



**OFFICE OF THE LEGISLATIVE AUDITOR**  
STATE OF MINNESOTA

**Financial Audit Division Report**

---

**Minnesota Racing  
Commission**

**Internal Controls and  
Compliance Audit**

**July 2012 through June 2014**

**December 4, 2014**

**Report 14-23**

---

FINANCIAL AUDIT DIVISION  
Centennial Building – Suite 140  
658 Cedar Street – Saint Paul, MN 55155  
Telephone: 651-296-4708 • Fax: 651-296-4712  
E-mail: [legislative.auditor@state.mn.us](mailto:legislative.auditor@state.mn.us)  
Website: <http://www.auditor.leg.state.mn.us>  
Through Minnesota Relay: 1-800-627-3529 or 7-1-1

---

## Financial Audit Division

The Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division has a staff of forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

The Office of the Legislative Auditor (OLA) also has a Program Evaluation Division, which evaluates topics periodically selected by the Legislative Audit Commission.

Reports issued by both OLA divisions are solely the responsibility of OLA and may not reflect the views of the Legislative Audit Commission, its individual members, or other members of the Minnesota Legislature. For more information about OLA reports, go to:

<http://www.auditor.leg.state.mn.us>

To obtain reports in electronic ASCII text, Braille, large print, or audio, call 651-296-4708. People with hearing or speech disabilities may call through Minnesota Relay by dialing 7-1-1 or 1-800-627-3529.

To offer comments about our work or suggest an audit, investigation, or evaluation, call 651-296-4708 or e-mail [legislative.auditor@state.mn.us](mailto:legislative.auditor@state.mn.us).

---

## Conclusion on Internal Controls

The Financial Audit Division bases its conclusion about an organization's internal controls on the number and nature of the control weaknesses we found in the audit. The three possible conclusions are as follows:

Conclusion	Characteristics
Adequate	The organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Generally Adequate	With some exceptions, the organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Not Adequate	The organization had significant weaknesses in the design and/or implementation of its internal controls and, as a result, the organization was unable to effectively manage the risks related to its financial operations.

---



## OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

December 4, 2014

Senator Roger J. Reinert, Chair  
Legislative Audit Commission

Members of the Legislative Audit Commission

Ralph Strangis, Chair  
Minnesota Racing Commission

Thomas DiPasquale, Executive Director  
Minnesota Racing Commission

This report represents the results of our internal controls and compliance audit of financial activities of the Minnesota Racing Commission for the period of July 2012 through June 2014.

We discussed the results of the audit with the commission's staff at an exit conference on September 30, 2014. This audit was conducted by Sonya Johnson, CPA, CFE (Audit Manager) and Pat Ryan, (Auditor-in-Charge), assisted by auditors Natalie Mehlhorn and Abdul Suleyman, CPA.

We received the full cooperation of the commission's staff while performing this audit.

Handwritten signature of James R. Nobles in black ink.

James R. Nobles  
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA  
Deputy Legislative Auditor



# Table of Contents

	<u>Page</u>
Report Summary .....	1
Agency Overview .....	3
Objective, Scope, and Methodology .....	8
Conclusion .....	9
Findings and Recommendations .....	11
1. The Minnesota Racing Commission made errors in processing awards from the Breeders' Fund account. This is a repeat finding.....	11
2. The Minnesota Racing Commission did not adequately monitor card club revenue reports to ensure the accuracy of taxes collected .....	12
3. The Minnesota Racing Commission did not ensure that it properly allocated and accurately recorded some of its revenues in the state's accounting system.....	12
Agency Response.....	15



## Report Summary

The Minnesota Racing Commission regulates horse racing and card playing at Canterbury Park, located in Shakopee, Minnesota, and Running Aces Harness Park, located in Columbus, Minnesota. Both facilities operate under licenses approved by the commission, and the commission has offices at both locations. The commission is governed by *Minnesota Statutes* 2013, chapter 240.

We examined the commission's internal controls over its financial operations and its compliance with finance-related legal requirements for fiscal years 2013 and 2014. Our review included revenues from license fees, pari-mutuel wagering taxes, payments from the race tracks, and card club taxes. We also reviewed expenses related to payroll, contractual services, and Breeders' Fund award and purse supplement payments. In addition, we reviewed steps the commission has taken to strengthen their oversight of the horseperson's purse agreements and purse accounts.

## Conclusion

We concluded the Minnesota Racing Commission's internal controls over its financial operations were generally adequate, and the commission generally complied with significant finance-related legal requirements; however, we found some internal control weaknesses and instances of noncompliance.

## Audit Findings

- The Minnesota Racing Commission made errors in processing awards from the Breeders' Fund account. This is a repeat finding. ([Finding 1, page 11](#))
- The Minnesota Racing Commission did not adequately monitor card club revenue reports to ensure the accuracy of taxes collected. ([Finding 2, page 12](#))
- The Minnesota Racing Commission did not ensure that it properly allocated and accurately recorded some of its revenues in the state's accounting system. ([Finding 3, page 12](#))





# Minnesota Racing Commission

## Agency Overview

The Minnesota Racing Commission regulates horse racing and card playing at Canterbury Park, located in Shakopee, Minnesota, and Running Aces Harness Park, located in Columbus, Minnesota. Both facilities operate under licenses approved by the commission, and the commission has offices at both locations. The commission is governed by *Minnesota Statutes* 2013, chapter 240.

The commission consists of nine members appointed by the Governor and confirmed by the Senate for six-year terms. The Governor also appoints the commission's executive director. Through the period covered by the scope of our audit, there were changes in executive directors. Richard Krueger, the executive director since 1989, retired in October 2012. From June 2013 to December 2013, the Department of Management and Budget assigned an employee to serve as a temporary executive director for the commission. In November 2013, Governor Dayton appointed Thomas DiPasquale as the commission's executive director, effective in December 2013. As of June 2014, the commission had nine full-time and 15 part-time employees.

The commission processed its own financial activity up until October 2013. At that time, the commission began using the Department of Administration's Small Agency Resource Team (SmART) to perform various accounting, payroll, human resource and personnel functions.

## Appropriations

The Legislature appropriates money to the commission from the Racing and Card Playing Regulation Account (in the Special Revenue Fund), which contains money the commission collects from issuing licenses.<sup>1</sup> The Legislature appropriated \$899,000 in fiscal year 2013<sup>2</sup> and \$899,000 in fiscal year 2014.<sup>3</sup> According to state law, the commission may only spend the receipts it collects in this account up to the amount that was appropriated.<sup>4</sup> During the 2014 legislative session, the commission received an additional appropriation of \$185,000 for the 2014/2015 biennium for general operations.<sup>5</sup>

---

<sup>1</sup> *Minnesota Statutes* 2013, 240.15, subd. 6.

<sup>2</sup> *Laws of Minnesota* 2011, First Special Session, chapter 10, art.1, sec. 16.

<sup>3</sup> *Laws of Minnesota* 2013, chapter 142, art. 1, sec. 16.

<sup>4</sup> *Minnesota Statutes* 2013, 240.15, subd. 6.

<sup>5</sup> *Laws of Minnesota* 2014, chapter 312, art. 4, sec. 2, subd.3.

## Revenue from License Fees

State law authorizes the commission to issue four types of licenses and sets the amount the commission may charge for each type of license, as follows:

1. Class A licenses are issued for ownership and operation of a facility where horse racing and pari-mutuel betting are conducted. The fee for a class A license is \$253,000 per year.<sup>6</sup> Canterbury Park and Running Aces Harness Park have each been issued a class A license.
2. Class B licenses are issued for the sponsorship and management of a facility where horse racing and pari-mutuel betting are conducted. The fee for a class B license is \$500 for each day the track conducts live racing, and \$100 for each day there is simulcast wagering. Canterbury Park and Running Aces Harness Park have each been issued a class B license.
3. Class C licenses are issued to anyone employed by or providing services to a race track facility. The fees for a class C license range from \$5 to \$100.<sup>7</sup> State law provides that the commission shall, by rule, establish the license fee for each occupation it licenses up to \$100 per license annually. The commission issued 5,226 class C licenses in calendar year 2013.<sup>8</sup>
4. Class D licenses are issued for the conduct of pari-mutuel horse racing by county agricultural societies or associations. The fee for a class D license is \$50 for each day racing is conducted. The commission did not issue any Class D licenses in calendar year 2013.

## Payments from the Race Tracks

The commission hires veterinarians, stewards, and contracts for laboratory testing, to ensure the integrity of the activities it licenses and regulates. The commission receives payments from the race tracks for these costs in addition to a portion of commission staff time for oversight responsibilities. During fiscal years 2013 and 2014, the commission billed the tracks in advance based on the estimated costs of these services. At the end of the live racing season, the commission performed a reconciliation between estimated and actual costs. Beginning in fiscal year 2015, the commission will bill the tracks based on actual costs to be more consistent with statute.<sup>9</sup>

---

<sup>6</sup> *Minnesota Statutes* 2013, 240.05, subd. 1, authorizes the four types of licenses, and *Minnesota Statutes* 2013, 240.10 set the fees for each type of license.

<sup>7</sup> The commission's rule that establishes the fees for each type of occupation license is *Minnesota Rules* 2013, 7877.0120.

<sup>8</sup> Minnesota Racing Commission 2013 Annual Report, February 1, 2014, p. 8.

<sup>9</sup> *Minnesota Statutes* 2013, 240.155, subd. 1

As shown in Table 1, the commission's main sources of funds consisted of payments from the race tracks and license and fee receipts. The commission's main uses of funds were payroll and contractual services.

**Table 1**  
**Special Revenue Fund**  
**Sources and Uses of Financial Resources**  
**Fiscal Years 2013 and 2014**

	<u>2013</u>	<u>2014</u>
<b>Sources</b>		
License and Fee Receipts <sup>1</sup>	\$ 800,361	\$ 831,392
Pari-Mutuel Tax Revenue <sup>2</sup>	45,821	51,250
Payments from Race Tracks <sup>3</sup>	1,113,000	1,178,000
Other Revenues	3,750	6,351
Balance Forward-In	<u>609,322</u>	<u>582,840</u>
Total Sources	<u>\$2,572,254</u>	<u>\$2,649,833</u>
<b>Uses</b>		
Payroll	\$1,010,280	\$1,004,081
Contract Services	765,536	862,350
Supplies/Equipment	52,444	42,351
Equine Grants	17,204	13,100
Other Operating Expenditures <sup>4</sup>	143,950	227,818
Balance Forward-Out	<u>582,840</u>	<u>500,133</u>
Total Uses	<u>\$2,572,254</u>	<u>\$2,649,833</u>

<sup>1</sup> *Minnesota Statutes* 2013, 240.15, subd. 6, allow the commission to use the receipts it collects up to the amount of its appropriation. The statutory appropriation for fiscal year 2013 was \$899,000 and \$999,000 for fiscal year 2014. However, the commission only collected license fees of \$800,361 and \$831,392 for fiscal years 2013 and 2014, respectively. The commission's spending authority allows it to carry forward balances to the next fiscal year.

<sup>2</sup> The commission retained a portion of the pari-mutuel taxes collected to fund its administrative costs associated with operating the Breeders' Fund as allowed by *Minnesota Statutes* 2013, 240.18, subd. 1.

<sup>3</sup> Canterbury Park and Running Aces Harness Park paid the commission for the costs of contracting with veterinarians, racing stewards, and testing laboratories. In addition, the tracks paid the commission for the costs of regulating the card clubs.

<sup>4</sup> Other operating expenditures include travel, printing and advertising, communications, state agency provided professional/technical services, and attorney general and statewide indirect costs.

Source: The state's accounting system.

## Breeders' Fund

The commission is responsible for administering the Breeders' Fund.<sup>10</sup> The primary purpose of the Breeders' Fund is to provide incentives to Minnesota horse breeders and owners to participate in the breeding and racing industry. The commission maintains separate accounts within the fund for Arabian,

<sup>10</sup> *Minnesota Statutes* 2013, 240.18.

thoroughbred, quarterhorse, and standardbred horses. *Minnesota Statutes* 2013, 240.18, allows the commission to deduct a portion of the revenues received from live racing to pay the costs of administering the fund before distributing the remainder for grants, breeders' and owners' awards, purse supplements, and other financial incentives.

The race tracks must pay the Breeders' Fund a pari-mutuel tax of one percent of the total amount wagered on each live race.<sup>11</sup> In addition, the tracks must pay a five and one-half percent tax<sup>12</sup> of the takeout<sup>13</sup> on simulcast races.<sup>14</sup> These taxes generated approximately \$499,000 in fiscal year 2013 and \$533,000 in fiscal year 2014.

Statutes require that the card clubs must also pay a tax on each club's total revenues.<sup>15</sup> The statute requires that 10 percent of revenues up to \$6,000,000, and 14 percent of revenues in excess of \$6,000,000, go into the purse accounts.<sup>16</sup> The Breeders' Fund receives ten percent of these revenues. The statute allows the tracks and the horsepersons'<sup>17</sup> associations to negotiate alternative rates different from the statutory rates if the agreement is in writing and on file with the commission.<sup>18</sup> This tax generated approximately \$608,000 in fiscal year 2013 and \$602,000 in fiscal year 2014.

Table 2 shows the Breeders' Fund financial activity.

---

<sup>11</sup> *Minnesota Statutes* 2013, 240.15, subd.1 (a).

<sup>12</sup> *Minnesota Statutes* 2013, 240.13, subd. 5(a) (3).

<sup>13</sup> Takeout is the amount that a racetrack deducts from various betting pools before paying holders of winning tickets. *Minnesota Statutes* 2013, 240.13, subd. 4, authorizes the maximum takeout rates.

<sup>14</sup> Simulcast is the televised display of one or more horse races conducted at another location where the televised display occurs simultaneously with the race being televised.

<sup>15</sup> *Minnesota Statutes* 2013, 240.135

<sup>16</sup> Each track maintains an account where horsepersons receive a certain amount of money based on the results of each race.

<sup>17</sup> Horsepersons are those currently licensed by the commission as owners, lessees, or trainers.

<sup>18</sup> During our audit scope, Canterbury Park followed the statutory formula. Running Aces Harness Park contributed 12 percent of total revenues into the purse accounts and 10 percent of that into the Breeders' Fund.

**Table 2**  
**Breeders' Fund**  
**Sources and Uses of Financial Resources**  
**Fiscal Years 2013 and 2014**

	<u>2013</u>	<u>2014</u>
<b>Sources</b>		
Card Club Taxes	\$ 607,523	\$ 602,390
Pari-Mutuel Taxes	499,051	533,261
Other Revenues <sup>1</sup>	28,778	32,884
Balance Forward-In <sup>2</sup>	<u>676,449</u>	<u>848,444</u>
Total Sources	<u>\$1,811,801</u>	<u>\$2,016,979</u>
<b>Uses</b>		
Purse Supplements	\$ 763,783	\$ 691,978
Awards	179,950	276,114
Other Operating Expenditures <sup>1</sup>	19,624	32,913
Balance Forward-Out	<u>848,444</u>	<u>1,015,974</u>
Total Uses	<u>\$1,811,801</u>	<u>\$2,016,979</u>

<sup>1</sup>Other revenues and other operating expenditures include fees paid by licensees to offset the commission's costs to perform background checks through the Department of Public Safety. These fees and costs are not directly related to the Breeders' Fund.

<sup>2</sup>The commission's spending authority allows it to carry forward balances into the next fiscal year.

Source: The state's accounting system.

## Purse Fund Oversight

In July 2014, the Office of the Legislative Auditor (OLA) issued a special review, which concluded that the commission had not exercised adequate oversight of purse agreements and purse contributions at Running Aces Harness Park.<sup>19</sup> During this review, we conducted interviews with commission management about their response to the OLA special review and obtained purse agreements and purse accounting records. The commission has begun implementing steps to strengthen their oversight procedures. The commission now receives daily wagering reports from both tracks that detail the calculation of purse contributions and purse fund accounting reports. The commission is reviewing all agreements negotiated between the tracks and the horseperson's associations. We tested purse contributions made by both tracks. However, not enough time has transpired for us to conclude on whether the weaknesses found in the special review have been fully resolved.

<sup>19</sup> Office of the Legislative Auditor, Special Review, report 14-16, *Minnesota Racing Commission: Oversight of Purse Contributions at Running Aces Harness Park*, issued July 8, 2014.

## Objective, Scope, and Methodology

The objective of our audit was to answer the following questions related to the financial operations of the Minnesota Racing Commission during the period of July 2012 through June 2014:

- Did the Minnesota Racing Commission have adequate internal controls and comply with significant finance-related legal requirements?
- Did the Minnesota Racing Commission resolve its prior audit findings?<sup>20</sup>

Our review included revenues from license fees, pari-mutuel wagering taxes, payments from the race tracks, and card club taxes. We also reviewed expenses related to payroll, contractual services, and Breeders' Fund award and purse supplement payments. In addition, we reviewed steps the commission has taken to strengthen their oversight of the horseperson's purse agreements and purse accounts.

We used several sources to evaluate internal controls and compliance. To evaluate the commission's controls, we used the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.<sup>21</sup> To evaluate compliance, we primarily used:

- *Minnesota Statutes* 2013, chapter 240.
- *Minnesota Rules* 2013, chapters 7869 through 7899.
- Department of Management and Budget's policies and procedures.
- Purse agreements between Canterbury Park, Running Aces Harness Park, and horseperson's associations.

To meet the audit objective, we performed the following procedures:

- We interviewed staff to gain an understanding of the commission's financial policies and procedures.

---

<sup>20</sup> Office of the Legislative Auditor, Financial Audit Division report 10-32, *Minnesota Racing Commission*, issued October 14, 2010.

<sup>21</sup> The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity. The resulting *Internal Control-Integrated Framework* is the accepted accounting and auditing standard for internal control design and assessment.

- We considered the risk of errors in the commission's accounting records, obtained and analyzed accounting data to identify unusual trends or significant changes in the commission's financial operations, and examined samples of financial transactions and supporting documentation.
- We obtained Horseperson's Purse Account financial records from Canterbury Park and Running Aces Harness Park.
- We obtained horse racing wagering data and analyzed the data to determine if both tracks deposited the appropriate amounts into the purse accounts and the Breeders' Fund.
- We obtained detail and summary level card club revenue reports and determined whether both tracks deposited accurate amounts to the purse accounts and the Breeders' Fund in compliance with finance-related legal requirements.
- We discussed with commission management the procedures and reviews they have implemented, and plan to implement, to increase their oversight of purse agreements and purse account activities.

We conducted the 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.

## Conclusion

We concluded the Minnesota Racing Commission's internal controls over its financial operations were generally adequate,<sup>22</sup> and the commission generally complied with significant finance-related legal requirements; however, we found some internal control weaknesses and instances of noncompliance.

The following *Findings and Recommendations* section provides further explanation about the exceptions noted above.

---

<sup>22</sup> With some exceptions, the organization designed and implemented internal controls that effectively manage the risks related to its financial operations.





# Findings and Recommendations

**The Minnesota Racing Commission made errors in processing awards from the Breeders' Fund account. This is a repeat finding.**

## Finding 1

The commission pays awards to breeders and owners of Minnesota-bred horses in various categories.<sup>23</sup> In order to perform this function, the commission developed a database to record the results of races in which Minnesota-bred horses competed. At the end of each live meet, the program calculated the award amounts due to eligible breeders and owners of various breeds of horses. In fiscal years 2013 and 2014, the program did not produce reliable data. In order to pay the required awards, commission staff manually recalculated the awards and entered the payments into the accounting system.

However, commission staff made the following Breeders' Fund payment errors:

- The commission paid three duplicate awards, totaling \$5,546.
- The commission overpaid two awards, totaling \$1,871.
- The commission failed to pay three awards, totaling \$1,794.
- The commission paid \$15,101 from incorrect Breeders' Fund award accounts.

The commission did not have an independent employee who was not involved in the payment process compare the calculated award amounts and the payments made. If a comparison had been done, it is likely the commission would have detected and corrected the errors, providing better assurance that the award payments were accurate.

In addition, the commission did not process award payments for the 2012 and 2013 live racing meets within 45 days of the end of the race meets for the standardbred, thoroughbred, and quarterhorse categories as required by *Minnesota Rules*.<sup>24</sup> The commission paid some awards as late as nine months beyond the 45-day requirement.

---

<sup>23</sup> *Minnesota Statutes* 2013, 240.18.

<sup>24</sup> *Minnesota Rules* 2013, 7895.0110, subp. 6, 7895.0250, subp. 6, and 7895.0300, subp 6.

*Recommendations*

- *The Minnesota Racing Commission should have an employee who was not involved in the payment process compare the calculated award amounts and the payments made to ensure it accurately pays owners and breeders.*
- *The Minnesota Racing Commission should seek repayment of award overpayments, and pay the awards it did not pay.*
- *The Minnesota Racing Commission should ensure it pays award payments within 45 days of the end of the live race meets.*

## **Finding 2**

**The Minnesota Racing Commission did not adequately monitor card club revenue reports to ensure the accuracy of taxes collected.**

The card clubs at Canterbury Park and Running Aces Harness Park provided monthly revenue reports to the commission showing the amount of gross revenue obtained from card club wagering for the previous month. The card clubs submitted these reports by the fifth day of each month along with the tax due based on these revenues to the Breeders' Fund.

The card clubs prepared daily count sheets and submitted them to the accounting department at each track. The card clubs use the daily count sheets to prepare the monthly revenue reports. Commission staff received the daily count sheets but did not compare them to the monthly revenue reports. This periodic comparison would verify both the accuracy of the reported monthly revenues and the amount due to the Breeders' Fund.

We tested a sample of daily count sheets to determine the accuracy of the amounts recorded on the monthly revenue reports. We did not find any discrepancies in the ones we tested.

*Recommendation*

- *The Minnesota Racing Commission should periodically compare the card clubs' monthly revenue reports to the daily count sheets.*

## **Finding 3**

**The Minnesota Racing Commission did not ensure that it properly allocated and accurately recorded some of its revenues in the state's accounting system.**

The commission did not allocate some card club tax revenues into the correct accounts in the Breeders' Fund. Commission staff told us the error occurred

because they were not informed of a change to the agreement between the horseperson's association and Canterbury Park, which changed the allocation of card club revenues to the purse supplement accounts for two different breeds in the Breeders' Fund.<sup>25</sup> As a result, the purse account for one breed (quarterhorses) received an overpayment of \$2,874, and the purse account for the other breed (thoroughbred) received an underpayment of \$2,874. Incorrect allocations affect the funds available for distribution of purse supplements.

In addition, the commission did not accurately record card club revenues to the correct purse account within the same breed of horse in the state's accounting system.<sup>26</sup> This error resulted in an underpayment to one purse account of \$17,706, with a corresponding overpayment of the same amount in a different purse account in the state's accounting system.

The commission also incorrectly recorded \$7,000 in membership dues to the Breeders' Fund account instead of the commission's operating account.

Finally, the commission incorrectly recorded \$2,750 of fine revenues in our sample in the commission's operating account. *Minnesota Statutes* 2013, 240.22, requires that fine revenues go into the state's General Fund.

#### *Recommendations*

- *The Minnesota Racing Commission should develop procedures to ensure the proper allocation of revenues and proper deposit into the correct funds.*
- *The Minnesota Racing Commission should correct the recording errors in the state's accounting system.*

---

<sup>25</sup> 2013-2014 Multi-Breed Racing Agreement between Canterbury Park, the Minnesota Horsemen's Benevolent & Protective Association, and the Minnesota Quarter Horse Racing Association, changed the allocation of card club revenues to the purse supplements for thoroughbred/quarterhorses from 90%/10% to 91.5%/8.5%.

<sup>26</sup> Each track maintains an account where horsepersons receive a certain amount of money based on the results of each race.





---

MINNESOTA RACING COMMISSION

Mr. James Nobles, Legislative Auditor  
Office of the Legislative Auditor  
Room 140 Centennial Building  
658 Cedar Street  
St. Paul, MN 55155

12.01.2014

Dear Mr. Nobles:

On behalf of the Minnesota Racing Commission (MRC), we wish to thank you and your staff for their work in completing the audit of MRC's financial operations for fiscal years 2013-2014. As your report notes, there has been significant change in Commission leadership since the prior audit in October 2010. Many of those leadership changes post-date the period covered by the current audit and were driven, in part, by the recognized need to shore up operational discipline in financial and administrative management.

Specifically, the Department of Administration's Small Agency Resource Team (SmART) began processing MRC's SWIFT financial transactions in October 2013. In June 2014, the MRC hired Deputy Director Joe Scurto, whose accounting, financial and operational experience has contributed greatly to the improvement in our internal controls. Finally, Governor Dayton's commission appointments of MRC Chairman Ralph Strangis and others have added legal, financial and administrative expertise to assist in oversight of our financial controls.

Although the audit report does have a repeat finding with respect to Breeders' Fund awards, we concur with the report's conclusion that the MRC's internal controls over financial operations were generally adequate and in compliance with finance-related legal requirements. This conclusion is consistent with our own Internal Controls Self-Assessment which we completed earlier this year. To be sure, improvement opportunities exist. Those opportunities have been identified and we are acting on them.

Before responding to the specific findings and recommendations, I'd like to address the purse fund oversight discussion at page 7 of the audit report. While it is true that not much time has passed since the OLA's Special Review on the oversight of purse contributions at Running Aces Harness Park, it's important to note that the purse contribution shortfall was resolved by Running Aces' full payment to the horsepersons' purse account and the MRC has implemented most of the corrective actions that were described in our June 30, 2014 response to the Special Review. MRC is confident that the measures now in place,

including agreement by all parties on the interpretation of the purse contribution statute, have ameliorated the issue.

The MRC's remedial actions in response to the specific audit findings are set out below.

**Finding 1. The MRC made errors in processing awards from the Breeders' Fund account. This is a repeat finding.**

The OLA recommendations include increased internal controls to ensure accuracy in payments to owners and breeders, reconciliation of previous under and over payments to specific owners and breeders, and ensuring award payments within the period provided by rule, that is, 45 days from the end of live racing.

The repeat finding is disappointing because owners and breeders must have confidence that awards are accurate and paid on time. Anything less simply provides a disincentive to participation in the Minnesota racing industry. However, the repeat finding is understandable because the root cause for the deficiency in 2010 was not adequately addressed. Our remedial action plan is as follows:

1. Breeders' Fund payment errors that were discovered in the audit report have been, or are being, corrected by staff and will be completed by December 31, 2014.
  - The three duplicate awards totaling \$5,546 from 2012 and 2013 had already been recovered prior to the audit.
    - *A repayment check was received in the amount of \$5265.92 to cover two of the 2012 overpayments from one party and redeposited into the Breeders' Fund on 1.15.13.*
    - *The duplicate check issued on 2013 for \$279.65 was physically recovered and a stop payment placed on 1.6.14.*
  - The \$1,859.99 overpayment of one award from 2013 was deducted from payments made to this individual in 2014. The MRC is currently trying to collect the second overpayment from 2012 in the amount of \$11.38, and if unsuccessful monies will be deducted from any future payments to this individual.
  - The three awards from 2012-2013 totaling \$1,794 that were not paid to individuals are currently scheduled to be paid in December 2014 from funds that have been rolled forward.

- The \$15,101 in awards that were paid from incorrect accounts within the Breeders' Fund have been identified. Staff has submitted corrections, and these corrections have been sent to SmART Finance to be placed into the proper accounts. These corrections will be completed by December 31, 2014.
2. As noted in the audit report, the Breeders' Fund database and related computer program are flawed. The need to manually recalculate awards results in both inefficiencies in processing awards (which contributes to payment delays) and errors in calculating awards. Therefore, MRC will abandon the program and create a new tracking process by installing new database/financial software. The Deputy Director will oversee the changeover and coordinate the efforts of MRC staff, SmART Finance and, to the extent needed, MN.IT to implement and administer the new program prior to next year's distribution in October 2015.
  3. The MRC has already put in place a system of checks and balances to ensure accuracy in future award payments. A newly-hired Compliance Administrator will be the lead Standardbred Breeders' Fund administrator and the secondary (back-up) administrator for the Thoroughbred and Quarter Horse Breeders' Funds. The Deputy Director and SmART Finance will provide final reviews before issuance of payments and guidance to improve the process.
  4. MRC staff and SmART have also instituted new pass through accounts that are specific to each category of Breeders' Fund revenues and expenditures. This new accounting procedure will allow for easier auditing and, importantly, will provide current balances during the fiscal year to all parties, including breeders and owners. This change was also endorsed by OLA auditors.
  5. Finally, attributable in part to the program flaws, award payments were not fully processed within 45 days but there was significant improvement. Thoroughbred and Quarter Horse payments for 2014 were processed within 60 days and Standardbred payments were processed within 50 days.

**Finding 2. The MRC did not adequately monitor card club revenue reports to ensure the accuracy of taxes collected.**

The audit report recommends that MRC periodically compare the card clubs' monthly revenue reports to the daily count sheets.

1. MRC staff will immediately begin conducting monthly comparative analysis and auditing of daily count sheets to ensure they are reconciled with the monthly reports. In addition, MRC is working with the Alcohol and Gambling Enforcement Division to develop additional auditing processes to assess the accuracy and integrity of daily count sheets and money handling procedures. We expect this additional layer of oversight to be in place by 1st Quarter 2015.

**Finding 3. The MRC did not ensure that it properly allocated and accurately recorded some of its revenues in the state's accounting system.**

The audit report recommended that MRC develop procedures to ensure proper allocation of revenues and deposit of funds into the correct funds and that it correct the recording errors found in the audit.

1. The recording errors have been or will be corrected by the following account transfers and reconciliations:
  - A correction for the purse supplement account for the Quarter Horse Breeders' Fund which was overpaid \$2,874 was submitted on 9.25.14 and said funds were transferred back into the purse supplement account for the Thoroughbred Breeders' Fund.
  - The inaccurate recording of a card club revenue deposit into the wrong purse supplement account due to a data entry error was addressed on 11.26.14, and will be corrected in the state's accounting system by 12.15.14.
  - The incorrectly recorded \$7,000 in MRC's membership dues for the Association of Racing Commissioners International was accounted for prior to the distribution of any Breeders' Awards in 2014 and will be correctly allocated within the commission's operating account prior to 12.31.14.
  - The \$2,750 in fines that were improperly recorded as revenue to the operating account was transferred out of said account and into the state's General Fund on 8.27.14.
2. MRC believes that the internal control changes described above are adequate in their own right to ensure increased accuracy in the allocation of revenue and deposit of funds into Breeders' Fund accounts. In addition, MRC will work with SmART Finance to ensure deposit templates and procedures remain updated. We will also establish a schedule for periodic reviews to ensure deposits are accurate.

Finally, it is worth highlighting the budget challenge facing the MRC and the potential impact on its regulatory mission. Table 1 on page 5 of the audit report demonstrates this in stark terms. License and fee receipts were \$800,361 and \$833,873 for fiscal years 2013 and 2014, respectively. Operating expenditures are anticipated to escalate to nearly \$1 million this year and will continue in that range in the next biennium. Payroll alone at current staffing levels will exceed \$1 million in the next biennium. Additional expenditures include anticipated increases in attorney general costs, costs of state agency-provided



professional/technical services, the need to address historical underinvestment in IT systems (as pointed out in this audit), professional development of our human resources, and travel costs for participation in industry-related conferences. These costs are directly related to MRC's core functions of protecting the health, welfare and safety of racing's participants and ensuring the integrity of racing and card room operations.

Addressing this structural operating budget shortfall without burdening the industry with increased fees is a major priority for the MRC.

The MRC and its staff appreciate the contributions of your staff in helping us improve our internal controls and financial compliance. I believe this report substantiates what those of us at MRC believe to be the case--that we are on an upward arc in the quality and integrity of our operations.

Sincerely,

*/s/ Tom DiPasquale*

Tom DiPasquale  
Executive Director

cc: Ralph Strangis, Chair  
Joe Scurto, Deputy Director  
Racing Commissioners