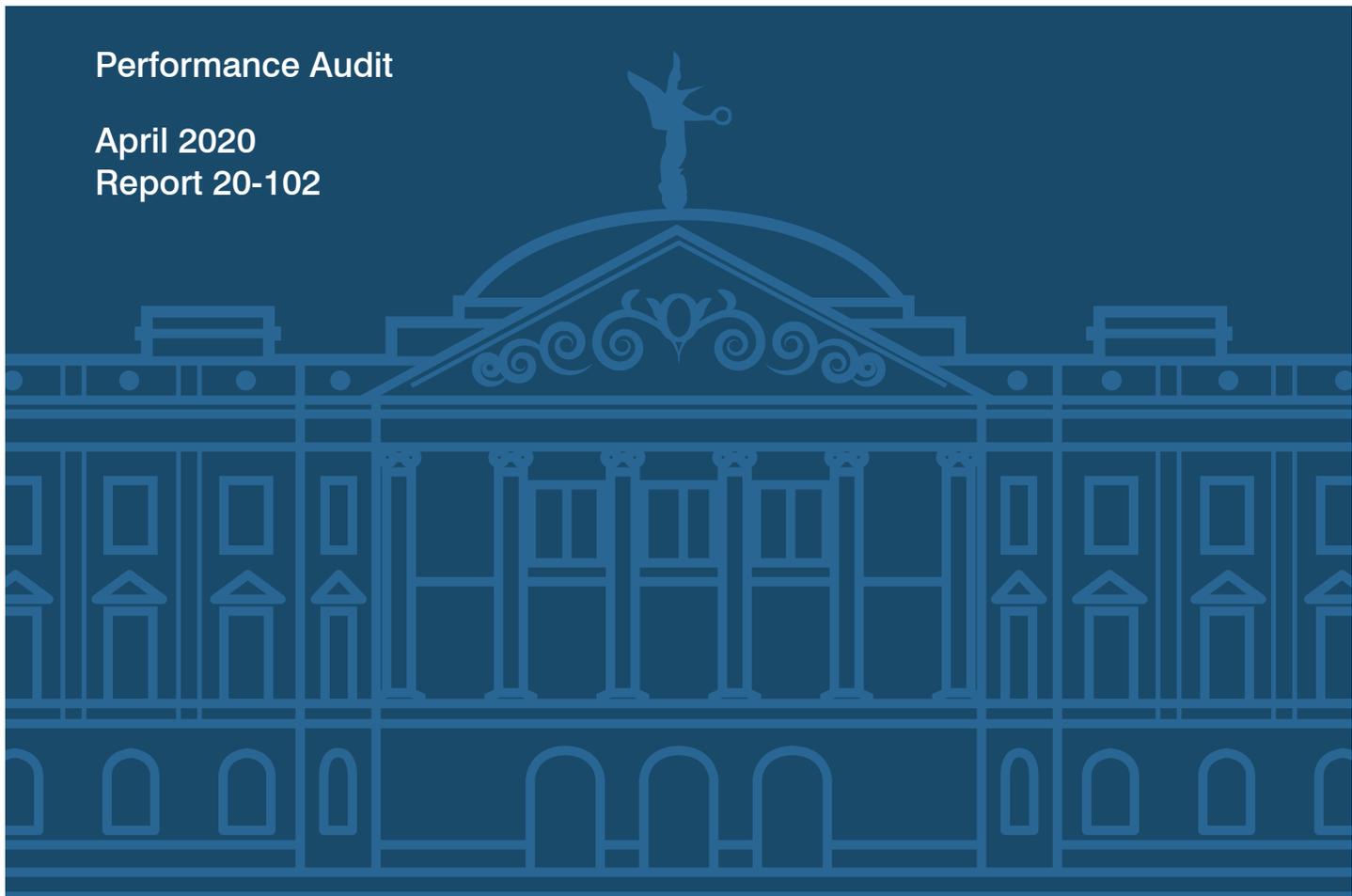


Arizona Department of Agriculture State Agricultural Laboratory

Department does not track the Lab's testing costs, limiting its ability to appropriately allocate costs to the Lab's funding sources, but adhered to State requirements in relocating the Lab

Performance Audit

April 2020
Report 20-102



A Report to the Arizona Legislature

Lindsey A. Perry
Auditor General





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April 10, 2020

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Mr. Mark Killian, Director
Arizona Department of Agriculture

Transmitted herewith is the Auditor General's report, *A Performance Audit of the Arizona Department of Agriculture—State Agricultural Laboratory*. This report is in response to a September 14, 2016, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights to provide a quick summary for your convenience.

As outlined in its response, the Arizona Department of Agriculture agrees with the finding and will implement or implement in a different manner all the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Lindsey Perry, CPA, CFE
Auditor General

Arizona Department of Agriculture State Agricultural Laboratory

Department does not track the Lab's testing costs, limiting its ability to appropriately allocate costs to the Lab's funding sources, but adhered to State requirements in relocating the Lab

Audit purpose

To determine whether the Lab tracked its testing costs and how these costs are allocated to various funding sources, and whether the Department met State requirements when relocating the Lab to a privately owned facility in the City of Chandler.

Key findings

- The Department does not track all of the costs associated with each of the Lab's various testing services and, as a result, does not have the information needed to ensure Lab costs are appropriately allocated to its various funding sources.
- Without this cost information, the Department cannot determine whether monies from the various sources of funding the Lab receives fully covers the cost of the associated tests. In addition, it cannot determine the extent to which some of the Lab's funding sources, such as the State General Fund, may be subsidizing testing costs.
- Further, the Department cannot ensure that the fees it charges, such as those paid by tribal nations and seed manufacturers, are appropriate and cover the associated testing costs.
- The Department's relocation of its Lab adhered to State requirements for such a process.
- The Lab's relocation cost of approximately \$642,000 was paid from various funds associated with the Department's regulatory responsibilities, including Lab testing responsibilities.

Key recommendations

The Department should:

- Develop a formal process for tracking all costs associated with Lab testing services, including direct and indirect costs, ensuring its testing services are as efficient as possible, and comparing the cost of its Lab testing services with its various funding sources, including fees, to accurately determine the extent to which these funding sources and fees cover the costs of the associated testing services.
- Determine who benefits from Lab testing services, such as the public or a specific industry.
- Work with other Department divisions, the Legislature, and industry stakeholders to determine if the Lab's funding structure should be changed, including changes to its fees, and take appropriate action based on these determinations.



TABLE OF CONTENTS

Introduction	1
Finding 1: Department does not track costs of specific Lab services, limiting its ability to appropriately allocate costs and set fees	6
Lab operations funded from various sources	
Department does not track specific Lab testing costs and therefore cannot use this information to appropriately allocate these costs to the Lab's various funding sources, some of which are restricted	
Best practices recommend formal process for tracking costs	
Recommendations	
Legislative Inquiry: Department's Lab relocation adhered to State requirements	10
Department worked with Arizona Department of Administration and State's contracted real estate broker to relocate Lab	
Department used nonappropriated funds to cover cost of relocation	
State General Fund monies are used to cover additional ongoing rent costs	
Appendix A: Objectives, scope, and methodology	a-1
Department response	
Figures	
1 Lab funding by source Fiscal year 2018	7
2 Lab relocation timeline	11
Tables	
1 Number of tests the Lab performed Fiscal year 2018 (Unaudited)	2
2 Schedule of Lab revenues and expenditures Fiscal years 2017 through 2020 (Unaudited)	4
3 Seven Lab employees' activities, hours, and wage information July 1, 2019 through October 1, 2019	8
4 Department trust fund balances, revenues, and expenditures used for Lab relocation Fiscal year 2019	13



The Office of the Auditor General has released the first in a series of 3 performance audits of the Arizona Department of Agriculture (Department). This performance audit report focuses on the Department's State Agricultural Laboratory (Lab). The second report will focus on the Department's processes for fulfilling its regulatory responsibilities, including issuing licenses and conducting inspections. The final report will provide responses to the statutory sunset factors. For this audit on the Lab, we reviewed the Department's processes for (1) tracking Lab costs and allocating these costs to various funding sources, and (2) relocating the Lab from its previous State-owned buildings to a privately owned facility in the City of Chandler in June 2019.

Lab mission and responsibilities

The Lab's mission is to help the Department and other regulatory agencies to protect consumers and natural resources by providing quality laboratory services. Specifically, the Lab's various responsibilities include:

- **Performing tests to support the Department's regulatory functions**—The Lab performs food safety, dairy, animal feed, pesticide, fertilizer, seed, and groundwater tests to assist the Department with its regulatory responsibilities. For example, the Lab tests fertilizer products to ensure they comply with labeling requirements and samples of dairy products to ensure they do not contain harmful bacteria (see textbox). The Lab performed more than 10,000 regulatory tests in fiscal year 2018 (see Table 1, page 2).¹ As of September 2019, the Lab began testing industrial hemp products in accordance with Arizona Revised Statutes (A.R.S.) §3-316(B) and Arizona Administrative Code (AAC) R3-4-1008(C) to test for hemp crop tetrahydrocannabinol (THC) concentration levels. During the first half of fiscal year 2020, the Lab reported performing 271 industrial hemp tests.
- **Performing various tests for other government and private entities**—Although uncommon, the Lab also provides some testing services for other State agencies and external entities for a fee.² For example, the Department reported that the Lab performed 10 pesticide tests for the Gila River Indian Community in fiscal year 2018. According to the Department, the Lab may also perform tests for other State agencies; however, it has not been requested to do so in the past 3 fiscal years. Further, according to the Department, the Lab performed 2 seed tests for seed manufacturers in fiscal year 2018 to provide a State-certified result to facilitate the shipment of seeds out of Arizona.
- **Working with federal agencies to address agricultural concerns**—The Lab also works with federal agencies to identify and resolve major agricultural emergencies, as needed. For example, the Lab has

Lab testing

The Lab conducts a variety of tests. Some of these tests detect harmful pests and insects or bacterial contamination in meat and dairy products. Other tests identify animal diseases; determine the quality of commercial seeds; analyze samples from investigations of alleged chemical misuse or from allegations of product adulteration; and compare fertilizer, feed, and pesticide contents to their labels.

Source: Auditor General staff review of information from the Department's website.

¹ Because the Department reported that the Lab's relocation impacted the number of tests it performed in fiscal year 2019, we used fiscal year 2018 testing numbers to more accurately represent the Lab's workload (see Legislative Inquiry, pages 10 through 14, for more information about the Lab's relocation).

² We were unable to determine whether these fees are appropriate because, as discussed in Finding 1, pages 6 through 9, the Department does not track costs of specific Lab services, limiting its ability to appropriately allocate these costs and set fees.

Table 1
Number of tests the Lab performed
Fiscal year 2018
(Unaudited)

Type of testing service	Number of tests performed	Percentage of tests performed
Dairy	8,620	84.5%
Meat/food safety	493	4.8
Fertilizer	299	2.9
Pesticide ¹	256	2.5
Feed	229	2.2
Seed	194	1.9
Groundwater	48	0.5
Aflatoxin	40	0.4
Animal disease	24	0.2
Total	10,203	100.0%

¹ According to the Department, pesticide testing includes formulation and residue tests on agricultural, structural, and any other pesticide products registered for use in Arizona.

Source: Auditor General staff summary of fiscal year 2018 testing data provided by the Department.

worked with the United States Department of Agriculture (USDA) on several initiatives to identify and eradicate pink bollworm and brucellosis by testing agricultural products.^{3,4} The Lab has also responded to several significant agricultural incidents, including the discovery of a destructive wheat fungus called Karnal bunt in 1996, and worked to prevent the spread of red imported fire ants since 1999.^{5,6,7} The Lab also participates in a cooperative program with the USDA to test products for foodborne pathogens. Further, the Lab is a member of the Food Emergency Response Network, a network of state and federal laboratories committed to testing food samples if a foodborne pathogen outbreak occurs.

- **Approving and certifying other laboratories in Arizona**—In addition to testing services, the Lab also approves dairy laboratories in Arizona as authorized by the U.S. Food and Drug Administration (FDA) to test dairy products for antibiotic residues. In accordance with the Grade “A” Pasteurized Milk Ordinance standards and FDA requirements, all state dairy laboratories are required to receive biennial onsite evaluations and annual proficiency testing by a certified Laboratory Evaluation Officer (LEO) in order to receive and maintain “approved” accreditation status. To help fulfill this requirement, the FDA certifies state government laboratory employees, such as those at the Lab, to act as LEOs on behalf of the FDA for the laboratory approval process. As of November 2019, there were 22 approved laboratories in Arizona.

Statute requires the Lab to annually certify other laboratories in Arizona that provide regulatory agricultural testing services, such as testing for aflatoxin in cottonseed products.⁸ As of November 2019, the Lab had certified 6 laboratories in Arizona to provide agricultural testing services.

³ Pink bollworm is a destructive pest that targets cotton plants.

⁴ Brucellosis is an infectious bacterial disease that affects animals like cattle, goats, dogs, and pigs. The disease is transferable to humans and can cause a fever, chills, and a severe headache in humans.

⁵ As a result of the wheat fungus discovery, the Governor of Arizona declared an emergency, and the USDA quarantined wheat from Arizona. During this emergency, the Lab operated 24 hours a day, 7 days a week to process wheat samples. The quarantine was lifted in 1997.

⁶ The USDA has identified red imported fire ants as a threat to agricultural products, humans, young animals, and agricultural equipment.

⁷ In January 2020, the Department reported it was no longer receiving any federal funding for these activities.

⁸ A.R.S. §3-145.

Lab is subject to external oversight to ensure testing accuracy

The Lab receives external oversight to ensure the accuracy for some of its testing. For example, the FDA certifies the Lab to test all dairy products produced in Arizona and performs an on-site audit of the Lab every 3 years to ensure the quality of dairy microbiology tests and analysis and requires Lab staff to complete annual proficiency tests. The FDA conducted its most recent certification review and proficiency testing of the Lab and its staff in the fall of 2019. According to the Department, the Lab and its staff passed all certification requirements and proficiency tests.⁹ In addition to the on-site audit, the FDA also requires the Lab to participate in annual proficiency testing. Further, the Department reported that the Lab submits 1-3 meat samples that have tested positive for pathogens to the USDA for species analysis. The Department also reported that the Lab undergoes similar proficiency testing for its other testing areas.

Staffing and budget

As of January 2020, the Department reported that the Lab had 12 filled Full Time Equivalent (FTE) positions, including a director, 4 lab managers, and 7 scientists.¹⁰

Table 2 (see page 4) provides information on the Lab's revenues and expenditures. Although the Lab receives funding from several sources, the majority of its funding consists of State General Fund appropriations. On average, State General Fund appropriations totaled nearly \$942,000 annually for fiscal years 2017 through 2019, and in fiscal year 2020, are estimated to increase to more than \$1.2 million to pay for increased rent costs (see Table 2, footnote 8, page 5 for additional information). The Lab also receives funding from the Department's Donations/Designated Fund (Miscellaneous Fund), which includes any fee revenues the Lab collects and federal grant monies transferred to the Lab.¹¹ Finally, the Lab receives funding from 4 nonappropriated trust funds consisting of licensing and inspections fees collected by the Department's regulatory divisions and deposited in the nonappropriated trust funds associated with each division (see Finding 1, pages 6 through 9, for more information on Lab funding).

Between fiscal years 2018 and 2019, the Lab's expenditures increased from nearly \$1.2 million to nearly \$1.9 million. This increase can be partly attributed to the Lab's relocation in 2019 to a privately owned facility in the City of Chandler, where it occupies nearly 16,000 square feet of leased space in a large tech center (see Legislative Inquiry, pages 10 through 14, for more information on the Lab's relocation). Estimated expenditures are expected to total more than \$1.5 million in fiscal year 2020.

⁹ As of February 2020, Department officials reported that the FDA had not finalized its certification review or proficiency testing reports.

¹⁰ The Department reported that all 12 Lab staff perform some testing.

¹¹ In addition to the funding received by the Lab, the Miscellaneous Fund includes monies from various fee, grant, and contribution-supported programs, such as inspection fees collected from the Arizona Beef Council, and monies collected from the University of Arizona (UArizona) for the collection of pesticide-use data. Monies collected from the Arizona Beef Council or UArizona are not used to help fund the Lab.

Table 2
Schedule of Lab revenues and expenditures
Fiscal years 2017 through 2020
(Unaudited)

	2017 (Actual)	2018 (Actual)	2019 (Actual)	2020 (Estimate)
Revenues				
State General Fund appropriations	\$949,285	\$932,450	\$944,106	\$1,226,158
Trust Funds ¹				
Fertilizer Materials ²	103,925	108,690	233,639	114,521
Pesticide ²	21,908	21,815	143,029	26,647
Commercial Feed ²	21,703	21,705	142,861	26,447
Seed Law ³	36,099	37,048	156,559	41,340
Pest Management ⁴			120,008	4,747
Total trust fund revenues	183,635	189,258	796,096	213,702
Miscellaneous Fund ⁵	22,033	60,602	137,987	120,000
Laboratory certification fees ⁶	600	600	500	1,900
Total gross revenues	1,155,553	1,182,910	1,878,689	1,561,760
Remittances to the State General Fund ⁶	(600)	(600)	(500)	(1,900)
Total net revenues	\$1,154,953	\$1,182,310	\$1,878,189	\$1,559,860
Expenditures and transfers				
Payroll and related benefits	\$762,895	\$808,367	\$798,005	\$870,750
Professional and outside services	7,367	19,440	31,089	4,000
Travel	5,547	5,586	10,501	11,000
Other operating ⁷	345,978	318,961	357,470	650,375
Furniture, equipment, and software	33,166	29,956	62,724	
Relocation costs ⁸			618,400	23,735
Total expenditures	\$1,154,953	\$1,182,310	\$1,878,189	\$1,559,860

¹ Trust Fund revenues amounts were the portions of these fund's revenues that the Department used to pay for Lab expenditures. For example, in fiscal year 2018, revenues deposited to these funds included (see footnote 4 for information on the Pest Management Trust Fund revenues used to pay for Lab expenditures) :

- a. \$503,767 in the Fertilizer Materials Trust Fund of which \$108,690 was used to pay for Lab expenditures.
- b. \$447,241 in the Pesticide Trust Fund of which \$21,815 was used to pay for Lab expenditures.
- c. \$363,152 in the Commercial Feed Trust Fund of which \$21,705 was used to pay for Lab expenditures
- d. \$56,313 in the Seed Law Trust Fund, of which the Department reported \$37,048 was used to pay for Lab expenditures.

² Revenues in the Fertilizer Materials, Pesticide, and Commercial Feed Trust Funds used for Lab expenditures largely consisted of licensing, inspection, and registration fees.

³ According to the Department, it used the Seed Law Trust Fund to pay for one half of a Lab employee and a portion of the relocation costs; Revenues in the fund used to pay for these expenditures were from seed dealer and labeler licensing fees.

⁴ According to the Department, it used Pest Management Trust Fund revenues to pay for Lab relocation expenditures in fiscal years 2019 and 2020. Revenues in the fund used for these expenditures were from fees for licensing of professional pest control companies and applicators for structural pesticides. For fiscal year 2019, revenues deposited to this fund included \$1,566,025, of which \$120,008 was used to pay for Lab relocation costs.

⁵ Miscellaneous Fund revenues were the portion of the fund revenues used to pay for Lab expenditures. According to the Department, revenues in the fund designated to the Lab were from laboratory services provided to grant-funded programs and others. For fiscal year 2018, total Department revenues deposited into this fund included \$610,101, of which \$60,602 was used to pay for Lab expenditures.

⁶ Lab certification fees comprised a \$200 laboratory certification fee and \$100 recertification fee the Department collected from the 6 labs certified by the Department to provide agricultural testing services. These fees are remitted to the State General Fund.

Table 2 continued

- ⁷ Other operating expenditures include rent, supplies, software support and maintenance, and repair and maintenance costs. In addition, fiscal year 2020 other operating expenditures include an increase of \$279,800 for increased rent costs because of the Lab's relocation from a State-owned building to a privately leased building in fiscal year 2019 (see Legislative Inquiry, pages 10 through 14, for more information).
- ⁸ Relocation costs are the amounts from the Fertilizer Materials Trust Fund, Pesticide Trust Fund, Commercial Feed Trust Fund, Seed Law Trust Fund, and Pest Management Trust Fund spent for relocating the Lab in fiscal year 2019. Specifically, \$500,000 was paid to the lessor for tenant improvement costs and the remaining costs were for other moving costs such as purchasing and installing furniture and equipment (see Legislative Inquiry, pages 10 through 14, for more information).

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2017 through 2019, and Department-provided information for fiscal years 2017 through 2020.



Department does not track costs of specific Lab services, limiting its ability to appropriately allocate costs and set fees

Lab operations funded from various sources

The Lab's operations are funded from various sources. Most of the Lab's funding, nearly 80 percent in fiscal year 2018, came from the State General Fund (see Figure 1, page 7).¹² The Lab also receives funding from multiple nonappropriated trust funds consisting of licensing and inspections fees collected by the Department. Specifically, the Lab receives funding allocations from the 4 nonappropriated trust funds associated with some of the Department's regulatory programs that utilize the Lab's testing services. For example, the Department collects inspection fees to inspect commercial fertilizer products and deposits them in the Fertilizer Materials Trust Fund. A portion of monies from this fund are then used to help fund the Lab. According to statute, these funds can only be used for the purpose of implementing, continuing, and supporting its respective program.¹³ These nonappropriated trust funds accounted for approximately 16 percent of the Lab's fiscal year 2018 funding.

Additionally, the Department receives some federal grant monies that are deposited into the Department's Miscellaneous Fund that it uses to help fund the Lab. For example, the Department reported it receives federal grant monies from the Environmental Protection Agency (EPA) for groundwater testing to help detect harmful pesticides and chemicals in groundwater. Because the Lab performs these tests, the Department uses a portion of these federal grant monies to help fund the Lab's operations. In State fiscal year 2018, the Lab received \$20,412 in funding from the EPA for this purpose and performed 16 separate analyses of groundwater.¹⁴ Similarly, according to the Department, the Lab receives funding from the USDA for meat testing as part of the Department's Meat and Poultry Inspection Program. The Meat and Poultry Inspection Program is funded through State General Fund monies, and according to the Department, the USDA reimburses the Department for about 50 percent of the cost of the program. The Lab received approximately \$12,200 for meat testing in fiscal year 2018.

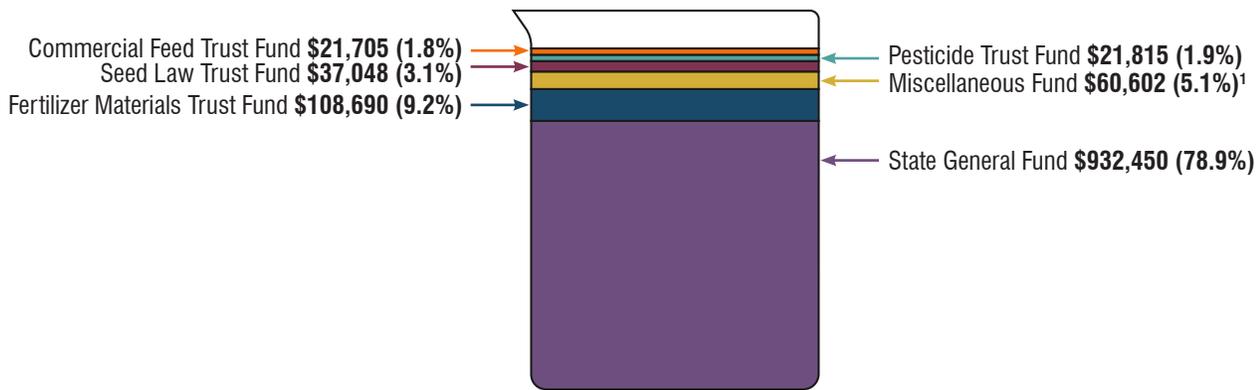
Finally, the Lab receives fee revenue for specific testing services that are also deposited into the Miscellaneous Fund. For example, the Lab provides pesticide-testing services to the Gila River Indian Community and seed testing services to seed manufacturers on a fee-for-service basis. According to the Department, the Lab collected about \$320 in fee revenue during fiscal year 2018 and received \$6,000 from the Gila River Indian Community for pesticide-testing services in fiscal year 2019.

¹² Fiscal year 2018 was used because, according to the Department, it is more representative of the Lab's historical funding. In fiscal year 2019, the Lab received additional funding to cover relocation costs (see Legislative Inquiry, pages 10 through 14). The Department was also appropriated State General Fund monies in fiscal year 2020 to help set up the Lab's testing capabilities for Arizona's industrial hemp program.

¹³ A.R.S. §§3-234, 3-269, 3-350, and 3-2607.

¹⁴ According to the Department, the number of groundwater tests it performs annually depends on the availability of staffing resources. The EPA grant requires the Department to provide adequate access to laboratory testing services and does not specify the number of groundwater tests that it must conduct annually.

Figure 1
Lab funding by source
Fiscal year 2018



¹ The Miscellaneous Fund comprises fees collected from the Lab for testing services from grant-funded programs and others.

Source: Auditor General staff analysis of the Arizona Financial Information System Accounting Event Transaction File for fiscal year 2018 and Department-provided information.

Department does not track specific Lab testing costs and therefore cannot use this information to appropriately allocate these costs to the Lab’s various funding sources, some of which are restricted

The Department does not track all the costs associated with each of the Lab’s various testing services and, as a result, does not have the information it would need to ensure Lab costs are appropriately allocated to its various funding sources. The Department reported that it previously tracked and compiled some cost information prior to fiscal year 2010 but indicated it no longer does so because of inadequate staffing. Some of the Lab’s funding sources, such as the nonappropriated trust funds, are restricted—meaning that only Lab costs that meet the purposes of these funds can be allocated to them. For example, Department officials reported that although State General Fund monies are intended to cover the full cost of dairy testing, the Department does not track the costs associated with the Lab’s dairy tests, such as labor, lab supplies, and any indirect costs, and therefore cannot assure that State General Fund monies fully pay for dairy-testing costs.^{15,16} Additionally, the Department cannot fully determine the extent to which the monies received from the 4 nonappropriated trust funds cover the costs of their associated tests because the Lab does not track the costs for its tests. Although the Department collects some limited cost-related information, such as time-tracking sheets for some Lab employees and laboratory equipment cost information, it does not use or analyze this information to help determine the costs associated with each Lab testing service. For example, the Department could use the time-tracking sheets to help calculate the personnel costs associated with the Lab’s various testing services.

To develop some information on the Lab’s testing costs, the Department provided us with Lab time-tracking sheet information that we used to develop estimated personnel costs for some of its testing services. Specifically, we obtained and analyzed time-tracking sheets for 7 Lab staff from the first quarter of fiscal year 2020 and used wage information reported by the Department to calculate the estimated personnel costs associated with each testing service.¹⁷ The time-tracking sheets for the 7 staff represent approximately 3,900 total hours of staff time and indicate that staff spent nearly 23 percent of their time conducting dairy tests, accounting for more than \$28,000 in labor costs (see Table 3, page 8).

¹⁵ Indirect costs could include various items, such as rent and utilities.

¹⁶ Statute requires that all monies received for the regulation of trade and real milk products be remitted directly to the State General Fund.

¹⁷ The Lab used time-tracking sheets for only 7 of the 11 Department staff that worked in the Lab during this time.

Table 3**Seven Lab employees' activities, hours, and wage information
July 1, 2019 through October 1, 2019**

Lab task/activity	Hours spent on the task/activity	Percentage of time spent on the task/activity	Estimated personnel cost ⁵
Dairy testing	879	22.7%	\$28,207
Administrative tasks ¹	765.5	19.7	24,565
Pesticide testing ²	645	16.6	20,698
Hemp testing	519	13.4	16,655
General testing-related tasks ³	517	13.3	16,591
Fertilizer testing	180	4.6	5,776
Feed testing	179	4.6	5,744
Meat testing	119	3.1	3,819
Other testing services ⁴	75	1.9	2,407

¹ Includes payroll, holiday, sick time, and other administrative tasks, such as managing the Lab's IT system and meetings.

² According to the Department, this includes formulation and residue tests on agricultural, structural, and any other products registered for use in Arizona.

³ Includes preparing samples for testing, training, repairing Lab equipment, and other testing-related tasks. Although some of these tasks should be considered a personnel cost associated with the specific tests, Lab staff track their time on these tasks separately. Therefore, we were not able to assign these hours to a specific testing activity.

⁴ Includes certifying laboratories, seed testing, animal disease testing, and mycotoxin testing.

⁵ We calculated personnel costs using the average hourly wage and employee-related expenses for the 7 Lab employees.

Source: Auditor General staff analysis of 7 Lab staff time-tracking sheets and wage information for Quarter 1 of fiscal year 2020.

Although analysis of employee time-tracking sheets provides important information for determining the Lab's testing costs, more extensive analyses of all Lab employee time-tracking sheets would need to be conducted for a longer time period, and additional cost information that the Department does not fully track would also need to be analyzed, such as the use of Lab supplies for its various tests and all indirect costs. Absent this type of information, the Department cannot accurately determine the costs for the various testing services it performs and whether monies from the various sources of funding the Lab receives fully covers the cost of the associated tests, or the extent to which some funding sources, such as the State General Fund, may be subsidizing testing costs. Further, without accurate cost information, the Department cannot ensure that the fees it charges, such as fees paid by tribal nations and seed manufacturers, are appropriate and cover the cost of the tests.

Best practices recommend formal process for tracking costs

Best practices recommend that agencies develop a formal process for tracking and determining program costs and then using this information to appropriately allocate these costs. Specifically, these best practices recommend the following:¹⁸

¹⁸ We reviewed the following fee-setting best practice sources: U.S. Government Accountability Office. (2015). *Federal user fees: Key considerations*. Washington, DC. Retrieved 9/4/19 from <https://www.gao.gov/assets/680/672572.pdf>; Boyle, R. (2012). *Using fees and charges: Cost recovery in local government*. Dublin, Ireland: Institute of Public Administration. Retrieved 9/4/19 from https://www.ipa.ie/_fileUpload/Documents/LocalGov_RS_No3.pdf; Office of the Comptroller General, Financial Management and Analysis Sector. (2009). *Guide to establishing the level of a cost-based user fee or regulatory charge*. Ottawa, Canada: Treasury Board of Canada Secretariat. Retrieved 9/4/19 from <https://www.canada.ca/en/treasury-board-secretariat/services/guidance-government-spending/guide-costing/guide-establishing-level-cost-based-user-fee-regulatory-charge.html>; Government Finance Officers Association. (2013). *Pricing internal services*. Chicago, IL. Retrieved 12/3/19 from <https://www.gfoa.org/print/448>; Government Finance Officers Association. (2004). *Full cost accounting for government services*. Chicago, IL. Retrieved 1/24/20 from <https://www.gfoa.org/full-cost-accounting-government-services>.

- Calculating the full cost of providing a service, including the direct and indirect costs associated with that service, and ensuring that the service is provided as efficiently as possible. Agencies should also compare the cost of a service to the associated funding source or fee to determine if the funding source or fee appropriately covers the cost.
- Identifying who benefits from the service and to what extent the service benefits the general public.
- Working with stakeholders, including agency personnel, policy makers, and industry officials, to determine how to fund services and what fees, if any, to levy or modify. For example, officials from the agricultural laboratory in Minnesota reported that laboratory staff work with program managers from the Minnesota Department of Agriculture annually to determine how much funding the laboratory will need from specific nonappropriated industry funds based on the cost of different lab testing programs, including the cost of maintaining testing capabilities for regulatory tests that are not regularly performed by laboratory staff. Similarly, lab officials from the agricultural laboratory in California reported that laboratory staff work with their respective client programs within the California Department of Food and Agriculture and other state and federal agencies to determine the amount of annual funding the laboratory will need based on the cost of its testing programs.¹⁹ Additionally, decisions on how program or testing costs should be allocated among various funding sources and/or fees should consider whether a particular service is a public good or whether it benefits certain industries, individuals, or stakeholders. For example, the Department and stakeholders may consider certain product testing a public good because it protects the general public from potentially harmful substances in various products that the general public uses. As such, the Department, along with stakeholders, may determine that funding certain product tests entirely from State General Fund monies is appropriate.

Recommendations

1. The Department should develop a formal process for tracking and determining how to allocate Lab costs, including:
 - a. Tracking all costs associated with Lab testing services, including direct and indirect costs, ensuring that its testing services are as efficient as possible, and comparing the cost of its Lab testing services with its various funding sources, including fees, to accurately determine the extent to which these various funding sources cover the costs of the associated testing services.
 - b. Determining who benefits from Lab testing services. For example, it should determine whether a specific testing service benefits the public or a specific industry.
 - c. In conjunction with the previous steps, working with other Department divisions, the Legislature, and industry stakeholders to determine whether changes should be made to the Lab's funding structure, including any changes to its fees, and take appropriate action based on these determinations.

Department response: As outlined in its [response](#), the Department agrees with the finding and will implement or implement in a different manner the recommendations.

¹⁹ We contacted officials from the state agricultural laboratories in California and Minnesota because they are among the states with the largest agricultural industries.



Department’s Lab relocation adhered to State requirements

Based on substantial legislative interest, we reviewed the process the Department used to relocate the Lab from 2 State-owned buildings to private space in the City of Chandler.

Department worked with Arizona Department of Administration and State’s contracted real estate broker to relocate Lab

Our review of the Department’s process for relocating the Lab from 2 State-owned buildings in the City of Phoenix, to space in a privately owned technology center in the City of Chandler in June 2019 found that the Department adhered to the various State requirements for relocation.²⁰ The Lab had to be relocated because one of the State-owned buildings in the City of Phoenix that housed the majority of the Lab was scheduled for demolition by the Arizona Department of Administration (ADOA). ADOA is statutorily responsible for managing State property and determined that the cost of renovating the building to address its deterioration outweighed the cost of demolition.²¹ Ultimately, ADOA decided that the most cost-effective approach would be to relocate the building’s occupants and demolish the building (see Figure 2, page 11, for a timeline of the Lab’s relocation process).²² In addition, the Lab had shared space at the Arizona Department of Health Services’ (ADHS) public health lab to perform some of its testing activities. However, the Department reported that ADHS needed to expand its available lab space to accommodate increased laboratory testing services for its own use. The Lab’s relocation process included the following steps:

- **Department and ADOA considered State and other publicly owned property for relocation but determined that such property was unavailable or not feasible**—Although we did not identify any statute, rule, or ADOA procedures requiring the Department or ADOA to do so, both the Department and ADOA searched for State or other publicly owned properties for possible new locations that could meet the Lab’s specific needs, such as spaces that included specialized ventilation and chemical extraction rooms. For example, in addition to identifying and considering State-owned property, the Department contacted other public entities, such as Gateway Community College and the City of Chandler, to discuss any available properties that could be leased for the Lab. However, according to ADOA, no available property was identified that met, or could be cost-effectively modified to meet, the Lab’s physical space requirements.

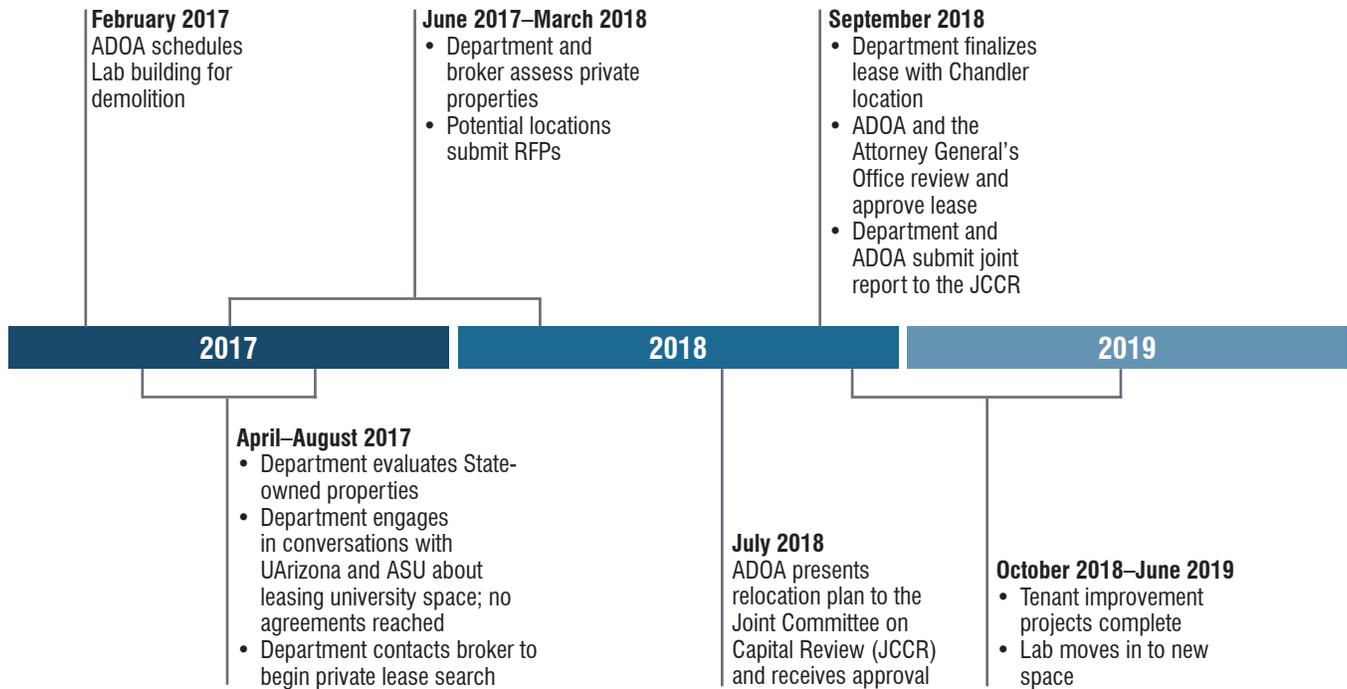
Department staff also engaged in informal conversations with the UArizona and Arizona State University (ASU) to discuss whether any university-owned lab space was available for lease. However, according to Department officials, the Department decided not to enter into agreements for leased space with either of these universities because it believed, based on conversations with university officials, that it could find more affordable options elsewhere.

²⁰ According to the Department, the Lab occupied approximately 10,765 usable square feet between the 2 locations in the City of Phoenix and moved to approximately 11,292 usable square feet at its new location in the City of Chandler. Usable square feet refers to the amount of square footage occupied and not shared with other tenants.

²¹ A.R.S. §41-791.

²² The Arizona State Data Center was also housed in this building and likewise had to be relocated.

Figure 2
Lab relocation timeline



Source: Auditor General staff analysis of Department, ADOA, broker, and the JCCR documentation, as well as interviews with Department, ADOA, and broker staff.

- **Department and ADOA expanded their search to include privately owned properties**—After determining that the Department would not be able to lease State, including UArizona and ASU, or other publicly owned space for the Lab, the Department and ADOA expanded the search to include privately owned properties. ADOA directs the process for identifying privately owned space and negotiating private leases for State agencies. Specifically, in addition to authorizing ADOA to manage State properties, statute requires that ADOA approve any leases proposed to be entered into by a State agency for privately owned office spaces. Operating under this authority, ADOA requires State agencies to use a single, State-contracted real estate broker (broker) for all private sector lease transactions, including performing property searches and negotiating lease agreements.²³
- **Department worked with broker to negotiate a private lease agreement in the City of Chandler**—According to broker staff, the Department contacted the broker requesting it to find 10,000 to 15,000 square feet of lab space around June 2017. Broker staff we interviewed explained that because of the limited inventory of available lab space in the State, the broker prioritized locations that were already structured as lab space and spaces that were open to extensive building improvements to convert to lab space. Department staff explained that existing lab space was preferred as it would allow the Lab to resume operations sooner and would likely require lower building improvement costs. Between June 2017 and March 2018, the Department and the broker assessed 16 potential properties located throughout the Phoenix metropolitan area, most of which were not established as lab spaces. After assessing the cost per square foot, existing infrastructure, and other characteristics of the 16 available properties, a request for proposal (RFP) was submitted by the broker to 4 independent private property owners. The RFP asked the property owners to propose their best starting offer for potential lease negotiations. Three of the 4 property owners, representing 2 buildings in the

²³ The broker’s services are provided to State agencies under a State-wide contract. Beginning in 2009, after a competitive bidding process, the State awarded a tenant broker service contract to a commercial real estate broker. ADOA most recently renewed the tenant broker service contract in July 2016. As such, the Lab did not enter into a separate contract with a broker.

City of Phoenix and 1 building in the City of Chandler, submitted a response to the RFP, including information that addressed the following:²⁴

- **Available lab infrastructure**—The City of Chandler location featured existing lab infrastructure within a single building that would only require modification for use, whereas the City of Phoenix locations featured warehouse space that would have required building out extensive lab spaces.
- **Rent abatement**—The City of Chandler location included the longest period of abated rent.²⁵ Specifically, both City of Phoenix locations offered 3 to 5 months of abated rent, whereas the City of Chandler location offered 7 months of abated rent—which resulted in a rent savings of approximately \$244,000 after finalizing the lease.

According to the broker and Department staff, after considering the various options that the 3 responses offered, such as the need for building improvements and rent abatement, the Department determined that the City of Chandler location presented the best option for the Lab. However, the Department did not document its analysis of the 3 responses. The Department and ADOA finalized and signed the lease agreement for the City of Chandler location in September 2018 (see textbox for key aspects of the finalized lease).²⁶

- **ADOA and the Department obtained approval for the relocation plan**—In addition to adhering to ADOA’s required process, the Department adhered to other oversight requirements, such as obtaining the JCCR’s approval of the anticipated lease and relocation plan.²⁷ Specifically, in July 2018, while the Department was continuing its negotiations for the lab space in the City of Chandler, ADOA presented to the JCCR the estimated lease costs for the Lab’s relocation as a part of its Building Renewal Allocation Plan, which included the proposed demolition of the State-owned building the Lab previously occupied, as required by statute.²⁸ At the time, ADOA and the Department presented an anticipated annual increase for the Department’s State General Fund appropriation request of approximately \$300,000 for lab rent and utility costs to the \$132,100 the Department had received for lab rent and utilities in fiscal year 2019, making its total lab rent and utilities request \$432,100. The JCCR approved the demolition and relocation subject to the submission of a report updating the JCCR on the signed private lease agreement. In September 2018, ADOA and the Department submitted that report, which included the finalized estimated rent and utility costs of approximately \$403,500 for fiscal year 2020 and \$473,100 annually thereafter for the remainder of the lease, which was more than the estimated annual amount of \$432,100 presented in July 2018.²⁹

Key aspects of the finalized Lab lease

- 15,771 square feet¹
- 91-month term (February 1, 2019 through August 31, 2026)
- Rent:
 - Months 01-07: \$0.00/sq. ft./year (\$0.00/month)
 - Months 08-91: \$26.50/sq. ft./year (\$34,827.62/month)
 - Annual unabated rent cost: \$417,931
- Department responsible for the first \$500,000 of tenant improvement expenses, with the lessor covering any additional tenant improvement expenses beyond \$500,000.²

¹ Includes usable square feet and common areas.

² According to ADOA, tenant improvement costs totaled \$1,176,202.

Source: Auditor General staff review of the Department’s finalized Lab lease documents.

²⁴ The fourth property owner did not respond to the RFP.

²⁵ Rent abatement refers to a common commercial real estate practice in which a landlord agrees to provide “free rent,” such as during building improvement projects.

²⁶ The finalized lease was signed and approved by ADOA and was reviewed for form to ensure necessary provisions, such as disclosure of conflict of interest, were included in the lease and approved by the Arizona Attorney General’s Office.

²⁷ The JCCR is a 14-member, joint-legislative committee of which the primary powers and duties relate to ascertaining facts and making recommendations to the Legislature regarding State expenditures for land, buildings, and improvements.

²⁸ A.R.S. §41-1252.

²⁹ The fiscal year 2020 lease included only 10 months of paid rent because 2 months were included in the rent abatement for building improvements.

Department used nonappropriated funds to cover cost of relocation

The Department used monies from 5 nonappropriated funds, which comprise fee monies collected by the Department's various licensing and inspection programs and are associated with some of the Lab's testing services, to pay for the Lab's relocation costs.³⁰ Although the JCCR approved the Lab's relocation, its approval did not include a commitment to fund any relocation costs. As such, the Department had to identify alternate funding sources to cover the Lab's relocation costs and used monies from the 5 nonappropriated trust funds to pay for these costs. Statute establishes these nonappropriated trust funds to implement, continue, or support the associated Department program and broadly authorizes the Department's director to use the trust funds for program purposes. Each of the programs associated with these trust funds use the Lab's testing services to fulfill their regulatory responsibilities (see Finding 1, pages 6 through 9, for more information about the Lab's testing services).³¹ Statute does not establish limits on the amounts disbursed from these funds but requires the Director approve the disbursement exclusively for the purpose of implementing, continuing, or supporting the associated program. The Department reported that the relocation of the Lab was a "program purpose" and budgeted approximately \$125,000 from each of the 5 nonappropriated trust funds for the Lab's relocation (see Table 4). The Department also reported that any relocation costs in excess of \$625,000 were paid for by any available operating monies from the 5 nonappropriated trust funds (see Table 4, footnote 1).

Based on our review of Department expenditures, the total cost associated with relocating the Lab was \$642,135 (see Table 4).³² This included \$500,000 in building improvement costs and an additional \$142,135 in other moving costs, such as furniture and equipment installation.

Table 4
Department trust fund balances, revenues, and expenditures used for Lab relocation
Fiscal year 2019

Fund name and statutory citation	Beginning balance	Revenue	Relocation expenditures	Other operating expenditures ²	Ending balance
Commercial Feed Trust Fund (A.R.S. §3-2607)	\$572,768	\$379,235	\$125,588	\$230,851	\$595,565
Fertilizer Materials Trust Fund (A.R.S. §3-269)	739,039	399,782	127,281	317,485	694,054
Pesticide Trust Fund (A.R.S. §3-350)	857,911	505,298	125,557	233,249	1,004,403
Seed Law Trust Fund (A.R.S. §3-234)	293,204	111,254	119,966	67,496	216,996
Pest Management Trust Fund (A.R.S. §3-3604)	2,905,654	1,490,162	120,008	1,484,677	2,791,132
Total	\$5,368,577	\$2,885,731	\$618,400¹	\$2,333,758	\$5,302,150

¹ An additional \$23,735 was expended from these 5 funds in fiscal year 2020 for the Lab's relocation, resulting in a total relocation cost of \$642,135. Relocation expenditures from each of the 5 funds totaled:

- a. \$130,335 from the Commercial Feed Trust Fund.
- b. \$132,028 from the Fertilizer Materials Trust Fund.
- c. \$130,304 from the Pesticide Trust Fund.
- d. \$124,713 from the Seed Law Trust Fund.
- e. \$124,755 from the Pest Management Trust Fund.

² Other operating expenditures include rent, supplies, software support and maintenance, and repair and maintenance costs.

Source: Auditor General staff analysis of Arizona Financial Information System data and fund information provided by the Department.

³⁰ Statute specifies that these funds are nonlapsing and that excess funds do not revert to the State General Fund.

³¹ Historically, the Lab has received funding from 4 of the nonappropriated funds used to cover a portion of the Lab's operating costs. Although the Pest Management Fund has not typically funded the Lab's operating costs, the Department reported that the Lab conducts tests on structural pesticides, and therefore, monies from the Pest Management Fund were also used to pay for relocation costs (see Table 2, page 4).

³² The \$642,135 amount includes an outstanding expenditure of \$6,458 the Department anticipates it will pay in fiscal year 2020.

State General Fund monies are used to cover additional ongoing rent costs

As mentioned earlier (see page 12), the Department anticipated that its annual Lab rent and utility costs would increase once it relocated. Therefore, it requested additional appropriations for rent and utilities in its fiscal year 2020 budget request. The Department received approximately \$132,100 in State General Fund monies for Lab rent and utility costs in fiscal year 2019. According to the Joint Legislative Budget Committee's fiscal year 2020 appropriations report, the Department will receive a State General Fund appropriation of \$411,900 in fiscal year 2020 and an ongoing annual State General Fund appropriation of \$481,500 thereafter to cover the increased Lab rent and utility costs.³³

In addition to these amounts, the Department requested an annual increase of \$35,000 to its State General Fund appropriation in its fiscal year 2021 budget request because electricity costs for the Lab at the new location have been higher than the initial estimates provided by ADOA. Specifically, the initial electricity estimates ADOA provided to the Department totaled approximately \$3,300 each month. However, between July and December 2019, monthly electricity costs billed to the Department exceeded this estimated amount in 4 of these months by \$777 to \$3,522. For 2 of the months, electricity costs fell below the estimated monthly amount by \$51 and \$364.

³³ According to the Department, the final State General Fund appropriated amounts are slightly higher than the Department's rent and utility estimates of \$403,500 and \$473,100 because internet costs were also considered in determining the final appropriation.



Objectives, scope, and methodology

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Agriculture (Department), State Agricultural Laboratory (Lab), pursuant to a September 14, 2016, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq. This audit addresses the Department's processes for (1) tracking Lab costs and allocating these costs to various funding sources, and (2) relocating the Lab from its previous State-owned buildings to a privately owned facility in the City of Chandler in June 2019.

We used various methods to address the audit's objectives. These methods included interviewing Department staff, interviewing external stakeholders involved in the Lab's relocation, reviewing Lab revenues and expenditures, reviewing applicable State laws and rules, and reviewing the Lab's website. We also used the following additional methods to meet the audit's objectives:

- To determine whether the Department has established processes to track and allocate Lab costs, we interviewed Department staff, including Lab officials, and reviewed and summarized 7 Lab staff time-tracking sheets dated between July and September 2019. Further, we identified and reviewed best practices in government fee setting and cost allocation guidance documents published by the U.S. Government Accountability Office, the Institute for Public Administration, the Government of Canada, and the Government Finance Officers Association.³⁴
- To determine whether the process and funds used to relocate the Lab were appropriate, we interviewed ADOA staff, JLBC staff, and the State's contracted real estate broker staff. Additionally, we reviewed documentation associated with the relocation process, including JLBC budget reports, ADOA private leasing procedures, market survey reports, request for proposals for 3 properties considered during the relocation process, and the Lab's relocation cost-tracking-sheet. We also compiled and analyzed data from the Arizona Financial Information System (AFIS) *Accounting Event Transaction File* reporting tool for fiscal year 2019 and compared this data with the Lab's relocation cost-tracking-sheet to determine whether relocation costs the Lab reported for fiscal year 2019 were accurate. Finally, we compiled and analyzed Department provided financial information for fiscal year 2020 regarding additional Lab relocation costs, including encumbered monies.
- To obtain information for the Introduction, we reviewed the Department's website and fiscal year 2019 annual report. We also compiled and analyzed data from AFIS *Accounting Event Transaction File* for fiscal years 2017 through 2019, and Department-provided financial information for fiscal years 2017 through 2020. Additionally,

³⁴ We reviewed the following fee-setting best practice sources: U.S. Government Accountability Office. (2015). *Federal user fees: Key considerations*. Washington, DC. Retrieved 9/4/19 from <https://www.gao.gov/assets/680/672572.pdf>; Boyle, R. (2012). *Using fees and charges: Cost recovery in local government*. Dublin, Ireland: Institute of Public Administration. Retrieved 9/4/19 from https://www.ipa.ie/_fileUpload/Documents/LocalGov_RS_No3.pdf; Office of the Comptroller General, Financial Management and Analysis Sector. (2009). *Guide to establishing the level of a cost-based user fee or regulatory charge*. Ottawa, Canada: Treasury Board of Canada Secretariat. Retrieved 9/4/19 from <https://www.canada.ca/en/treasury-board-secretariat/services/guidance-government-spending/guide-costing/guide-establishing-level-cost-based-user-fee-regulatory-charge.html>. Government Finance Officers Association. (2013). *Pricing internal services*. Chicago, IL. Retrieved 12/3/19 from <https://www.gfoa.org/print/448>. Government Finance Officers Association. (2004). *Full Cost Accounting for Government Services*. Chicago, Illinois. Retrieved 1/24/20 from <https://www.gfoa.org/full-cost-accounting-government-services>.

we reviewed Department-provided data regarding the number and types of tests it performed in fiscal year 2018, as well information published by the U.S. Department of Health and Human Services.³⁵

- Our work on internal controls included reviewing the Department's methods to accurately track and record cost information for its Lab services. In addition, we also reviewed the Department's compliance with Arizona Revised Statutes and/or ADOA policies for relocating the Lab and using specific Department funds. We also validated the Department's relocation expenditure and purchase order data by comparing it to expenditures found in AFIS. Our work included reviewing the following components and associated principles of internal controls:
 - Control activities including the design of control activities and recording of accurate financial transactions.
 - Information and communication related to the use of quality information.
 - Internal control system monitoring.

We reported our conclusions on applicable internal controls in Finding 1 and the Legislative Inquiry.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We express our appreciation to the Department's Director and staff for their cooperation and assistance throughout the audit.

³⁵ Food and Drug Administration, Public Health Service & National Conference on Interstate Milk Shipments. (2017). *Evaluation of milk laboratories, 2017 Revision*. Washington, DC: U.S. Department of Health and Human Services. Retrieved 1/7/2020 from <https://www.fda.gov/media/115265/download>.

DEPARTMENT RESPONSE

Douglas A. Ducey
Governor



Mark W. Killian
Director

Arizona Department of Agriculture

1688 W. Adams Street, Phoenix, Arizona 85007
(602) 542-4373

April 6, 2020

Lindsey Perry
Auditor General
2910 N 44th Street, Suite 410
Phoenix, AZ 85018

Dear Ms. Perry:

I have reviewed the revised preliminary report draft of the performance audit of the Arizona Department of Agriculture – State Agricultural Laboratory. Enclosed, please find the Department's formal response.

Respectfully,

Mark Killian
Director

MK/dm

Finding 1: Department does not track costs of specific Lab services, limiting its ability to appropriately allocate costs and set fees

Recommendation 1: The Department should develop a formal process for tracking and determining how to allocate Lab costs, including:

Recommendation 1a: Tracking all costs associated with Lab testing services, including direct and indirect costs, ensuring that its testing services are as efficient as possible, and comparing the cost of its Lab testing services with its various funding sources, including fees, to accurately determine the extent to which these various funding sources cover the costs of the associated testing services.

Department Response: The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented.

Response explanation: Prior to FY2009, the Lab did collect, store and analyze data to determine unit cost per test. However, during the Great Recession, the laboratory was reduced from 27 staff to 12 staff. This included the elimination of all administrative support staff (3). One function of the support staff was to collect and enter the data necessary to perform cost-based analysis of the individual tests. Without such support staff, it is not feasible to begin collecting, storing and analyzing all the necessary data to enable full cost accounting to resume. The Department is committed to seeking the additional administrative support necessary to fully implement this recommendation.

The Lab has already begun switching its old task tracking system from its labor-intensive, internally developed system to a new online, cloud-based system which should allow for improved time accounting although it will increase the burden to existing staff and has an approximately \$500/year licensing fee. The Lab is also working with persons at the State Procurement Office to determine if the new statewide purchasing software platform (APP) can be utilized in a way which will allow itemized reporting on a sub-function level. If possible, this may aide in determining a portion of the operating costs. Whether this can be achieved without a substantial personnel time expenditure will also be examined.

Recommendation 1b: Determining who benefits from Lab testing services. For example, it should determine whether a specific testing service benefits the public or a specific industry.

Department Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department believes it knows who benefits from the Lab testing but will reconfirm.

Recommendation 1c: In conjunction with the previous steps, working with other Department divisions, the Legislature, and industry stakeholders to determine whether changes, if any, should be made to the Lab's funding structure, including any changes to its fees, and take appropriate action based on these determinations.

Department Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees to implement this recommendation; however, the cost analysis is contingent upon the Department's success in seeking the additional administrative support necessary to fully implement the first recommendation.

