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SUNSET IN MONTANA: THE FIRST CYCLE

by

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ABSTRACT

Sunset review is one of the latest in a progression of management techniques designed to control the growth of government. It has found favor in many states recently, including Montana where the first cycle of reviews was completed in 1979.

This paper begins with a definition of sunset in theory. It places sunset within the context of recent management reforms. It moves to a description of how sunset has been applied in other states and examines the language of Montana's sunset law, including a discussion of the framework for administering the process.

The second part of the paper describes the components of selected sunset examinations, in three cases. Some elements of commonality are drawn about the Montana sunset process. The variety of recommendations for disposition of the regulatory functions are reviewed.

The third part focuses on an evaluation of sunset from a benefit-cost perspective. From this analysis, the paper makes suggestions regarding the utility of sunset review in achieving its management control objectives, offers suggestions for modifying the process, and invites speculation concerning the future application of sunset in Montana.

From a strictly monetary standpoint, sunset appears to be marginally cost-beneficial, at best, but the long term benefits to which a dollar figure is difficult to attach could tip the balance in favor of sunset. The paper also notes three factors, (the use of sunset in combination with other management tools, the type of agency reviewed under sunset, and strong legislative support) which could determine whether sunset is just a passing fad.

CHAPTER I

INTRODUCTION TO THE SUNSET REVIEW PRINCIPLES

Sunset review (commonly referred to simply as sunset) is one of the more recent in a long tradition of governmental reforms in the U.S. The conceptual basis of sunset allows that a governmental agency should terminate on a specific date unless explicitly re-established by the legislature. Some of sunset's supporters see it as a panacea for many of the chronic problems of government growth, but other observers remain skeptical.

This paper examines the experience of one state, Montana, with sunset. As a case study, it provides a preliminary evaluation of sunset and examines its future as a management tool for the control of government growth.¹

Sunset in Theory

Sunset is designed to solve some of the problems associated with the efficiency and effectiveness of government. Sunset's supporters argue that it promotes greater

¹The author is a member of the program audit staff of the Legislative Auditor's Office in Montana. He participated in four of the first cycle sunset reviews. Subjective analysis and information in this paper comes from his personal observations and from discussions with other members of the program audit staff.

efficiency and accountability in government agencies by increasing the public exposure of agency operations. In addition, sunset requires the legislature to assume an active oversight role or risk the termination of a necessary agency. Finally, sunset should expose and eliminate government agencies and regulations which are unnecessary.

One of the major forces behind sunset, Common Cause, originally developed ten principles which it considered necessary for a workable sunset law:

- 1) Programs and agencies should terminate automatically at a certain date unless affirmatively recreated by law.
- 2) Termination should be periodic in order to institutionalize the program review process.
- 3) Introduction of the sunset mechanism is a learning process and should be phased in gradually.
- 4) Programs and agencies in the same policy area should be reviewed simultaneously in order to encourage coordination, consolidation, and responsible pruning.
- 5) Existing entities should undertake the preliminary program evaluation work, but their evaluation capacities must be strengthened.
- 6) The sunset law should establish general criteria to guide the program evaluation process.

- 7) Substantive preliminary work must be packaged in manageable decision-making reports to top decision-makers to use in exercising their common sense political judgments.
- 8) Safeguards must be built into the sunset process to guard against arbitrary termination and to provide for outstanding obligations and displaced personnel.
- 9) Substantial legislative committee reorganization is a prerequisite to meaningful sunset review.
- 10) Public participation in the form of public access to information and public hearings is an essential part of the sunset process.²

Common cause suggested that sunset be tried initially on a selected group of agencies prior to expanding it to the entire executive branch. Sunset, like other new analytical endeavors, apparently needs to be applied in a limited manner in order to resolve initial problems and to gain expertise with the system. The question is: What agencies should be included in these pilot reviews? Because of the lack of experience of the agency conducting the reviews, the agencies selected to undergo review probably should be the most simple ones. Since the smallest and simplest agencies in most jurisdictions are the

²Bruce Adams, "Guidelines for Sunset," State Government, Summer 1976, pg. 139.

regulatory agencies, they are likely candidates for inclusion in the first phase of sunset.

An additional reason for selecting regulatory agencies as the targets for sunset is that regulatory agencies are notorious for being controlled by the industry they are supposedly regulating. Samuel P. Huntington, in his discussion of the ICC, noted that the ICC gradually moved from an active regulatory posture to one in which it championed the positions of the railroad industry which it was supposed to regulate.³ Subsequently, Marver Bernstein noted that there appears to be a pattern throughout regulatory agencies in which they eventually are captured by the regulated industry and serve the industry's interests rather than protecting the public.⁴ Because sunset exposes agency operations to public scrutiny, some feel that sunset can be used to counteract the tendency of regulatory agencies to do the bidding of the regulated industry.

³Samuel P. Huntington, "The Marasmus of the ICC," Yale Law Journal, Volume 61, 1952, pp. 467-509.

⁴Marver Bernstein, Regulating Business by Independent Commissions, 1955, pp. 74-95.

Sunset and Other Governmental Reform

To put sunset into perspective, one should examine how it relates to other governmental reforms. There have been several attempts to get better control of government operations. Each type of reform has specific purposes in addition to the general purpose of improving control over government. Further, one should note which branch of government is supposed to use the analysis generated by each of the following reforms.

In the early 1900's, a movement developed to give the executive, whether he be mayor, governor, or president, more authority over executive/administrative activities. This has been termed the executive budget movement. Its basis lies in the concept that government should operate more like a business. This reform concentrated on giving the chief executive the authority for day-to-day activities, like his private sector counterpart, and to assign the legislature the role of policy-making, much like a corporation's board of directors. In effect, the legislative branch relinquished some of its oversight responsibilities by adopting this reform. Still, people complained that they were unsure whether or not they were getting enough for their tax dollars.

In the 1930's and 1940's, performance budgeting emerged as an attempt to relate governmental expenditures to results. In essence, all funds expended were to be linked to an indicator of performance. For example, the Highway Department had to justify its spending by relating expenditures to the number of miles of road built. The chief executive could use the performance indicators and the previous year's expenditure level to set the following year's spending level for an agency. Performance budgeting's focus on base expenditures and performance is its major weakness. It was not used for holding a lower manager accountable for a certain level of performance because people failed to use it as a predictor of future levels of performance. This would have put pressure on a subordinate to live up to those expectations.

In the 1950's, management by objectives (MBO), a more sophisticated form of performance budgeting, was brought forth as a management and budgeting innovation. It modified the concept of performance budgeting that indicators of performance should be linked to expenditures (by identifying the expected output). MBO mandated that the supervisor and subordinate agree on the output for which the subordinate would be responsible and the amount

of resources which the subordinate would receive to reach that goal. Then, the supervisor would judge the subordinate on whether the goal was met. For example, a person might receive \$1 million to build 10 miles of road, and he would be held accountable for meeting that goal. As in the case of performance budgeting, the chief executive was the primary user of the analysis. But MBO had a major shortcoming. It did not provide a good method for choosing between government programs.

In the 1960's, economics offered a method, program budgeting, for choosing the most efficient alternative for the use of tax dollars. Economists proposed that two activities could be compared on the basis of the costs and benefits of each. At first, analysts attempted to compare very dissimilar programs such as jet fighters and dams. Later, it was used to compare only similar programs, such as building a power plant in one area versus another area. However, in neither case did it incorporate political realities into the calculations. It is highly unlikely that a congressman will vote against a program which would benefit his district regardless of the benefit and cost figures. Program budgeting fell into disrepute, and the problem of how to choose between governmental

programs in the case of finite resources remained.

Zero-based budgeting (ZBB) emerged in the early 1970's as the latest of the budgeting reforms and as a response to worsening economic conditions and tightening revenue situations for many government jurisdictions. ZBB focused on ranking levels of funding for governmental activities (termed decision packages), both old and new, in order of priority in order to fund only those decision packages given the highest priority. In addition, it incorporated the concept that subordinates should be held accountable for their budgets by specifying the level of output which the subordinate would be expected to achieve. Currently, not enough jurisdictions have implemented ZBB for an evaluation to be made, but the problem of controlling an expanding government remains.

While these reforms attacked the problem of controlling government with different weapons, each has among its problems a flaw: a focus on the executive as the component best able to control government. In fact, each seemed designed to ignore the role of the legislative branch in the decision-making process. Many chief executives have used these reforms to help formulate proposals

for the legislature. But the legislature ignored this analysis and made decisions on the basis of political judgment. This was due to the fact that the legislature was not shown how to utilize the analysis. While these reforms have had some effect on government policy, the lack of integration of the legislative branch into these reforms has minimized their effect.

For most of this century, the chief executive assumed a leadership role in formulating public policy, including the responsibility for controlling government. As taxes rose and government programs proliferated, the mood of the voters changed. People realized that government was involved in almost every phase of their lives. The voters reacted negatively and began applying pressure on their legislators. The voters seemed to say: "The executive branch has tried and failed to control government growth. Now it is your (the legislature's) turn to get things under control. If not, we (the people) will do something to control government growth."

The legislatures reacted by establishing legislative post-audit agencies. The legislative post-audit movement reawakened the oversight role of the legislature.

These agencies started as financial auditing organizations to assure the accountability of the executive branch for public funds. Later, these agencies began to examine the efficiency, the effectiveness, and, to some extent, the results of executive branch operations. Over the last two decades, the number of states with legislative post-audit agencies has more than doubled to the present number of thirty.⁵

The sunset movement, to some extent an outgrowth of the legislative post-audit movement, constitutes another legislative reaction to voter pressure to control government growth. The voters expressed concern to their legislators about the proliferation of government agencies and regulations, and they requested that government agencies be more responsive to the needs of the public. Sunset responds to these concerns by terminating agencies unless the legislature takes affirmative action to re-establish them.

In order to punctuate their concerns, the voters have taken some actions to limit government growth. One

⁵Richard E. Brown, "Performance Auditing Pays Dividends; The Kansas Experience," Public Administration Times, December 1978, pg. 9.

voter reaction came at the local level as they started defeating local property tax mill levies for education. Apparently, voters felt that such actions would slow the increase in property taxes.

Because many state constitutions allow voters to amend the constitution by direct popular vote, people in several states, most notably California, have spearheaded amendments. Proposition 13 in California put a limit on future property taxes and, in effect, limited the growth of government. In November of 1978, nine other states approved similar measures to cut or limit taxes and government growth.⁶

If sunset or some other reform does not succeed in controlling the growth of government, it appears that the voters will take matters into their own hands. Such voter action could and probably would lead to ill-considered and simplistic solutions which will have a detrimental effect on the effectiveness of government.

Sunset in Other States

The first attempt to adopt sunset came in Texas in

⁶Public Administration Times, "Voters Reject Heavy Tax Cuts," December 1978, pg. 1.

the early 1970's. The Texas Constitutional Convention incorporated a sunset provision into its proposed constitution. That constitution was defeated, but sunset was not stillborn. Common Cause took up the banner of sunset.⁷

In 1976, Colorado became the first state to adopt a sunset law. Adoption of this sunset law seemed to be the result of a series of fortuitous events. At the time that Colorado's chapter of Common Cause attempted to get a sunset law adopted, a new administration took office in Colorado. In addition, a series of articles published in newspapers around the state charged ineptness in the state's regulatory agencies and alleged discrimination against non-Coloradoans in licensing. Finally, an interim committee of the Colorado legislature was reviewing the state's regulatory agencies.⁸

Common Cause sponsored a series of public meetings to acquaint citizens and legislators with sunset. The legislative committee heard much testimony on the merits

⁷Gerald H. Kopel, "Sunset in the West," State Government, Summer 1976, pg. 135.

⁸Ibid.

of sunset. And the state's two major newspapers came out in favor of sunset.⁹

The movement for sunset was so strong and widespread that the anti-sunset lobbyists could not find a legislator to introduce their amendments. Even legislators who would have liked to see sunset die supported the legislation because they had been preaching about cutting waste in government and because 1976 was an election year.¹⁰ Now it was time to "put up or shut up."

In Colorado's case, the legislature chose the Department of Regulatory Agencies for the experiment. The abolition of some agencies within this department could substantially reduce the amount of paperwork for the citizenry without greatly reducing the size of the state's public sector labor force. This enabled the movement to attract popular support without arousing the opposition of large numbers of public employees. Sunset's supporters felt that a moderate approach was needed to demonstrate that the concept could work before expanding its scope to

⁹ Ibid.

¹⁰ Ibid.

include other agencies with stronger constituent bases.¹¹

Colorado's sunset law served as the model for many subsequent sunset laws. Some of the major provisions of Colorado's law included:

- 1) The agencies covered by the law were divided into three groups with approximately one-third coming up for review and possible termination every two years.
- 2) All agencies terminate on July 1 of the odd-numbered year after their review unless the legislature takes affirmative action to continue them.
- 3) Each agency terminated has one year to wind up its affairs before going out of business.
- 4) The following guidelines were set down for the evaluation of each agency:
 - Have the number of licensees been restricted unduly?
 - To what extent has affirmative action for women and minorities been observed?
 - Has the agency operated for the benefit of its licensees or the public interest?
 - Has the agency recommended statutory changes to benefit the public?
 - Has the agency sought information from those who are regulated concerning the effect of regulation?
 - Has the regulated industry been required to assess problems which affect the public?

¹¹ Ibid.

--How well does the agency handle complaints concerning licensees?

--To what extent has the agency encouraged public participation?

- 5) Performance audits, under the direction of the Legislative Audit Committee, were to be conducted on each agency.¹²

A comparison of Colorado's sunset process with the sunset principles set down by Common Cause reveals substantial agreement between the two. Colorado's process fulfills, at least partially, eight of the ten principles. The two exceptions were numbers 4 and 9.

In addition to Colorado, twenty-eight states, including Montana, have passed one or another form of sunset law. Many other states and the federal government also are considering the passage of sunset legislation. Table 1 provides a summary of the various state sunset laws.

¹²House Bill 1088, Colorado Legislature, 1976.

TABLE 1

Sunset Law Summary

Provision	Alternatives	Number of States
Agencies to be Reviewed	Comprehensive	9
	Regulatory	18
	Selective	2
Review Cycle	4 or 5 Years	5
	6 Years	16
	More than 6 Years	8
Evaluating Agency	Legislative Audit or Budget Committee	12
	Standing Committees	11
	Other Review Agency	6
Phase Out Period	6 or 9 Months	5
	1 Year	20
	None	4

Source: Compiled by the Montana Office of the Legislative Auditor

CHAPTER II

THE SUNSET PROCESS IN MONTANA

Two members of the Legislative Audit Committee introduced Montana's sunset bill into the 1977 Legislative Session. Apparently, they became acquainted with sunset through a Common Cause publication and decided that it might be a solution to the problem of controlling government growth. They requested the Legislative Council to draft a sunset bill. The two sponsors showed the bill to the Legislative Auditor's Office and had the bill reviewed based on the comments from the Legislative Auditor's Office.

At the time of the introduction of Montana's sunset bill, no striking set of events occurred to prompt its introduction as had happened in Colorado. In fact, there was very little controversy surrounding Montana's sunset bill. It sailed through both houses of the legislature with hardly any opposition and almost no lobbying on either side of the issue.

Montana's Sunset Law

Montana was one of the first states to enact a sunset law when the 1977 Legislature passed Senate Bill

162. Colorado's and Florida's sunset laws served as models for Montana's law.

The sunset law states that it is the intent of the legislature to ensure:

- 1) The executive department is responsive to the needs of all of the people of the state.
- 2) No agency, program, or rule exists which is not responsive to those needs.
- 3) No profession, occupation, business, industry, or other endeavor are subject to the state's regulatory power unless the exercise of such power is necessary to protect the public health, safety, or welfare from significant and discernible harm or damage. The exercise of the state's police power shall be done only to the extent necessary for that purpose.
- 4) The state may not regulate a profession, occupation, industry, business, or other endeavor in a manner which will unreasonably adversely affect the competitive market.
- 5) There exists a systematic legislative review of the need for and public benefits derived from a program or function which licenses or otherwise regulates a profession, occupation, business, industry, or other endeavor by a periodic review and termination, modification, or re-establishment of such programs and functions.¹

Some of the major provisions of Montana's sunset law include:

¹Senate Bill 162, Montana Legislature, 1977.

- 1) Three cycles are set up with a portion of the agencies reviewed each biennium.
- 2) Each agency terminates on July 1 of the odd-numbered year of the biennium it is reviewed unless the legislature re-establishes it.
- 3) Any agency terminated has one year to put its affairs in order before becoming inactive.
- 4) The Legislative Audit Committee must conduct a performance review of each agency prior to termination.
- 5) Each agency affected must delineate its goals and objectives.
- 6) The following guidelines are set up for each review:
 - Would the absence or regulation significantly harm or endanger the public health, safety, or welfare?
 - Is there a reasonable relationship between the exercise of the state's policy power and the protection of the public health, safety, or welfare?
 - Is there another less restrictive method of regulation available which could adequately protect the public?
 - Does the regulation have the effect of directly or indirectly increasing the costs of any goods or services involved and, if so, to what degree?
 - Is the increase in cost more harmful to the public than the harm which could result from the absence of regulation?
 - Are all facets of the regulatory process designed solely for the purpose of and have as their primary effect the protection of the public?

- 7) The standing committee which reviews the termination question is required to take into consideration the audit committee recommendation and the testimony of the public at large.
- 8) Any new regulatory agency established immediately becomes subject to the sunset law.²

Montana's law bears a similarity to the laws of most other states. For example:

- 1) It focuses on regulatory agencies as do the laws of 17 other states.
- 2) The Legislative Audit Committee does the evaluation as in 11 other states.
- 3) Each agency is reviewed on a cyclical basis every six years as in 15 other states.
- 4) Each agency which is terminated is allowed a one year phase out period as in 19 other states.

Montana's sunset law and process also resemble the principles set down by Common Cause. In fact, it fulfills, at least partially, nine of the ten sunset principles. The only exception is the principle relating to substantial legislative committee reform.

The Legislative Audit Committee and the Legislative Auditor's Office

The Legislative Audit Committee and its staff, the Legislative Auditor's Office were the two main actors

²Senate Bill 162, Montana Legislature, 1977.

in Montana's sunset process. They were created by an act of the 1967 Montana Legislature.³

The act states that the legislature's intent for creating this audit capability is:

"Because the legislative assembly is responsible for authorizing the expenditure of public moneys, designating the sources from which moneys may be collected, shaping the administration to perform the work of state government, and is held finally accountable for fiscal policy, the legislative assembly should also be responsible for the audit of fiscal accounts and records so that it may be assured that its directives have been faithfully carried out. It is the intent of this act that each agency of state government be audited for the purpose of furnishing the legislative assembly with factual information vital to the discharge of its legislative duties.

The Legislative Audit Committee is a bipartisan joint committee of the legislature. Four members of each house, two from each political party, make up the committee. Each member serves from the sixtieth day of one legislative session to the sixtieth day of the next.

The Legislative Audit Committee selects the Legislative Auditor. He must have a degree in accounting or a related field and have at least two years experience in governmental accounting and auditing. The Legislative

³Chapter 249, Laws of Montana, Fortieth Legislature, 1967.

Auditor serves a two year term and is responsible solely to the legislature.

The act specifies that the Legislative Auditor's Office will:

- 1) Provide the legislative assembly with factual audit information about the operations of state agencies.
- 2) Make recommendations and suggestions on how to improve state agency operations.
- 3) Assist the legislature and its members during legislative sessions by gathering and analyzing information about state government.

To accomplish these duties, the Legislative Auditor employs a staff of fifty. These include an attorney, a secretarial and clerical staff, and approximately forty auditors. Most of the auditors are accountants who conduct the financial audits of state agencies. In addition, the office employs ten program auditors who examine state agencies concerning the efficiency, effectiveness, and, in some cases, the results of their operations. The members of the program audit staff possess degrees in business administration, accounting, systems analysis, economics, statistics, engineering, political science, and public administration. The program audit staff conducted the sunset audits.

The Audit and Report Process

There was a great deal of internal debate among members of the Legislative Auditor's Office on how to conduct the sunset performance reviews and on the best report format. In this case, as in most cases, the audit committee left the technical aspects of the format for the audits and reports to the staff. At the beginning of the first cycle, the staff did not know what the best format was for conducting the sunset audits. All of the states were struggling to find the ideal format. Finally, the staff decided that substantially the same process should be used for sunset as was used for other program or performance audits. This decision seemed to be based on an attempt to apply familiar principles to a new problem, even if it might not be the best methodology.

At the beginning of the cycle, the Deputy Legislative Auditor in charge of program and performance audits set up a schedule of tentative completion dates and assigned staff to each audit. Basically, this schedule attempted to take on audits earlier in the cycle which would lay the groundwork for the later audits. For example, the board selected to be the first one reviewed, the Board of Abstracters, was thought to be one of the

easiest, and the second one selected, the Board of Public Accountants, regulated a profession which was familiar to the staff. After starting with these, the auditors progressed to more complicated agencies, such as the Insurance and Investment Departments. This schedule changed dramatically as the cycle proceeded because of the time constraints and the shift of additional personnel to sunset.

For each of the sunset audits, a single auditor, the in-charge auditor (ICA), was assigned primary responsibility. In most cases, this auditor handled most, if not all, of the work himself. But for a few of the audits, such as the Investment Department, the Board of Real Estate, and the Board of Professional Engineers and Land Surveyors, the ICA had substantial assistance from other auditors.

The audit process began with an entrance conference. The ICA and perhaps a senior staff member met with officials of the audited agency and explained what the audit was all about and what the auditor(s) would be doing. At this meeting, the auditors attempted to allay the fears and uncertainty engendered by sunset. The Legislative Auditor's Office believed that if agency

personnel (and board members) were less apprehensive they would provide better and more complete information to the auditor(s).

After this conference, the ICA set about gathering some background information on the audited agency. The ICA attempted to determine some of the issues which might come up during the audit. With this background information and in the case of later audits, audit programs of earlier audits, the ICA planned how to conduct the audit. This plan, called an audit program, detailed the basic steps that the auditor(s) would go through while conducting the audit. Some of the things contained in the audit program were: who would be interviewed, what files would be examined, and what other information would be gathered. The audit program could and often was changed as the audit progressed and new information surfaced. In one case, the information came to the attention of the auditors which alleged that members of the board had taken bribes to assist certain persons to get licensed. When this information came to light, the auditors proceeded to investigate this situation and later turned the results over to the Attorney General.

Once the audit program had been written, the

auditor(s) began the review. The auditors examined the agency's legal mandate to determine what the agency should have been doing and also to determine if any part of this mandate was inconsistent with other laws and/or the protection of the public. The audit staff interviewed the agency's staff and, in the case of the regulatory boards, the board members. Through this process, the ICA attempted to determine what each person did and what the agency did as a whole. Then the ICA compared the information on what the agency was doing with the laws and the agency's own rules and regulations which prescribe what it should have been doing.

Other areas which came under the auditor's scrutiny were the agency's recordkeeping, its complaint process, its licensing activities, any examinations that the agency gave, and agency policy manuals and policies. Also, the auditors interviewed members of the profession, trade, or industry which was regulated by the agency in question. The ICA attempted to allay some of their apprehensions about sunset and to gain information on regulation from their point of view. In the case of the audit of the Insurance Department, the ICA received some valuable insight into the industry from these contacts.

When the ICA believed that sufficient information had been collected, the report drafting began. During this initial drafting stage, the auditor(s) continued to collect information in order to fill any gaps in the information base and to provide adequate backing for any judgments made in the report.

Almost all of the sunset performance audit reports had the same basic format. The first chapter gave a general introduction to the sunset process and laid out the format for the remainder of the report. Chapter two provided general background on the regulation of the profession, trade, or industry and on the organization, staffing, funding, and objectives of the agency. The third chapter discussed two of the sunset questions. The first question was whether the absence of regulation would harm the health, safety, or welfare of the public (is it needed?). The second question addressed was whether there was a reasonable relationship between the exercise of the state's police power in regulating the profession, trade, or industry and the protection of the public. Chapter four examined whether all facets of the regulatory process were designed solely for the protection of the public. And in chapter five, two more sunset questions were reviewed.

First, was state regulation of the profession, trade, or industry directly or indirectly increasing costs to the public? And secondly, if so, was such an increase more harmful than the harm which could result from the absence of regulation? The sixth chapter considered the final sunset question of whether there was a less restrictive alternative method of regulation available which would adequately protect the public.

The following paragraphs outline the methodology used to answer the six sunset questions. In addition, chapter three presents detailed summaries of three audit reports.

The auditors answered the question of need based primarily upon whether there was evidence of harm to the public without regulation. In the case of the Insurance Department, the auditors found that without regulation a great many people could be swindled out of huge sums of money. On the other hand, the auditors could find no substantial evidence of public harm if the abstracting industry was not regulated.

In an effort to provide the answer to the question of whether there was a reasonable relationship between the exercise of the state's policy power and the protection of

the public, the auditors took two different approaches. One set tried to look at the major aspects of the regulatory process and give an overall evaluation of them. The other concentrated primarily on pointing out the deficiencies in the current regulatory process. For example, the audit of the Investment Department examined each of the major aspects, registration of securities and securities dealers and investigation of securities violations. But the report on engineers and land surveyors discussed the deficiencies in the process (i.e., the lack of licensing by specialty and the lack of assurance of continued competency). This disparity was a function of the views of the auditor(s) who prepared the reports and was allowed because of the latitude given the ICA in preparing the report.

On the question of whether certain regulations were designed to protect the public, the auditors pointed out areas where there were regulations which primarily benefited the industry. One example of this occurred in the report on the Board of Professional Engineers and Land Surveyors when the auditors questioned the requirement that a person pass two examinations, and, in effect, serve an apprenticeship between taking the two as being overly

restrictive of entry.

After much research and discussion, the auditors concluded that it would be an impossible task to quantify all of the costs and benefits from deregulation. They decided that the only practical way to answer the cost questions posed in the sunset law was to try to identify the major costs and benefits associated with regulations and express them in a narrative. The auditors decided which, the costs or the benefits of deregulation, were the more important primarily on the basis of the perceived weight of the costs and benefits since the auditors were unable to quantify the two. The possibility exists that another person examining the same facets could have come to a different conclusion on whether or not deregulation would be better for the public.

The final sunset question deals with the alternatives to the present form of regulation. After some research and some intraoffice discussion, the auditors developed a standard package of alternatives. This package included the following:

- 1) Licensing--granting the right to do something by an administrative body.

- 2) Restriction of Practice--prohibition of the performance of an act or holding oneself out as being able to perform that act unless he has met certain statutory requirements.
- 3) Reserve of Title--reserves the title of licensed or certified to only those who have met certain requirements.
- 4) Limited Statutory Regulation--requires only protective measures such as insurance or bonding.
- 5) Registration--registration by the state of a private association with no demonstration of competency.
- 6) Certification--designation by an industry that a person has met certain qualifications.
- 7) No Regulation.

Once the ICA was satisfied with the report, he submitted it to the Legislative Auditor and the staff attorney for their review. Then the Legislative Auditor, the staff attorney, and the auditor(s) who worked on the audit met and went over the report. They reviewed the report section by section with the Legislative Auditor or the attorney suggesting word changes and questioning statements in the report.

After the conference with the Legislative Auditor and the attorney, the auditor(s) rewrote the report. During this period, the auditor(s) generally made the suggested changes in style and to delete or change any

statements or sections which were questioned during the conference and which the auditor(s) were unable to justify to the satisfaction of the Legislative Auditor.

When the Legislative Auditor was satisfied with the draft, the audited agency received a copy for review. An exit conference was held with the agency personnel to solicit any comments that they may have had about possible inaccuracies in the report. After this conference, the auditor(s) made the final revision of the report.

The Legislative Auditor's Office sent copies of the report to the audited agency, the Governor's Office of Budget and Program Planning, the profession, trade, or industry being regulated, and any other interested parties. The Legislative Auditor included written comments by any of the above with the final draft of the report which was sent to the audit committee.

The Audit Committee Review

Once the report was ready, the Legislative Auditor scheduled a public hearing on the report. At this hearing, a member of the audit staff, usually the person who conducted the audit, gave a summary presentation on the report. This presentation took the form of a

recapitulation of the audit report in combination with an overhead projector slide show to highlight certain points in the report. At the end of the presentation, the members of the audit committee normally asked for clarification on certain points in the report.

Once the presentation had been completed and all questions by the audit committee had been answered, any interested persons who were in attendance at the hearing could testify before the committee. These persons who gave testimony were usually members of the regulated profession, trade, or industry, or representative of the affected agency who came to speak in favor of the status quo.

The audit committee then considered this information for approximately one month, the time between audit committee meetings. Between committee meetings, the staff prepared a spread sheet for the committee which detailed some of the options available.⁴ At the next committee meeting, the auditors presented the spread sheet

⁴The spread sheet was a decision device. It examined whether there should be regulation, who should regulate, and how the regulation should be accomplished. It detailed the staff opinion and that of the agency and industry.

to the committee to assist it with its decision. The committee then made a tentative decision about the fate of the agency.

There appear to be two reasons for the one month delay between the hearing and the tentative decision. First, the committee wanted some time to deliberate, although some members probably had made up their minds at the time of the first hearing. Also, some members of the audit staff believed that the committee felt they would be under less political pressure if the decision and the hearing were not at the same meeting.

The audit committee had an extensive range of possibilities for recommendations. Some of these included:

- 1) Agency re-establishment.
- 2) Agency re-establishment with regulatory modifications.
- 3) Agency termination and the transfer of regulation to another agency.
- 4) Agency termination with or without continuation of the consumer protection statutes (the laws which allow suits for remedies for inadequate service).

At the committee meetings just prior to the 1979 legislative session and during the first weeks of the session, the audit committee reviewed all of its tentative

recommendations and made some changes. For example, instead of recommending one "superboard" to oversee licensing, the committee decided to recommend three superboards, one for the health-related professions, one for other professions, and one for the trades.⁵ The audit committee changed the original recommendations in an attempt to make them more palatable to the legislature.

Once the committee had agreed upon the final form for the recommendations, it directed the staff attorney to draw up the necessary legislation to implement the recommendations. Later, the committee met and approved the legislation and decided which member(s) would introduce each bill.

Chapter three summarizes the recommendations. Chapters four and five include some of the results from the legislative session.

⁵"Superboard" is a concept in which several professions or trades are licensed and/or regulated by a single board.

CHAPTER III

THE AUDIT REPORTS AND RECOMMENDATIONS

The Legislative Auditor's Office issued reports on each of the fourteen agencies which were reviewed by the office pursuant to the sunset law. Because of the length and complicated nature of the reports, this chapter will give a synopsis of three of the audit reports as an indication of the content of these reports. (These three reports were selected because they treated the question of reasonableness of regulation differently, they involved three of the more complex agencies reviewed, and the author was most familiar with them.) A synopsis of the audit committee recommendations also will be included.

The Performance Audit Summaries

The Investment Commissioner and the Investment Department.¹ Securities regulation in Montana began in 1913 when the 13th Legislative Assembly created the Office of the Investment Commissioner. The only major change in the law occurred in 1961 when Montana adopted the

¹Office of the Legislative Auditor, Sunset Performance Review--The Investment Commissioner and the Investment Department, 1978, 77-SS-12.

Securities Act of Montana which is based on the "Uniform Securities Act." This act was the product of a cooperative effort of the American Bar Association, the North American Securities Administrators Association, the Securities and Exchange Commission (SEC), the Investment Bankers Association of America, and the National Association of Securities Dealers (NASD). The regulatory body established by this act was the Investment Department of the State Auditor's Office. Montana's regulation was designed to meld with the regulation by the SEC, the NASD, and the Securities Investor Protection Corporation (SIPC).

Securities include such things as stocks, bonds, certificates of indebtedness, and investment contracts. The two most common type traded by the general public are stocks and bonds. Over 33 million people in the United States own stocks and the cumulative value of all new securities registered in Montana over the last seven years is approximately \$4.5 billion.

As of June, 1978, Montana had the following numbers of securities dealers and securities registered:

- 131 Broker-dealers,
- 12 Investment advisors,

-1367 Salesmen, and

--719 Securities.

The Investment Department collects registration fees from securities dealers and issuers of securities which it registers. These fees are deposited in the state General Fund, and the agency receives a General Fund appropriation. Over the last six fiscal years, the Investment Department has collected fees which were more than double the expenditures of the department.

Montana's Investment Department fits into the pattern of regulation of the securities industry by licensing persons who deal in securities and by regulating securities including some not covered by other agencies. (These persons and securities are not covered by other regulation primarily because they are not involved in the interstate markets.) It also prohibits fraudulent practices in securities deals. In this capacity, the Investment Department investigates cases of possible legal violations and turns them over to the Attorney General or the appropriate county attorney for prosecution. In addition, the department cooperates with the SEC, the IRS, and other states in investigating and prosecuting securities-related crimes. The department states that it has

been directly responsible for nine convictions and the recovery of over \$800,000 during the past six years.

The auditors concluded that the absence of state regulation would harm the public. There would be no regulation of intrastate dealers or securities sold in the intrastate market. Substantial securities swindles could be perpetrated on the public. In addition, there would be a gap in the communication system which has been set up between regulatory bodies. Without this system, many securities violators probably would not be caught.

The report discussed whether the different facets of the regulatory process were reasonable. An examination of the files on registered securities found them complete and up-to-date. There was some question about the state making a judgment on whether a security should be sold to any investor or restricted in some way. The only study on this subject has shown that these "merit" requirements provide more protection to the public than simple disclosure does.

The report revealed that the registration of broker-dealers, investment advisors, and salesmen requires primarily the disclosure of information about these persons. The files on these registrants appeared to be in

good order and complete. As part of the registration, the department checks with the SEC and the NASD for derogatory information on applicants.

When the enforcement activities were examined, the auditors found that Montana's Investment Department is quite active. It investigates approximately 30 cases per year. When this is combined with Montana's participation in the communication network with other regulatory agencies, the auditors concluded that this aspect of the regulatory process was reasonably related to the protection of the public.

In short, the auditors believed that the functions of the department were reasonably related to the protection of the public.

The auditors did note some weaknesses in the regulatory process. These included:

- 1) The lack of an operations manual and a formal training program.
- 2) The lack of constant availability of trained legal counsel.
- 3) The lack of reimbursement to the state for expenses incurred during an examination or investigation as required by law.
- 4) The lack of a standard format or organization in the investigation files.

- 5) The questionable need for requiring salesmen to be bonded.
- 6) The needs for more oversight in the area of mutual funds and variable annuities.

The auditors believed that regulation increases costs to the public through the fees and the cost of complying with the regulations placed on the securities industry which are passed on to the consumer, but this appeared to be minimal. When this was weighed against the probability of a multi-million dollar swindle if deregulation occurred, the auditors concluded that deregulation would be more costly to the public than the present regulation.

The Board of Professional Engineers and Land Surveyors.² Montana was the last state to regulate the practice of engineering and land surveying when the board was created in 1947. The original board regulated civil engineers and land surveyors through the licensure of persons practicing those professions. In 1957, the other engineering disciplines were included under regulation. Under the executive reorganization of 1972, the board was

²Office of the Legislative Auditor, Sunset Performance Review--The Board of Professional Engineers and Land Surveyors, 1978, 77-SS-10.

allocated to the Department of Professional and Occupational Licensing for administrative purposes.

Two major national organizations are involved in the regulation of the engineering profession. The National Council of Engineering Examiners (NCEE) is an association of the state registration boards. The NCEE prepares the examination for licensure used in Montana. The Engineers Council for Professional Development (ECPD) is a private national organization which accredits engineering curricula.

Montana's present law prohibits the practice of engineering and land surveying and the use of the title "professional engineer" or "land surveyor" except by persons licensed by the board. The only exceptions are other recognized professions, such as architects.

The Governor appoints five engineers and two land surveyors to the board. Each board member must have been engaged in the practice of his profession for 12 years, have been in responsible charge of important work for at least five years, and have been licensed in Montana for at least five years. Each board member receives \$25 per day plus travel expenses.

The department furnishes one full-time secretary

and one part-time secretary plus legal, budgeting, and accounting services to the board. The board receives all of its funds through license and renewal fees. Over the last six years, the board's revenues and expenditures have been approximately equal.

The board issues licenses to engineers, land surveyors, and engineer-land surveyors. As of August 1978, the board had the following numbers of licensees:

- 2018 Engineers,
- 253 Land surveyors, and
- 292 Engineer-land surveyors.

The auditors attempted to identify the public harm that would result if deregulation occurred. In the case of engineers, there is the danger of poorly designed structures which could threaten the public's physical safety. Financial and property loss could occur from misplaced boundaries if land surveying was not regulated. There are cases of structural failure and misplaced boundaries even with regulation, but the auditors concluded that without regulation these cases might become commonplace. In addition, the public relies on the license as evidence of competence when they seek services. Based upon this information, the auditors concluded that the

absence of regulation would harm the public.

The auditors found two areas where the present regulatory process was not reasonably related to the protection of the public. No regulation requires licensed engineers to only practice in their specialty. This means that an engineer may attempt to provide a service for which he is not trained. In addition, the board does not assure that licensees continue to be competent. The problem is especially acute with engineers where technological change occurs so rapidly that an engineer's skills are soon out-of-date.

The auditors found several instances in which they believed that facets of the regulatory process were not designed solely for the protection of the public. Some of these were:

- 1) Excessive licensure requirements, such as:
 - two different examinations for engineers,
 - a four year experience requirement between the two examinations for engineers, and
 - the land surveying examination may not be valid.
- 2) The complaint records were not complete and up-to-date. In addition, complaints were not resolved in a timely manner.

- 3) The rules of the board prohibit competitive bidding.
- 4) County surveyors are practicing without being licensed.
- 5) The roster of licensess was not distributed in 1978 until six months after the date required by law.
- 6) There is little or no public notice of board meetings and almost all meetings are held in Helena which limits public access.
- 7) There are no members of the public on the board to protect the public's interest.

The auditors identified two basic types of costs associated with regulation. The first, the administrative costs of regulation, amount to only about \$45,000 per year. There are also costs in complying with the law but these are minimal. If deregulation occurred, the auditors believed there would be substantial physical harm and property loss from incompetent individuals practicing engineering or land surveying. In general, the auditors concluded that the costs of deregulation would outweigh the costs associated with regulation.

The Board of Real Estate.³ Regulation of the real

³Office of the Legislative Auditor, Sunset Performance Review--The Board of Real Estate, 1978, 77-SS-4.

estate industry in Montana began in 1921 when the Legislative Assembly passed a law similar to the model law developed by the National Association of Real Estate Boards (NAREB). Originally, the Commissioner of Insurance and later the Commissioner of Agriculture carried out the regulation. In 1963, the Legislature created the Real Estate Commission to regulate the industry. The Executive Reorganization Act of 1971 changed the name to the Board of Real Estate and allocated it to the Department of Professional and Occupational Licensing for administrative purposes.

The board is composed of five members appointed by the Governor. At least two of the members of the board must be licensees, and at least one member must be a representative of the public.

The board meets in various cities throughout the state, and members receive \$7.50 per half day plus travel expenses when on the business of the board.

The board receives administrative support from the department. The department provides the services of an administrative officer, an administrative assistant, an investigator, and a secretary. The investigator does some work for other boards.

The board receives all its funds through fees for examinations and licenses. Over the last six years, revenues have exceeded expenditures by almost \$150,000. (Since these extra costs are passed on to consumers, the real estate consumers have paid excessive prices.)

The board licenses real estate brokers and salesmen. As of June 1978, there were 1254 licensed brokers and 1894 active salesmen. In addition to regulating real estate agents in Montana, the board also:

- 1) Registers subdivided land which are located outside Montana but which are sold in Montana.
- 2) Records notices of intent to sell subdivided lands located in Montana to persons outside Montana.

The real estate industry touches almost everyone from the individual to the large corporation. The Federal Home Loan Bank estimated that their customers closed approximately \$250 million in real estate loans in Montana in 1978. The median price for a new house was nearly \$50,000 in 1978. Because of the complicated nature of the real estate business, the average person depends on a real estate broker or salesman for advice and assistance. The auditors identifies these five areas of possible public harm:

- 1) Misleading, untruthful, or inaccurate advertising.
- 2) Making false promises or guarantees.
- 3) Failing to account for or remit money belonging to others.
- 4) Offering real property for sale without the client's knowledge or on unauthorized terms.
- 5) Misrepresenting the property of financing.

In short, there is potential for substantial public harm, and the auditors concluded that without regulation the public would suffer substantial economic loss.

The next question was whether the present form of regulation was reasonable related to the protection of the public. Regulation by the board is only one part of a network of regulation of the real estate industry. The federal government mandates the full disclosure of all costs associated with buying a home, requires that interstate sellers of subdivided land disclose all pertinent information about the property, and requires that all costs associated with mortgage purchases be disclosed. On the state level, the Consumer Affairs Division of the Department of Business Regulation protects all consumers including real estate purchasers from unfair trade practices. Building codes, zoning laws, and subdivision regulations also protect the consumer. The auditors concluded

that present board regulation does not overlap unduly with these other laws, but there are two areas of weakness in the regulation:

- 1) The board's regulation of subdivisions is not adequate. The subdivision files were incomplete. Many subdivisions regulated by HUD under a similar law do not appear in the Montana files. There is almost no communication between HUD and the board on subdivisions.
- 2) The auditors also noted that certain segments of the industry do not come under board regulation. One specific area is the sale of a leasehold interest. Most of these are shares of condominiums in resort areas. Another is the case where a developer sells his own land and is exempt from board regulation. The auditors believed that closing such loopholes would better protect the public.

The auditors found several instances where parts of the regulatory process did not seem designed solely to protect the public. These included:

- 1) The board may not be acting on complaints as well as it might. Some reasons for this include the fact that some complaints never reach the board because they are not submitted in writing, the primary mode of investigation is the telephone due to a lack of staff, and board action has not caused the remittance of any money.
- 2) The board has not applied equal standards to persons seeking licensure as brokers who have not been licensed as salesmen in Montana for two years but who have other experience.
- 3) The board has not taken adequate steps to assure that money held in trust by a broker is not used improperly.

- 4) The board's fund balance is inordinately high.
- 5) The board may be overly restricting entry by requiring that all licensed salesmen be residents of Montana.

The costs of regulation include such things as license and renewal fees, subdivision registration fees, and the costs of complying with other board regulations. The auditors believed that these costs were minimal when compared with the financial loss that could occur from unscrupulous real estate agents if deregulation were to occur.

The other audit reports present similar information on the eleven boards and agencies not discussed here.⁴

Comments on the Audits and Audit Reports

Each of these sunset reports, like almost all of the other reports, were much too lengthy. The reports ranged mainly from 60 to 90 pages in length. In effect, the length of the reports made them unmanageable, and hence, the auditors violated the sunset principle which

⁴The complete audit reports may be obtained from the Office of the Legislative Auditor at the State Capitol in Helena, Montana.

states that audit information should be put into a manageable package for decision-making.

In these three boards, one finds probably the best run and two of the poorer run agencies which were reviewed. The Investment Department proved to be a very well managed agency with few problems other than some minor administrative adjustments. On the other hand, the Board of Real Estate and the Board of Engineers and Land Surveyors had two types of problems which haunt most regulatory agencies. The problems, in the case of the Board of Real Estate, involved inconsistencies in the application of its rules and regulations, such as the granting of equivalency for license applicants. The Board of Engineers and Land Surveyors had problems with rules and laws which were overly protective of the regulated professions (e.g. the requirement for two examinations plus an apprenticeship for licensure).

One difference between the sunset reports and normal audit reports is that the sunset reports did not offer recommendations for the improvement of agency operations although the reports hinted at such problems. Recommendations provide valuable information to the audit committee and other legislators because the recommendations

focus attention on problem areas.

The Audit Committee Recommendations

In late December 1978 and early January 1979, the audit committee reviewed its preliminary recommendations on each of the agencies under review. The committee made some minor changes in the preliminary recommendations before presenting them to the legislature. (The final recommendations are too numerous and complex to be completely enumerated in this paper, but a summary is included.) The recommendations basically fell into two main categories, the disposition of the agencies and regulatory modifications.

Agency Disposition. The committee recommendations call for the termination of four agencies, the transfer of seven agencies to different departments, and the re-establishment of three others.

The committee recommended that four of the fourteen boards be terminated. The committee recommended the Board of Abstracters for termination with no further licensing of abstracters, but regulation of abstract plants would continue under the Department of Business Regulation. The committee recommended that the Board of County

Printing be abolished and that a statutory provision be enacted to provide for competitive bidding on county printing contracts. In addition, the Board of Landscape Architects and the Board of Institutions were recommended for termination with no vestige of regulation.

The committee scheduled the transfer of seven boards presently attached to the Department of Professional and Occupational Licensing (DPOL) to other departments. A Board of Realty Regulation within the Department of Business Regulation was to replace the Board of Real Estate. The committee recommended that three more boards, the Board of Public Accountants, the Board of Architects, and the Board of Professional Engineers and Land Surveyors, be combined into a Board of Professional Service Regulation under the Department of Business Regulation. The committee recommended that a Board of Public Safety under the Department of Administration replace the Board of Plumbers, the State Electrical Board, and the Board of Warm Air Heating, Ventilation, and Air Conditioning. Three members of the public with no affiliation with any of the professions or trades would serve as members of the combined boards.

The audit committee recommended that the Investment

and Insurance Departments within the State Auditor's Office and the State Banking Board in the Department of Business Regulation be re-established with no real changes.

Regulatory Modification. As for the modifications in the regulatory process suggested by the audit committee, virtually all were derived from the audit reports. The following represent some of the major provisions of the audit committee recommendations:

- 1) The board members on each of the newly created or recreated boards would be subject to Senate confirmation and would receive \$35 per day plus travel expenses rather than the previous \$25 per day plus travel expenses.
- 2) Each of the sunset bills introduced by the audit committee provided that the fees charged must be reasonably related to the cost of regulation. Previously fees were either set by statute or by the board with little or no relation to the actual cost of regulation.
- 3) In the case of accountants and architects, the education and experience requirements were definitely spelled out and not as restrictive. Also, provision for continuing education was made.
- 4) The Board of Architects could not prohibit competitive bidding.
- 5) In the case of electricians and plumbers, the building inspectors were charged with checking persons for valid licenses and reporting violators to the board. Also, the inspectors were required to report cases of substandard work to the board for appropriate action.
- 6) The bills would create a class of residential electricians to better serve the public.

Comments on the Audit Committee Recommendations

While it is difficult to substantiate, the committee appeared to be recommending the de facto, if not de jure, dismantling of the Department of Professional and Occupational licensing. One indication is the fact that one member of the audit committee introduced a bill to do away with DPOL and transfer all of the boards to other departments. He introduced this bill at the request of the Governor's office after it had determined that dismantling DPOL was the probable intent of the audit committee.

The audit committee made one major change between its preliminary and final recommendations -- the creation of three superboards rather than one. Originally, the committee recommended that engineers, land surveyors, architects, electricians, plumbers, and warm air heating mechanics be regulated by one board. Apparently, the committee later decided that the superboard concept would be more politically viable if professions and trades were regulated by different boards. In addition, the creation of the health-related superboard seemed to be a move to facilitate the dismantling of DPOL by providing a place to house the regulation of the health-related professions.

CHAPTER IV

THE BENEFITS AND COSTS OF SUNSET

There is a question whether sunset is really worth the time and effort which it requires. This chapter will attempt to compare the benefits and costs of sunset from the perspective of Montana's process.

Measurable Monetary Benefits and Costs of Sunset

The measurable monetary benefits and costs are those positive and negative impacts to which dollar values can readily be attached.

Benefits. A conservative estimate of the benefits of sunset is the monetary savings from the termination of agencies. In contrast, a more optimistic estimate of the benefits is proposed by Michael March.

Many people measure the benefits of sunset by the amount of the savings derived through the termination of agencies. These benefits can take the form of direct tax savings in the case of agencies financed through taxes or savings from reduced prices for services in the case of agencies financed by fees from licensees. Theoretically, a consumer should benefit from reduced prices because the fees are passed through to the consumer in the form of

increased prices.

In order to estimate the benefits of sunset, one must calculate and discount back to the present the estimated future expenditures of each agency which was terminated. The parameters of this calculation include the rate of inflation of future expenditures, the discount rate for the use of money in the future, and the number of years over which the calculation is to be made. While no one knows how fast government expenditures will expand in the future, Wildavsky suggests the past is the best predictor of the future.¹ In the case of Montana, expenditures from the earmarked revenue and general funds have expanded at an average of seven to nine percent per year for the past four fiscal years.² To be conservative, the calculation will use the seven percent figure. E. J. Mishan suggests that one way to calculate the discount rate is to use the rate of return required on a relatively risk-free private investment plus two percent.³ In this

¹Aaron Wildavsky, The Politics of the Budgetary Process, 2nd ed., 1974, pg. 13.

²Montana's Financial Reports, Fiscal 1975 through Fiscal 1978.

³E. J. Mishan, Cost-Benefit Analysis, 1976, pg. 374.

case, the interest rate on corporate bonds plus two percent yields approximately a twelve percent discount rate. Since it is unlikely that any agency would be terminated without sunset and predicting very far into the future is a very risky process, Mishan suggests that discounting over thirty years is the best procedure.⁴

The 1979 Legislature decided on the termination of three agencies, the Board of Warm Air Heating, Ventilation, and Air Conditioning, the Board of Abstracters, and the Board of Institutions. The combined expenditures for these boards was approximately \$7,300 for fiscal 1978. Both the Board of Warm Air Heating, Ventilation, and Air Conditioning and the Board of Abstracters receive all funding through license fees. For the Board of Institutions, general tax receipts provide all of the funds.

Using the previously established parameters and discounting future expenditures to the present, the benefits from terminating these three agencies amount to approximately \$115,000. This amount is probably a minimum estimate of the benefits of the first cycle of sunset in

⁴Ibid., pg. 380.

Montana.

In contrast, Dr. Michael March of the University of Colorado has proposed another method of estimating the benefits of sunset.⁵ His proposal is very optimistic and some of his assumptions are suspect. One should regard the results of his procedure with some caution, but it should provide an optimistic estimate of the benefits of sunset.

Dr. March postulates that sunset in the public sector is analogous to research and development in the private sector. In the private sector, it is implicit that an activity is not undertaken unless the benefits outweigh the costs. Since the private sector spends approximately five percent of its total expenditures on research and development, the benefits must be at least that large. Therefore, if sunset and research and development are analogous, the benefits of sunset should equal at least five percent of the expenditures of the agencies under review.

In Montana, sunset covers an agency's operations

⁵Dr. Michael March, "Sunset Evaluation: Theory vs. Practice," October 18, 1976, pg. 4.

over a six year period so it seems logical that the expenditures for that period should be used to calculate the benefits. The fourteen boards and agencies of the first cycle expended approximately \$850,000 in fiscal 1978. Using this figure and discounting over the six years with the previously stated discount and inflation rates, a figure of \$4,300,000 is obtained for the estimated total expenditures for these agencies over the next six years. Using the five percent figure, the benefits are approximately \$215,000.

Therefore, the true benefits of sunset probably lie somewhere between the two estimates of \$115,000 and \$215,000.

Costs. Most people associate the concept of costs of a governmental activity with the amount of tax dollars spent to carry it out. In the case of sunset, these costs take the form of the resources expended on the audits conducted by the Office of the Legislative Auditor. A staff report disclosed that the office expended approximately \$183,600 on the fourteen sunset audits. The staff based its estimate on the amount reimbursed to the office for audits of federal funds. The audit costs ranged from a high of \$20,659 for the board of Professional Engineers

and Land Surveyors to a low of \$3,705 for the Board of Institutions.⁶

The report also pointed out one factor which had a significant impact on the costs of the first cycle of sunset but which may not be present in later cycles. The first cycle was very much a learning process. The amount of time devoted to the earlier audits was very much higher than the later audits when one takes into account the complexity of the agency. The auditors attribute the extra cost to such things as developing audit programs and the audit report format, researching background on regulation, and training the audit staff which was new to both sunset and auditing.⁷ The average cost of the first five reviews (Abstracters, Public Accountants, Architects, County Printing, and Real Estate) was approximately \$16,500 while five comparable later reviews (Landscape Architects, Electricians, Plumbers, Banking, and Investments) averaged only \$10,000 per audit.

⁶Office of the Legislative Auditor, "The Present Approach to Sunset--Philosophy, Benefits and Costs, Recommendations--," December 1978, pg. 6.

⁷Ibid., pg. 6-7.

By way of contrast, the State Auditor's Office in Colorado reviewed thirteen agencies (vs. fourteen in Montana) during its first cycle at a cost of approximately \$140,000. The thirteen boards and agencies included the Board of Barber Examiners, the Board of Cosmetology, the Board of Mortuary Science, the Board of Professional Sanitarians, the Tramway Safety Board, the Athletic Commission, the Board of Examiners of Institutions for the Aged, the Collection Agency Board, the Board of Shorthand Reporters, the Board of Nursing Home Administrators, the Racing Commission, the Insurance Division, and the Public Utilities Commission.⁸

Montana's sunset audits averaged \$13,000 per audit or somewhat more than the \$11,000 per audit for Colorado. Most of this difference results from the fact that the audits of the small and medium size agencies in Colorado cost significantly less than in Montana. (See Table 2.)

⁸Office of the State Auditor, "Seminar on Sunset," State of Colorado, pg. 8.

TABLE 2

Comparison of Audit Costs
Montana vs. Colorado

<u>Agency Size (Expenditures)</u>	<u>Average Cost Montana</u>	<u>Average Cost Colorado</u>
Small (Under \$40,000)	\$10,000	\$ 6,000
Medium (\$40-100,000)	15,000	10,000
Large (Over \$100,000)	20,000	24,000

Comparison. As stated earlier, the measurable monetary benefits of sunset in Montana range between \$115,000 and \$215,000 depending upon whether a conservative or an optimistic estimate is used. In addition, the auditors estimated the measurable monetary costs of sunset to be \$183,600 for the first cycle. For the more conservative estimate of the benefits, the ratio of benefits to costs is .63 with a negative net benefit of approximately \$70,000. On the other hand, the optimistic estimate of benefits yields a ratio of benefits to costs of 1.17 with net benefits of slightly more than \$30,000. At best, these figures indicate that the sunset audits of the first cycle in Montana were only marginally justifiable for the costs incurred. However, one must bear in mind that these

benefits and costs are only those expressible in dollar terms. One also should note that as sunset progresses the benefits will be reduced because fewer agencies are likely to be terminated. Most unnecessary agencies probably will be detected during the first or second round of reviews. But, costs also should decrease as the auditors become more adept at the reviews.

Other Benefits and Costs of Sunset

In addition to the measurable monetary benefits and costs, sunset has some benefits and costs which are neither easily measurable nor of a monetary nature. These are the benefits and costs discussed in this section.

Benefits. Theoretically, the increased public exposure of the operations of the agencies under sunset review should provide an incentive for these agencies to improve their operations. These improvements could come in two forms. One form comes from changes in the regulatory process which better protect the consumer, while the other comes from increased diligence by the agencies in the performance of their duties.

In the case of the first cycle agencies in Montana, the improvements in the regulatory process

prompted by sunset fall into two categories. One set of improvements is administrative changes made by the agencies while the other is the changes in the legal mandates of the agencies.

The administrative improvements resulted from problems identified by the auditors during the conduct of the sunset audits. Some examples of these administrative improvements include:

- 1) The Department of Professional and Occupational Licensing changed its method of accounting for expenditure abatements to more adequately reflect expenditures.
- 2) The Investment Department improved its file maintenance and expanded a cross-reference system that checks license applications against complaints.
- 3) The Insurance Department expanded a statistic gathering system to analyze complaints.
- 4) The Board of Real Estate and the State Electrical Board revised the administration procedures for their respective examinations.
- 5) The Board of Real Estate improved the maintenance of its subdivision files.
- 6) The Board of Public Accountants initiated a file system to store information about examinees in more detail.
- 7) The Board of Architects and the Board of Professional Engineers and Land Surveyors improved their complaint file maintenance.

- 8) Most boards now have adopted Rules for Public Participation.

Besides the administrative improvements, sunset also prompted legislation to correct perceived weaknesses in the laws of the various agencies. In most cases, these changes were prompted by the sunset audit reports. Some of the legislative changes included:

- 1) Provision for the maintenance of competency by engineers, land surveyors, accountants, and architects.
- 2) Addition of public members for the Board of Professional Engineers and Land Surveyors, the Board of Architects, the Board of Public Accountants, and the Board of Landscape Architects.
- 3) Requirement of passage of a "uniform national examination" prior to licensure rather than the state board examination for landscape architects.
- 4) Provision for a residential electrician's license.
- 5) Allowing the boards to set fees according to the costs of regulation rather than setting them arbitrarily.

It is very difficult, if not impossible, to assess the impact of either type of change upon efficiency and effectiveness of the operations of these agencies. Several of the improvements will cause an increase in agency expenditures such as improving file maintenance or adding members to several boards, but hopefully the benefits from

the improvement will outweigh these increased costs. The benefits from these two sets of changes should have a substantial positive impact on the protection of the public. However, additional research and data will be needed to verify this conclusion.

As noted earlier, the increased exposure of agency operations by sunset should provide an incentive for agencies to provide high quality service to the public. At this point in time, one cannot assess the impact of sunset on the service provided by the agencies under review because there is no information on what the future quality of service will be.

Costs. Discussions with members of the program audit staff and personal observations identified problems with the scope of the reviews and the time frame of committee consideration. In addition, there are some costs associated with deregulation.

Montana's sunset reviews were very comprehensive. As stated earlier, the staff conducted extensive research into the professions, the evolution of regulation of those professions, and regulation at the federal and local levels as well as the state. Much of the information contained in the audit reports was, at most, of peripheral interest to

the committee. This would indicate that the reviews were too extensive and the information needs of committee members could have been served with a less comprehensive set of reviews.

In addition, there appeared to be a problem with the time frame for the hearings and decisions of the audit committee. The first hearing on a board occurred in March of 1978. Further, almost all of the hearings took place between June and October of 1978. During this time period, the audit committee held hearings on approximately three boards or agencies per meeting with only about one month between meetings. Concurrently, the committee had to draft recommendations on each of the agencies under review as well as to fulfill its normal program and financial audit responsibilities. In Wildavsky's terms, the sunset audits resulted in increased complexity of calculations for the committee within the limited time frame available to them.⁹

These problems may have affected the quality of the audit committee decisions. One should remember that the members of the audit committee are only part-time

⁹Aaron Wildavsky, The Politics of the Budgetary Process, 2nd ed., 1974, pg. 74

legislators with other jobs which take up much of their time. With the excessive amount of information presented in the reports and the short time period for consideration, the audit committee probably did not make the best use of the audit reports in their decision-making.

One also can anticipate some costs to the consumers from deregulation. These costs include such things as a lack of information for consumers on the competency of service providers and the chance that consumers may be swindled by unscrupulous practitioners. The auditors attempted to quantify these costs but were unable to do any more than simply enumerate the costs of deregulation without attaching a dollar figure. Further examination determined that the only statement that can be made on this subject is that there will be some cost from deregulation.

Comparison. Neither the benefits nor the costs presented in this section are easily quantifiable in dollar terms. Therefore, one can make only a subjective comparison. The basis of this comparison is whether one believes that the improvements in the regulatory process are more important than the problems encountered with sunset and the costs of deregulation or vice versa. It is likely that the changes in the regulatory process and the

impetus for improved service will have a substantial positive impact on the consumer. On the other hand, the extra audit time required to do the comprehensive reviews reduced the effectiveness of the audit committee's use of the reviews and probably caused the costs of the audits to be unnecessarily high.

Further, one must consider the costs from deregulation. While these costs accrue immediately and the benefits from the regulatory improvements will not accrue until well into the future, it appears that in the longer run the benefits presented in this section should outweigh the costs presented here.

A Comparison of the Total Benefits and Costs of Sunset

After reviewing the benefits and costs of sunset, one must combine all of the factors in an attempt to determine the overall worth of sunset. A casual observer probably would tend to disregard the other benefits and costs of sunset and attempt to decide solely on the measurable monetary benefits and costs. But this would lead to a faulty evaluation because the theoretical basis of sunset suggests that making government more efficient and effective is more important than terminating a few minor

boards and agencies. Since the other benefits and costs do not come with easy dollar price tags, the reader and the legislature must make the decision on whether sunset is worthwhile based upon their own subjective weighing of all of the factors.

From the information presented in this chapter, one might conclude that sunset is only marginally effective. But one must remember that this was only the first cycle and, as with most management techniques, experience brings on modifications which tend to improve the process. Also, one should note that the benefit/cost picture may be clouded by the fact that most of the costs accrue immediately while many of the benefits do not accrue until the future. The next chapter discusses some possible improvements in the process and the possible future of sunset.

CHAPTER V

SUNSET IN MONTANA: A PROSPECTIVE

What will be the future of sunset? This chapter attempts to provide some information upon which to answer this question.

The Revised Sunset Process

The Legislative Auditor, after reviewing the costs and benefits of the process used during the first cycle, decided to make some adjustments in the review process. These adjustments should solve some of the problems encountered during the first cycle as well as make sunset more efficient.

The second cycle sunset audits began about January 1, 1979 which was two and one half years before any of the second cycle boards would terminate.

The auditors will conduct a more abbreviated review and present a more abbreviated report when compared with the first cycle. The auditors will prepare an initial report on each board. This report will provide background on the audited board and the group being regulated. In addition, the preliminary review should identify areas which may be of concern to the audit committee.

One should note that the model for this new audit process and report was the audit and report on the Board of Institutions which was conducted during the first cycle. It required the fewest man-hours to complete and was the briefest of all of the first cycle audit reports. But it seemed to provide sufficient information for the audit committee.

Once the auditors prepare the initial report, they will present it to the committee at a public hearing. The committee then will have two options. It can make its decision based on the preliminary report and the public hearing. Or it may request further audit work in areas in which it feels it lacks adequate information. If the second option is chosen, the audit staff will gather the information and present it to the committee. Then the committee may hold another public hearing and make its decision.

Starting the cycle so early should prevent the log jam at the end of the biennium as happened during the first cycle and give the committee more time to make its decision.

In addition, the reduced scope of the reviews and the envisioned reduced size of the audit reports should

help the process. These thirty page audit reports should be more manageable for the committee members than the seventy to one hundred page reports which were common during the first cycle.

Further, the process will provide additional flexibility. The audit committee can determine to a great extent the depth of analysis it feels it needs. Also, the committee can direct additional inquiries into those areas which are of interest to the members.

One final benefit of this new process is that it will allow the use of resources for other audits. During the first cycle, the Office of the Legislative Auditor had to assign virtually all of its program audit staff to sunset. With this more abbreviated process, only part of the program audit staff will work on the sunset audits and only for part of the time.

Agencies for Review Under Sunset

The groups which initiated the concept of sunset included the various regulatory boards as the targets of the reviewed because they assumed that such boards would be relatively easy targets upon which to build a track record. In retrospect, these agencies received the support

of the group being regulated in almost every case. Most of these groups have enough political power to make it difficult to eliminate some questionable boards. In Montana, intense lobbying saved the County Printing Board and the Board of Landscape Architects. In Colorado and Florida, extensive lobbying efforts overturned several committee recommendations. This fact makes it highly unlikely that very many agencies will be terminated under the present sunset system.

On the other hand, could sunset be applied to larger agencies? The Insurance Departments and the Public Utilities Commission were the only reasonably large agencies which have been reviewed in either Colorado or Montana. In each of these cases, the reviews took more review time than most other agencies, but they were not that much more difficult. From the experience of the audit staff in Montana, it appears that agencies of reasonable size (i.e., perhaps a bureau or a small division) would be manageable. From a practical standpoint, the legislators probably could not handle the massive amounts of information which would be generated by a review of an extremely large agency. One should note that ZBB also takes the approach of using smaller agencies as the focus of its

analysis and then uses them as building blocks to form the entire budget because it provides for better understanding on the part of the person doing the analysis and the person who attempts to use the analysis.

Further, it appears that sunset audits of agencies other than regulatory boards may be more effective for two reasons. First, these agencies have much larger budgets and operations so even a seemingly minor change could mean relatively large benefits. Also, many of these main-line agencies lack powerful interest group support. This could mean that suggested changes would have a better chance of passage because they would not be subject to the intense lobbying which marked the first cycle in Montana.

Sunset as a Pilot for Program Audits

The Legislative Auditor's Office uses financial audits as a basis for program audits. Financial audits examine agency operations cursorily, but even these limited examinations can provide information on facets of agency operations which seem to require in-depth review. Under the proper circumstances, the office could use sunset in the same manner.

Sunset audit and program audits are related forms of analysis. Both examine agency operations although program audits tend to be limited to very specific facets of an agency's operations. In addition, the persons who conduct these two types of audits are more aware of problems with agency operations than financial auditors are..

To use sunset as a pilot, the legislature must expend sunset to main-line agencies. Since the first cycle sunset audits were very similar to normal program audits, it appears that program audits of regulatory boards would not be very cost effective. But if sunset is expanded to main-line agencies, it could identify areas which would provide worthwhile material for program audits. For example, a sunset audit of the Alcohol and Drug Abuse Division of the Department of Institutions might identify the funding of local alcohol treatment programs as an area for possible review. Then if authorized by the Legislative Auditor, members of the program audit staff would do an in-depth review of this area and issue recommendations to improve the funding process.

Additional Benefits of Sunset

Besides the other benefits of sunset, three

features provide some potential benefits which are not readily apparent from an examination of the first cycle. These include a police effect, a force for legislative oversight, and a force for change and compromise.

Sunset provides an incentive for an agency to improve its operations (a police effect). In some cases, this takes the form of an agency keeping its standards of service high because of the scrutiny. Also, some of the agencies will submit legislation to improve their own operations in anticipation of the sunset audits. In fact, several of the second cycle boards introduced such legislation into the 1979 Legislature. One should note that it will be difficult to determine which changes are attributable to sunset and which would have occurred without sunset. In addition, any changes made in anticipation of sunset review would reduce the changes which would otherwise show up as resulting directly from sunset.

Further, sunset forces the legislature to take an active role in the oversight of executive agencies because the legislature must take affirmative action to avert agency termination. This could indicate that the legislature is recapturing some of the initiative in

assuring that agencies are operated properly. For the public, this may not appear as a direct benefit, but in the longer run a more involved legislature is expected to lead to better government.

Finally, the automatic termination provision of sunset forces the agency and the regulated group to compromise with the supporters of agency reform in order to get the agency re-established. Since it is much more difficult to get the legislature to pass a bill than it is to kill a bill, the agency and the regulated group should accept more readily some modifications in agency operations in return for passage of the bill to re-establish the agency.

Legislative Reaction to Sunset

It appeared that the 1979 Legislature was rather ambivalent toward sunset.

One legislator unsuccessfully introduced a bill which would have removed the periodic termination provision from the sunset law. This bill would have taken some of the effect out of sunset by removing the mechanism which forces the legislature to maintain its oversight. If this bill had passed, each agency would have been

reviewed once then the sunset review cycles would have terminated.

It appeared that few legislators were very interested in sunset. None of the standing committees which handled the sunset legislation spent much time on it. This seemed to be a function of both a lack of time and a lack of interest on the part of the members of the standing committees.

In the case of most of the agencies under sunset review, two sets of bills were introduced into the 1979 Legislature. The Legislative Audit Committee introduced one set which included modifications in the regulatory process and in the make-up and disposition of the agencies. In addition, the regulated industry and/or the agency under review usually introduced legislation to re-establish the agency in its present form but then incorporated most of the audit committee recommendations for regulatory modifications. In cases where two bills were introduced, the Legislature normally passed the industry/agency bill and rejected the changes in the disposition of agencies (i.e., superboard) recommended by the audit committee. This resulted primarily from heavy lobbying efforts by the

regulated industry which wanted to maintain regulation in nearly its present form.

Overall, it seemed that sunset had an impact on the regulatory process but little direct impact on the number of agencies or the physical size of state government except to the extent that some of the regulatory modifications may hold down the future growth of government.

Sunset in the Future--Fad or Reform?

There is a question whether sunset is just a passing fad or a reform which will have a definite positive impact on government. The answer seems predicated on the future use of sunset. If sunset is used as one of a group of management tools, it can help make government more efficient, effective, and accountable, and hence control the growth of government. On the other hand, if sunset is judged on the basis of the termination of agencies or is used in an attempt to supplant other management techniques it will fail and expire.

Another factor which could affect the effectiveness of sunset is the type of agency which comes under review. The fact that sunset only covers regulatory boards severely limits the usefulness and thus the future

of sunset but expanding sunset to main-line agencies must be done carefully to assure that the agencies for review are of a manageable size.

In addition, sunset lacks strong support in the legislature. While the members of the audit committee generally support the concept of sunset, no true champions exist. In fact, one member of the audit committee scuttled a committee recommendation to terminate the Board of Landscape Architects by publicly denouncing the recommendation. It is likely that sunset will come under attack from the regulated industries and legislators who see little, if any, benefit from sunset when compared to the costs. Since it will take a long time to see the real benefits of sunset, some strong legislative support will be needed to counteract indifference and opposition to sunset if it is to survive until the time when the long term benefits become apparent.

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