



The Florida Senate

Interim Project Report 98-40

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Committee on Regulated Industries

Senator James A. Scott, Chairman

PRIVATIZATION OF DEPARTMENT OF BUSINESS AND PROFESSIONAL REGULATION FUNCTIONS

SUMMARY

Privatization of functions related to professional regulation is a timely topic. For years, dissatisfaction with the efficiency and effectiveness of the current system has been growing within the professions and among consumers. Recent legislation has been enacted to privatize computer-based testing and administrative support for the Board of Engineers. In addition, proposals have been offered, though not adopted, to privatize continuing education compliance and facilities inspections. This report focuses on an approach for ascertaining the potential benefits and costs of privatizing certain functions relating to the regulation of nonmedical professions by the Department of Business and Professional Regulation.

BACKGROUND

The same Government Performance and Accountability Act that mandates performance-based program budgets for state agencies also created the State Council on Competitive Government (*see* section 50 of Chapter 94-249, Laws of Florida). A goal of the legislation is to hold agencies accountable for delivering products and services in the most efficient and effective manner and to create incentives for restructuring ineffective programs and eliminating unnecessary programs. The act specifically provides:

It is the policy of this state that all state services be performed in the most effective and efficient manner in order to provide the best value to the citizens of the state. The state also recognizes that competition among service providers may improve the quality of services provided, and that competition, innovation, and creativity among service providers should be encouraged. (Section 14.203, Florida Statutes).

The State Council is composed of the Governor and Cabinet, sitting as the Administration Commission. Its duty is to "identify commercial activities currently being performed by state agencies and, if it is determined that such services may be better provided by requiring competition with private sources or other state agency service providers, . . . [to] recommend that a state agency engage in any process, including competitive bidding, that creates competition with private sources or other state agency service providers." (Subsection (2) of section 14.203, Florida Statutes). As part of its evaluation process, the Council may require agencies to estimate the baseline costs of providing an identified service.

The Council was established in 1994. Since then, it has reviewed several privatization proposals relating to professional regulation, including computer-based testing, administrative support for the Board of Engineers, and outsourcing of professional facility inspections. The Council has required the Department of Business and Professional Regulation to prepare "Agency Cost Surveys" for these programs. Obtaining valid measures of the baseline costs of performing identified services is a key step in evaluating competitive proposals.

In 1997, the Legislature created a private, not-for-profit entity, the Florida Engineers Management Corporation (FEMC), to provide administrative, investigative, and prosecutorial support services for the state Board of Professional Engineers under annual contract with the Department of Business and Professional Regulation (*see* Chapter 97-312, Laws of Florida). The first annual contract was executed on July 15, 1998.

Also in 1997, the Legislature amended sections 455.213 and 455.217, Florida Statutes, to facilitate administration of computer-based testing for professional license examinations (*see* Chapter 97-228, Laws of Florida). The concept was to make tests available at

multiple locations year-round, rather than requiring applicants to be tested at a central location only 2 to 4 times per year. The 1997 amendments provided that the Department of Business and Professional Regulation (instead of the individual boards) may determine who will promulgate and administer examinations. It also provided that an applicant's examination fees may be paid directly to a private vendor, rather than through the department and that examination fees would be set by the respective boards, based on the "actual cost for any purchase, development, and administration" of the examination. However, examination fees are not to exceed the statutory fee caps.

In 1998, the Legislature enacted a bill relating to barbering and cosmetology that authorizes the Board of Cosmetology to require up to 16 hours of continuing education biennially (*see* Chapter 98-323, Laws of Florida). The law also authorizes the Department of Business and Professional Regulation to privatize provider and course approval and compliance monitoring for continuing education under a contract ensuring that the privatized service, including the cost of oversight, will be without cost to the Department.

METHODOLOGY

The objective of this report is to recommend a method for ascertaining the potential benefits and costs of privatizing additional functions relating to the regulation of nonmedical professions by the Department of Business and Professional Regulation.

As part of the project, committee staff solicited comments from the professions and other interested parties concerning the desirability of privatization and the benefits or detriments that might result to licensees or consumers of professional services. Staff also gathered relevant information from the Department of Business and Professional Regulation regarding existing and previously proposed privatization efforts. In addition, staff surveyed literature and other relevant information relating to privatization of regulatory functions.

FINDINGS

Privatization of government services usually is proposed as a way of improving public service and saving tax dollars. Among the advantages of privatization identified in a report, "Assessing Privatization in State Agency Programs," by the Office of Program Policy Analysis and Government Accountability (OPPAGA) are:

- Cost savings, due to lower labor costs in the private sector, reduced regulatory requirements, reduced overhead, higher productivity, and flexibility for private firms to invest in modern equipment;
- Increased flexibility, and the superior ability of private firms to adapt to changing situations;
- Staffing flexibility and the ability to obtain specialized expertise for short-term or occasional projects; and
- Shift of start-up costs to the private sector.

However, privatization is not always appropriate. The OPPAGA report identifies several disadvantages to privatization, including: reduced control of program activities, reduced quality of service, increased costs (particularly in the long run), layoffs of employees (which may undermine morale or disrupt other programs because of "career service bumping rights"); upsetting of agency equal employment opportunity goals (if affected employees include substantial numbers of minorities); and loss of continuity and historical context.

Determining whether a program should be privatized involves first a *policy decision* (whether it is appropriate to administer the program under a private contract) and second a *cost-benefit decision* (whether privatization will be cost-effective, not only in the short-term, but also in the long term).

The policy decision

The Constitution, statutes, and case law guide the policy decision. It is well established that the regulation of professions involves the exercise of sovereign police power, which must be exercised by state officers and cannot be delegated. However, ministerial activities related to the making of ultimate and binding decisions may be delegated. For example, on-site inspections, investigations of complaints and perceived violations of law, and the making of findings of fact and recommendations for disciplinary action may be delegated, provided that the private entity is furnished clear criteria for gathering information and all final determinations affecting the rights of the public are made by state officers (*see* November 15, 1996 memorandum from Debby Kearney, Deputy General Counsel in the Executive Office of the Governor, to Lee Ann Barron). Examples of activities that cannot be dele-

gated include: issuance of citations, determination of legal sufficiency for further action, determination of probable cause, and emergency closure of non-complying facilities as a result of an on-site investigation.

Other questions pertinent to making the policy decision include antitrust liability, work force issues, and the applicability of sovereign immunity, public records, open meetings, purchasing, and the Administrative Procedures Act to the private entity. Some of these questions are addressed in the Interim Project Report by the Senate Committee on Governmental Reform and Oversight titled "Model Contracted Services Corporation" (98-25).

The cost-benefit decision

Once a policy decision is made that privatization of a particular program or function is appropriate, the critical question becomes, "Will the benefits of competition outweigh the costs?" For making this cost-benefit decision, John C. Hilke succinctly describes which programs are the best candidates for privatization in *Competition in Government-Financed Services* (New York: Quorum Books, 1992):

The probability that privatization will be successfully implemented and will be preferable to government service delivery is strongly associated with certain prerequisites. Among these are relatively narrow objectives, readily defined and easily measured; specifiable tasks and well-know production processes, monitorable at modest cost; a number of willing and able competing private-sector suppliers; and a competent, honest government to enforce the rules of a fair market.

Hilke's point is that privatization is most likely to work when a competitive market already exists for delivering a product or service and when agencies can specify exactly what they want and can make sure that they get it.

A related point is that contracted services should be defined in terms of *outcomes* instead of *processes*. If outcomes are not clearly defined, and instead the contract is specified in terms of how the agency thinks the contractor should organize its operations, the private firm will be forced into the mold of the public agency, eliminating many of the options that might enable private management to be more cost effective.

Council on Competitive Government criteria

Consistent with these theories, the State Council on Competitive Government developed 5 criteria for determining whether a public service qualifies for competitive contracting:

1. Does a competitive market exist? A function with few competitors may not produce desired savings, particularly after the initial contract expires. Also, the advantages of competitive contracting are diminished if switching contractors will be disruptive.
2. Can a description of service delivery be determined? Precise requirements must be specified in advance. Unless the agency knows exactly what it wants, determining existing costs, drafting and managing the contract, and evaluating performance will be impossible.
3. Is contracting of the program legally authorized? Programs considered for competitive bids must be free from constitutional or statutory requirements to the contrary.
4. Is a contract monitoring system defined? Successful privatization requires careful definition of the contractor's responsibilities and close monitoring of performance, both in terms of quantity and quality. Monitoring costs must be included in the cost-benefit analysis.
5. Can existing costs be determined? Unless the existing costs of providing a service are known, it will be impossible to determine whether savings can be achieved through competition.

Determining baseline costs

Privatization is most likely to succeed when the program or function can be precisely specified in terms of outcomes and existing costs can be fully determined. To determine baseline costs, it is important to accurately identify and properly allocate all direct and indirect costs of providing the service or product. A standard accounting system used to accurately identify all such costs is called "activity based costing." Activity based costing assigns costs to products or services based on the resources they consume.

The costs of all activities are traced to the product for which they are performed. Over-

head costs are also traced to a particular product rather than spread arbitrarily across all product lines. It allows management to understand what triggers costs and how to manage them. United States Department of Defense, "Activity Based Costing" (December 12, 1995).

Privatization efforts by DBPR

Some functions related to the regulation of professions by the Department of Business and Professional Regulation already have been contracted out to private entities. Significantly, 14 of the 23 professions use examinations obtained from national companies and 2 use examinations developed by the University of South Florida, leaving 7 professions that rely entirely on the Bureau of Testing in the Division of Professions for development of their examinations.

Computer-based testing

As for the administration and scoring of tests, the Department is moving forward with computer-based testing, as was facilitated by Chapter 97-228, Laws of Florida. A vendor has been competitively selected, and a contract is being negotiated under which applicants will pay the testing firm \$13 per hour for administration of the exam and will pay the Department an amount set by the boards for test development and monitoring of the contract. Beginning early in 1999, examinations for auctioneers, community association managers, cosmetology, real estate, and veterinary medicine will be conducted by computer-based testing, with asbestos consultants, athlete agents, barbers, construction contractors, and landscape architects to follow by September of 2000. Computer-based testing through a private vendor will move exam administration fees off-budget and will give applicants much greater flexibility in scheduling exams (written exams are offered at a single location as infrequently as twice a year).

Florida Engineers Management Corporation

As provided by Chapter 97-312, Laws of Florida, the Department on July 15, 1998, executed a contract with the Florida Engineers Management Corporation (FEMC), to provide administrative, investigative, and prosecutorial support services for the state Board of Professional Engineers. The impetus for moving these support functions outside the Department was not to realize the benefits of competition or save money, but rather to improve the level of service to licensees and

the public. In fact, the projected biennial budget for FEMC for 1998-2000 (plus contract management costs for the Department) is 25% more than the costs incurred by the Department for regulating engineers during 1996-1998. FEMC opened its office this summer. It has 12 employees who work exclusively for the Florida Board of Professional Engineers. Dennis Barton, the executive director of FEMC, contends that the principle benefit of this new organizational structure is that it places all of the functions necessary to administer, test, investigate, and prosecute professional engineers under one roof, and allows the staff to develop expertise in that particular field. Other advantages cited by Mr. Barton include greater accountability to the board because of the smaller staff, better coordination between the investigator and prosecuting attorney, flexibility for the board to determine spending priorities unfettered by arbitrary categorical limitations, and flexibility to serve licensees with modern technological resources and data, without being held back by the "lowest common denominator" within the Division of Professions. According to some, the term "privatization" is a misnomer for the Florida Engineers Management Corporation, since FEMC by law is an instrumentality of the state and for many purposes (including sovereign immunity and antitrust liability) is treated as a state agency would be treated.

Continuing education for cosmetologists

The Department also is proceeding with negotiations to contract with a private firm to provide continuing education services, course approval, and compliance monitoring for cosmetologists, as provided by Chapter 98-323, Laws of Florida.

Other administrative functions

Other functions that have been out-sourced by the Department include validation of fee payment for license renewals, which is administered under a contract with the Department of Revenue, and collection of unpaid fines and penalties, which are forwarded to the Department of Banking and Finance for referral to collection agencies that operate under state contract. Also, a number of administrative support functions are performed in part by private firms, including computer support, printing, training, legal services, and maintenance of vehicles.

Additional areas identified for privatization

On its own initiative, the Department of Business and Professional Regulation has identified other areas that should be considered for privatization. Among these

are monitoring of continuing education, inspections of facilities (cosmetology salons, barber shops, funeral facilities, and veterinary clinics), service of process, and initial processing of licensure applications. Each of these functions could be narrowly defined and, if transferred to the private sector, would have the advantage of freeing investigators and other personnel employed by the Department to focus on the agency's regulatory mission.

Monitoring continuing education compliance

The Department's proposal for monitoring compliance with continuing education requirements is to extend to other professions the model being implemented for cosmetologists. Under the current system, approximately 455,000 professional non-medical licensees are subject to mandatory continuing education requirements. Licensees are required to complete a prescribed number of credits within each two-year renewal period, using providers, courses, and, in some cases, instructors approved by the board. After the license renewal process, the Department audits randomly selected licensees to check compliance with continuing education requirements and prosecutes violations. Auditing and prosecution of violations is time consuming, expensive, and does not effectively deter non-compliance. Compliance rates vary among the professions from better than 90% (veterinarians, interior designers, and surveyors and mappers) to less than 60% (barbers, construction contractors, and cosmetologists).

The new method proposed by the Department is to decouple continuing education compliance from the disciplinary system and to link it instead with the license renewal process. Continuing education providers would be required to report credits earned by licensees to a private vendor, who at the time of license renewal would transmit the data for each licensee to the Department. Individuals who do not satisfy continuing education requirements would not be disciplined, but simply would lose their licenses and ability to practice. The private vendor would be paid by continuing education providers (and the cost would be passed on to licensees), and the substantial costs now incurred by the Department in auditing and prosecuting continuing education violations would be eliminated.

Inspections

Privatizing inspections of cosmetology salons, barber shops, funeral homes, crematories, direct disposers, and veterinary clinics was proposed to the State

Council on Competitive Government but not approved. The Department has 18 inspector positions, some of which are vacant (budget authority of approximately \$650,000). It is required by law to inspect approximately 17,000 licensed facilities per year. Because of its inability to meet this workload, the Department in 1995 recommended discontinuing the inspection program. A proposed solution would be for the Department to contract with one or more private firms to conduct inspections, collect fees directly from the licensees (transferring the program off-budget), and forward compliance reports to the Department prior to the renewal of licenses. When this proposal was made to the State Council on Competitive Government, the Department opposed it. However, if its concerns about unlawful delegation of sovereign police power can be satisfied, the Department will support conducting an accurate cost-benefit analysis to determine if privatization could solve current problems in the inspection program.

Service of Process

The Department's interest in privatizing service of process stems from the fact that the time spent by investigators serving subpoenas, suspensions, and the like, is time away from their primary job of conducting investigations. Furthermore, investigators are not law enforcement officers (and are not trained to handle situations that may arise when serving papers). As proposed by the Department, the funds for contracting with a private company would be in addition to the existing budget authority.

Preliminary processing of applications

The final initiative suggested by the Department, privatizing the initial processing of licensure applications, could be integrated with the contract for administering examinations (e.g., computer-based testing). In addition to administering examinations, the private firm could process and verify applications. This model is used by the Department of Insurance for agent examinations.

Comments from interested parties

In addition to collecting information from the Department of Business and Professional Regulation, committee staff also solicited comments from the professions and other interested parties about the desirability of privatization and the benefits or detriments that might result to licensees or consumers of professional services. Most respondents were generally supportive of the concept of greater privatization. Detailed infor-

mation was provided in support of privatizing administration of examinations (computer-based testing) and inspections of facilities. One respondent suggested privatizing the entire investigative function. Another complained about the “high cost of regulation and lack of adequate inspections in the funeral industry,” adding that “rising regulatory costs contribute significantly to the increasing cost of funeral services for consumers.” (The biennial license fee is \$250 per facility.) A representative of the American Society of Home Inspectors detailed how, in the absence of a practice act in Florida, that organization “has been in the forefront of self regulation.” Self regulation, of course, represents the ultimate in privatization. (The American Society of Home Inspectors has tried unsuccessfully for several years to persuade the Legislature to enact a practice act.)

Several of the responding professional associations expressed interest in the Florida Engineers Management Corporation model. In particular, the associations believe that the current arrangement, where administrative support services are necessarily supplied by the Department of Business and Professional Regulation and the Department of Legal Affairs, undermines accountability to the professional boards. Because the Florida Engineers Management Corporation commenced just this summer, further monitoring is warranted. A performance audit by the Office of Program Policy Analysis and Governmental Accountability (OPPGA) is scheduled for the period of January 1, 1998 through January 1, 2000. If the FEMC model is extended to other professions, consideration must be given to how best to serve the residual professions that have fewer licensees and cannot support an entire separate staff.

The American Federation of State, County and Municipal Employees, AFL-CIO, cautioned against further extending the FEMC model before current performance is measured:

Years ago, professionals were completely self-regulating resulting in limited access to licensure and selective regulation. It is risky to

revert to a self-regulation model, particularly when cost-savings, efficiency and accountability have not been proven. AFSCME has found that contracting out government services often results in higher costs, poorer quality of service, increased opportunities for corruption, and the loss of government flexibility and accountability. . . . AFSCME believes that responsible government needs to improve the quality of public management and services, not sever the contract between government and its citizens or its workers.

RECOMMENDATIONS

- The privatization of professional regulation functions should occur gradually rather than in a single movement. The first pilot projects should involve programs or functions where expected outcomes can be precisely specified and baseline cost information is available.
- Staff should monitor closely the Florida Engineers Management Corporation and should study further issues relating to expanding privatization to other boards.
- The Legislature should consider requiring the Department of Business and Professional Regulation to collect accurate baseline cost data for monitoring of continuing education, inspections, and any other programs that are candidates for privatization.
- The Legislature should consider amendments to Chapter 455, Florida Statutes, to improve compliance with continuing education requirements by licensed professionals.

COMMITTEE(S) INVOLVED IN REPORT *(Contact first committee for more information.)*

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MEMBER OVERSIGHT

Senator James A. Scott, Chairman, Senator Charlie Clary and Senator Tom Lee