 215.3208, F. S., implements this provision and allows the review schedule to be included in the legislative budget instructions. Periodic review of the fees and underlying policies in conjunction with this trust fund review could provide a more meaningful evaluation without significant additional burden on any given agency.

In the alternative, if the Legislature conducts a Zero Based Budgeting (ZBB) review as required by s. 216.1825, F.S., such process could also include a review of the fees and underlying policies. The ZBB review is an extensive, comprehensive analysis of agency programs, services, and activities performed by legislative staff under the direction of designated members of the Legislative Budget Commission. The objective of this zero-based budget review is to provide an inventory of agency programs, services, and activities; including cost, performance, and customer information to support the Legislative Budget

Commission in making recommendations relative to the following questions:

1. Should government continue providing a service and its associated activities at the current level of funding and performance?
2. If the service or activity is recommended for continuation, can it be provided more efficiently and effectively?
3. Should the activity be reengineered, should the service or activity be outsourced or privatized if quality is improved or costs decreased?

In its 2001-02 Annual Report, the Office of the Auditor General references Report 02-147, issued February 2002, "Statutory Revision Could Improve State Trust Fund Administration Structure." Recommendations relevant to this project include:

1. Establish certain cost accounting capabilities to accumulate both the direct and indirect cost of each activity.
2. Authorize the Governor's Office and the Chief Financial Officer to develop policies and related guidelines for identification and classification of direct and indirect costs.
3. State law does not currently require state agencies to develop and implement cost allocation plans. Therefore, in support of maintenance of cost records, each agency should adopt and periodically thereafter update a plan for allocating to each activity an appropriate share of the agency's indirect cost.
4. A policy should be in place requiring that when a program receives funding from both the general revenue fund and one or more state trust funds, any reversion of appropriate balances from the trust funds be transferred to the general revenue fund except when such transfers would violate contract provisions, Federal laws, or the State Constitution.

A review of the underlying policy by which fees are established to cover or defray costs of a particular service or regulation could move a potentially significant portion of cost to those who utilize the service or cause costs to be incurred by their regulation. Clearly, there are circumstances in which the levying of a regulatory fee produces an adverse policy result. A public policy targeting a reduction in high risk health matters among the very young would find a mandatory vaccination fee inappropriate; an admissions charge for the use of a public library would evoke similar concerns as it could effectively place a means test on literacy. Such review however, should be done in a

systematic and periodic manner so as not to cause unnecessary cost and to allow for considered debate on policy matters that consider the nature of the regulated activity, the appropriateness of a fee, the rate and base, and the ease and durability of its collection.

### **RECOMMENDATIONS**

Fee structures should be reviewed to insure consistency with stated policy. Further, with the concept of cost recovery, the appropriateness of fee caps should be reviewed to make sure these upper limits are sufficient to cover all included costs.

Any review should be tied to an existing systematic and periodic review such as that required for trust funds under s. 215.3208, F.S. The review should consider all costs of providing a service for which a fee is charged and of regulating professionals assuring that all costs shall be borne solely by those receiving the service or regulation or to justify sharing the cost among a broader source.

Under s. 215.3208, F.S., the legislature reviews each state trust fund once every four years. Part of that review should include an examination of the relevance of the funding method along with its revenue sufficiency.