

California Horse Racing Board Operational Performance Audit



Golden Gate Fields

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EXECUTIVE SUMMARY

At the request of the Business, Consumer Services and Housing Agency, the Department of Finance, Office of State Audits and Evaluations, audited selected administrative and programmatic operations at the California Horse Racing Board (Board). The audit objectives were to determine whether the:

- Internal controls over licensing, steward fines, cash and payroll disbursements, and cash receipts are properly designed and implemented.
- State's hiring policies and procedures are properly implemented.
- Contract amounts for veterinarian, laboratory and steward services are reasonable.
- Equine blood and urine samples are properly controlled throughout the collection and remittance process.
- Enforcement Unit's structure and operations are sufficient to meet the organization's statewide oversight requirements and objectives.
- Board of Directors' structure and oversight activities are adequate to protect consumers and the state.

Based on our audit we determined the following:

- Licensing, steward fines, and cash receipts controls are not properly designed and implemented to prevent errors, misappropriations or inaccurate reporting. Written policies and procedures were inadequate or did not exist.
- Cash and payroll disbursement controls are properly designed and implemented.
- The Board complied with state hiring policies and procedures; however, controls over applications were not always operating properly.
- Steward and veterinarian contract rates were unsupported and we were unable to determine the reasonableness of the Equine Medical Director and laboratory service contracts due to a lack of comparative data.
- Security over equine test samples and the controls over the sample remittance process should be strengthened.
- The Enforcement Unit is at risk of not meeting its statewide oversight responsibilities. Operations are not consistent and written policies and procedures are outdated.
- The Board of Directors' oversight activities are adequate. However, all Board-related documents are not made available to the public.

We also identified other matters during the course of our audit that should be considered by management. They are included in the Other Matters section of our report.

The Board must implement and strengthen its administrative and programmatic controls and practices to address the identified weaknesses. To improve operations, the Board must develop a corrective action plan within 90 days to address the observations and recommendations noted in this report.

BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

The California Horse Racing Board (Board), headquartered in Sacramento, regulates horse racing pari-mutuel wagering, adopts rules and regulations to protect the public and ensure the safety and health of human and equine participants, and promotes horse racing, breeding, and wagering opportunities. It also acts as a quasi-judicial body adjudicating matters relating to horse racing violations. The Board was established in 1933 by constitutional amendment and is overseen by a seven member commission who are appointed by the Governor to serve staggered four-year terms. The Governor can reappoint members at his discretion and appoints one of the seven to serve as the chairperson.

The Board maintains licensing and enforcement satellite offices at all California racetracks, including county fairs. Board operations are funded through a portion of all wagers made by the public.

SCOPE

At the request of the Business, Consumer Services and Housing Agency, the Department of Finance, Office of State Audits and Evaluations (Finance), audited selected administrative and programmatic operations. Our audit objectives were to determine whether the:

- Internal controls over licensing, steward fines, cash and payroll disbursements, and cash receipts are properly designed and implemented.
- State's hiring policies and procedures are properly implemented.
- Contract amounts for veterinarian, laboratory and steward services contracts are reasonable.
- Equine blood and urine samples are properly controlled throughout the collection and remittance process.
- Enforcement Unit's structure and operations are sufficient to meet the organization's statewide oversight requirements and objectives.
- Board of Directors' structure and oversight activities are adequate to protect consumers and the state.

The audit period was May 2013 through April 2014, except for contract testing, which included contracts for fiscal year July 1, 2013 through June 30, 2014, and personnel testing, which included hiring and promotions from March 2012 through March 2014.

METHODOLOGY

To address the audit objectives, we performed the following general procedures:

- Reviewed applicable laws, regulations, policies and procedures significant to the audit objectives.
- Interviewed key personnel to gain an understanding of the Board's overall operations, oversight activities, duties and responsibilities.
- Reviewed audit reports and other publications significant to the audit objectives.

Additionally, specific procedures were performed based on identified key controls within each audit objective. See Appendix A.

In conducting our audit, we obtained an understanding of the Board's internal controls, including any information system controls, as they relate to and that we considered significant within the context of our audit objectives. We assessed whether those controls were properly designed and implemented. Any deficiencies in internal control that were identified during the course of our audit and determined to be significant within the context of our audit objectives are included in this report.

Except as discussed in the following paragraph, we conducted this audit in accordance with generally accepted government performance auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our observations and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations and conclusions based on our audit objectives.

Finance and the Board are both part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. Under *Government Auditing Standards*, performance of those activities creates an organizational impairment with respect to independence. However, Finance has developed and implemented safeguards to mitigate the organizational impairment so reliance can be placed on the work performed.

The results of our audit are based on our review of documentation, observations, other information made available to us, and interviews with key staff. Our results are organized into the following sections:

- Licensing and Steward Fines
- Accounting Controls and Processes
- Hiring and Promotions
- Contracting Controls and Processes
- Equine Sample Process
- Enforcement
- Board of Directors
- Other Matters

Included in the results are observations and recommendations to assist the California Horse Racing Board (Board) in improving its operations.

LICENSING AND STEWARD FINES

Overall Results

The Board's internal controls over licensing processes are not properly designed and/or implemented to prevent errors, misappropriation of cash, improper payments, and inaccurate reporting and tracking of licenses. Further, the internal controls over steward fines are not adequate to ensure fines issued and outstanding are adequately accounted for and monitored.

Licensing Unit

All participants¹ in a race meeting at any of the racetracks in California must hold a valid Board-issued license which allows access to the restricted areas of a racetrack. Individuals may hold more than one license. To ensure all participants are properly licensed, the Board established a Licensing Unit at its headquarters in Sacramento, with field offices located at every Board-licensed racetrack including county fair racetracks. The Licensing Unit consists of two racing license supervisors and eight racing license technicians, with one supervisor located in the northern region and one in the southern region. The Chief of Enforcement oversees the unit's operations. The Licensing Unit is responsible for processing license applications, collecting appropriate license fees, assigning unique license numbers, and creating license photo identification cards. To assist the unit's staff, the Board developed a licensing manual to provide guidance on the different types of licenses issued, licensing requirements, license fees, and monitoring of the racing program. However, the manual does not include guidance on how to use the license tracking or photo identification software.

¹ Participants include, but are not limited to, trainers, owners, jockeys/drivers, pari-mutuel employees and racetrack security guards.

Licensing Process

The Licensing Unit uses the California Horse Racing Information System (CHRIS), an in-house developed system, to maintain the license applicant's information, process and track licenses, and maintain information regarding any fines related to the licensee. The photo identification (ID) system produces the photo for the license cards. This photo ID system is not linked to CHRIS, so the applicant's information is manually input to generate the photo identification card. The photo identification card includes a background color indicating the racetrack access level, name of applicant, license number, license expiration month and year, and the identification number of the employee issuing the license. No reconciliation is performed between the photo ID system and CHRIS.

Payment of the license fee can be made by cash, check or credit card. Licensing staff at each racetrack and at headquarters secure cash and check payments collected in a locked safe until deposited. Batching and reconciling of all license fees made by cash and check are performed daily between the amount received and the amount due per the application, with deposits made weekly. As part of the deposit slip preparation, cash and checks are reconciled with the amounts recorded in CHRIS; however, payments made by credit card are not reconciled with CHRIS. The Licensing Unit provides the total credit card payments received and a copy of the deposit slip to the Accounting Unit who reconcile the amounts to the deposit reported by the bank. Supervising license technicians review the deposit amount and the batch reports identifying the licenses issued and the fees paid. We tested thirty deposits in August 2013 and found a discrepancy of \$150 between the amount reported by CHRIS (\$4,215) and the amount deposited (\$4,065). Additionally, the licensing office at Golden Gate Fields has only one licensing technician to process applications, collect license fees and prepare deposits. The licensing supervisor at headquarters and southern California can perform similar duties with no oversight.

Steward Fines

The CHRIS system is also used to record and monitor the issuance and collection of fines issued by the racetrack stewards. Stewards, who are appointed by the Board, have the overall responsibility for the conduct of race meets and have the authority to conduct administrative hearings, issue rulings and impose suspension or revocation of licenses and fines for racing infractions. When a steward issues a ruling, a copy of the ruling is provided to an enforcement unit investigator who enters the fine amount and the ruling number into the CHRIS system under the specified license number. Fines must be paid within seven days of the ruling. Payment can be made to the racetrack paymaster, who is a racetrack employee, or to Board headquarters. Payments made to the paymaster are confirmed verbally by the investigator who then updates CHRIS. The Board's Accounting Unit receives a collection report and a check from each racetrack paymaster for fines paid at the racetrack. However, the CHRIS system is not reconciled with the payment records received from the paymaster. Payments received at headquarters are also not reconciled with CHRIS. In a review performed by the Enforcement Unit in November 2013, \$85,626 in unpaid fines was identified in CHRIS. The fines dated from January 23, 1993 through November 17, 2013, with the largest fine totaling \$10,000.

After the seventh day, if a fine remains unpaid, CHRIS will automatically suspend the associated license. CHRIS only suspends the license attached to the ruling as the system does not have the ability to suspend all licenses associated with an individual. Therefore, individuals with a suspended or revoked license are still able to access restricted racetrack areas if they possess multiple licenses.

Observation 1: Limited Written Licensing Policies and Procedures

The Board maintains a licensing manual for use by its staff; however, the manual does not provide sufficient instruction on the use of CHRIS or the photo ID system. Without written procedures, inconsistencies in processing and recording licenses can result in incomplete or inaccurate licensee information recorded in CHRIS, and reduce the Board's ability to effectively monitor the licensing process. The State Administrative Manual (SAM) section 20050 states that policy and procedural or operational manuals that are either not currently maintained or are nonexistent usually indicate a poorly maintained or vulnerable control system.

Recommendations:

- A. Develop comprehensive policies and procedures for the license application and issuance process to ensure licenses are issued and tracked correctly according to the California Code of Regulations, title 4, section 1481, et seq.
- B. Provide training to employees on how to properly use the CHRIS and photo ID system and ensure staff are adhering to established policies and procedures.

Observation 2: No Reconciliations of Licensing Fees

License fees paid by cash or check are not reconciled to CHRIS by the Accounting Unit and credit cards are not reconciled by either the Accounting or Licensing Units. Further, reconciliations between the photo ID system and CHRIS are not performed by the Licensing Unit. Reconciliations between the two systems would assist in ensuring the completeness and accuracy of the daily licensing activity. Reconciliations of cash and checks by the Accounting Unit would provide additional controls over the license cash receipting process. Without an effective reconciliation and monitoring process, the Board is susceptible to risk of inaccurate license fees applied to licenses, and misappropriation of fees paid. SAM section 7901 requires departments to reconcile the account balances to supporting documentation such as invoices, receipts, etc., to ensure the accuracy and completeness of transactions posted to the departmental accounts.

Recommendations:

- A. Develop and implement policies and procedures for reconciling license fees paid by cash, check, and credit card with CHRIS.
- B. Reconcile the photo ID system with CHRIS.

Observation 3: Licensing Unit Duties are Not Adequately Segregated

The licensing unit staff structure is not properly designed to ensure adequate separation of duties over the licensing process. Headquarters and various field office staff perform all functions of the licensing process, including processing applications, collecting license fees, recording information into CHRIS, preparing bank deposits, and performing reconciliations. Supervisor and staff duties are interchangeable, and a second level review is not performed. SAM section 8080 requires agencies to maintain adequate internal controls, with separation of duties a key element in order to reduce the risk from fraud and errors.

Additionally, subsequent to the end of our fieldwork, as required by SAM 20080, the Board notified Finance it is in the process of investigating a suspected embezzlement of license fees at one of the field offices.

Recommendations:

- A. Evaluate staff duties to ensure proper segregation over the license fee applications, cash collecting, depositing, reporting, and reconciling processes.
- B. Implement a system of continuous monitoring and oversight of the employees performing these duties, to minimize the risk of errors or irregularities.

Observation 4: Inadequate Internal Controls Over Processing of Steward Fines

No oversight activities are performed to ensure information related to steward fines is entered correctly into CHRIS. This includes the reconciliation, from the initial recording of the fine to the collection of the fine payment. Additionally, no written policies or procedures over the recording and collection of steward fines exist. Government Code section 13403 lists elements of a satisfactory system of internal accounting and administrative control, which includes a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Recommendations:

- A. Develop and implement policies and procedures over the recording, tracking, and collection of steward fines.
- B. Ensure policies and procedures include, but are not limited to, reconciliations of the information in CHRIS to the rulings, payments received by the paymaster and headquarters, and payments posted by the enforcement staff.

Observation 5: Racetrack Access Not Restricted After License Suspension or Revocation

Licensees who have a revoked or suspended license, but hold multiple licenses, are not prohibited from accessing restricted racetrack areas. The Board does not have a process, nor does CHRIS have the ability to suspend other licenses held by an individual. Business and Professions Code sections 19510(b) and 19520(b) state that no person required to be licensed by this article may participate in any capacity in any horse race meeting without a valid and unrevoked license authorizing the participation.

Recommendation:

Ensure any person with a revoked or suspended license does not participate in any capacity in a horse race meeting. This includes ensuring that individuals with multiple licenses in which only one license is suspended or revoked no longer have access to restricted racetrack areas.

ACCOUNTING CONTROLS AND PROCESSES

Overall Results

The Board's internal controls over cash disbursements for procurements and payroll accounting processes are properly designed and implemented. However, internal controls over the cash receipts accounting processes are poorly designed and present vulnerabilities to errors, misappropriation, and inaccurate accounting and reporting.

Accounting Unit

The Board's two-person accounting unit is part of the Administrative Services Unit. The Accounting Unit's roles and responsibilities include performing fiscal activities related to cash receipts, cash disbursements, payroll accounting, account reconciliations, year-end financial reporting, and fulfilling the statutory annual reporting requirements. The supervisor of the Administrative Services Unit is also responsible for overseeing the accounting processes and ensuring controls are properly implemented.

Procurement and Payroll Cash Disbursements

We verified vendor payments included the appropriate approvals and purchasing and receiving documents were maintained. We also confirmed the validity and existence of a sample of vendors. No variances were identified.

The Board's payroll process follows the State Controller's Office guidelines based on interviews with the human resources and accounting staff, and our testing of payroll transactions. We tested a sample of payroll transactions including per diem payments to the Board commissioners. We verified the employee's gross pay was supported by personnel action documents, leave used per the employee timesheet agreed to the leave recorded on the employee's leave balance card, and timesheet was properly approved. For commissioners, we verified the appropriate signed document certifying meeting attendance was maintained. We also confirmed the existence of all employees listed on the April 2014 Time and Attendance report. No variances were identified.

Cash Receipts

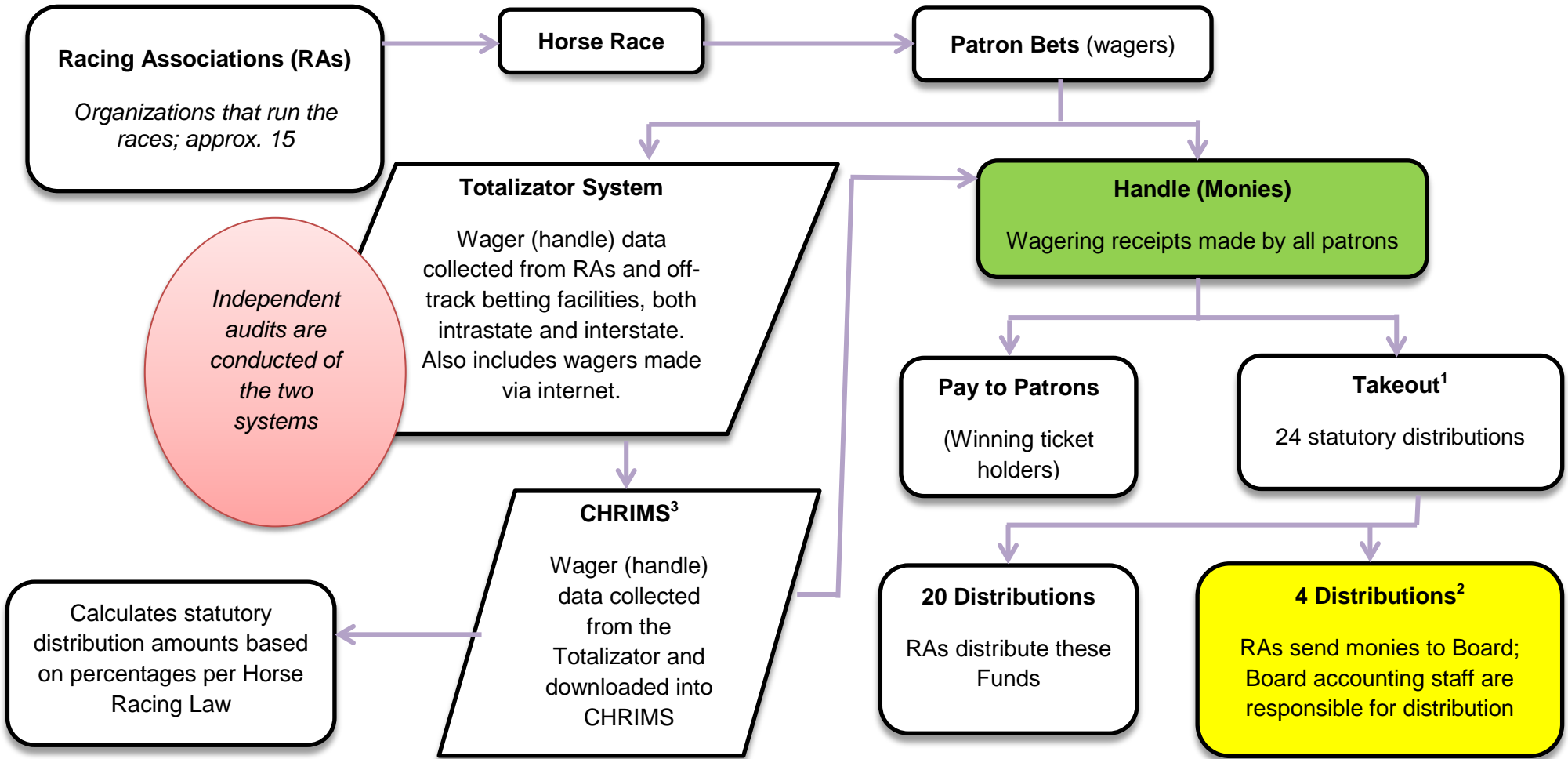
In regulating pari-mutuel wagering, one of the Board's principal activities is to collect the state's lawful share of revenue derived from California horse racing meets. The Board is responsible for the collection and deposit of certain portions of the funds generated from pari-mutuel wagering. This revenue, also known as the handle, represents all wagering receipts collected by racetracks, including fairs, for wagers placed on horse meets run in California. The handle also includes monies wagered at establishments located off-site (satellite facilities) but still in the state, online via the internet, and out-of-state entities that collect wagers on California horse races. A portion of the handle must be set aside to pay winning tickets with the remaining portion of the handle, which is called the takeout, being allocated to fund various aspects of the California horse racing industry, including full financial support for the Board's operations. Per the Board's fiscal year 2012-13 annual report, handle totaled \$3 billion while takeout represented \$642 million. Business and Professions Code sections 19433 and 19567 through 19620 provide for the allocation of the takeout to be distributed to 24 categories, including the Board's financial support, equine research, vanning and stabling of horses, insurance for jockeys and employees of trainers/owners, state payroll audits, and a retirement fund for jockeys. See Figure 1 for flowchart detailing the handle and its distribution.

CHRIMS and Takeout

To manage the pari-mutuel wagering data, the Board uses the services of two independent system providers, the Totalizator system and the California Horse Racing Information Management System (CHRIMS). These two systems maintain pari-mutuel data and calculate the allocation of the handle using the statutory percentages per the Business and Professions Code sections discussed above. After every race, the pari-mutuel data from all Totalizators are merged with all the pari-mutuel pools including out-of-state, online betting, and satellite

locations, and downloaded daily into CHRIMS. CHRIMS allocates the handle, calculating the amount set aside to pay winning tickets and the takeout amounts including the 24 statutory distributions. The two systems are regularly audited by different independent auditors to ensure internal controls are operating effectively. The Board receives copies of the audits performed. We sampled three reports, one for the Totalizator system and two for CHRIMS, and noted that internal controls over both systems were reported as operating effectively. We also interviewed the Board's Internal Audit Unit which is currently performing an audit of the Equine Research Fund portion of the takeout. The internal auditor was able to demonstrate the allocation to the fund was correctly calculated in accordance with statutory requirements.

Figure 1: Horse Racing Revenue



¹ Takeout: remaining part of the handle after paying patrons. Retained by the RAs and distributed according to statute for racetrack operations, taxes, and industry welfare.

² These four distributions include Board support, jockey retirement, equine research, and Public Employees Relations Board/gambling prevention.

³ California Horse Racing Information Management System.

Takeout Receipting and Disbursing

Four of the twenty-four takeout categories are directly remitted to the Board by the racing associations. These four takeout categories include the Board's administrative support fund; and three non-Board funds: the jockey retirement fund, the equine research fund, and the Public Employee Relations Board (PERB)/gambling prevention fund. The Board receives checks for all four funds throughout the year. One employee in the accounting unit receives the checks, prepares the deposit and records the amounts received in the accounting records or for the three non-Board funds, records the receipts in Excel spreadsheets. The same employee determines the amounts available for disbursement for the non-Board funds and prepares the check request for disbursement to the respective recipients. No reconciliations between the non-Board fund tracking sheets and the takeout amounts per CHRIMS are performed regularly and when performed, the reconciliation is prepared by the employee maintaining the tracking spreadsheet. Further, though an accounts receivable is recorded at fiscal year-end for the Board's administrative support fund, the supporting spreadsheet for the accrual is continuously updated subsequent to year-end, thus eliminating the support for the accrual. Finally, no written policies and procedures over the accounting and distributing of the funds administered by the Board exists.

Observation 6: Inadequate Internal Controls Over Cash Receipting

The Board does not have proper internal controls, including inadequate separation of duties, over the receipting process for statutory collections from pari-mutuel wagering, or for other cash receipts. Currently, one employee is responsible for collecting, depositing, and recording receipts, and the distribution of takeout receipts received by the Board. The same employee also performs reconciliations between the amounts reported in CHRIMS and the internal fund tracking sheets; however, the reconciliations are not performed with regularity. Regular reconciliations would assist the Board in monitoring cash flows and identify delays in the collection of outstanding funds. Because no separation of duties exists for collecting, depositing, and recording cash receipts, the Board is vulnerable to the risk of errors or irregularities. In addition, management does not provide oversight and monitoring over the accounting functions. Finally, the Board has no documented policies and procedures to ensure funds received are collected timely, properly recorded, and reconciled regularly. Per Government Code section 13403, management is required to establish a system of practices in performance of its duties.

Recommendations:

- A. Evaluate staff duties to ensure proper segregation over the cash collecting, depositing, reporting, and reconciling processes.
- B. Implement a system of continuous monitoring and oversight of the cash receipts process, including regular reviews of the work performed by the employee processing cash receipts, to minimize the risk of errors or irregularities.
- C. Develop and maintain policies and procedures for the cash receipts process to ensure funds are collected timely, recorded properly, and reconciled regularly.

HIRING AND PROMOTIONS

Overall Results

The Board's internal controls over hiring and promotion processes are properly designed and comply with state hiring policies and procedures. Our audit focused on the process of advertising for positions, processing candidate applications, and timeliness of providing benefits. Based on our interviews, observations, and testing, controls are operating as designed except as described in Observation 7.

Hiring and Promoting Practices

The Board's Human Resources Unit provided a listing of staff hires and promotions from March 2012 through March 2014. We tested 100 percent, or 19 hiring and promotion documents for key internal controls over the posting of available positions, processing of examination applications, and timeliness of benefits provided to hired candidates. Twenty-six percent, or five of the examination/employment applications (standard form 678) were missing date stamps indicating receipt by human resources, and/or initials indicating the application had been reviewed by human resources to verify the candidate met the minimum qualifications.

We also reviewed the practice of advertising positions at a higher salary range but then filling the positions at a lower range. For example, a job announcement advertises a position for the classification pay rate at ranges B and C, but the candidate is hired at range A. This practice is acceptable, as the job announcement is for the classification and not limited to the specific ranges listed.

Finally, during our review of the timeliness of providing benefits to new hires or transfer employees, we found employees received benefits within three months of hiring or transfer to the Board. We identified one employee who was inappropriately allowed to cash-out vacation time to pay for an accounts receivable related to unpaid benefit contributions.

Observation 7: Evidence of Receipt and Review of Applications Was Not Always Documented

Five of the nineteen examination/employment applications (standard form 678) did not include initials of the human resources staff indicating a review of the application was performed to verify the minimum qualifications were met. Further, four of the nineteen applications did not include date stamps indicating receipt by human resources. Date stamping and initialing applications by human resources staff are integral to the unit's policies and procedures to ensure all applications are processed timely and appropriately reviewed.

Recommendation:

Ensure examination/employment applications are date stamped when received, and indicate evidence of review for minimum qualifications.

Observation 8: Unauthorized Cash-Out of Leave Credits

One employee was allowed to cash-out vacation time to pay for an accounts receivable related to unpaid benefit contributions. Cash-outs, also known as buy-backs of leave time, are only allowed after an agreement has been made between the represented employee's union and the

California Department of Human Resources (CalHR); no such agreement was in effect at the time of the cash-out. When such agreements are in effect, and prior to employees cashing-out leave credits, the employee's agency is required to certify to CalHR that the agency has adequate funding to participate in the cash-out program to ensure supplemental funding will not be needed for other expenditures.

Recommendation:

Develop and implement procedures to ensure leave credit cash-outs are only allowed after prior approval from the Executive Director and notification from CalHR that the cash-out program is available.

CONTRACTING CONTROLS AND PROCESSES

Overall Results

The Board's contracts with the Regents of the University of California, Davis (Regents) to provide equine drug testing services and an equine medical director are in accordance with statutory contracting requirements. Contracting procedures used to obtain services for stewards, veterinarians, and hearing officers were in compliance with statutory intent and state contracting policies. Contract costs for hearing officers and portions of the equine medical director contract were reasonable. However, we were unable to determine the reasonableness of contract costs for stewards, veterinarians, and the salary portion of the equine medical director contract.

Equine Drug Testing Contract

The Board contracts with the Regents to provide equine drug testing services in compliance with Business and Professions Code section 19578(a). While section 19578(a) states the Legislature intends for the Board to contract with the Regents, section 19578.1 states if equine drug testing is not conducted at the Kenneth L. Maddy Equine Analytical Chemistry Laboratory at the University of California, Davis, the Board can contract with the best qualified equine drug testing laboratory. While the Board has the ability to contract with other laboratories, currently they have chosen not to exercise this option.

The equine drug testing services contract is comprised of two components: routine post-race drug testing program and the out-of-competition drug testing program. The routine post-race drug testing is limited to 16,000 blood and 16,000 urine samples, while the out-of-competition testing is limited to 3,000 samples. The amount of the contract has not changed since fiscal year 2009-2010. To determine if the contract amounts were reasonable, we obtained copies of the Kentucky and New York equine drug testing contracts for comparison. Unlike California, Kentucky's equine drug testing program is not funded by the state racing commission; rather, the program costs are paid by the racing associations. New York funds its program similar to California; however, though the contract was provided, the contract details were redacted to the extent it was unusable for our purposes. Therefore, we were unable to determine if the equine drug testing contract rates were reasonable.

Equine Medical Director (EMD) Contract

The current EMD was selected in 2006 in accordance with Business and Professions Code section 19578, which states the Dean of Veterinarian Medicine, with the advice of the Board, will appoint the EMD.

The EMD contract is comprised of five budget categories: salary, benefits, indirect costs, travel, and operating costs. The EMD contract rates for benefits and indirect costs were reasonable based on our comparison of the University of California, Davis's approved federal rates for the same time period. Approved federal rates for benefits and indirect costs were 30.3 percent and 36 percent, respectively, while the contract rates were 27 percent and 9.8 percent, respectively. The budgeted travel costs were reasonable based on our comparison of actual costs incurred for fiscal year 2012-2013 to the amount budgeted. Travel costs incurred were Board-related based on our testing of a sample of travel expenses. To determine if the EMD salary cost was reasonable, we requested copies of the Kentucky and New York EMD contracts for comparison. However, because Kentucky's EMD was a state employee and New York would not disclose the EMD's salary, we were unable to determine the reasonableness of the EMD salary costs. The EMD salary has remained the same amount since July 2009. We did not evaluate the reasonableness of operating costs because they comprised only 1.5 percent of the total contract costs.

Steward and Veterinarian Contracts

Eligibility to contract with the Board as a steward or veterinarian requires a valid Board-issued steward or veterinarian license. We discussed the examination licensing process with Board management and reviewed Business and Professions Code section 19512, which specifies respective licensing examination requirements. We also discussed the non-competitive bid process used with the California Department of General Services legal counsel and reviewed Business and Professions Code section 19518. We determined the steward and veterinarian contract process complied with statutory intent and state contracting policies.

The individual steward and veterinarian contracts are comprised of a daily rate (\$525) multiplied by the number of race dates awarded by executive management to a contractor, plus elected health reimbursement costs. Of the steward and veterinarian contracts tested, the same rate was applied to all contracts and the race dates awarded were consistent with the previous year's racing calendar. The same health reimbursement amounts were offered to all the stewards and veterinarians. However, no documentation was available to support the contracted daily rate of \$525. We contacted two other states, New York and Kentucky, to compare the rates paid to the stewards and veterinarians. Because neither state had a similar steward or veterinarian structure to allow for a reasonable comparison, we were unable to determine if the daily rates are reasonable.

Hearing Officer Contracts

We discussed the selection process for hearing officers with Board management and reviewed Business and Professions Code section 19517.5. We also discussed the non-competitive bid process used with Board management. We determined the hearing officer contract process complied with statutory intent and state contracting policies.

The hearing officer contracts are comprised of an hourly rate (\$187) multiplied by the previous year's estimate of adjudicated cases. Hearing officers' hourly rate is based on the rate paid by the Office of Administrative Hearings to administrative law judges. The hourly rate and methodology for calculating the contract amount for hearing officers are reasonable.

Observation 9: Unsupported Contract Per Diem Rate

Stewards and state veterinarians are paid a per diem rate of \$525 for days worked at the racetracks. The Board does not have information or documents to support the basis for the per diem rate, and therefore, is unable to determine if they are over- or underpaying for services received. The State Contracting Manual requires contracts to be reasonable in cost and justification.

Recommendation:

Develop a basis for the per diem rate paid and maintain the justification in the contract files.

EQUINE SAMPLE PROCESS

Overall Results

The Board's internal controls over the equine laboratory sample collection procedures, and receiving and sample processing procedures at Kenneth L. Maddy Equine Analytical Chemistry Laboratory (Maddy Laboratory) are properly designed and implemented. However, we determined controls over certain racetracks' storage of samples and headquarters' receiving procedures for the split sample need strengthening.

Racetrack Sampling Process

To protect animal health and the integrity of horse racing, the Board requires analysis of blood and urine samples from horses in competition. We observed controls over the sample taking, collection, securing, and remittance processes at the following racetracks: Golden Gate Fields, California Exposition and State Fair (Cal-Expo), Santa Anita Park (Santa Anita), and Los Alamitos Race Course (Los Alamitos). At each racetrack, we interviewed the custodian of the samples, determined the method of selecting the horses to test, the timing of the sample draws, the location of the testing, the storing of the samples, and the methods used to transport the sample. We observed the post-race blood draw and urine sampling process, and at Santa Anita and Cal-Expo, we also observed the pre-race blood draw. For all racetracks visited, official samples were simultaneously taken for split samples in accordance with California Code of Regulations, title 4, section 1859.25. Split samples are drawn and maintained by the Board to allow the owner or trainer of a horse that has a positive test result to send the split sample to a Board-approved laboratory for independent testing. We found all racetracks complied with the horse selection requirements of post-race and pre-race testing, and appropriately performed the sample draws either in the racetrack testing barn or the receiving barn. Further, blood and urine test samples were properly taken from the winner of the race and a random horse selected by the stewards. All sample draws observed were properly witnessed, confirmed, or acknowledged by the official veterinarian, or a person designated by the official veterinarian. Samples were then secured and stored in refrigerators at the racetracks until they were subsequently packed in padlocked ice chests and transported via common carrier to the final destination of either the Maddy Laboratory, or for the split sample, to Board headquarters. The ice chests also included a red evidence tag. At two racetracks, samples were not properly secured to ensure restricted access.

Maddy Laboratory Process

We observed the sample intake process and the sample testing process at Maddy Laboratory. We found the shipments of samples from the racetracks delivered to Maddy Laboratory were properly stored in sealed and signed containers, included necessary forms completed by the racetracks, and were appropriately locked in ice chests. Ice chests are moved from the Maddy Laboratory loading dock to the laboratory through key card restricted thoroughfares secured by cameras. Upon arrival at the laboratory, all ice chests are immediately logged in with the date received, courier name, sender's name/city, air bill or tracking number, signature of the receiving individual, and any comments. Samples are checked-in, assigned a unique identification number in the laboratory's tracking and testing software, and secured in one of the laboratory's three refrigerators when not being processed. Maddy Laboratory has extensive standard operating procedures for the processing and handling of the samples.

Split Sample Process

We observed the sample intake process at Board headquarters for the split samples. We found the shipments of samples from the racetracks were properly stored in sealed and signed containers, included the necessary forms completed by the racetracks, and were appropriately locked in ice chests. Upon arrival at Board headquarters, the ice chests are moved to the split sample office which is restricted by key card access and has a camera facing the door, with views of the sample storage area (refrigerators). Weekly, the samples are moved to two walk-in freezers at Cal-Expo. However, the Board has no written policies and procedures for the processing and handling of the samples.

Observation 10: Strengthen Security Over Equine Samples

Samples were not properly secured at two racetracks and Board headquarters. To ensure security, specific details regarding the deficiencies were discussed with Board management. California Code of Regulations, title 4, sections 1859 and 1859.25, require the Board to ensure the security and storage of the equine samples.

Recommendation:

Develop and implement procedures to ensure equine samples are properly secured at all racetracks and Board headquarters.

Observation 11: Strengthen Controls Over the Split Sample Remittance Process

Board headquarters does not verify the count of split samples received from racetracks. During our observation of the racetracks' split samples remittance process, the split sample technician relied on the sample count from the test sample shipping invoice, and did not count the actual samples to ensure all samples were received. Further, the Board does not have written policies and procedures over the split sample process to ensure staff is aware of the proper remittance procedures. California Code of Regulations, title 4, section 1859.25 requires the Board to ensure the security and storage of the split sample. Additionally, SAM section 20050 states that policy and procedural or operational manuals that are either not currently maintained or are nonexistent usually indicate a poorly maintained or vulnerable control system.

Recommendations:

- A. Develop and implement policies and procedures over the split sample remittance process.
- B. Ensure these policies and procedures include a reconciliation of the test sample shipping invoice to the actual samples received.

ENFORCEMENT

Overall Results

The Board has not defined the Enforcement Unit's statewide roles and responsibilities to ensure it has sufficient strategic direction and priorities to efficiently and effectively meet its oversight requirements and objectives. Differences exist between the northern and southern regions' operating environments, and communication between enforcement unit staff is limited. Further, because the Enforcement Unit lacks an updated policies and procedures manual, there are no standard operating procedures to lend uniformity to enforcement unit operations.

Enforcement Unit

The Enforcement Unit consists of ten investigators including the Chief and Deputy Chief. All investigators and managers hold the proper Police Officer Standards and Training (POST) certifications for their current positions. The Chief is headquartered in southern California at Los Alamitos, but splits his time between Los Alamitos and Santa Anita. The Deputy Chief is headquartered in Sacramento where he oversees the northern California region, including Cal-Expo and Golden Gate Fields.

Enforcement Unit Activities and Communication

The four racetracks we visited performed different enforcement activities based on regional location (northern or southern). For example, based on our interviews and observations at Santa Anita, the southern enforcement unit's focus is mainly on administrative activities, such as preparing cases for steward meetings and researching financial claims. Backside monitoring is primarily performed by the racetrack's safety steward and security staff. Conversely, although some administrative activities are also performed at Golden Gate Fields, the northern enforcement unit mainly focuses on enforcement-related activities, including regularly patrolling the backside.

A significant factor in the different focus between the two regions is that communication between investigators and management is limited by region. For example, the southern region investigators receive direction from the Chief while the northern region receives direction from the Deputy Chief. No meetings, including teleconference meetings, were conducted with the full Enforcement Unit during our audit or any time prior based on our interviews. While the Chief stated he spoke daily with the Deputy Chief, it was not clear if these discussions included the unit's priorities and mission, or if the discussions were limited to day-to-day operational issues.

Additionally, the Enforcement Unit's procedures manual has not been updated since August 1996, resulting in each racetrack's Enforcement Unit developing its own operating procedures. Based on interviews, the manual is obsolete and not used by staff.

Observation 12: Enforcement Unit's Statewide Roles and Responsibilities are Not Defined

The Board has not defined the Enforcement Unit's statewide roles and responsibilities, resulting in inconsistencies between northern and southern region operations. Each region emphasizes different enforcement activities. As noted above, the southern region emphasizes administrative activities, while the northern region focuses more on enforcement activities. Although regular contact between the unit Chief (located in southern California) and the Deputy Chief (located in northern California) occurs, no staff meetings with the full Enforcement Unit are held to discuss operational expectations, priorities, and processes.

Due to the lack of defined roles and responsibilities, and clear guidance from the Board, the Enforcement Unit is at risk of being unable to efficiently and effectively meet its statewide oversight requirements and objectives.

Recommendations:

- A. Define the Enforcement Unit's statewide oversight roles and responsibilities, mission and goals, and priorities.
- B. Ensure the consistent implementation of the unit's defined roles and responsibilities.
- C. Establish regular, ongoing communication to all unit employees of operational expectations and priorities.

Observation 13: Outdated Policies and Procedures

The Enforcement Unit's policies and procedures manual is out-of-date and is not being used by the investigators. As a consequence, no standard operating procedures exist, resulting in different processes performed at the various racetracks. Management is required to establish a system of practices in performance of its duties as discussed in Government Code section 13403.

Recommendations:

- A. Update or develop new standard operating procedures for the Enforcement Unit and document them in a policies and procedures manual. Periodically review and revise the manual to ensure it represents current practices and procedures.
- B. Distribute the manual to all enforcement staff and provide regular training to ensure staff understand and effectively implement the procedures.

BOARD OF DIRECTORS

Overall Results

The Board of Directors' oversight activities are adequate to protect the consumers and the state. However, to increase transparency, the Board should make available all Board-related documents to the public.

The Commissioners and Board Meetings

The Board of Directors is comprised of seven commissioners with background or interest in horse racing and the welfare of race horses. The commissioners meet approximately 11 times a year at horse racing tracks throughout the state. The Board publishes the meeting agendas

on its website ten business days in advance of the meeting, as required by the Bagley-Keene Open Meeting Act of 2004 (Bagley-Keene Act). Our review of the meeting minutes indicated the commissioners are actively engaged in the oversight of Board activities as demonstrated in the discussion topics, such as the approval of rules and regulations, assigning of race dates, regulating medication usage, monitoring and instituting track safety measures, approving contract agreements, and approving license applications for conducting race meets, satellite wagering and advance deposit wagering.

As mentioned above, Board meetings are held at racetracks that charge a nominal admission fee during race meets. The Bagley-Keene Act requires the public to have access to the meeting without incurring a fee. We confirmed that no fee was charged to attendees by attending two meetings during 2014.

Board Meeting Documents

Prior to a Board meeting, each commissioner receives an information packet comprised of documents relevant to the meeting agenda. The packets are also provided to the public via the Board's website. However, packets available on the website did not include all the information provided to the commissioners, such as financial information and advance wagering applications. While some information may be excluded under the California Public Records Act (Public Records Act), the Bagley-Keene Act requires all non-excluded information provided to the commissioners be made available to the public. During our audit we also noted the Board did not maintain an original complete copy of the information packet sent to the commissioners.

Conflict of Interest

Each commissioner is required to file a Statement of Economic Interest (Form 700) annually, upon appointment, or when leaving office. Form 700 requires filers to disclose their investments, interests in real property, business positions and income including loans, gifts and travel payments. The Board Rule Book further requires disclosure of financial interest in racing associations, racetracks and companies participating in pari-mutuel wagering. Our testing of the commissioners' 2013 Form 700s identified no reported conflicts of interest.

We also considered the location of the Board meetings held at racetracks. Meeting locations are determined by the Board, and the designated locations have not been in violation of the Bagley-Keene Act.

Observation 14: Board Packets are Not Complete or Properly Retained

The Board does not maintain a complete copy of the information packet provided to the commissioners, nor are complete copies of the packets made available to the public on the Board's website. While some information may be exempt from the Public Records Act, retaining a complete copy and providing complete information packets to the public will ensure compliance with the Bagley-Keene Act.

Recommendations:

- A. Maintain a complete copy of the information packets provided to the commissioners.
- B. Make available on the Board's website all packet information not exempted by the Public Records Act.

OTHER MATTERS

During the course of our audit, we identified other matters that should be considered by management. They are as follows:

Unsecured Personnel Information

Not all personnel information is adequately restricted. The human resources office, while restricted with electronic key card access, contains personnel information that is not secured in locking cabinets. Unsecured sensitive information, such as employee addresses, timesheets, and leave balances provide opportunities for unauthorized use. Civil Code section 1798.21 requires agencies to ensure the security and confidentiality of records. Purge unnecessary documents and assess the need for additional locked storage.

Increase Internal Audits Oversight

Since June 2008, the Board's Internal Audit Unit has performed audits of 6 of 24 takeout categories, and 5 audits related to oversight of pari-mutuel wagering. While the wagering establishments—racing associations or horsemen's organizations, fairs, satellite locations, and internet on-line wagering companies—are responsible for ensuring takeout funds are available and remitted for the 24 categories, the Board is responsible for ensuring the wagering establishments follow the pari-mutuel rules and regulations. Develop and implement a plan to increase audits of takeout and wagering activities.

Obtain EMD Travel Expense Claims

Support for the EMD travel costs are not provided to the Board in the quarterly invoices submitted for payment, limiting the Board's ability to perform its oversight responsibilities. The Board should request copies of the EMD's travel claims and supporting documents to ensure expenses are for Board-related activities.

Incompatible Job Duties

Since April 2013, the Supervising Special Investigator II has been acting as the Board's information systems supervisor in conjunction with his supervising investigator duties. The information systems oversight is unrelated to investigation activities, and is not a duty of the Supervising Special Investigator II classification. One person performing the full time duties of two unrelated management positions could impair the Board's ability to meet its operational demands, compromise the quality and performance of each position's responsibilities, and overburden staff. Fill the vacant information systems supervisor position with a qualified candidate.

Incomplete POST Training

Mandated POST continuing professional training requirements are not met by all members of the Enforcement Unit. POST requires peace officers to perform 24 hours of POST-qualifying training every two years to maintain and/or update the officers' knowledge and skills. For the cycle ending December 2012, two of the officers did not complete the minimum training requirements. Implement procedures to ensure all training requirements are fulfilled.

Ensure Submittal of Financial Audit Reports

Horsemen's associations are required to file annually audited financial statements to the Board in accordance with Business and Professions Code section 19940.5. In its 2011-2012 annual report, the Board reported one horsemen's association audit was from 2004, while another association's audit was from 2008. The Board should strengthen its enforcement efforts to ensure annual audits of horsemen's organizations are being performed, audit reports are submitted timely, and the submitted statements are reviewed for financial operational concerns.

Form 700-Requirement for EMD and Hearing Officers

Form 700s were not obtained for the EMD or hearing officers. The Board should request the EMD's Form 700 and update its conflict of interest code to include hearing officers and the EMD as designated filers.

APPENDIX A

AUDIT OBJECTIVES AND PROCEDURES

The Business, Consumer Services and Housing Agency (Agency) requested the Department of Finance, Office of State Audits and Evaluations, to perform an operational audit of the California Horse Racing Board (Board). The table below lists the Agency's audit objectives and the procedures performed to address those objectives.

Audit Objective	Procedures
1. Determine if controls over licensing and steward fines are properly designed and implemented.	<ul style="list-style-type: none"> • Reviewed available policies and procedures for the processing of licenses and fines. • Reviewed California Code of Regulations, title 4, division 4, sections 1405, 1481 et seq., 1528, and 1532. • Interviewed and observed licensing technicians to understand their roles and responsibilities. • Identified the key controls over licensing and fines processes, and selected a limited sample of licenses to understand the licensing process. • Reviewed the Enforcement Unit's November 2013 review of unpaid fines.
2. Determine if controls over the accounting processes are properly designed and implemented, including controls over cash disbursements, payroll disbursements and cash receipts.	<ul style="list-style-type: none"> • Reviewed policies and procedures for the processing of cash disbursements, payroll disbursements and cash receipts. • Interviewed staff regarding the procedures over accounting processes. • Identified the key controls over the accounting processes, and selected a sample of vendors, vendor payments and payroll transactions for testing of key controls.
3. Determine if state hiring policies and procedures are properly implemented.	<ul style="list-style-type: none"> • Reviewed applicable rules and regulations, and California Department of Human Resources' examination publications. • Interviewed key personnel to understand hiring processes. • Reviewed new hires, transfers and promotions from March 2012 through March 2014.
4. Determine the reasonableness of contract amounts for veterinary, laboratory services, stewards and other significant contracts.	<ul style="list-style-type: none"> • Reviewed Business and Professions Code sections 19517.5, 19518, 19578, et seq. • Interviewed key personnel to understand contracting processes. • Selected a sample of fiscal year 2013-2014 contracts for testing. • Requested comparable contracts from Kentucky and New York.
5. Determine if equine blood and urine samples are properly controlled throughout the collection and remittance process, including collection, securing the sample prior to transport, transporting and receiving at the laboratory.	<ul style="list-style-type: none"> • Reviewed California Code of Regulations, title 4, division 4, sections 1858, 1859, 1860, and 1863. • Interviewed key personnel to understand the equine sample process at Golden Gate Fields, California Exposition and State Fair (Cal-Expo), Santa Anita Park (Santa Anita), Los Alamitos Race Course (Los Alamitos), Kenneth L. Maddy Equine Analytical Chemistry Laboratory (Maddy Laboratory), and the Board's headquarters.

	<ul style="list-style-type: none"> • Conducted observations of the equine sample processing during one or two races at Golden Gate Fields, Cal-Expo, Santa Anita, and Los Alamitos. • Observed equine sample processing of racetracks' samples received at the Maddy Laboratory and the Board's headquarters. • Evaluated the controls over sampling to determine if the samples were properly collected, secured, and custody established at all racetracks visited, in accordance with California Code of Regulations, title 4, sections 1858 through 1863. • Evaluated the controls over the sample transporting and receiving at Maddy Laboratory and the Board's headquarters in accordance with California Code of Regulations, title 4, sections 1858 through 1863.
<p>6. Determine if the Enforcement Unit's structure/culture is adequate to address the organization's oversight requirements and objectives.</p>	<ul style="list-style-type: none"> • Reviewed applicable rules and regulations governing responsibilities and oversight requirements of the Enforcement Unit. • Interviewed investigative staff and conducted observations at four racetracks-Los Alamitos, Santa Anita, Cal-Expo and Golden Gate. • Reviewed available policies and procedures manual.
<p>7. Determine if the Board of Directors' structure and oversight activities are adequate to protect consumers and the state.</p>	<ul style="list-style-type: none"> • Reviewed Government Code section 87200 et seq. and California Code of Regulations, title 2, section 18700 et. seq.; California Horse Racing Board Rule Book, Article 20, section 2000; and Government Code sections 11120-11132-the Bagley-Keene Open Meeting Act (Bagely-Keene Act). • Interviewed staff designated as the filing officer and staff who prepare and distribute the Board information packets. • Reviewed Board minutes, packets and agendas to verify compliance with the Bagley-Keene Act. • Evaluated Board meeting locations for compliance with the Bagley-Keene Act. • Evaluated the listing of all Statement of Economic Interest (Form 700) designated filers to determine the completeness of the listing. • Reviewed the 2013 Form 700s the Board had on file for potential conflicts of interest. • Reviewed the Board's Conflict of Interest Code.

