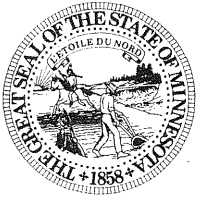

**MINNESOTA RACING COMMISSION
FINANCIAL AND COMPLIANCE AUDIT
FOR THE PERIOD JULY 1 THROUGH
DECEMBER 31, 1985**

MARCH 1986

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Randolph W. Peterson, Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Ray Eliot, Chairman
Minnesota Racing Commission

Members of the Minnesota Racing Commission

and

Mr. David J. Freeman, Executive Director
Minnesota Racing Commission

Audit Scope

We have completed a financial and compliance audit of the Minnesota Racing Commission for the period July 1 through December 31, 1985. Section I provides a brief description of the Minnesota Racing Commission's activities and finances, and clarifies that any licensed racetracks in Minnesota are independently operated and not administered by the Commission. Our audit was made in accordance with generally accepted auditing standards, and the standards for financial and compliance audits contained in the U.S. General Accounting Office Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, and accordingly, included such audit procedures as we considered necessary in the circumstances. Field work was completed on January 30, 1986.

The objectives of the audit were to:

- study and evaluate the system of internal control of the Commission as of December 31, 1985;
- evaluate compliance with applicable state laws, regulations, and administrative procedures;
- evaluate the recording and reporting of financial transactions, including procedures to ensure that financial transactions were processed and recorded in conformance with applicable accounting principles; and
- determine the status of prior audit recommendations.

Our study included a review of administrative disbursements, receipts and imprest cash. We reviewed methods followed by the Commission to ensure that the proper amount of pari-mutuel taxes and license fees were paid to the state. We also studied receipts and disbursements pertaining to equine drug testing and the Minnesota Breeders' Fund.

Senator Randolph W. Peterson, Chairman
Members of the Legislative Audit Commission
Mr. Ray Eliot, Chairman
Members of the Minnesota Racing Commission
and
Mr. David J. Freeman, Executive Director
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The management of the Minnesota Racing Commission is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

The management of the Commission is also responsible for compliance with laws and regulations. In connection with our audit, we selected and tested transactions and records from the programs administered by the Commission. The purpose of our testing of transactions was to obtain reasonable assurance that the Commission had, in all material respects, administered its programs in compliance with applicable laws and regulations.

Conclusions

In our opinion, except for the issues raised in Recommendations 1 through 10, the system of internal accounting control of the Minnesota Racing Commission in effect on December 31, 1985, was sufficient to provide management with reasonable, but not absolute assurance, that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization.

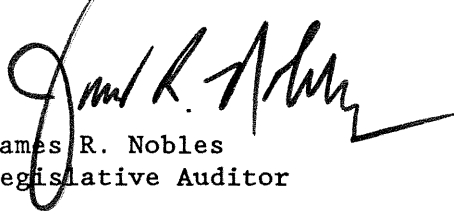
In our opinion, for the period July 1 through December 31, 1985, financial transactions were properly recorded in the Statewide Accounting System.

In our opinion, for the period July 1 through December 31, 1985, the Minnesota Racing Commission administered its programs in compliance, in all material respects, with applicable finance-related laws and regulations.

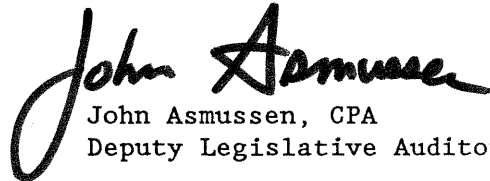
Section II of this audit report contains the recommendations we developed during this audit. They are presented to assist you in improving accounting procedures and controls. We will be monitoring and reviewing your progress on implementing these recommendations after the dates projected for completion as identified in the response to this report. Section III includes a summary of the progress on all recommendations developed during our audit of the years ended June 30, 1984 and 1985.

Senator Randolph W. Peterson, Chairman
Members of the Legislative Audit Commission
Mr. Ray Eliot, Chairman
Members of the Minnesota Racing Commission
and
Mr. David J. Freeman, Executive Director
Page 3

We would like to thank the staff of the Minnesota Racing Commission for the cooperation extended to our staff during this audit.



James R. Nobles
Legislative Auditor



John Asmussen, CPA
Deputy Legislative Auditor

April 2, 1986

MINNESOTA RACING COMMISSION

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AUDIT PARTICIPATION

The following members of the Office of the Legislative Auditor prepared this report:

John Asmussen, C.P.A.	Deputy Legislative Auditor
Warren Bartz, C.P.A.	Audit Manager
Kathy Quandt	Auditor-In-Charge
Ellen Merlin	Staff Auditor

EXIT CONFERENCE

The findings and recommendations included in this report were discussed with the following Minnesota Racing Commission staff at an exit conference which we held with them on January 31, 1985:

David J. Freeman	Executive Director
Richard G. Krueger	Director of Pari-mutuels and Finance
Patrick Shannon	Director of Security

MINNESOTA RACING COMMISSION

I. INTRODUCTION

The Minnesota Racing Commission was created by the Minnesota Legislature and the powers and duties of the Commission are specified in Laws 1983, Chapter 214 (coded Minn. Stat. Chapter 240). The Racing Commission consists of nine individuals appointed by the Governor. The Commission appoints an executive director to serve as the chief administrative officer of the Commission. David J. Freeman has served as executive director of the Commission since August 1, 1985.

Primary powers and duties of the Commission include: regulating horse racing and enforcing all laws and rules governing horse racing; collecting and distributing all taxes imposed upon receipts collected by licensed racetracks; supervising the conduct of pari-mutuel betting on horse racing; conducting necessary investigations and inquiries, including obtaining information and documentation deemed necessary to carry out its duties; and issuing four classes of licenses. The Commission receives an appropriation from the Legislature to cover operational expenses.

At the present time, Canterbury Downs in Shakopee is the only racetrack licensed by the Commission. It is not operated by the Commission, but by a private corporation which uses a computerized wager processing system to account for receipts at the racetrack including revenue to the state. This corporation is audited by an independent certified public accounting firm, and we did not review the accuracy of the financial information provided by the computerized wager processing system.

For the 1985 race season at Canterbury Downs (June 26, 1985 - October 15, 1985), the Commission collected approximately \$4,462,747, which was deposited as nondedicated receipts of the General Fund and was not available for use by the Racing Commission.

General Fund

Taxes collected from Canterbury Downs, Shakopee, including tax levied as a percent of total pari-mutuel bets, admission fees and one-half of breakage receipts . . .	\$3,957,729
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License receipts collected by the Commission for issuance of Class A, B, and C licenses pertaining to the 1985 race meet	116,800
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Fees billed to Canterbury Downs to cover part of the costs of equine drug tests performed by the Commission . . .	58,825
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Statutory fines.	9,000
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Unredeemed ticket money turned over to the Commission for unclaimed winning pari-mutuel tickets at Canterbury Downs as of January 23, 1985.	<u>320,393</u>
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Total nondedicated receipts collected for the 1985 race meet and deposited in the General Fund	<u>\$4,462,747</u>
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The Minnesota Breeders' Fund also earned \$600,949 during the 1985 race meet. Of this total, \$133,902 was paid in purse supplements by the race-track and \$321,825 was paid by the Commission to Minnesota horse owners and breeders. Before the next race season, \$116,583 remains to be paid in the form of grants for equine research.

MINNESOTA RACING COMMISSION

II. CURRENT FINDINGS AND RECOMMENDATIONS

Daily summaries of occupational license revenue did not always reflect the actual revenue for a particular day and did not consistently equal daily deposits.

The Minnesota Racing Commission issues class "C" occupational licenses to all individuals who are employed at licensed horse racing tracks in the state or who have an ownership interest which pertains to horse racing or a racetrack. For example, concessionaires and all other employees who worked at the racetrack in Shakopee had to apply for a class C license before beginning work.

On a daily basis, summaries of license revenue did not always equal deposits. However, over the 1985 racing season, total calculated revenue of \$97,735 almost equaled daily deposits of \$98,500.

Before the 1985 race meet began on June 26, 1985, the Commission was not able to develop a computer system which would accurately summarize license revenue for each day. Therefore, staff attempted to segregate license applications received on a particular day from all other applications. At the end of the day, applications were reviewed and staff calculated total license revenue for the day. Calculated revenue infrequently equaled total deposits for the day. For example, in our test sample of ten days, calculated revenue exceeded deposits by as much as \$362 on one day and deposits exceeded calculated revenue on two days by \$120 and \$600.

Although the reason for most variances could not be identified, some discrepancies were explained as follows:

- Licenses were removed by staff from processing batches for various purposes. Such purposes included completing security checks on license applicants or entering data from license applications onto the Commission's computer system.
- When the Commission first began issuing licenses, approximately \$300 of receipts were withheld from a daily deposit and the money was used as a change fund for about four days until cash for the change fund was received from the Department of Finance. This procedure was contrary to the requirements of Minn. Stat. Section 16A.275, which requires daily deposit of amounts over \$250.
- In another instance, deposits on four or five consecutive days were less than calculated revenue. Daily license summaries showed that from \$280 to \$440 was withheld on each of these days to pay salaries owed to stewards. Stewards later reimbursed the Racing Commission for salaries advanced to them from licensing receipts, and this money was deposited as license receipts in the General Fund. This procedure also was contrary to the requirements of Minn. Stat. Section 16A.275.

MINNESOTA RACING COMMISSION

- Other over/short deposits may have been caused by using receipts to balance the amount in the change fund. Any cash overages were added to daily deposits and cash shortages were withheld from deposits. Cash over and short amounts were not offset against each other during the race meet. Problems with imprest cash are also discussed in a following section.

Commission staff stated that problems such as those identified above were unique to the first racing season. Other licensing problems are also discussed in the following section. During the next racing season, Commission staff will process license applications and renewals via an on-line computer licensing system. The computer system may resolve many of the problems noted above because the computer is to generate an accurate daily summary of total license revenue earned.

RECOMMENDATIONS:

1. *The Commission should ensure that an accurate summary of daily license revenue is maintained for each day licenses are issued. The summary of daily license revenue earned should be reconciled to cash deposits.*
2. *The Commission should deposit all receipts intact each day that they total over \$250, as required by Minn. Stat. Section 16A.275.*
3. *The Commission should work with the Department of Finance to establish a cash over and short account in accordance with Minn. Stat. Section 16A.276.*

Duties for processing payroll and occupational license transactions need to be separated.

The segregation of incompatible functions is an essential element of accounting control. Incompatible functions are those that place any person in a position to both perpetrate and conceal errors or irregularities in the normal course of the person's duties. Although our audit showed no evidence of any irregularities, it is important that the Commission establish controls to prevent or detect errors or irregularities.

Incompatible functions performed by the same individual were noted in the areas of payroll and licensing. A summary of problems noted in each area follows:

Payroll

The office manager performs certain duties in the payroll system which are incompatible. She prepares and inputs information into the state personnel/payroll system from the payroll time roster and authorizes the payroll by signing the payroll precertification and certification reports. These reports state the number of hours worked by each employee and identify any annual or sick leave taken by employees. Because the office manager inputs payroll data and authorizes the payroll reports, errors in the calculation of wages or payments to fictitious employees could occur and remain undetected.

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Occupational Licensing

Commission staff expected to issue 3500 licenses during the 1985 race meet; however, more than 5600 class C occupational licenses were actually issued. Because Commission staff were primarily concerned that all individuals were licensed before the race meet began, some internal control procedures which would have helped to ensure the accuracy and validity of license receipts processed by Commission staff were not followed.

During June 1985, most Commission staff were actively involved in handling cash receipts. At least two Commission employees had responsibility for issuing licenses, preparing accounting records, and reconciling receipts to the Statewide Accounting System.

Under a proper system of internal controls, the same individual should not have access to cash receipts and responsibility for preparing accounting records. When one individual performs both functions the potential for mistakes or malfeasance increases.

RECOMMENDATIONS:

4. *The payroll precertification and certification reports should be authorized by someone other than the employee preparing and entering the payroll data.*
5. *Only the employee acting as cashier should have access to the cash drawer and process cash receipts. Someone other than the cashier should handle accounting functions such as comparing calculated license revenue to deposits and reconciling deposits to the Statewide Accounting System records.*
6. *Commission staff should conduct a periodic inventory of license cards and validation stickers to ensure that all licenses issued have been entered onto the computer.*

PRIOR RECOMMENDATION NOT IMPLEMENTED: Internal controls over the imprest cash/change funds maintained by the Minnesota Racing Commission are inadequate.

During the audit we noted that imprest cash funds were not adequately safeguarded and procedures established by the Department of Finance for the maintenance and reimbursement of imprest cash/change funds were not being followed. Photocopy fees collected by the Commission were also erroneously added to imprest cash and used for office expenditures.

The Department of Finance established procedure 06:06:05 which requires state agencies to reimburse their imprest cash fund to the full authorized amount. The intent of the procedure is to ensure that internal control over the fund is maintained by providing adequate security over imprest cash funds. The Commission did not follow the definition of imprest cash funds, because it did not reimburse them to the original authorized amounts.

MINNESOTA RACING COMMISSION

The Minnesota Racing Commission has two imprest cash funds. A \$200 imprest cash fund is used to make small purchases for the Commission offices. Another imprest cash fund for \$300 is used as a change fund for issuing licenses at the racetrack. The following imprest cash problems were noted during our audit:

- A box containing \$200 of imprest cash is presently kept in a file cabinet in a common area of the Commission office. During our audit it was noted that the cabinet was unlocked during normal working hours and various individuals obtained access to imprest cash when necessary.
- The commission did not reimburse the office imprest cash fund to the authorized amount of \$200 as required under the Department of Finance Operating Policy and Procedure Number 06:06:05.
- Photocopying receipts have been incorrectly added to the office imprest cash fund instead of being deposited in the General Fund under revenue code 357 for copy machine earnings. On December 27, 1985, the fund balance totaled \$231.24.
- Documentation supporting imprest cash disbursements did not adequately identify the purpose of expenditures or the individual requesting reimbursement.
- A \$300 balance was not maintained in the change fund kept at the racetrack. Over/short deposits may have been caused by using receipts to balance the amount in the change fund, as discussed in the first finding.

RECOMMENDATIONS:

7. *One person should be held accountable for the imprest cash account used at the Racing Commission offices. Imprest cash should be kept in a locked box and funds should only be made available to the person who has accountability for the fund. Another employee should periodically reconcile the balance in the account with the authorized amount.*
8. *The office imprest cash fund should be maintained at \$200 and the change fund used at the track should be maintained at \$300 as authorized by the Department of Finance. Imprest cash funds should always be reimbursed to the authorized amount.*
9. *Photocopying receipts should be deposited in the General Fund and not used for office purchases.*
10. *Imprest cash expenditures should be supported by documentation such as a short form identifying the individual who spent imprest cash amounts and the purpose of the expenditure.*

MINNESOTA RACING COMMISSION

III. STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND
PROGRESS TOWARD IMPLEMENTATION

Duties over administrative accounting functions at the Minnesota Racing Commission offices are inadequately separated.

1. Incompatible administrative functions should be separated as follows:
 - A. Purchase orders, requisitions, and payment batches should be authorized by a staff person other than the office manager who performs purchasing and disbursing transactions.
 - B. Since the office manager performs purchasing and disbursing functions another staff person should verify the receipt of goods.

Recommendation Implemented. In fiscal year 1985 incompatible administrative functions were assigned to Racing Commission staff. During our current audit, we determined that there was an adequate separation of duties over administrative functions. The Executive Director now authorizes all payment batches and the receptionist verifies that goods received conform to purchase order quantities and specifications.

2. Someone other than the individual preparing time rosters should reconcile time rosters to the payroll system. Different employees should perform personnel and payroll functions, such as authorizing payroll time rosters, receiving payroll checks, and distributing them.

Recommendation Implemented. Since October 1985, the Executive Director authorizes the payroll roster and the Director of Security distributes paychecks.

3. A Commission staff member, other than the office manager, should authorize payment batches used to reimburse the imprest cash fund.

Recommendation Implemented. As of February 1, 1986, the Executive Director of the Minnesota Racing Commission began authorizing payment batches used to reimburse the imprest cash fund.

Accounting documentation supporting administrative receipts and disbursements of the Commission was not readily available in the current filing system.

4. For each purchase, supporting documentation including a purchase order, invoice, and evidence showing the receipt of goods, should be maintained.

MINNESOTA RACING COMMISSION

Recommendation Implemented. In June 1985, Commission staff developed a new filing system for accounting records. A purchase order, invoice, and receiving report are maintained for each transaction and the documentation is filed by vendor name.

5. Commission staff should develop a system, such as use of receiving reports, which would ensure that purchases are received before invoices are paid.

Recommendation Implemented. In October 1985, Commission staff began maintaining a log which identified the date merchandise was received. The office manager does not pay vendors until a receiving report or a packing slip have been compared to a purchase order and invoice.

6. Employees should complete leave requests and have them authorized by their immediate supervisor. Compensatory overtime should also be authorized before employees work overtime.

Recommendation Implemented. As of July 1, 1985, all employees of the Commission began using leave and overtime requests, which are authorized by appropriate personnel within the division.

7. Imprest cash expenditures should be supported by documentation such as a short form identifying the individual who spent imprest cash funds and the purpose of the expenditure.

RECOMMENDATION NOT IMPLEMENTED. See current recommendation #10.

8. Accounting documentation supporting employee travel and subsistence expenses should identify the purpose of expenditures and explain how expenses for air fare, conferences, etc., pertain to Commission business.

Recommendation Implemented. When Commission staff organized their vendor filing system in July 1985, staff decided that documentation identifying the reason for incurring travel expenses would be filed with documentation supporting the travel disbursement.

The Minnesota Racing Commission needs to reconcile administrative disbursements to the Statewide Accounting (SWA) system for the purpose of ensuring that expenses are properly posted.

9. In order to ensure that expenditures have been properly recorded, Commission staff should reconcile administrative disbursements to the SWA system on a monthly basis.

Recommendation Implemented. The Director of Pari-Mutuels and Finance began reconciling administrative disbursements to SWA totals in October 1985. Since the Commission now has a SWA terminal, staff can verify the accuracy of data input by comparing calculated batch totals to totals calculated by the SWA system. Because staff can verify the accuracy of data input, it is no longer necessary for staff to reconcile administrative disbursements to SWA totals on a monthly basis.



MINNESOTA RACING COMMISSION

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David J. Freeman
Executive Director

April 2, 1986

Mr. James R. Nobles, Legislative Auditor
OFFICE OF THE LEGISLATIVE AUDITOR
Veterans Service Building
St. Paul, Minnesota 55155

Dear Mr. Nobles:

On March 24, 1986, the Minnesota Racing Commission (MRC) received its preliminary audit report from Mr. Warren Bartz, Audit Manager. The audit report covered the period July 1 through December 31, 1985. I have enclosed responses to the report recommendations prepared by Dick Krueger, MRC Director of Pari-Mutuels and Finance, and me.

The MRC is pleased that in the Statement of Conclusion your audit team found that the MRC did comply overall with Statewide Practices and Policies. However, a number of the recommendations contained within the report criticize the manner in which the MRC administered its licensing function during the 1985 racing season. I would contend that the systems and controls that were planned and implemented for the first season of racing were adequate. The systems included development, control, and reporting of the following:

- Verification, collection, and deposit of pari-mutuel taxes to both the General Fund and the Breeders' Fund (including admissions tax and breakage).
- Reimbursement to the State for the cost of Steward services.
- Partial reimbursement to the State for the costs of drug testing.
- Reporting, collecting, and depositing of fines in the General Fund.

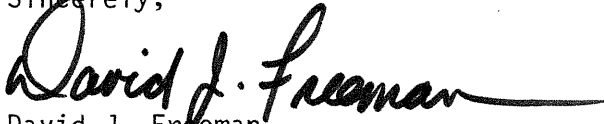
The MRC's management and accounting systems have been thoroughly reviewed since the close of the 1985 racing season. This has enabled the MRC to identify the areas that were in need of improvement and those improvements have been made. As you will find in the MRC's response to recommendations, the verification of receipts and disbursements, reporting procedures, and documentation of all financial matters have been greatly improved. The MRC's process of performance evaluation, with your recommendations and assistance, will be a continuing process to enhance the MRC's efficiency.

James R. Nobles, Legislative Auditor
April 2, 1986
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Once again it was the MRC's pleasure to work with members of your audit staff. Warren Bartz, Kathy Quandt, and Ellen Merlin maintained their professionalism and objectivity at all times yet displayed courteousness and a pleasant, cooperative demeanor.

If you have any questions or if I may be of any assistance, please do not hesitate to contact me at any time.

Sincerely,

A handwritten signature in cursive script that reads "David J. Freeman". The signature is written in dark ink and has a long, sweeping horizontal line extending to the right.

David J. Freeman
Executive Director

DJFsb
enclosure

RECOMMENDATIONS AND RESPONSES

1. **The Commission should insure that an accurate summary of daily license revenue is maintained for each day licenses are issued. The summary of daily license revenue earned should be reconciled to cash deposits.**

The computer system that was mentioned on page 3 of the draft report has been developed and will be operational for the 1986 racing meet. Input will be done at the time an applicant presents his application, and the computer licensing system will promptly summarize all licenses issued during a licensing day. All of the manual processing problems the MRC experienced during the 1985 racing meet have been eliminated. The daily license revenue on the system recap form is the amount to be deposited each day and will automatically be totaled by the computer.

2. **The Commission should deposit all receipts intact each day that they total over \$250.00, as required by Minn. Stat. Section 16A.275.**

This will be complied with. With the exception of the instances that are addressed on page 3 of the draft report, the MRC did comply with Minn. Stat. Section 16A.275.

3. **The Commission should work with the Department of Finance to establish a cash over and short account in accordance with Minn. Stat. Section 16A.276.**

The licensing format for daily balancing includes an entry for overage or shortage should such an entry be needed. Procedures and format have been implemented after discussion with the State's Accounting Director. The format has been transmitted to his office.

4. **The Payroll Precertification and Certification Reports should be authorized by someone other than the employee preparing and entering the payroll data.**

Since November of 1985, the Executive Director has been completing the payroll certification report. Effective with the pay period beginning April 2, 1986, either the Executive Director or the Director of Finance and Pari-Mutuels will authorize the payroll precertification and certification reports.

5. **Only the employee acting as cashier should have access to the cash drawer and process cash receipts. Someone other than the cashier should handle accounting functions such as comparing calculated license revenue to deposits and reconciling deposits to the Statewide Accounting System records.**

Within staffing and funding levels available and workload indicators, the MRC intends to implement a separate cashier function as part of our overall licensing responsibilities. Further, the Director of Finance and Pari-Mutuels or the Director of Security will review and compare each day's calculated license revenues to deposit for the day. The reconciling of deposits to the Statewide Accounting

System will continue to be done by the Director of Finance and Pari-Mutuels or, in his absence, by the Office Manager.

6. **Commission staff should conduct a periodic inventory of license cards and validation stickers to ensure that all licenses issued have been entered into the computer.**

The MRC Director of Racing Security or, at his direction, licensing supervisors, will conduct inventories of license cards and validation stickers on a bi-weekly basis. Whereas the licensing cards are no longer pre-numbered (numbers are assigned by the computer system), the vulnerability of the MRC has been reduced. Systems for inventory control have been developed by the Director of Security.

7. **One person should be held accountable for the imprest cash account used at the Racing Commission offices. Imprest cash should be kept in a locked box and funds should only be made available to the person who has accountability for the fund. Another employee should periodically reconcile the balance in the account with the authorized amount.**
8. **The office imprest cash fund should be maintained at \$200 and the change fund used at the track should be maintained at \$300 as authorized by the Department of Finance. Imprest cash funds should always be reimbursed to the authorized amount.**
10. **Imprest cash expenditures should be supported by documentation such as a short form identifying the individual who spent imprest cash amounts and the purpose of the expenditure.**

The MRC has closed out its administrative office imprest cash funds, thus eliminating the need for response to recommendations 7, 8 and 10.

9. **Photocopying receipts should be deposited in the General Fund and not used for office purchases.**

All receipts for photocopying are deposited each day, effective March 1, 1986.