

OPERATIONAL AUDIT

OKLAHOMA HORSE RACING COMMISSION - BREEDING FUND

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



*Independently serving the citizens of
Oklahoma by promoting the
accountability and fiscal integrity of
governmental funds.*



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

**Audit Report of the
Oklahoma Horse Racing Commission – Breeding Fund**

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



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 - Breeding Fund 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,

A handwritten signature in blue ink that reads "Gary A. Jones".

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

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Background

The Oklahoma Breeding Development Fund Special Account (the Breeding Fund) at the Oklahoma Horse Racing Commission (the Agency) is an incentive fund which increases income for Oklahoma horse racing and breeding enterprises. Purse supplements, stallion and broodmare awards are paid to owners and breeders of qualifying accredited Oklahoma-bred horses through a system of restricted and open company races at Oklahoma racetracks. The Breeding Fund receives monies from unclaimed tickets, breakage, gaming activities, and registration and transfer fees for Oklahoma-bred horses.

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

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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 and expenditures were accurately reported in the accounting records.

Conclusion

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

The Agency's internal controls provide reasonable assurance that expenditures were accurately recorded in the accounting records for the period of January 1, 2011 through June 30, 2015, with the exception of controls over the Breeding Fund Retirement Program as discussed later. However, due to insufficient documentation, we were unable to conclude on the Agency's internal controls over expenditures for the period of July 1, 2010 through December 31, 2010. This lack of documentation also only allowed us to ensure the agency was in compliance with 3A O.S. § 208.3.B, outlining the permitted purposes of Breeding Fund expenditures,

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for the period of January 1, 2011 through June 30, 2015; we were unable to conclude upon the first six months of the audit period.

The Agency was not in compliance with Oklahoma Administrative Code sections 325:75-1-12.1 and 325:75-1-21 governing the Breeding Fund program for the care of retired or unwanted Oklahoma-Bred racing stock, due to overspending and further lack of documentation.

It should be noted that our concurrent audit of the main Oklahoma Horse Racing Commission¹ revealed high risk in the control environment. Among employees' concerns were an atmosphere of mistrust and ill communication, perceived unfair treatment, insufficient supplies and support, and poor leadership by the executive director on staff during the audit period. Whether the concerns are factual or perceived, the risks resulting from an environment colored by these doubts affects not only Oklahoma Horse Racing Commission operations but the activities of the Breeding Fund covered in this report as well.

FINDINGS AND RECOMMENDATIONS

Missing Documentation for Breeding Fund Expenditures

The United States Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*² states, "Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination."

In addition, the Oklahoma Archives and Records Commission Consolidated Records Disposal Schedule (dated January 22, 2015) section 2-40 states: "Invoices, vouchers and supporting documentation for payment of obligations from Agency Special or Clearing Accounts should be retained in office for seven (7) years, then destroy provided all audits have been completed and all applicable audit reports have been accepted and resolved by all applicable federal and state agencies provided no legal actions are pending."

Supporting documentation for 16 of 120 randomly selected Breeding Fund expenditures (dated from May 2010 to November 2010) could not be located for review, and only documentation from January 2011 forward was made available. Therefore, we were unable to conclude on the operating effectiveness of controls for the first six months of the audit period. Management stated that they were unable to locate these records because a storage facility move resulted in the records having been either lost or destroyed.

¹ Audit period July 1, 2010 through June 30, 2015, available online at <http://www.sai.ok.gov>.

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.

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Failure to maintain documentation of transactions increases the risk of unapproved payments being made without being detected, and impedes the ability of auditors or other independent parties to verify the appropriateness of transactions. It also places the agency out of compliance with state agency records retention guidelines.

Recommendation

We recommend management ensure Breeding Fund expenditure documentation is safely maintained and readily available for examination, and observe the records disposal timelines established for state agencies by the Archives and Records Commission.

Views of Responsible Officials

The Commission and Staff have always maintained retention of documents for audit and to their proper destruction date. During the move of all state agencies' storage from one warehouse to another the documents dated June 1, 2010 to December 31, 2010 for the Breeding Fund were destroyed in error. It was not until the audit was started five years later that the agency realized the documents were destroyed. The Agency has begun to scan many of the historical documents for permanent retention.

Overspending and Inadequate Documentation in the Breeding Fund Retirement Program

As authorized by Oklahoma Administrative Code section 325:75-1-21, the Agency administers the Breeding Fund Retirement Program. Through the program, monies are awarded for the purpose of caring for retired or unwanted accredited Oklahoma-Bred racing stock in adoption or pension programs. These monies derive from thoroughbred horse registry fees per 325:75-1-12.1. Non-profit horse adoption and pension entities must meet eligibility requirements, be requested by the official horsemen's representative organization, and be approved by the Agency executive director before receiving funding through the program.

Payments from the program were made from November 2012 through October 2014, when it was noticed that the program funding was overdrawn and payments were halted. We reviewed all documentation for the 43 payments made during audit period, totaling \$292,100, and related vendor approvals and supporting documentation, and noted the following:

Criteria	Compliance Status
The GAO's <i>Standards</i> state, "Internal control and all transactions and other significant	There were 43 total payments made to rehabilitation facilities during the audit period. Only a

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<p>events need to be clearly documented, and the documentation should be readily available for examination.”</p>	<p>letter from the executive director to the claims supervisor requesting payment was available for each of the 43 items. The agency was able to provide invoices for 8 of the 43 payments, and 5 of those invoices did not include a detailed listing of horses that were receiving treatment at the facility. Overall, we were unable to determine the appropriateness of 93% (40/43) of the payments due to inadequate documentation.</p>
<p>OAC 325:75-1-21.1 (1) states, “Should the Legislature in the future authorize the Oklahoma Breeding Development Fund Special Account monies to be used for the care of retired and unwanted Oklahoma-Bred accredited horses, then 50% of [thoroughbred] fees shall be placed in the Fund to be administered by the Commission for the care of retired and unwanted accredited Oklahoma-Bred Thoroughbred horses....”</p>	<p>We recalculated 50% of total Thoroughbred Registry Fee revenues through the final date the agency made payments from the Breeding Fund Retirement Program (October 8, 2014). As of that date, the agency had overspent the balance dedicated to the Retirement Program since its inception in fiscal year 2011 by \$56,665 or 24%. It appears the Retirement Program fund balance was not monitored by the executive director or an independent party to ensure adequate funds were available for the program payments. We did note that as of the end of calendar year 2015, sufficient revenues had been collected and that the Retirement Program was no longer at a negative balance.</p>
<p>OAC 325:75-1-21 (5)(A) lists the purpose of the Oklahoma Breeding Development Fund Special Account as “caring for retired and unwanted Oklahoma-Bred racing stock.”</p>	<p>Program payments were requested by rehabilitation facilities on a quarterly basis, and it appears the executive director approved the invoices to be paid at the beginning of each quarter for care that had not yet been provided to horses in the following three months. The three detailed invoices we were able to view from the rehabilitation</p>

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	<p>facilities were dated in the first month of the quarter and the check request from the Executive Director was dated the same month. All of the executive director's payment requests were dated in the first month of a quarter (January, April, July, and October). Payments being made at the beginning of a quarter could allow for rehabilitation facilities to receive payments for horses that have left the program prior to the end of the quarter.</p>
<p>OAC 325:75-1-21 (5)(A) states, "Requests by the official horsemen's representative must be made on an annual basis and no matter when made will only make the non-profit entity eligible during the calendar year in question, assuming all other requirements are met by the non-profit entity."</p>	<p>The Agency was unable to provide documentation of the breed association's official approval of the retirement facilities for each calendar year in which payments were made. We spoke with the breed association's representative, who stated that approval letters were sent directly to the OHRC executive director. However, it appears the Agency did not retain the evidence of these approvals.</p>
<p>OAC 325:75-1-21 (5)(B)(i) states, "No more than fifty percent (50%) of funds made available in the Oklahoma Breeding and Development Fund Special Account for the purpose of caring for retired or unwanted Oklahoma-Bred racing stock can be used to care for pensioned horses, horses that because of their health or condition are not being rehabilitated and/or retrained for adoption."</p>	<p>While available Agency records indicated that the 50% limit on funding to be provided to pension programs was not exceeded, without detailed original supporting documentation of the rehabilitation facilities' invoices, we were unable to independently verify which horses were classified as pensioned.</p>

The underlying cause of these issues appears to have been that adequate segregation of expenditure duties related to the Oklahoma Bred Retirement Program was not present. The executive director was responsible for approving retirement/rehabilitation facilities, receiving and approving invoices, and requesting and authorizing payments. Independent oversight of the Retirement program was non-existent.

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Failure to maintain documentation of transactions increases the risk of unapproved payments being made without being detected, and impedes the ability of auditors or other independent parties to verify the appropriateness of transactions. Without adequate controls and review by someone independent of the expenditures process, it is possible for funds to be misappropriated without being detected in a timely manner. Furthermore, due to lack of proper oversight of fund balances, overspending occurred, placing the agency in non-compliance with significant regulations.

Recommendation

To strengthen internal controls related to the Retirement Program, we recommend management should:

- Develop a system of monitoring and recordkeeping to ensure Breeding Fund expenditure documentation is safely maintained and readily available for examination.
- Segregate duties and responsibilities related to Retirement Program expenditures to ensure that not one person has control of all key aspects of a transaction (authorizing, processing and recording, reviewing, and handling any related assets).
- Consider implementing on-site inspection procedures to ensure payments are being made for qualified horses receiving appropriate care.
- Monitor the fund balance to ensure expenditures do not exceed 50% of thoroughbred registry fees dedicated to the Thoroughbred Retirement Program, ensuring compliance with OAC 325:75-1-21.1.

Views of Responsible Officials

The Commission has appointed a Committee to prepare written procedures, forms, inspections, and reports to more accurately administer the Thoroughbred Retirement Program. With the completion of the audit the Committee will make recommendation for implementation of these changes to the program.



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