OPERATIONAL AUDIT

Oklahoma Horse Racing Commission

For the period July 1, 2007 through June 30, 2010

Oklahoma State
Auditor & Inspector
Gary Jones, CPA, CFE

Audit Report of the Oklahoma Horse Racing Commission

For the Period July 1, 2007 through June 30, 2010

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Oklahoma State Auditor & Inspector

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November 10, 2011

TO THE OKLAHOMA HORSE RACING COMMISSION

This is the audit report of the Oklahoma Horse Racing Commission for the period July 1, 2007 through June 30, 2010. The goal of the State Auditor and Inspector is to promote accountability and fiscal integrity in state and local government. Maintaining our independence as we provide this service to the taxpayers of Oklahoma is of utmost importance.

We wish to take this opportunity to express our appreciation for the assistance and cooperation extended to our office during our engagement.

Sincerely,

GARY A. JONES, CPA, CFE
OKLAHOMA STATE AUDITOR & INSPECTOR

Background

The Oklahoma Horse Racing Commission (the Agency) encourages agriculture, the breeding of horses, and the growth, sustenance and development of live racing, and generates public revenue through the forceful control, regulation, implementation and enforcement of licensed horse racing and gaming.

Oversight is provided by a nine-member commission (the Commission). Members serve terms of six years and are appointed by the governor.

Commission members are:

Becky Goumaz.. Chair
Brandon Burton, Esq.................................. Vice-Chair
Mel Bollenbach.. Secretary
Wayne Carter.. Member
Malcolm Savage, Esq. .... Member
Jim Bowers .... Member
Phillip Kirk .... Member
Ran Leonard.. Member
Joe Lucas .... Member

Table 1 summarizes the Agency's sources and uses of funds for state fiscal years 2010 and 2009 (July 1, 2008 through June 30, 2010).

	2010	2009
Sources:		
Participating Tribe Gaming Fees	$ 5,938,497	$ 6,822,744
Breakage/Unclaimed Tickets/Forfeit	5,377,043	5,731,360
State Appropriations	2,297,457	2,666,197
Horse Racing Licenses and Fees	995,024	1,002,146
Horse Drug Testing Fee	426,000	350,000
Registration Fees	241,088	230,665
Other Fines/Forfeits/Penalties	2,400	251,122
Clearing Account TBD[1]	(75,000)	(226,149)
Other Revenues	15,326	155,184
Total Sources	$ 15,217,835	$ 16,983,269
Uses:		
Scholarships/Tuition/Incentive Payments	$ 10,541,904	$ 13,246,399
Personnel Services	2,530,733	2,704,627
Shop Expense	513,126	329,358
Professional Services	267,485	49,183
Miscellaneous Administrative	111,549	457,432
Travel Expenses	140,143	183,706
Rent Expense	116,645	152,342
Other Expenses	64,410	109,408
Total Uses	$ 14,285,995	$ 17,232,455

Source: Oklahoma PeopleSoft Accounting System (unaudited, for informational purposes only)

[1] These amounts are due to the agency having used an incorrect account code to transfer funds from its Breeding Fund Special Account to the Breeding Fund Administrative Account. The error was corrected by the Office of State Finance and appears not to be occurring anymore; totals for FY 2011 show $0.00 for Clearing Account TBD.

Purpose, Scope, and Sample Methodology

This audit was conducted in response to 74 O.S. § 212, which requires the State Auditor and Inspector's Office to audit the books and accounts of all state agencies whose duty it is to collect, disburse or manage funds of the state.

The audit period covered was July 1, 2007 through June 30, 2010.

Sample methodologies can vary and are selected based on the audit objective and whether the total population of data was available. Random sampling is the preferred method; however, we may also use haphazard sampling (a methodology that produces a representative selection for non-statistical sampling), or judgmental selection when data limitation prevents the use of the other two methods. We selected our samples in such a way that whenever possible, the samples are representative of the populations and provide sufficient evidential matter. We identified specific attributes for testing each of the samples. When appropriate, we projected our results to that population.

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. This report is a public document pursuant to the Oklahoma Open Records Act (51 O.S. § 24A.1 et seq.), and shall be open to any person for inspection and copying.

Objective 1 - To determine whether the Agency's internal controls provide reasonable assurance that revenues, expenditures (including payroll), and inventory were accurately reported in the accounting records, and whether financial operations complied with 3A O.S. § 204.1A.D, 3A O.S. § 204.1B, 3A O.S. § 204.2 E., 3A O.S. § 205.2.K, 3A O.S. § 263.L, and 3A O.S. § 282.D.

Conclusion

The Agency's internal controls provide reasonable assurance that payroll expenditures were accurately reported in the accounting records. They do not provide reasonable assurance that revenues, miscellaneous expenditures, or inventory were accurately reported in the accounting records.

Financial operations complied with the following statues:

- 3A O.S. § 204.2 E. – Fingerprinting fee payments to the Oklahoma State Bureau of Investigation (OSBI);
- 3A O.S. § 204.1A.D, 3A O.S. § 205.2.K, 3A O.S. § 204.2.E – transfers to the state general revenue fund; 3A O.S. § 204.1B – transfers to the equine drug testing fund; and 3A O.S. § 282.D – transfers to the gaming regulation revolving fund. Please note that the lack of segregation of duties in the revenue process, as discussed on pages three and four, may impact the funds transfer process. If any funds received were not deposited, they also would not have been transferred. Our procedures

were designed to determine whether the funds ultimately deposited were transferred appropriately.

Financial operations generally complied with 3A O.S. § 204.1B – equine drug testing expenditures. However, one area could be strengthened.
With respect to the items tested, financial operations complied with 3A O.S. § 263.L – Participating Tribe fund expenditures[2].

Methodology

To accomplish our objective, we performed the following:

- Obtained an understanding of internal controls related to the receipting, expenditure, and inventory processes through discussions with Agency personnel, observation, and review of documents;
- Tested controls, which included:
    - Reviewing payroll documentation for twelve randomly selected months from the period to ensure the payroll expenditures were properly reviewed and approved;
    - Reviewing all 12 pay rate changes and 18 separations during the audit period to ensure they were properly approved by the executive director as well as accurately reflected in the payroll documentation;
- Recalculated the amounts transferred to the state's general revenue fund, the Equine Drug Testing Revolving Fund, the Participating Tribes Fund and Gaming Revolving Fund, to ensure the proper transfers were conducted as required by state statutes;
- Reviewed all audit period payments (36 payments totaling $224,593) to the OSBI to ensure fingerprinting fee payments were passed through as required by 3A O.S. § 204.2;
- Reviewed 62 randomly selected payments totaling $11,018,812 from the Participating Tribes Fund during the audit period (50% of payments) to ensure they were supported by requests from the appropriate purse committees (official elected horsemen representing each breed) as required by 3A O.S. § 263.L;
- Reviewed all audit period payments (36 payments totaling $1,189,960) from the Equine Drug Testing Revolving Fund to ensure they were properly approved and for purposes allowed by statute, and that they were supported by a contract approved by the attorney general.

[2] Funds collected from the three participating tribes (Cherokee, Creek, and Osage) in compliance with the State Tribal Gaming Act are distributed to qualifying racetracks to be included in winning horse purses. Distributions are decided by purse committees, official elected horsemen representatives for each breed, according to statutory apportionments (50% to thoroughbreds, 40% to quarter horses, and 10% to paints and appaloosas).

Observation **Inadequate Segregation of Duties in the Revenue Process (Repeat Finding)**

To protect against possible errors or irregularities, an effective internal control system should provide reasonable assurance that assets are adequately safeguarded by properly segregating the duties of employees.

The main office accountant is responsible for the following:

- Receipting some monies received by the Agency;
- Preparing the clearing account and agency special account reconciliations;
- Writing vouchers from the clearing account;
- Preparing the deposit;
- Making the deposit.

Personnel at the satellite locations are responsible for:

- Receipting monies received at the track;
- Preparing the deposit;
- Making the deposit.

Both the accountant and track personnel also have the ability to void transactions in the receipting systems. If these voids are not properly reviewed, this ability may afford them the opportunity to effectively remove misappropriated payments from the deposit records.

Management has stated that it is unable to properly segregate duties due to small staff size and lack of funding to expand the staff. Without adequate segregation of duties or other controls to reduce the associated risks, errors and improprieties could occur and not be detected in a timely manner.

Recommendation At the main office, management should implement a review of the daily deposits prepared by the accountant to the walk-in and mail receipting logs completed by personnel accepting the payments or develop and implement other mitigating controls to reduce the risk. In addition, the employee responsible for writing vouchers from the clearing account should be independent from the responsibilities of preparing the clearing account reconciliation and approving the vouchers.

At the satellite locations, we recommend management design mitigating controls related to the track deposits to assist in preventing and detecting errors in a timely manner. These controls should address the risk that track employees have the ability to record a transaction in the system, misappropriate the payment, and then void the transaction in the system.

Views of Responsible Officials The Agency understands the necessity of segregation of duties in the revenue process and the importance of effective internal controls to safeguard those revenues. As discussed previously in the audit, limited staff and budget makes the segregation of duties extremely difficult at times. The agency will review procedures for receiving and depositing state revenue in both the main and racetrack offices and make every effort to segregate those duties when possible.

Observation — **Inadequate Segregation of Duties in the Expenditure Process**

To protect against possible errors or irregularities, an effective internal control system should provide reasonable assurance that assets are adequately safeguarded by properly segregating the duties of employees.

The fiscal administrative officer is responsible for receiving the warrants from the State Treasurer's Office (OST), and she also posts various complex payments for the Agency into the PeopleSoft accounting system which account for almost 90% of the dollar value of all payments. The accountant reviews the warrants and prepares them for mailing. However, as the fiscal administrative officer is his supervisor, the accountant may not be in a position to question her if a warrant is missing or seems problematic.

Due to the small size of the accounting department, the Agency has attempted to segregate duties in its expenditure process but the current review procedure appears to be inadequate. Without adequate segregation of duties, errors and improprieties could occur and not be detected in a timely manner.

Recommendation An employee with knowledge of financial operations other than the fiscal administrative officer and accountant should receive the warrants and compare them to the OST warrant register and the invoice, verifying that the warrants are all received and appear reasonable.

Alternatively, the accountant could begin posting all expenditure transactions and the fiscal administrative officer's ability to post could be removed.

Views of Responsible Officials The agency understands the necessity of segregation of duties in the expenditure process and the importance of effective internal controls to safeguard those processes.

The agency will begin immediately to have a third person available to review and compare the agency's warrant register, warrants and claim documentation to validate accuracy. That person will sign off on the warrant register at the time the warrant is mailed to the vendor.

Observation — **No Inventory Count Performed (Repeat Finding) and Inadequate Segregation of Duties in the Inventory Process**

An effective internal control system should provide for a periodic, independent review of inventory records. It should also provide reasonable assurance that assets are adequately safeguarded by properly segregating the duties of employees.

According to our discussion with Agency personnel, a physical inventory count was not conducted during the three-year audit period. In addition, the fiscal administrative officer is responsible for the following:

- Receiving and tagging some inventory items;
- Updating inventory records;
- Approving surplus items to be removed from inventory.

It appears proper segregation of duties is not in place in the inventory process.

According to staff, no inventory count was performed because the Agency was in the process of developing a new inventory system. It appears management was unaware of the risks created by not conducting a periodic physical inventory count and the fiscal administrative officer's conflicting inventory duties. Errors and improprieties could occur and not be detected in a timely manner.

Recommendation

Management should develop procedures to ensure that a physical inventory count is conducted annually, and that the count procedures include ensuring that all items are properly tagged with inventory numbers, marked as property of the State of Oklahoma, and that serial numbers agree to the inventory records as applicable. Evidence of the count should be maintained by the Agency.

In addition, the responsibilities of purchasing inventory items, maintaining inventory records, performing the inventory count, and approving changes to inventory records should be segregated. For example, the fiscal administrative officer could continue to maintain the inventory records, while the inventory count is performed by independent staff members and changes are approved by the executive director.

Views of Responsible Officials

The agency understands the necessity of effective internal controls of inventory to safeguard the State's property. The agency has taken steps to update and maintain proper inventory records and processes. As discussed with the state auditors, during the three-year period of the audit, inventory was tracked and recorded, but not adequately to provide reasonable assurance of the records. During that same time period the agency began creating an online agency inventory program to track and record State assets. A full inventory was done after June 30, 2010 and an updated inventory was performed after June 30, 2011, each time updating the agency's assets. An inventory report was also filed with the Department of Central Services for the fiscal years ending June 30, 2010 and June 30, 2011. Also during this same time period, supervisors were taking a more active role in reviewing inventory. During the FY 2012 inventory, supervisors will be receiving inventory reports to review, compare and report back to the fiscal administrative officer. Also during this same time period, the agency's computer services coordinator has begun to take an active role in recording agency assets prior to deploying those items.

Observation

Lack of Approval of Equine Drug Testing Contract

3A § 204.1B establishes the Equine Drug Testing Revolving Fund and states: "All monies accruing to the credit of said fund are hereby appropriated and may be budgeted and expended by the Oklahoma Horse Racing Commission for the purpose specified in paragraph 14 of subsection A of Section 204 of Title 3A of the Oklahoma Statutes." 3A § 204.A.14 authorizes the Agency to contract with testing laboratories in order to conduct tests on the horses run or to be run in any race meeting, and further requires that: "Prior to the Commission entering into any contract pursuant to this paragraph, the Attorney General shall review and approve the contract."

We reviewed all individual audit period expenditures from the Equine Drug Testing Revolving Fund and they appeared to be allowable per these statutes. However, the Agency was unable to provide us with documentation of the attorney general's approval of its contract with the drug testing laboratory.

Management indicates the approval was obtained; however, as a result of lack of documentation, it appears the Agency is not in compliance with 3A § 204.A.14.

Recommendation Management should ensure proper documentation of the attorney general's approval of drug testing contracts is retained in the future.

Views of Responsible Officials After much discussion with all parties involved, the agency is assured that the approval letter was done by the Attorney General's Office and delivered to the Department of Central Services prior to approving the contract, but a copy of the letter cannot be found. In June 2011, the agency went through the bidding process for the primary equine drug testing laboratory again. The attorney general's approval was obtained and a copy is available as a part of the bidding process. The agency will be more diligent in the future in retaining those copies.

Other Items Noted

Although not considered significant to the audit objective, we feel the following issue should be communicated to management.

Observation **<u>Surplus Fingerprinting Fees Balance in Agency Clearing Account</u>**

3A O.S. § 204.2.E states that, "Of the original application fee for an occupation license, the amount of the fingerprinting fee shall be deposited in the OSBI Revolving Fund."

Per Agency policy, fees for fingerprinting services are collected by the Agency and held until invoices are received from OSBI for fingerprints processed. Payments are then made based upon these invoices. In some cases the fingerprints collected by the Agency are unable to be processed, in which case OSBI charges for only a background check by name. When this occurs, the difference between the $44 fingerprinting fee and $15 background check fee is retained by the Agency.

As a result of this process and the fact that invoices may lag behind fingerprint fee collections due to OSBI processing time, the Agency retains a growing balance of fingerprinting fee funds in its clearing account. The Agency tracks and accounts for these fees separately, but is unable to spend the funds due to the statutory requirement to deposit all fingerprinting fees to OSBI. As of the end of our audit period, a balance of $194,095 in fingerprinting fees existed. According to our discussions with staff, the Agency has attempted to reach an agreement with OSBI in which the surplus funds would be used to upgrade existing fingerprinting technology. However, this agreement has not been finalized.

It appears that the growing balance of fingerprinting fees in the Agency's clearing account is not being utilized efficiently.

Recommendation

We recommend that management continue to pursue an agreement with OSBI and consider modifications to the 3A O.S. § 204.2.E that would allow them to make efficient use of the fingerprinting fee funds balance.

Views of Responsible Officials

The agency emphatically agrees with the audit's recommendation. This situation has been an ongoing project of the agency during the last three fiscal years. The agency has again included the change in the statute into the agency's budget request for FY 2013 for legislative changes. As discussed with the State Auditor and Inspector's staff, changes in 3A O.S. Section 204.2.E to allow the agency to transfer fingerprints to the Oklahoma State Bureau of Investigation electronically would be a more economical and efficient way of processing fingerprints. The agency does have legislative approval to spend the funds for digital fingerprints, but must obtain statute changes to allow the OSBI to accept fingerprints digitally. This will be a continuing request of the agency until it is completed.

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