# *Legislative Background Brief*

*for the*

*Economic Affairs Interim Committee*

6/30/14

## Department of Livestock Funding Concerns, Components

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***Purpose of Reviewing Department of Livestock Budgets, Options***

The following are among the reasons that the Economic Affairs Committee's July 14-15 meeting has been expanded to include presentations on the Department of Livestock's budgets and options for funding in addition to discussions of the Veterinary Diagnostic Laboratory:

- the Department's financial concerns were presented to the Board of Livestock and the Legislative Finance Committee at May and June meetings, respectively. As provided in 5-5-215, MCA, the Economic Affairs Committee is responsible for monitoring the operations of the Department of Livestock with particular attention to:
  - issues likely to require future legislative attention;
  - opportunities to improve existing law through analysis of problems experienced with the application of the law by the Department; and
  - experience of citizens with the Department's operations if those experiences can be mitigated through legislative action.
- the Legislative Audit Committee heard about financial management concerns after a financial audit;
- Rep. Greg Hertz had asked stakeholders to look at various ways of funding the Department in part because there were indications that not all livestock owners were paying their fair share; and
- after the Economic Affairs Committee's January 27 meeting, when the Committee reviewed building and funding concerns related to the Veterinary Diagnostic Laboratory, the Committee asked for those concerns to be discussed with more stakeholders, including Montana State University-Bozeman. That additional review was to have been in May but was postponed until July. In the meantime, discussions at the Board of Livestock in May included comments that the Veterinary Diagnostic Laboratory should be reduced in size or dissolved if a switch to 50% funding from the general fund instead of the current 15%-20% does not occur. The per capita fees that now are used for the Veterinary Diagnostic Laboratory are being proposed instead for the Brands Enforcement Division and other Livestock operations.

The first three funding issues cast a shadow over the Veterinary Diagnostic Laboratory, including whether there should be continued funding support from per capita fees or whether, in light of the funding and building concerns, Montana even needs a state diagnostic laboratory.

- ***Financial Concerns***

  At the Board of Livestock meeting in May, the Board's Executive Officer informed the Board that a supplemental appropriation would be needed. He estimated that the needed supplemental ran between $700,000 and $800,000, which he later said was only an estimate. He reiterated a need for a supplemental appropriation before the Legislative Finance Committee at its

early June meeting. George Harris, the administrator of Livestock's Central Services Division, told the Board of Livestock that the cost overruns included $468,000 in the Brand Enforcement Division and $200,000 in Veterinary Diagnostic Laboratory bills as the largest components. Since that meeting, there have been reports that the Department has "found" $400,000, which apparently was redefined and determined not "lost". One explanation offered by the Department's budget person at a meeting of stakeholders to brainstorm over funding options, held in part to address issues coming before the Economic Affairs Committee, was that the issue was partly related to "appropriation authority" and that it was determined that the "appropriation authority" in the per capita fees account could be used for the Brands Enforcement Division. In addition, "unearned revenue" is coming in gradually so that the negative numbers in the Brands Enforcement account are starting to be erased as revenue is "earned".

Also at the Board of Livestock meeting in May Chief Executive Officer Christian Mackay told the Board that more general fund money would be sought for the Veterinary Diagnostic Lab as a substitute for per capita fees because there was a public health and safety component to many of the Lab's activities. He suggested that the amounts to be requested from the general fund would be about $1 million a year. Currently the lab's biennium budget shows a general fund appropriation of about $580,000.

- ***Audit Concerns***

  The Montana Department of Livestock had five audit recommendations in its latest biennial financial audit provided to the Legislative Audit Committee in May. Two will not be discussed because they related to the Board of Horseracing, which the 2013 Legislature transferred to the Department of Commerce. Three dealt with Livestock finances.
  - One was headlined "unconstitutional payments from the Treasury" and related to approximately $197,000 being disbursed without a charge to an appropriation as required by the Montana Constitution and state law. A rationale given by the Department's Executive Officer was that the money was related to federal Homeland Security money for which spending authority was delayed.
  - Another audit concern related to the base amount used when the Department sought to increase the per capita fee by 10%. There is a disagreement on terms. The Department used ***all*** revenues in the per capita state special revenue account, not just those attributed to per capita fee collections. Under 15-24-922(2), MCA, increases are limited to not more than 110% of the average annual revenue generated in the three previous fiscal years. The audit claimed the Department collected about $158,000 more than they ought to have based on their interpretation of "all revenues" instead of "per capita revenues".
  - The third concern was that the department was spending money in one fiscal year above the amount that ought to have been prorated for that year. The money in this case comes from brand record and re-record fees that are to be prorated over 10 years because the brands are good for a 10-year cycle.

- ***Veterinary Diagnostic Laboratory Concerns***

  In addition to the question of what funding sources should be used for the Veterinary Diagnostic Laboratory, there is a question of the future of the building

in which the Veterinary Diagnostic Laboratory is housed. The building has numerous problems related to ventilation, exposure to asbestos, and inefficiencies associated with lack of space. The Montana State University-Bozeman's long-range plans do not at this time apparently include retaining the laboratory or building in which it is housed.

An interim Senate Joint Resolution No. 14 study of state laboratories focused on laboratories in the Bozeman area and included among recommendations made by the 2011-2012 Economic Affairs Committee that a shared laboratory with the Wildlife Lab be considered as a long-range building project in conjunction with Montana State University-Bozeman. The issue was scheduled for the July 2014 Economic Affairs Committee meeting.

The  indication that the Veterinary Diagnostic Laboratory might not be a consideration for merger meant that the discussion might be premature about potential synergies with Montana State University's new satellite veterinarian program or a potential long-range building plan to combine that lab with other state laboratories on the MSU campus. However, the invitations had been extended on that subject, and the laboratory's funding concerns remain hypothetical until the governor releases his budget, so a discussion remains valid on what the future holds for the Veterinary Diagnostic Laboratory. The university's long-range building plans do not include either the Veterinary Diagnostic Laboratory or the Wildlife Lab.

The options posed in Table 1 are intended to look at a broad scope of considerations regarding the Department of Livestock. The material below the Table gives more fodder to the discussion of some of the options.

Table 1:  Options for addressing Department of Livestock Funding Concerns
*Some of these options may be at cross-purposes but are provided for discussion.*

| | **Suggestion** | **Fiscal Impact?** | **Other Impacts?** |
|---|---|---|---|
| Structural Changes | Combine Department of Livestock and Department of Agriculture | Removes duplicate directors and some central service jobs | See 1993 report on a merger study of Ag and Livestock. |
| | Combine nonpolicy functions of Department of Livestock and Department of Agriculture | Removes duplicated central service costs | Livestock's Central Services Budget in FY 2014: $1.7 mil. Agriculture's Central Services in FY 2014: $1.1 million. |
| | Make Department of Livestock a cabinet office and Board of Livestock into advisory body rather than the head of the Department | | Focuses responsibility on governor or one appointee of governor |
| | Include a staff attorney on department payroll | | May help avoid legal challenges after the fact. |

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| Fiscal Changes | Remove the per capita fee from horses and replace with brand inspections and raise cost of horse brand inspections. | | If boarding of horses is part of noncompliance in paying per capita fees, then replacing per capita fees with brand inspections and charging the equivalently greater cost of brand inspections might help resolve the noncompliance. This might require a change in brand inspection payments. |
| | Combine Veterinary Diagnostic Lab with the Wildlife Lab with costs to be shared by tourism industry, livestock industry, and general fund. | | Tourism industry benefits from wildlife. Perhaps the lodging tax could be further diversified to help fund the diagnostic lab [See Note 1] |
| | Dissolve Veterinary Diagnostic Lab | | State and ranchers/others would have to go elsewhere for diagnostic services. May be problem in viral outbreak. |
| | Remove the per capita fee from bees, poultry, domesticated bison, llamas and alpacas, flightless birds, and domestic ungulates and replace with a flat amount or a tiered assessment structure reflected in income tax filings for all Montanans. | Would need to be designed to avoid spikes in costs. | Given that the Veterinary Diagnostic Lab deals with rabies in domesticated and wild animals, perhaps the per capita fee should reflect fees for all domesticated animals. Currently cities can charge for animal licenses; counties don't. Alternately, could charge breeders of animals not tied to per capita fee. |
| | Put Veterinary Diagnostic Laboratory under the general fund. | Shifts costs from per capita fee | Makes Vet Diagnostic Lab compete with other general fund recipients |

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| | Revise the way brand inspectors are paid. Currently brand inspectors who are not state employees can pocket what they collect and charge expenses, although there may be many that do not charge expenses and what they pocket may not cover their costs. For those not adequately reimbursed, a suggestion was to require (not just allow) "trip fees" to pay for fuel, use of truck, and down time for travel. | | Deputies function as the equivalent of an independent contractor who can receive expenses from the owners and, as provided in 81-3-205, MCA, the inspection fee levied by the department. The department determines compensation, 81-1-203,MCA. 1) Does the department lose money by deputy inspectors collecting fees for brand inspecting? 2) How much does the department gain by having inspectors who are not state employees? |
| | Revise 15-24-922, MCA, which restricts increases in the per capita fee to 110% "of the average annual revenue that was generated in the 3 previous years". | | There's a dispute over the language as to whether the 110% is applied to all revenue in the per capita fund or only the amount specifically raised by the per capita fee. Applying to all revenue (including interest) raises more money. |
| | Charge for more animal health services. | | If per capita fees do not cover costs, then service fees may be needed. |
| | Realign per capita fee recipients, e.g.: remove central services from per capita fee. | Assign administrative costs to general fund. | May provide more scrutiny to central services budget. |

Note 1: Lodging Facility Tax actual revenues in FY 2012: $15.606 million. FY 2013 estimate-- $17.314 million. FY 2014 estimate-- $18.365 million. FY 2015 estimate-- $19.477 million. Approximately 30% goes to general fund as provided in 15-65-121, MCA. Of remainder: 1% to Montana Historical Society, 2.5% to the university system for tourism research, 6.5% to FWP for state parks, 64.9% to Dept. of Commerce; 22.5% in general to regional nonprofit tourism groups.

The options posed in Table 1 are intended to look at a broad scope of considerations regarding the Department of Livestock. The material below gives more fodder to the discussion and includes some observations made by stakeholders during the June 27 informal brainstorming session at the Capitol.

***Budget Review -- in terms of a merger or partial merger***

A previous review regarding merger of the Department of Livestock and the Department of Agriculture took place in 1993. An effort to pass a study bill on a merger during a special session in 1992 failed, but the Department of Livestock organized a study headed by then Rep. Chase Hibbard. In that report, funding sources were described as the following:

| | Gen'l Fund | Proprietary. | Fed. | St. Spec. | Trust | Total |
|---|---|---|---|---|---|---|
| Department of Agriculture | 9.25% | | ---------90.75-------- | | | $6.8 m |
| Department of Livestock | 10.4% | | 6.3% | 83.3% | | $5.1 m |

That compares with funding today, based on the 2015 Biennium Budget, showing:

| | Gen'l Fund | Proprietary* | Fed. | St. Spec. | Trust | Total |
|---|---|---|---|---|---|---|
| Department of Agriculture | 8.4% | 30% | 7.7% | 53.6% | | $53.7m |
| Department of Livestock | 13.3% | | 12.4% | 74.3% | | $22.5m |

*Agriculture's proprietary funding includes $1.15 million in general fund, $1,116,400 in nonbudgeted proprietary, and $14.97 million in statutory appropriations. Agriculture's statutory appropriations are for hail insurance, a commodity dealers-warehouse account, and commodity research and development.

> ***Stakeholder views on a merger or change in the Board of Livestock:***
> The Board of Livestock represents industry and those cattle ranchers, sheep ranchers, livestock market operators, and various other farm and ranch representatives who feel they pay for the Department through the per capita fee placed on their livestock, so they should be able to direct the Department through the Board of their industry representatives, appointed by the governor.

***Potential Savings with Department Merger or Combination Options***

Savings may not equate to those achieved with dissolution of one entire unit because additional staff may be necessary in the remaining department. For example, 2 HR people on Ag might not be enough to support both programs. The 3 accountants in Ag might not be sufficient to handle both Departments. Public information officers may be needed in both departments, given the specific knowledge needed in both areas.

A combination of limited department services may be structurally difficult, and details would have to be worked out.

Administratively attached committees and boards typically have employees associated with them. Changing the Board of Livestock to an advisory board may require an associated staff but not necessarily director-level. Program areas that would still need funding would include the Board of Milk Control, which is in Livestock's Centralized Services Division. Another option would be to change the structure of how the Board of Milk Control operates.

Finally, having a staff attorney for the Department of Livestock may or may not cost more money than it saves in avoided lawsuits. Given that lawsuits may occur regardless of having an attorney on staff, the benefits are not necessarily assured or obvious. Currently the Department contracts with the Department of Justice for legal services. From July 1, 2008, to June 24, 2014, the Department of Livestock paid $146,976 on general legal fees and $175,919 on lawsuits, according to information from the Department of Justice. See Appendix A.

***Livestock's Per Capita Fees***

In the 2013 cycle, the following per capita fees in Figure 1 were paid in the quantities and at the rates indicated. It is not clear whether the rates are high or low to correspond with any particular increase in risk to human health, surveillance requirements, or other reason.

| Figure 1 | Horses | Cattle | Bison | Sheep | Swine | Goats | Poultry | Bees | Ungulat | Emus/O | Llamas/ |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Quantity | 73,415 | 1,803,000 | 8001 | 176,926 | 90,430 | 6465 | 486,628 | 51,065 | 803 | 182 | 1958 |
| Rate | $5.29 | $2.10 | $5.77 | $0.47 | $0.68 | $0.47 | $0.05 | $0.37 | $23.83 | $8.81 | $8.81 |
| Subtotal | 388,376 | 3.786,311 | 46,166 | 83155 | 63492 | 3039 | 24331 | 18894 | 19135 | 1603 | 17250 |

The total of per capita fees in FY 2013 was $4,449,752.71. As of June 24, 2014, the amount for per capita fees was slightly more, $4,586,532.27.

Per capita fees help pay for the following budgets and make up a significant share of total costs (See Appendix B):

- Centralized Services
- Veterinary Diagnostic Laboratory, 32.7% of total funding
- Animal Health, 33.5% of total funding
- Brands Enforcement, 48.3% of total funding

***Purpose of Veterinary Diagnostic Laboratory***

A key question asked regarding the Veterinary Diagnostic Laboratory is whether the lab is needed. A statute defining the powers of the Department of Livestock states that the Department may establish and maintain a laboratory to "foster, promote, and protect the livestock industry in this state by the investigation of diseases and other subjects related to ways and means of prevention, extirpation, and control of disease or the care of livestock and its products...:" Not stated specifically in statute is that the Veterinary Diagnostic Laboratory also protects human health. However, the Montana Veterinary Diagnostic Laboratory's own mission statement authorized in August 2012 lists as a lead objective "to protect the public health, promote a compliant state dairy industry and assist in the control and prevention of zoonotic diseases, including rabies" as well as "to promote the marketability and reproductive health of Montana livestock".

***Staffing at Veterinary Diagnostic Laboratory***

A total of 27 people are on the Veterinary Diagnostic Laboratory roster, including one IT person funded out of Central Services, one with federal funding, and one temporary person who is working under "soft" or grant funding. One position is a job-share, and one position works less than full time. In all, there are 21.6 legislatively budgeted positions. Their job types include clinical pathology, clinical lab technologists (in virology, histopathology, molecular diagnostics, milk lab, and serology), pathologists, receiving office administrative assistants, and a receiving/shipping clerk. A quality assurance manager charts documentation and process flow to help assure the lab of continued accreditation under the American Association of Veterinary Laboratory Diagnosticians, Inc.

***Tests at Veterinary Diagnostic Laboratory***

Among the tests run at the Veterinary Diagnostic Laboratory are those performed for a public health purpose as well as those requested by veterinarians, agencies protecting the health of animals and wildlife, and livestock producers. Some tests involve biopsies and necropsies. Others involve microbiological and molecular analysis that require expensive microscopes, refractometers, incubators, and even a lowly blender.

Among tests that can be done daily are the following:

- rabies;
- post-mortem pathologies;
- CBC (complete blood count) panels and clinical chemistries;
- bacteriological tests ranging from *Campylobacter* cultures to *Chlamydia* stains and *Clostridium*, *Cryptosporidium*, *Giardia*, and Tricomonas tests;
- certain kinds of *Brucella abortus*; and
- immunoglobulin levels for horses or cattle.

Unless a widespread outbreak occurs, testing for West Nile virus between June and October is done on Mondays and Wednesdays, while bluetongue tests are on Wednesdays, and avian influenza testing is Monday through Thursday. These are examples of the 29 serology tests done at the lab.

***Costs of Testing and Other Funding for Veterinary Diagnostic Laboratory***
The laboratory charges for testing and has established a minimum fee of $8. The most expensive individual test at $210 is milk testing for chlorinated hydrocarbon pesticides. The fees posted on the lab's website http://liv.mt.gov/content/lab/forms/FeeSchedule indicate they went into effect in October 2013. The lab must go through the Board of Livestock to revise animal health fees by rule. Some tests are done by referral only, particularly those that typically come through a veterinarian.

> ***Stakeholder views on testing:***
> The Montana Veterinary Medical Association is conducting a survey to see how many of its members use the Veterinary Diagnostic Laboratory routinely and within the last year. Some results may be available for the July Economic Affairs Committee meeting. Christian Mackay noted during the stakeholders' discussion that the tests involving small animals tend to be a profit-leader for the Veterinary Diagnostic Laboratory while the Board of Livestock has considered brucellosis testing to be important enough that subsidies are made available either from the general fund or per capita fees.

As indicated in Table 2, about 15% of the Veterinary Diagnostic Laboratory's funding now comes from a general fund appropriation in House Bill 2, which provides $579,108 to the laboratory's roughly $4 million biennial budget. Notes in the 2015 Biennium Fiscal Report say that state special revenue declined as general fund increased to fully fund some brucellosis surveillance efforts. That general fund money was one-time only (OTO). The remaining legislatively authorized funding comes from per capita fees and animal health fees, which go into the state special revenue account.

**Table 2: Veterinary Diagnostic Lab Funding, FY 2014**

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| Veterinary Diagnostic Lab Total Funding, FY 2014 | $1,954,500 |
| General Fund | $289,824 |
| State Special Revenue | $1,664,676 |

Under 81-23-202, MCA, a portion of assessments on milk produced or distributed in Montana is to go for the "milk diagnostic laboratory functions of the department". Neither statute nor rule specifies what proportion, but the Department has indicated that about 30% goes to the Veterinary Diagnostic Laboratory, or $118,923 in 2013. That amount is included in the $1.66 million in state special revenue.

Not showing in the FY 2015 Biennium Fiscal Report is money provided by the federal government in the form of various grants, including funding for a Quality Management position that has helped continue the lab's accreditation from the American Association of Veterinary Laboratory Diagnosticians, Inc.

***Costs of Testing Elsewhere and Lab Scope/Quality***

One proposal has been that the Veterinary Diagnostic Laboratory be dissolved and that ranchers and veterinarians send tests out of state or to private laboratories. Although many veterinarians run in-house testing on small animals, the situation is different for large animal testing. A letter from one of the veterinarians involved in the accreditation review of the Montana Veterinary Diagnostic Laboratory during the years of the 2009-2010 SJR 14 study indicated that private labs may not be satisfactory, especially for issues related to brucellosis testing. Dr. Barbara Powers, director of the Colorado State University Diagnostic Laboratories, made the following points, among others, in a June 8, 2010, email that was included as Appendix K of the SJR 14 report:

- ***Regarding lack of profit***: "...private labs in general do not do large animal testing as there is no profit in it". She noted that some private labs may do testing if they are affiliated with feedlots or dairies but that the unpredictable cattle markets in particular mean a steady income flow is not guaranteed.

- ***Regarding federal subsidies:*** "The government (USDA) will subsidize regulatory testing like Brucellosis, Tuberculosis, etc. but the government will NOT delegate this type of work to private labs, only AAVLD accredited labs. ... [Y]ou have a large Brucellosis program there that could NOT be sent to private labs."

- ***Regarding public health and reliability***: "There is also a large public health component that is very difficult to regulate in private labs; state government labs are much more reliable to collect and transmit data to the appropriate public health officials."

- ***Regarding trade:*** "Your state being on the border with Canada could also affect trade, not to mention the need to be vigilant of introducing any foreign animal diseases." In a June 30, 2014, email Dr. Powers reiterated the importance of a Veterinary Diagnostic Lab for Montana as a border state with Canada.

Another option might be state-run labs elsewhere. Dr. Powers noted that California and Texas charge an out-of-state fee for submissions because in many cases the testing fees for large animals are insufficient to cover costs so the states decline to subsidize out-of-state entities.

Being served in a timely manner also is important for many tests. In addition, quality of lab tests usually relies on an indication of whether the lab is accredited by such organizations as the American Association of Veterinary Laboratories Diagnosticians, Inc. or other accreditation entities.

Table 3 provides information on regional veterinary diagnostic laboratories. Questions sent out to some of the labs are listed below with their answers either through email or their website information. Various tests seem to be defined differently so not all information is comparable.

**Table 3: Regional Veterinary Diagnostic Laboratories** (no response from S. Dakota)

| | ID | WY | CO | ND | SD | WA |
|---|---|---|---|---|---|---|
| State-run lab affiliated with college | Not affiliated | Yes | Yes | Yes | Yes | Yes |
| Accredited | No | Yes, AAVDL | Yes, AAVDL | Yes, AAVDL | Yes, AAVDL | Yes, AAVDL |
| Charges more to out-of-state submissions | | Only one test | No | Yes 20% surcharge | | Yes - 50% surcharge |
| Funding | Gen'l fund, Client fees | Gen'l fund, Client fees | $7 million - University pays faculty salaries. Lab pays other salaries, supplies, etc. Lab pays $239,000 a yr for facilities. | Gen'l fund, federal grants and client fees | | State through WSU 35-40%, Rest is fee, grants, contract |
| Sample Fees, Tests*<br>Necropsy<br>Necropsy 500+lb. horse<br>Surgical pathology<br>Johne's disease (referred)<br>Rabies (FA, in-state)<br>Coggins -EIA (ELISA)<br>Blue-tongue serology<br>West Nile Virus | | $150<br>$ 80<br>$35 for 3 slides<br>$35<br>no chrg<br>$9 | Increasing 5% July 1<br>$175<br>$255<br>$49<br>$5.50-ELISA<br>$65<br>$13 ELISA<br>$32 PCR<br>$15 serology | $60-all tests same, incl. tests<br>$30 /1 site<br>$50 PCR pooled<br>$45 alone.<br>$40<br>$6<br>in-state $0<br>$50 nonND<br>$25 serology | | $31.50 instate<br>varies $15.80 + ~ $40<br>don't do<br>$9.50 instate<br>$36.80<br>$36.80 |
| What tests are typically sent out of state? Where? | Caseous Lympha-denitis serology to UC Davis. Leishmania to Texas | EPM - equine parasite test - sent to KY priv. lab. Caseous Lymphade nitis to TX | Toxicology to TX or MI | a few non-beef toxicology - varies; serum neutralizing titres - TX | | Multiple to multiple different labs |

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| Significant use by Montanans? (either routine use or more than $1,000/year) | No | Not known | Yes - some sm. animal biopsies & chronic wasting | Yes - (Eastern MT) routine from vets & $1000+ | | Yes, for some tests. Routine & $1000 |

*Unless otherwise stated the fees are for in-state services. Any surcharge would be added to that fee.

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