OPERATIONAL AUDIT

Oklahoma Horse Racing Commission

For the period July 1, 2010 through June 30, 2015

Oklahoma State
Auditor & Inspector
Gary A. Jones, CPA, CFE

Audit Report of the Oklahoma Horse Racing Commission

For the Period July 1, 2010 through June 30, 2015

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Oklahoma State Auditor & Inspector

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June 1, 2016

TO THE OKLAHOMA HORSE RACING COMMISSION

This is the audit report of the Oklahoma Horse Racing Commission for the period July 1, 2010 through June 30, 2015. 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.

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.

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 the nine-member Horse Racing Commission (the Commission). Commissioners serve terms of six years and are appointed by the governor.

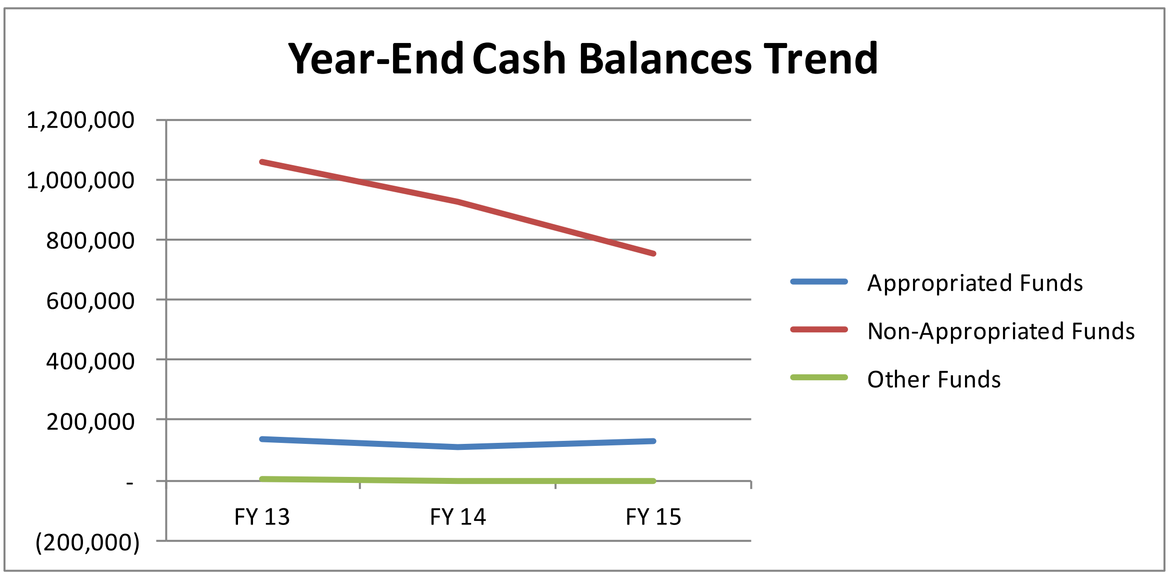
Board members as of June 30, 2015 are:

Ran Leonard .... Chair
Keith Sanders .... Vice-Chair
Mel Bollenbach .... Secretary
Becky Goumaz .... Member
Stanton Harrell, Esq. .... Member
Phillip Kirk .... Member
Joe Lucas .... Member
Monty Marcum .... Member
Kinsey Money, Esq. .... Member

The following information illustrates the Agency's budgeted-to-actual revenues and expenditures and year-end cash balances.[1]

BUDGET TO ACTUAL COMPARISON						
	FY 2014			FY 2015		
REVENUES	**Budgeted**	**Actual**	**Variance**	**Budgeted**	**Actual**	**Variance**
General Appropriations	2,079,068	2,072,167	(6,901)	1,991,198	1,973,779	(17,419)
Taxes	-	2,300	2,300	-	2,280	2,280
Licenses, Permits, and Fees	-	1,371,189	1,371,189	1,875,000	1,339,814	(535,186)
Fines, Forfeits and Penalties	-	4,900	4,900	50,000	4,600	(45,400)
Total Revenues	**2,079,068**	**3,450,556**	**1,371,488**	**3,916,198**	**3,320,473**	**(595,725)**
EXPENDITURES						
Personnel Services	2,481,671	2,469,137	(12,534)	2,452,859	2,420,357	(32,502)
Professional Services	336,657	347,061	10,404	340,920	667,034	326,114
Travel Expenses	90,320	69,961	(20,359)	67,819	47,779	(20,040)
Administrative Expenses	1,020,420	713,692	(306,728)	1,004,600	303,343	(701,257)
Property, Furniture, Equipment, and Related Debt	50,000	11,711	(38,289)	50,000	15,511	(34,489)
Gen Assistance, Awards, Grants, and Other Prog-Dir Pymts	6,500,000	16,455,549	9,955,549	6,500,000	13,587,339	7,087,339
Transfers and Other Disbursements	-	115	115	-	93	93
Total Expenses	**10,479,068**	**20,067,226**	**9,588,158**	**10,416,198**	**17,041,456**	**6,625,258**
Expenditures Over (Under) Revenues		**16,616,670**			**13,720,983**	

Year-End Cash Balances: FY 13 - FY 15			
	FY 13	**FY 14**	**FY 15**
Appropriated Funds	134,040	108,244	131,840
Non-Appropriated Funds	1,061,299	927,104	750,065
Other Funds	1,551	(205)	(155)
Total Available Cash	1,196,890	1,035,143	881,750



[1] This information was obtained from the Oklahoma PeopleSoft accounting system. It is for informational purposes only and has not been audited. See summary of management's explanation of variances on page 3 of this report.

Summary of Agency responses to budgeted-to-actual variances

This information is a summary of responses obtained from the Oklahoma Horse Racing Commission. It is for informational purposes only and has not been audited. See budgeted-to-actual analysis on page 2 of this report.

Revenues

- 2015 Licenses, Permits, and Fees includes payment for Gaming License Fee ($150,000) and Gaming Machine Assessment Fee ($300,000). Due to changes in the fee, the Commission extended the deadline for payment of those fees from June 1, 2015 (FY-2015) to July 15, 2015 (FY-2016).

Expenditures

- 2014 Administrative Expenses includes payments for Equine Drug Testing. Agency budgets for the maximum number of drug test in a fiscal year, approximately $750,000. This is to accommodate any new drug that causes an increase in the number of positive tests, new drug that causes a new test which might increase the cost of the drug contract or change in the number of tests required. $750,000 is the most the Agency has ever spent in a fiscal year. Most years the cost is under $450,000.00.
- 2014 and 2015 General Assistance, Awards, Grants, and Other Program-Directed Payments. This includes both expenditures from Fund 700, Participating Tribe Fund at approximately $6,000,000, and payments from Agency Special Account 1353B Oklahoma Bred Fund at approximately $9,000,000. Budgeted expenditures from 1353B were not included in the State's budget system, but actual expenditures are included.
- 2015 Professional Services and 2015 Administrative Expenses. This also concerns Equine Drug Testing. There are two expenditure codes that can be utilized to describe the expenditure of Equine Drug Testing: Professional Services 515530 Veterinary Services or 537210 Laboratory Services. Budget was created using one account code and contract was created under second object code. Corrected for FY-2016.

Scope and Methodology

Our 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.

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.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessment of materiality and risk for the period July 1, 2010 through June 30, 2015. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the Oklahoma Horse Racing Commission operations. We utilized sampling of transactions to achieve our objectives. To ensure the samples were representative of the population and provided sufficient, appropriate evidence, the random sample methodology was used. We identified specific attributes for testing each of the samples and when appropriate, we projected our results to the population.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, errors or fraud may occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

OBJECTIVE

Determine whether the Agency's internal controls provide reasonable assurance that revenues, expenditures (both payroll and miscellaneous), and inventory were accurately reported in the accounting records.

Conclusion

The Agency's internal controls provide reasonable assurance that payroll expenditures were accurately reported in the accounting records.

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

FINDINGS AND RECOMMENDATIONS

Control Environment and Communication Risks Are High

An effective internal control system has in place policies and procedures that reduce the risk of errors, fraud, and professional misconduct within the organization. Key factors in this system are the environment established by management, and effective information and communication to achieve the Agency's objectives. Management's ethics, integrity, attitude, and operating style become the foundation of all other internal control components. In addition, Agency management needs to access relevant and reliable communication related to internal as well as external events.

As part of our control risk assessment, we surveyed and interviewed the Agency employees and the following general concerns were expressed:

- The importance of integrity and ethical values of the executive director was questioned.
- An atmosphere of mistrust and poor communication existed between the executive director and employees.
- There was a perception of favoritism and employees being treated unfairly.
- Employees lack adequate supplies, equipment, and support to perform their job duties.
- The executive director did not provide a clear sense of purpose and direction for the Agency or employees.

Employees' concerns, whether factual or perceived, have a negative impact on the Agency's control environment. This increased the risk of errors and misappropriation of assets. It should be noted the former executive director resigned effective September 2, 2015, during the planning portion of our audit.

Recommendation

We recommend the Commission and the current executive director recognize the risk associated with this type of environment and work towards evaluating and addressing the situation to ensure the mission of the Agency is accomplished in the most efficient and positive manner possible. In addition, we recommend they identify the Agency's information requirements and design an appropriate method to effectively communicate this information within the organization.

Views of Responsible Officials

The current Commission and Executive Director recognize the necessity for effective communication of information to Agency staff and industry. The Commission and the Executive Director have established smaller committees to improve divisions of the Agency and industry operations. The Commission and the Executive Director will be working toward improving written procedures and communication of operations to all participants.

Inadequate Segregation of Duties Related to Revenues – ***Repeat Finding***

The United States Government Accountability Office's *Standards for Internal Control in the Federal Government (2014 Revision)*[2] states, "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include responsibilities for authorizing transactions, processing and recording them, and handling any related assets. No one individual should control all key aspects of a transaction or event."

The Agency has not segregated key duties related to receipts. We identified the following conditions:

The main office accountant is responsible for:

- 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 deposits;
- Making the deposit.

It appears management chose not to alter the assigned duties or implement mitigating reconciliations of revenue activity since this finding was reported in our previous audit report. 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. Each party receiving funds and preparing and making the deposit has the ability to misappropriate a payment without detection.

This deficiency also creates a risk of noncompliance with revenue-related statutes. Our procedures indicated the Agency appeared to be in compliance with statutes governing transfers to the State general revenue fund and Agency funds (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. § 282.D, and 62 O.S. § 34.57.E.1), deposits of fingerprinting fees to the State Bureau of Investigation (3A O.S. § 204.2), and distribution of Participating Tribe funds as authorized

[2] Although this publication addresses controls in the federal government, this criterion can be treated as best practices. The theory of controls applies uniformly to federal or state government.

by the horsemen's purse committees (3A O.S. § 263.L). However, the lack of appropriate revenue controls creates an underlying risk that receipts could be misappropriated, and therefore not transferred or distributed appropriately.

Recommendation

We recommend the agency segregate the duties of receipting, preparing the deposit, and making the deposit. Additionally, the employee writing vouchers from the clearing account should be independent from the responsibility of performing the clearing account reconciliation.

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 misappropriate funds without timely detection.

Views of Responsible Officials

The Commission and staff recognize the importance of segregation of duties as it relates to the handling of revenues for the State of Oklahoma. The Commission will take under advisement the recommendations of the State Auditor and Inspector to implement a division of duties. With the reduction in budgets and personnel, the Commission will make every effort to implement additional checks and balances for the receipting, depositing, and recording of revenue to the State.

Inadequate Segregation of Duties Related to Expenditures – *Repeat Finding*

The GAO *Standards* again state, "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event."

Duties related to expenditures are not properly segregated, as the fiscal administrative officer has the following abilities:

- Create a purchase order;
- Post claims into PeopleSoft (the State's accounting system);
- Make electronic payments in PeopleSoft;
- Mail paper warrants to vendors.

In addition, there is no independent review of detailed expenditure information after payments are made. This could allow the fiscal administrative officer to make an unapproved payment or misappropriate a legitimate payment without timely detection.

It appears management chose not to alter the assigned duties or implement a mitigating review of detailed expenditures since this finding was reported in our previous audit report.

Recommendation

We recommend management segregate duties to ensure that no one individual can post payments as well as create purchase orders. Alternatively, or in addition to this change, line-item detailed expenditure information should be reviewed by an individual who is not involved in processing expenditures but does have sufficient knowledge of Agency expenditures to perform the review.

Views of Responsible Officials

The Commission and staff recognize the importance of segregation of duties as it relates to the handling of expenditures for the State of Oklahoma. The Commission will take under advisement the recommendations of the State Auditor and Inspector to implement a division of duties. With the reduction in budgets and personnel, the Commission will make every effort to implement additional checks and balances for expenditures for the Agency. Staff will provide to the Commission monthly expenditures reports from the State's financial system.

Inadequate Segregation of Duties and Inventory Counts Not Conducted – *Repeat Finding*

The GAO *Standards* state, "Management must establish physical control to secure and safeguard vulnerable assets. . . . Management periodically counts and compares such assets to control records." Furthermore, the *Standards* state that management should design "an internal control system to provide reasonable assurance regarding prevention or prompt detection and correction of unauthorized acquisition, use, or disposition of an entity's assets."

The Agency does not perform an annual inventory count. While they do maintain an inventory listing for required state reporting, without a regular count this listing may be inaccurate or incomplete.

Additionally, the fiscal administrative officer has the following responsibilities and abilities:

- Receive and tag some inventory items;
- Update inventory records;
- Approve surplus items to be removed from the inventory listing.

Both the lack of an annual inventory count and the lack of adequate segregation of duties related to inventory provide opportunities for inventory to be misstated or misappropriated without detection.

It appears management chose not to alter the assigned duties or implement a regular inventory count since this finding was reported in our previous audit report.

Recommendation

We recommend management identify all assets owned by the Agency and ensure they have a complete and up to date inventory listing. The individual responsible for maintaining the inventory records should not have the ability to receive purchased items or approve inventory items as surplus. In addition, we also recommend that management ensure a comprehensive annual physical inventory count is performed and documented by someone independent from purchasing assets, maintaining inventory items or inventory records, and disposing of surplus assets.

Views of Responsible Officials

The Commission and Staff recognize the importance of segregation of duties as it relates to the handling of inventory and inventory yearly count for the State of Oklahoma. The Commission will take under advisement the recommendations of the State Auditor and Inspector to implement a division of duties. Staff will begin preparing written procedures for a proper inventory for the end of this calendar year.

Other Items Noted

Unexpected Balance in Participating Tribe Fund

As required by 3A O.S. § 263.L of the State Tribal Gaming Act, each month the three participating tribes submit payments derived from gaming revenues to the Participating Tribe Fund. These funds are then distributed by purse committees composed of official elected horsemen representing each horse breed, as follows:

> "The total contributions of the participating tribes made to subparagraph 3 of subsection K of this section shall be distributed as directed by the purse committees based on the following formula, to wit: fifty percent (50%) by the purse committee representing Thoroughbred horses; forty percent (40%) by the purse committee representing Quarter horses; and ten percent (10%) by the purse committee representing Paint and Appaloosa Horses."

During our review of Agency records and CORE records, it came to our attention that the Participating Tribe Fund balance as of March 31, 2016 was $5,645,626.78. The fund balance saw growth in four years of the five year audit period.

According to Agency records, the following were the total deposits allotted to and total expenditures made by each purse committee during the audit period[3]:

FY 10-15	Deposits Allotted	Expenditures	Balance	% Undistributed
Thoroughbred (50%)	16,459,043.00	11,682,867.01	4,776,175.99	29%
Quarterhorse (40%)	13,167,234.40	12,637,134.00	530,100.40	4%
Paint/Appaloosa (10%)	3,291,808.60	3,302,601.00	(10,792.40)	-0.3%

Although 3A O.S. § 263.L does not explicitly specify a timeline for distribution, purse committees are required to meet annually "prior to the beginning of a calendar year to provide directions for placement of the purse funds." That requirement coupled with the statutory language stating "*total contributions* of the participating tribes shall be distributed by the purse committees" (emphasis added) could be interpreted to imply that total funds should be disbursed annually.

Recommendation

We recommend the Commission, along with the representatives of the breed associations review the procedures performed by the purse committees related to the disbursement of participating tribe contributions to determine whether funds are being disbursed in accordance with 3A O.S. § 263.L. Management should consider seeking an Attorney General's opinion on the interpretation of the statutory language concerning timing of distributions.

Views of Responsible Officials

The Commission does not determine when and what expenditures are made from the Participating Tribe Fund. That responsibility falls to the Purse Committee that consists of the two breed associations. Each year they provide a directive of purses to the Commission, a proposal of expenditures towards purses, administrative expenses, benevolence, and advertising. The Commission will meet with the breed association representatives to review the Participating Tribe Fund and to continue it to be in compliance. The Commission will contact the Attorney General's office and Commission Counsel on interpretation of statutory language.

[3] Note: This table does not reflect the pre-existing balance of $1,135,302 in the Participating Tribe Fund as of June 30, 2010. While the audit period figures alone may cause the Paint/Appaloosa account to appear to be overdrawn, that is not the case when the pre-existing balance is taken into consideration.

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