



EXAMINATION

Department of Livestock
Expenses Directly
Incurred Through
the Collection of Beef
Check-Off Fees

For the Contract Term July 1, 2011 to
September 30, 2012

NOVEMBER 2012

LEGISLATIVE AUDIT
DIVISION

12SP-35

EXAMINATION

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Examinations are conducted by the Legislative Audit Division to provide a high-level of assurance on a subject matter, or assertion about a subject matter, that is the responsibility of another party. In performing the examination work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Those standards require that we plan and perform the examination to obtain sufficient evidence to provide a reasonable basis for the conclusion expressed in the examination report.

The results of this examination, contained in this report, are intended for the sole use of the Montana Legislature, Department of Livestock, and Montana Beef Council. These parties can be presumed to have an adequate understanding of the criteria used by audit staff in performing the examination. The report, however, is a public document and its distribution is not limited.

The examination was performed in order to fulfill the Legislative Audit Division's statutory responsibility under §81-8-901, MCA. It was conducted by Financial-compliance audit staff members. Financial-compliance audit staff hold degrees with an emphasis in accounting, and most hold Certified Public Accountant (CPA) certificates.

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November 2012

The Legislative Audit Committee
of the Montana State Legislature:

This is the report for our examination of the direct costs incurred by the Montana Department of Livestock (Department) through the collection of Beef Check-Off fees, for the contract period of July 1, 2011, to September 30, 2012. This report provides information about the Beef Check-Off program and the Department's collection activities related to the program.

We thank the Montana Department of Livestock Executive Officer, Department staff, and Montana Beef Council staff for their cooperation and assistance throughout the examination. The Department's response to the report is at page B-1.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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APPOINTED AND ADMINISTRATIVE OFFICIALS

| | | <u>Location</u> | <u>Industry</u> | <u>Term Expires</u> |
|---------------------------|---------------------------|-----------------|-----------------|---------------------|
| Board of Livestock | Jan French, Chair | Hobson | Cattle | 2015 |
| | Linda Nielson, Vice Chair | Nashua | Cattle | 2017 |
| | Stan Boone | Ingomar | Cattle | 2013 |
| | Brett DeBruycker | Dutton | Cattle | 2015 |
| | Ed Waldner | Chester | Swine | 2017 |
| | Jeffrey Lewis | Corvallis | Dairy | 2017 |
| | John H. Lehfeldt | Lavina | Sheep | 2013 |

Department of Livestock Christian Mackay, Executive Officer
 John Grainger, Administrator, Brands Enforcement Division
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For additional information concerning the Department of Livestock, contact:

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MONTANA LEGISLATIVE AUDIT DIVISION

EXAMINATION

Expenses Directly Incurred by the Department of Livestock Through the Collection of Beef Check-Off Fees

For the Contract Term July 1, 2011, to September 30,
2012

NOVEMBER 2012

12SP-35

REPORT SUMMARY

For the contract period, the Department of Livestock (Department) billed the Montana Beef Council (Council) approximately \$13,000 for costs incurred for the collection of over \$1,000,000 of beef check-off fees.

Context

Section 81-8-901, MCA, requires the Department to contract with the Council for the collection of \$1 per head beef check-off fee. Proceeds of the check-off fees are used to promote the beef industry through research and marketing.

Under state law, the contract between the Department and Council must contain a provision requiring the Council to reimburse the Department for all direct costs incurred in the collection of the check-off fees, not to exceed 5 percent of the total check-off fees collected. These direct costs are required to be verified by the Legislative Auditor.

To address the verification requirement in §81-8-901, MCA, we performed an examination of the expenses directly incurred by the Department through the collection of beef check-off fees.

Results

Our examination found that, for the contract period, the Department billed the Council approximately \$13,000, which did not exceed 5 percent of the total beef check-off fees collected. This \$13,000 includes almost \$4,800 for printed materials. Department management anticipates these materials will be used in the future, and does not expect to incur similar costs on an annual basis.

However, at the time of our review, the Department did not have records available indicating the actual amount of costs directly incurred for postage or personal services associated with the collection of the fee. As a result, we were unable to verify that the Department billed the Council for all direct costs incurred for the collection of beef check-off fees during the contract period.

For a complete copy of the report (12SP-35) or for further information, contact the
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Chapter I – Introduction

Introduction

Chapter 417, Laws of 2011, requires the Legislative Auditor to verify the direct collection costs incurred by the Department of Livestock (Department) through the collection of beef check-off fees. We performed an examination to comply with this verification requirement. The remainder of this chapter presents information on the Beef Check-Off program, the Department's collection and billing activities related to the program, and the results of our examination.

Background

The Federal Beef Promotion and Research Act of 1985 created the Cattlemen's Beef Promotion and Research Board (Board). The Board is responsible for over-seeing the collection of the \$1 per head assessment on all cattle sold within the United States, more commonly referred to as the beef check-off fee. The Montana Beef Council (Council) has been approved by the Board as a qualified state beef Council (QSBC). As the Montana QSBC, the Council is responsible for managing the collection of beef check-off fees.

Federal Beef Promotion and Research regulations stipulate the "collecting person" for collection of the \$1 fee. In Montana:

- ◆ For sales through an auction market, the person or organization paying the producer has the responsibility to collect the beef check-off fee and remit it to the Council.
- ◆ For sales other than those through an auction market, brand inspectors have the responsibility to collect the beef check-off fee, and remit it to the Council. Brand inspectors in Montana are either state inspectors who are employees of the Department or deputy state inspectors who are volunteers subject to oversight by the Department.

Montana law historically required the Department to cooperate and contract with the Council for the collection of the beef check-off fee. To comply with this requirement, the Department and the Council entered into contractual agreements whereby the Department collected check-off fees and remitted them to the Council.

Table 1 summarizes the collection activities for fiscal years 2007-08 through 2010-11.

In fiscal year 2010-11, the Department and Council could not come to an agreement on the amount of cost reimbursement that should be provided to the Department for its collection activities. As a result, livestock inspectors submitted their collections directly to the Council for a portion of the fiscal year. This caused the decrease in collections accounted for by the Department and reported in Table 1 from fiscal year 2009-10 to fiscal year 2010-11.

| Fiscal Year | Check-off Fees Collected |
|-------------|--------------------------|
| 2007 - 08 | \$1.663 million |
| 2008 - 09 | \$1.664 million |
| 2009 - 10 | \$1.680 million |
| 2010 - 11 | \$1.168 million |

Source: Compiled by Legislative Audit Division from Department Accounting Records.

2011 Legislative Changes

Chapter 417, Laws of 2011, amended §81-8-901, MCA, requiring the Department to enter into a contract with the Council for the collection of beef check-off fees. The contract must contain a provision for the Council to pay a fee, not to exceed 5 percent of check-off fees collected, to reimburse the Department for all expenses directly incurred through collection of the fees. The amendments had an effective date of July 1, 2011.

The Department entered into a contract with the Council for the period July 1, 2011, to September 30, 2012. Under the contract, all fees collected by deputy state livestock inspectors are remitted directly to the Council. All fees collected by state livestock inspectors are deposited in treasury-approved state bank accounts by the inspector. These collections are accounted for by the Department in an agency fund, until such time they are remitted to the Council.

Department records show that for the contract period, state livestock inspectors collected approximately \$131,000 of beef check-off fees. The Council estimates that deputy state inspectors collected and remitted approximately \$1,199,000 of fees directly to the Council for the same time period. The Department billed the Council approximately \$13, 000 for costs incurred for these collection activities.

Chapter 417, Laws of 2011, also included a provision, codified in §81-8-901(2)(b), MCA, whereby the Department is not obligated under state law to contract for collection of the beef check-off fee if the direct collection costs incurred by the Department exceed 5 percent of the fees collected. Even though the Department might not be obligated to contract under state law the federal regulations discussed on page 1 would still require the Department's livestock inspectors to collect the beef check-off fee.

Examination Engagement Methodologies

The examination engagement was conducted under the Statements on Standards for Attestation Engagements (SSAEs) issued by the American Institute of Public Accountants. Under the SSAEs, an examination engagement is designed to provide a high level of assurance about an assertion or a subject matter. This engagement was also performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States.

The overall objective of our work was to examine the expenditures directly incurred by the Department through collection of beef check-off fees for the contract term July 1, 2011, to September 30, 2012.

To accomplish this objective, we performed work to determine whether the: 1) Department complied with the provisions of the contract entered into between the Department and the Council; 2) amounts billed by the Department were for valid expenditures incurred for the collection of beef check-off fees; 3) Department billed the Council for all direct costs actually incurred through the collection of beef check-off fees; and 4) Department complied with §81-8-901, MCA.

We used the following methodologies in completing the examination:

- ◆ Reviewed applicable federal regulations and state laws;
- ◆ Obtained and reviewed the contract entered into by the Department and Council for the collection of beef check-off fees for the examination period;
- ◆ Interviewed Department personnel regarding beef check-off collection activities;
- ◆ Gained an understanding of Department processes and procedures associated with the collection of beef check-off fees and tracking of the related direct costs incurred;
- ◆ Reviewed Department documentation of amounts billed to the Council; and
- ◆ Interviewed Council personnel regarding beef check-off collection activities.

Examination Results

Using the methodologies outlined above, we verified that the Department did not bill the Council in excess of 5 percent of total beef check-off fees collected. However, due to insufficient information being available for our review, we were not able to verify the Department billed the Council for all costs directly incurred for collection of the check-off fees during the contract period. The following paragraphs provide further information on the results of our examination.

Based on our work, we determined that:

- ◆ The contract between the Department and the Council did not explicitly contain a provision that the Council pay a fee not to exceed 5 percent of the total check-off funds collected to reimburse the Department for all expenses directly incurred through the collection of the check-off, as required by §81-8-901(2)(a), MCA. Instead, the contract contained a schedule of expenses intended to be sufficient to reimburse the Department for all direct costs related to collection activities.
- ◆ The Department did not comply with provisions of the contract. The contract stipulated costs in the schedule of expenses were to be billed as incurred by the Department. Instead, the Department billed the Council monthly at a flat rate of 5 percent of the collections made by state livestock inspectors. In September 2012, the Department compared the total amount billed at 5 percent to the amount that should have been billed, per the schedule of expenses. The Department then sent a final invoice to the Council for the difference.
- ◆ The Department overbilled the Council by approximately \$285, as a result of continuing to bill at 5 percent of state inspector collections after the final invoice had been sent. Department management indicated a refund will be issued for this amount.
- ◆ In the final invoice, the Department over-billed by approximately \$200 for rent. The Department did not pass on cost savings from a rent holiday given the Department by the Department of Administration.
- ◆ The amounts billed for printing and payment compliance were reasonable in relation to the direct costs actually incurred for those items.
- ◆ The Department did not track the actual postage costs incurred related to the collection activities. Department management believes it will not be cost effective to track postage costs.
- ◆ The Department had accounting staff manually track the time they spent on beef check-off collection activities during the contract term. However, the Department did not compile the results or analyze the personal services costs incurred for this time. At the time of our examination, the Department had not quantified the direct costs incurred.
- ◆ The total amount billed by the Department over the contract term, approximately \$13,000, did not exceed 5 percent of the total check-off fees collected. This \$13,000 includes almost \$4,800 for printed materials. Department management anticipates the materials will be used in the future, and does not expect to incur similar costs on an annual basis.

Because the Department did not have records available at the time of our review indicating the actual amount of postage and personal services incurred during the contract period, we were unable to confirm the direct costs actually incurred for these items. As such, the Independent Accountant's Report found on page A-1 disclaims an opinion on whether the direct costs incurred by the Department through the collection of beef check-off fees exceeded 5 percent of the total fees collected.

Communication of Deficiencies in Internal Control and Violation of Contract Agreements

In accordance with Government Auditing Standards, we are required to report deficiencies in internal control that are considered to be significant or material to the subject matter. These standards also require us to report violations of provisions of contract agreements that could have a material effect on the direct costs incurred by the Department for the collection of beef check-off fees.

Deficiencies in Internal Control

A deficiency in internal control exists when the design or operation of a control does not allow management or employees to prevent or detect and correct misstatements of the subject matter. A material weakness is one or more deficiencies in internal control, such that there is more than a remote likelihood that a material misstatement of the subject matter will not be prevented or detected. A significant deficiency is one or more deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. The results of the examination, outlined on pages 3 and 4, indicate a significant deficiency in internal control exists over the determination and billing of direct costs associated with beef check-off collection activities.

Violation of Provisions of Contract Agreements

As outlined on pages 3 and 4, the Department did not comply with expense reimbursement provisions established in the contract between the Department and the Beef Council. We believe that the noncompliance has a material effect on the subject matter.

Examination Summary

As noted on page 4, we were unable to confirm the direct costs actually incurred by the Department for the collection of check-off fees. As such, we did not issue an opinion as to whether or not the direct costs incurred by the Department exceed 5 percent of the total fees collected during the contract term. However, if the Department and Council continue to use the collection procedures in place during the contract period covered in this examination, the likelihood of direct collection costs exceeding 5 percent of total check-off fees collected is minimal.

Prior to the 2011 legislative changes, both deputy and state livestock inspectors remitted all of their beef check-off collections to the Department. Currently, only state livestock inspectors remit their collections to the Department; deputy state inspectors remit their collections directly to the Council. For the current contract period, state

inspectors remitted, and the Department accounted for, approximately \$131,000 of the total \$1,330,000 fees collected. As these numbers indicate, the Department's accounting staff are currently responsible for processing significantly fewer collection fees than in prior years, which reduces the personal services costs incurred by the Department for collection activities. Because the Department is incurring direct costs on only a small portion of the total fees collected, it is unlikely that direct costs would exceed 5 percent of total collections made.

The results of the examination work will be referred to the next financial-compliance audit of the Department. The Department's response to this report can be found on page B-1.

Independent Accountant's Report

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Angus Maciver

INDEPENDENT ACCOUNTANT'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We were engaged to examine the expenses directly incurred by the Department of Livestock through the collection of beef check-off fees for the contract term of July 1, 2011, to September 30, 2012. Department management is responsible for the accuracy and completeness of beef check-off collections and the related direct costs incurred for those collections.

The Department did not have records available indicating the actual amount of costs directly incurred for postage or personal services associated with the collection of beef check-off fees. As such, we were not able to confirm the direct costs incurred for these items. We believe these items to be pervasive to the subject matter of expenses directly incurred by the Department through the collection of beef check-off fees.

Because of the restriction on the scope of our examination discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether the expenses directly incurred by the Department of Livestock through the collection of beef check-off fees for the contract term of July 1, 2011, to September 30, 2012, exceeded 5 percent of the total beef check-off fees collected during that same time period.

This report is intended solely for the information and use of the Montana Legislature, the Montana Department of Livestock, and the Montana Beef Council, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor

October 16, 2012

DEPARTMENT OF
LIVESTOCK

DEPARTMENT RESPONSE

STATE OF MONTANA

BRIAN SCHWEITZER, GOVERNOR

DEPARTMENT OF LIVESTOCK
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LEGISLATIVE AUDIT DIV.

November 7, 2012

Tori Hunthausen
Legislative Auditor
Room 160, State Capitol
PO Box 201705
Helena, MT 59620

Dear Ms. Hunthausen,

On behalf of the Board of Livestock, I submit the following responses to your audit determinations for expenses directly incurred through collection of beef check-off fees.

I believe this verification to be unnecessary. 81-8-901 MCA 2(b) states: "The department is not obligated under this section or any other state law to contract for collection of the fee if the department's direct collection costs as verified by the legislative auditor exceed 5% of the check-off funds collected." At no time did the Department or the Montana Beef Council claim expenses to be in excess of 5%, thus a separate examination was not necessary. I would hope that in the future, our contract with the Montana Beef Council could be taken up during our regular financial audit. Nevertheless, I appreciate the opportunity to respond to this examination.

With regard to the determinations on page 4:

The Department did comply with the contract and bill the Montana Beef Council for all printing costs incurred. MBC responded that they would only pay for printed materials as they were used. Additionally, the Department incurred expenses in accounting and rent each month. Rather than bill for incurred expenses which were already agreed to by contract, 5% of monthly receipts were held as per past practice. However, in the current agreement, the Department and MBC have come to agreement for an annual bill for all expenses.

\$285 has been refunded to MBC.

This is the first year of collection under the new method mandated by the Legislature. Both the Department of Livestock and Montana Beef Council are looking for ways to cut expenses and give the producer the most return for their check-off dollar. To that end, we have mutually agreed to make innovations during the current agreement. I anticipate that future expenses for the Department to be much less.

Sincerely,

A handwritten signature in black ink, appearing to read "Christian Mackay", is written over a horizontal line.

Christian Mackay, Executive Officer
Montana Board of Livestock