

LEGISLATIVE AUDIT DIVISION

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MEMORANDUM

TO: Legislative Audit Committee Members
FROM: John Harrington, Senior Performance Auditor
CC: Mike Honeycutt, Executive Officer, Department of Livestock
John H. Lehfeltd, Chair, Board of Livestock
John Scully, Vice Chair, Board of Livestock
DATE: November 2017
RE: Performance Audit Follow-Up (18SP-03): Montana Veterinary Diagnostic Laboratory (orig. 15P-04)
ATTACHMENTS: Original Performance Audit Summary

Introduction

The *Montana Veterinary Diagnostic Laboratory* (15P-04) report was issued to the Legislative Audit Committee in June 2016. The audit included five recommendations to the Department of Livestock (department). We conducted follow-up work to assess implementation of the report recommendations. This memorandum summarizes the results of our follow-up work.

Overview

Our audit found opportunities for the Montana Veterinary Diagnostic Laboratory (lab) to improve the way it assesses the costs for each test performed, and to more regularly and thoroughly review the fees it charges for the tests it performs. We found the department should determine a consistent and sustainable amount of per capita funding to contribute to the lab's budget each biennium, and should fully implement all of the contractually obligatory features and functions of its new information management system. We also recommended the department develop a detailed and specific plan for eventual replacement of the lab, which is located in an outdated and unsafe building in Bozeman. Follow-up work found the department has made substantial progress toward implementation of these recommendations, with four implemented, and implementation of the recommendation related to the lab building still in progress.

Background

The department is overseen by a seven-member Board of Livestock (board), whose members are appointed by the governor and who represent various segments of the livestock industry. The executive officer of the department serves at the pleasure of the board. The Montana Veterinary Diagnostic Laboratory is a division of the Department of Livestock and is located on the campus of Montana State University-Bozeman (MSU). The lab is the only accredited, full-service veterinary laboratory in Montana, performing more than 200,000 tests annually on a wide variety of animal species, as well as regulatory milk testing and testing on suspected rabies cases. The lab's mission is to "protect the public health, promote a compliant state dairy industry and assist in the control and prevention of zoonotic diseases," as

well as to “fulfill requirements and surveillance duties directed by regulatory and guidance agencies.” The division provides disease diagnostic support to veterinarians, livestock producers, and companion animal owners, as well as many state and federal agencies. Our performance audit found the lab did not maintain a regularly updated accounting of the costs associated with the majority of its testing services, and did not have a process for monitoring and reviewing the fees it charged for those testing services. Initial audit work also found the department was inconsistent in providing per capita funding to the vet lab; had not received all contractually obligated functionality of a new information management system; and is housed in a building that is outdated and in some ways not safe.

Audit Follow-Up Results

The following sections summarize the progress toward implementation of the report recommendations. To complete our follow-up work, we solicited information from the department regarding implementation of the report’s recommendations; reviewed documentation of cost analysis and fee review performed by the department and the board; interviewed staff; reviewed department budget documents for the current biennium; and reviewed the activities of the Legislative Finance Committee’s Montana State Labs Subcommittee.

RECOMMENDATION #1

We recommend the Department of Livestock regularly analyze and document the Montana Veterinary Diagnostic Laboratory’s material and overhead costs of the tests performed at the lab.

Implementation Status – Implemented

Our initial audit work determined the department and the lab did not regularly assess the costs associated with all of their testing services. In response to the audit, the department indicated it undertook a full cost analysis on the lab in late 2016. As part of our follow-up work, we reviewed a cost analysis developed by the lab and determined it broke down direct material testing costs by lab section, and also allocated all administration and general overhead costs among the various sections of the lab. Documents reviewed and interviews conducted indicate the lab allocated some indirect costs to various sections based upon the square footage of the building occupied by the section, and other costs based upon the size of the section (as measured by number of FTE). Department management reported they intend to update the cost analysis annually at the end of each calendar year, so that the board can use the information for an annual review of the fees the lab charges, to be conducted each spring.

RECOMMENDATION #2

We recommend the Department of Livestock biennially review the Montana Veterinary Diagnostic Laboratory fees in a systematic, documented manner that takes into account the direct and indirect material costs of the tests and regional lab fees for competitive analysis.

Implementation Status – Implemented

In addition to not assessing the costs associated with testing services, our initial audit work found that the department did not review fees charged for testing services in a regular and documented way. Our review of the subsequent cost analysis work conducted by the department determined that information on both direct and indirect testing costs was used to create a revised fee schedule in the spring of 2017. As a result of this work, the board approved a 10 percent increase in the fees charged for selective tests. Some test fees were not increased because they are already competitive with charges at other labs, while other fees were left alone to encourage compliance by producers. The department also recommended, and the board approved, an accession fee of \$4 for each submission to the lab by a veterinarian or producer. The department expects this fee may generate \$100,000 per year and help defray a measure of the indirect and

overhead costs of maintaining the lab. Management indicated intent to present the board with its fee schedule each spring.

RECOMMENDATION #3

We recommend that when developing a budget for the Montana Veterinary Diagnostic Laboratory, the Department of Livestock determine a recurring, consistent, and sustainable level of per capita funding to be contributed to the lab budget as one source of non-fee revenue.

Implementation Status – Implemented

The original audit found the department was inconsistently contributing per capita amounts to the lab's budget from one biennium to the next. Our audit work found that a more consistent per capita contribution to the lab's operations would reduce uncertainty on the part of the legislature regarding the amount of general fund support the lab would need from year to year. Department leadership indicated this recommendation was addressed by analyzing the difference between cost and revenue for tests that primarily benefit the livestock industry in Montana (as opposed to those tests that are more aimed at protecting public health). Per capita fees are paid by the livestock industry, thus it was felt that per capita funding was an appropriate source of funds to cover the shortfall in the area of tests that largely benefit the industry. The department allocated approximately \$430,000 per capita each year for the current biennium, and signaled its intent to maintain this level of per capita funding.

RECOMMENDATION #4

We recommend the Department of Livestock fully implement all features and functionality indicated in its information management system contract.

Implementation Status – Implemented

At the time of our audit, our work found the department had paid for but not fully implemented the functionality of a new information management system that improves communication between the lab in Bozeman and staff in Helena. During follow-up work, a demonstration of the system at the Helena office indicated the department has achieved what was promised in the system contract and has the ability to monitor test results via an interface between the lab's system and the system used in Helena. While the department has implemented the recommendation related to ensuring contractually obligated functionality of the information management system, additional work is ongoing to establish full messaging integration with the National Animal Health Laboratory Network and an interface for veterinarians across Montana.

RECOMMENDATION #5

We recommend the Department of Livestock develop a detailed and specific plan and timeline for replacing the Montana Veterinary Diagnostic Laboratory.

Implementation Status – Being Implemented

Our initial audit work found the MSU-owned building that currently houses the lab is at the end of its safe and useful life. The building's facility condition index score indicates a number of deficiencies with the building's major systems, and the national accrediting organization indicated the facility may become a hindrance to accreditation for the lab going forward. While a detailed and specific timeline for replacing the lab is not complete, the department has engaged with two different stakeholder groups to develop a plan for a new lab building serving multiple interests in Bozeman. An industry group was convened with representatives from various segments of the livestock industry, and for this group the lab prepared a needs analysis on what facilities would be necessary to maintain and enhance available services. Also, subsequent to the release of our audit report, the legislature authorized a Montana State Labs Study Subcommittee, a subcommittee of the Legislative Finance Committee. Review of subcommittee meeting

recordings showed the department has also been active and responsive, providing a needs analysis for what it would require in a new facility, potentially to be shared with other state-operated labs. Department leadership said the department is currently analyzing funding needs for its portion of a joint building, how such a facility might be funded through the legislature, and how the department would cover presumed debt service on its portion of any new facility.

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