

INTERNAL AUDIT OF THE
TEXAS BRED INCENTIVE PROGRAMS
Associations (Breed Registries) and
Policies & Procedures

AS OF MARCH 10, 2018

AT THE

TEXAS RACING COMMISSION

(REPORT NO: TxRC 018-001)

MONDAY RUFUS & CO., P.C.

CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS



MONDAY RUFUS & CO., P.C.
Certified Public Accountants & Advisors

Audit Committee and Commissioners
Texas Racing Commission
Austin, Texas

We have conducted the internal audit (audit) of the Texas Bred Incentive Programs – Associations (breed registries) and Texas Bred Incentive Programs – Policies and Procedures at the Texas Racing Commission with respect to the reliability and integrity of information, compliance with rules, policies, procedures, laws, regulations, efficiency and effectiveness of operating procedures, and safeguarding of assets as of March 10, 2018. The results of our audit disclosed that there are adequate procedures and controls in place in the administration of the Texas Bred Incentive Programs. However, we noted an opportunity for improving the controls in place. The report that accompanies this letter summarizes our comments and recommendations.

We appreciate the courtesy and cooperation shown by the management of the Commission and the breed registries during the course of the audit engagement.

Monday Rufus & Co., P.C.

March 10, 2018
Austin, Texas

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Executive Summary

Background Information

The Texas Racing Commission was created in the Second Called Session of the 69th Legislature and approved by a state-wide referendum in November 1987. The Texas Racing Commission (Commission) is the sole state agency responsible for regulating horse and greyhound races with pari-mutuel wagering. The Texas Racing Act (Article 179e, Vernon's Civil Statutes) sets out the Commission's responsibilities with respect to the operations of pari-mutuel racetracks. The Commission has adopted rules (16 Texas Administrative Code section 301.1 et seq.) to implement the Texas Racing Act and to establish the minimum standards for operating a pari-mutuel racetrack.

The Texas Racing Act provides purse supplements and monetary awards to breeders and owners of Texas-bred horses and greyhounds. The purse supplements and monetary awards are provided through the Texas Racing Commission's Texas Bred Incentive Program which provides economic incentives to encourage agriculture and the horse and greyhound breeding industries. Texas Bred Incentive Program distributions to the horse and greyhound associations for fiscal year 2016 were \$3,261,646 (See Appendix 3).

The Texas Racing Act names the official breed registries that are responsible for determining the qualifications for Texas-bred accreditation, maintaining the eligibility lists, and distribution of the monetary awards. The breed registries which currently participate in the Texas Bred Incentive Programs are the Texas Thoroughbred Association (TTA), the Texas Quarter Horse Association (TQHA), the Texas Arabian Breeders Association (TABA), the Texas Paint Horse Breeders Association (TPHBA), and the Texas Greyhound Association (TGA). Under the Texas Bred Incentive Programs an incentive award is paid to each owner, breeder, and stallion owner of an accredited Texas-bred (ATB) horse that finishes first, second, or third in any race other than a Texas-bred stakes race. The awards are funded from breakage from all pari-mutuel pools and one (1) percent of all multiple two and multiple three wagers from live, simulcast same-species, and simulcast cross-species handle. A Texas-bred stakes race supplement is funded from 9.8% of the breakage from all pari-mutuel pools.

The Texas Racing Act also authorizes funding for the Texas-bred Greyhound Incentive Program from 50% of the total breakage from live, simulcast same-species, simulcast cross-species handle, and from 1% of multiple two and multiple three wagers from simulcast same-species and simulcast cross-species handle. The 50% of breakage and the 1% of multiple two and three wagers is paid to the Texas Greyhound Association (TGA). The remaining 50% of breakage received by the TGA is used to pay administrative costs associated with the ATB program. However, TGA uses an actual cost basis for administrative and any remaining breakage funds after costs are deducted are added to the ATB funds when distributing awards. The entire 1% of multiple two and three wagers is paid out as ATB awards. The payout of awards is made to the first four accredited Texas-bred greyhounds that finish the race. Two percent (2%) of the breakage money received by the TGA must be set aside for grants to qualified Texas non-profit adoption groups for rehabilitating or locating homes for greyhounds. Any money earned from simulcast wagering on inter-state greyhound races at a horse track is also paid to the TGA for use at Texas greyhound racetracks.

For fiscal year 2016 the Texas Legislature appropriated the Commission a budget of \$7,681,200 with 51.2 Full-Time-Equivalent (FTEs) employees. The 51.2 FTEs shall be increased by an additional 5.0 FTEs under the agency's appropriation rider number 5 in each year for each new horse racetrack that begins operations for the first time during the biennium or for each reopening horse racetrack that initiates operations again during the biennium contingent upon the Texas Racing Commission generating the amount of revenue indicated in the appropriation for each new horse racetrack.

Internal Audit Results

We audited the five associations (breed registries) which distributed the Texas Bred Incentive Programs awards in fiscal year 2016. The five associations were the Texas Thoroughbred Association (TTA), Texas Quarter Horse Association (TQHA), Texas Paint Horse Breeders Association (TPHBA), Texas Arabian Horse Breeders Association (TABA), and the Texas Greyhound Association (TGA). The five breed registries evaluated have controls in place that are generally effective to administer the Texas Bred Incentive Programs and to ensure that incentive awards are paid on a timely basis to accredited racehorse and greyhound winners. However, we identified an opportunity that could improve the control processes in place.

The Commission can improve the Texas Bred Incentive Programs administration process by ensuring that the breed registries review their policies and procedures for consistent and accurate performance measures reporting.

Summary of Management's Response

As you recommended, the agency will require the breed registries to review their established policies and procedures to ensure consistent accurate performance measure reporting and will periodically remind them about the importance of submitting accurate information.

Objectives and Observations

The primary objectives of internal audit were:

1. Reliability and Integrity of Information
2. Compliance with Policies, Procedures, Laws, and Regulations
3. Efficiency and Effectiveness of Operating Procedures
4. Safeguarding of Assets

RESULTS AND RECOMMENDATIONS

Internal Audit Objective 1: Reliability and Integrity of Information

- Each breed registry has a system in place to separately identify Texas Bred Incentive Programs activity expenses and the breed registry’s operational costs.
- Required audited financial statements and performance reports are submitted annually by the breed registries to the Texas Racing Commission.
- The breed registries have supporting documentation in their files for payments made to racing horse and greyhound award winners.

Finding 1: Improve Controls Over The Annual Performance Measures Reports Submitted By The Breed Registries

Criteria:

The breed registries (associations) are required to submit annual performance reports regarding the operations of the Texas Bred Incentive Programs by June 15th of each year in accordance with Section 303.83 (b) of the General Provisions.

Condition:

During our testing of the Texas Quarter Horse Association’s Texas Bred Incentive Program activity for fiscal year 2016 we found that a voided check dated 6/22/2016 for the amount of \$1,144.13 and the related five (5) Accredited Texas Bred (ATB) awards were included in the annual Performance Measures report totals submitted to the Texas Racing Commission. The TQHA management engaged a tech programmer to review and correct the reporting system program and reprinted the 2016 Performance Measures report. There was an overstatement difference of \$57,110.93 and 194 awards between the original Performance Measures report submitted to the Commission and the corrected reprinted Performance Measures report.

Reported 2016 Performance Measures Report Amounts	\$ 820,690.21	2444
Reprinted 2016 Performance Measures Report Amounts	<u>\$763,579.28</u>	<u>2250</u>
Overstatement of Performance Measures Reported	\$ 57,110.93	194

Cause:

The breed registry did not have procedures or process(es) to ensure consistent and accurate performance measures reporting. According to TQHA management, they had updated their computer reporting system and were unaware that voided checks and related information continued to be included in the number totals being reported.

Effect:

The accuracy of reported performance measures information being reported to the Texas Racing Commission on the Texas Bred Incentive Programs activity may determine to what extent the Governor and the Legislature can rely on the reported performance measures when making decisions or evaluating a state agency.

Recommendation

The Commission should require the breed registries to establish policies and/or review procedures to ensure consistent accurate performance measures reporting. Additionally, the Commission should periodically remind the breed registries about the importance of submitting accurate information. Finally, the Commission should consider evaluating the costs-benefits of requiring each breed registry to engage an independent party to provide an attestation service (examination, review, or agreed-upon procedures) to provide assurance on the accuracy of the performance measures reporting.

Management's Response

As you recommended, the agency will require the breed registries to review their established policies and procedures to ensure consistent accurate performance measure reporting and will periodically remind them about the importance of submitting accurate information.

Internal Audit Objective 2: Compliance with Policies, Procedures, Laws, and Regulations

- Race horse files tested at the Texas Thoroughbred Association, Texas Quarter Horse Association, Texas Paint Horse Breeders Association, and Texas Arabian Horse Breeders Association were verified for ownership, registration, and eligibility of all horses that finish first, second, or third in a race.
- Texas Thoroughbred Association horses tested who received ATB awards were accredited through the Jockey Club and the TQHA horses tested were accredited through the American Quarter Horse Association.
- All accredited Texas-bred horses that finish first, second, or third in a race in Texas (with the exception of a stakes race restricted to accredited Texas-bred) are being paid an owner's incentive award, as well as the first four Texas-bred accredited greyhounds that finish the race.
- The Texas Racing Act requires 2% of the breakage funds received by the Texas Greyhound Association to be paid out in the form of grants to tax exempt organizations that conduct programs for the rehabilitation or adoption of greyhounds who have completed their racing careers.

- All breed registries submitted the required annual schedule of awards payable to the Commission.
- The breed registries are submitting the required audited financial statements and performance reports regarding the operations of the Texas Bred Incentive Program by June 15th of each year in accordance with Section 303.83 (b) of the General Provisions.

Internal Audit Objective 3: Efficiency and Effectiveness of Operating Procedures

- Awards are being paid timely by the horse and greyhound associations at the end of the races and/or race meets as required by the programs.

Internal Audit Objective 4: Safeguarding of Assets

- The Texas Thoroughbred Association includes a list of award winners for Undeliverable/Unpayable ATB awards in the association's publication, "The Thoroughbred Magazine " for three months each year beginning in the month of January.
- All participants must provide the associations their payee and address in writing in order to send them their Texas Bred Incentive Program awards in case they win.
- Deductions from the wagering pools for the breed incentive funds are reconciled by the Texas Racing Commission against monies received from the racing associations before the funds are electronically transferred from the State Comptroller's account for the breed associations to pay awards to winners under the Texas Bred Incentive Programs.
- Adequate internal controls were in place for the recording and payment of program awards.

Appendix 1

Objective and Scope

Objective

The primary objective of the audit was to evaluate the following:

- *Reliability and Integrity of Information*
- *Compliance with Policies, Procedures, Laws, and regulations*
- *Efficiency and Effectiveness of operations or program.*
- *Safeguarding of Assets*

Scope

The scope of our audit included reviewing the processes and controls for the administration of the Texas Racing Commission Texas Bred Incentive Programs by the Texas Thoroughbred Association (TTA), Texas Quarter Horse Association (TQHA), Texas Paint Horse Breeders Association (TPHBA), Texas Arabian Horse Breeders Association (TABA), and the Texas Greyhound Association (TGA), breed registries.

Methodology

Our procedures included a review of applicable statutes and rules, reviews of audited financial statements, performance reports, interviews with the appropriate personnel of the Commission and breed registries, testing of reports and supporting documentation prepared by the associations, and review of other pertinent reports and documents related to the administration of the Texas Bred Incentive Programs.

Information collected and reviewed included the following:

- Texas Racing Commission enabling legislation
- Texas Racing Act (Vernon's Texas Civil Statutes, Art. 179e)
- Texas Racing Act and Rules of Racing
- Agency policies and procedures in administering the Texas-Bred Incentive Programs
- Agency's Strategic Plan for FYs (2017-2021)
- Agency's Appropriated Budget for FY 2016
- Agency's Annual Financial Report for FY 2016
- Management Internal Control Questionnaires or communication with Texas Bred Incentive Programs breed registries.
- Texas Bred Incentive Programs associations financial audits, payout schedules and supporting documentation
- Texas Racing Commission website
- Texas Bred Incentive Programs associations websites

Procedures and tests conducted included the following:

- Interviewed Commission executive management and staff to obtain an understanding of the Commission's processes and controls related to the administration of the Texas Bred Incentive Programs.
- Reviewed Texas Racing Act, Texas Racing Commission Rules of Racing, and Commission's policies and procedures for administering the Texas Bred Incentive Programs with the horse and greyhound racing associations (breed registries).
- Communicated with Texas Bred Incentive Programs breed registries and obtained documents and an understanding of the policies and procedures used by the Texas Thorough Bred Horse Association, Texas Quarter Horse Association, Texas Greyhound Association, Texas Paint Horse Breeders Association, and the Texas Arabian Horse Breeders Association
- Obtained copies of the annual audited financial statements and performance measures reports regarding the operation of the Texas Bred Incentive Programs which are required to be submitted to the Texas Racing Commission each year by the breed registries.
- Obtained and reviewed documents which are required to be submitted by the breed registries to the Commission under the General Provisions of the Texas Racing Act and Related State Laws for compliance testing.
- Tested the breed registries awards paid to race horses for compliance with the Texas Bred Incentive Programs eligibility and accreditation requirements for the horses.
- Tested for timely payment of Texas Bred Incentive Programs awards to winners of horse and greyhound races.
- Reviewed breed registries financial statements to ensure that records of the Texas-bred program activities could be separately identified.
- Obtained and reviewed Texas Greyhound breed registry procedures and documentation for the awarding of grants for greyhounds.

The criteria used included the following:

Texas Racing Act and Rules of Racing
Agency policies and procedures in administering the Texas-Bred Incentive Programs

Other Information

Our audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our internal audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our internal audit objectives. Our audit also conforms with the Institute of Internal Auditor's (IIA) *International Standards for the Professional Practice of Internal Auditing*.

Appendix 2

Background Information

The Texas Racing Commission was created in the Second Called Session of the 69th Legislature and approved by a state-wide referendum in November 1987. Article 179e, V.T.C.S., created the Texas Racing Commission and authorizes the Commission to:

1. Oversee the Texas Bred Incentive Programs for horses and greyhounds;
2. Evaluate applications and award licenses for pari-mutuel racetracks in Texas;
3. Oversee the construction and renovation of major horse tracks, major greyhound tracks, and numerous smaller horse tracks and county fair tracks throughout the State;
4. License, regulate, and enforce all aspects of pari-mutuel wagering and participants in pari-mutuel racing; and
5. Provide state and local revenues.

The Racing Commission is composed of nine members, seven of whom are appointed by the governor with the advice and consent of the Senate to serve overlapping six-year terms. In addition to the appointed members, there are two ex-officio members, the Chair of the Public Safety Commission and Commissioner of Agriculture. The Governor appoints the chair and the members elect the vice-chair. The Commission appoints an Executive Secretary to supervise the agency's daily activities.

Although the Agency's budget is approved by the legislature, it does not receive any General Revenue funds from the State for its operations. Revenues are primarily from license fees and fines. Approximately 50% of the expenditures are passed through the Agency to the official breed registries for the Texas Bred Incentive Programs. Funds collected by the Agency are directly utilized in operations, and not passed on to the State.

Five associations (breed registries) receive and distribute incentive awards under the Texas Bred Incentive Programs in Texas. The five associations reviewed during the audit are listed below:

Texas Thoroughbred Association (TTA)

The Texas Thoroughbred Breeders' Association is a Texas nonprofit corporation, having as its primary function the promotion of interest in thoroughbred breeding and racing. The TTA was organized to promote and encourage research, discussion and interchange ideas, information and methods relating to raising, breeding, racing and marketing thoroughbred horses and to encourage public interest in such activities. Under the Texas Racing Act, the Association is designated the official breed registry for thoroughbred horse in the State of Texas.

The Texas Bred Incentive Programs provides incentive awards to owners of successful thoroughbred racehorses winning or placing in Texas races, along with the breeders and sire owners of these racehorses, provided the winning racehorse is bred, raised and raced in the State of Texas. The incentive awards and purses are paid out within 30 days of the end of each race meet. After one year, incentive award funds which have been unclaimed, undeliverable, or unpayable to owners, breeders or stallion owners, are transferred from the escrow account to the operating account and recognized as revenue. In an effort to pay unclaimed awards, a list of participants who have not collected their awards is printed in the TTA monthly magazine for the first three months of the year. Funds for the Program are derived from a percentage of certain monies wagered at Texas racetracks, as defined by the Texas Racing Act. The Association retains, in accordance with the Texas Racing

Act, ten (10%) percent of the Program funds received for the administration of the Program. Additionally, the Association receives a fee paid by horse owners to have their horse accredited.

Texas Quarter Horse Association (TQHA)

The Texas Quarter Horse Association (TQHA) is a Texas nonprofit corporation, having as its primary function the promotion of interest in quarter horse breeding and racing. The TQHA was organized to promote and encourage the popularity of the Quarter Horse Breed in the State of Texas by accumulating, compiling and disseminating information pertaining to the breeding, training and exhibiting of quarter horses; organizing and promoting quarter horse exhibitions and training clinics for the education and pleasure of owners, exhibitors and the general public; and to educate individuals and others with respect to the benefit and advantages derived from breeding, exhibiting, training and otherwise caring for horses. The TQHA holds Program funds pending payout for incentive awards and purses for certain restricted races. The incentive awards and purses are paid out within 60 days of the end of each race meet. The TQHA retains ten (10%) percent of the Program funds received for the administration of the Program.

Texas Greyhound Association (TGA)

The Texas Greyhound Association was incorporated on September 26, 1985 as a Texas nonprofit corporation by a group of National Greyhound Association members living in Texas. The Association represents its members in all facets of legislative actions that pertain to the regulation of breeding, raising, training, care, racing and adoption of greyhounds in Texas. In addition, the Association assists in all matters pertaining to the regulation of pari-mutuel and non-pari-mutuel greyhound racing in Texas, administers breakage amounts received from the Texas Racing Commission (TRC), distributes purse monies received from Texas horse tracks, maintains a Texas bred registry, encourages the breeding, training and racing of greyhounds and provides management services to race tracks in the State of Texas.

The TGA receives a predetermined administration fee from the funds received from the Texas Racing Commission and various contractual management services.

Texas Paint Horse Breeders Association (TPHBA)

The Texas Paint Horse Breeders Association has been operating for approximately 9 years and is located in Fort Worth, Texas. The Texas Paint Horse Breeders Association's goal is to encourage the breeding and ownership of racing American Paint Horses. The TPHBA administers the Texas Paint Horse Breeders Association Accredited Texas-Bred Program for accredited qualified horses registered with the TPHBA. The TPHBA administers the incentive program to encourage the breeding and ownership of accredited racing Texas-Bred Paint Horses by providing racing awards, breeder awards, and stallion owner awards.

Texas Arabian Horse Breeders Association (TABA)

The Texas Arabian Horse Breeders Association (TABA) was formed in 1988 to assure Arabian horses a rightful place in Texas horse racing. The Texas Racing Act of 1987 included Arabian horses as a racing breed and guaranteed the right to race on all Texas pari-mutuel horse racing tracks. The Arabian horses enjoy racing opportunities at three Class 1 horse racing tracks in Texas. These racing tracks include Sam Houston Race Park, Retama Park, Lone Star Park at Grand Prairie, as well as tracks in other states in the United States and many other countries. The Texas Arabian Breeders Association is the organization mandated by the Texas Racing Commission to oversee the Accredited Texas Bred Program (ATB) for Arabian racehorses, which is a breeder incentive program.

Appendix 3

<u>Texas Bred Incentive Program Distributions:</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Texas Thoroughbred Association	\$1,837,399	\$1,792,844	\$1,774,521
Texas Quarter Horse Association	\$ 941,257	\$ 900,649	\$ 890,209
Texas Greyhound Association	\$ 492,327	\$ 469,883	\$ 424,165
Texas-bred Stakes Race Supplements	\$ 101,861	\$ 93,300	\$ 95,436
Texas Arabian Breeders Association	\$ 53,777	\$ 51,894	\$ 51,439
Texas Paint Horse Breeders Association	\$ 26,952	\$ 26,106	\$ 25,876
Total	\$3,453,573	\$3,334,676	\$3,261,646

<u>Performance Measures :</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Texas Thoroughbred Association (as of August 31st):			
Total Number of Incentive Awards Paid	4,595	4,388	4,579
Total Number of ATB Horses Finishing 1 st , 2 nd , or 3 rd	796	743	741
Texas Quarter Horse Association (as of December 31st):			
Total Number of Incentive Awards Paid	2,444	2,545	2,489
Total Number of ATB Horses Finishing 1 st , 2 nd , or 3 rd	955	1,099	1,067
Texas Paint Horse Breeders Association (as of December 31st):			
Total Number of Incentive Awards Paid	8	11	9
Total Number of ATB Horses Finishing 1 st , 2 nd , or 3 rd	7	5	14
Texas Arabian Breeders Association (as of December 31st):			
Total Number of Incentive Awards Paid	89	82	118
Total Number of ATB Horses Finishing 1 st , 2 nd , or 3 rd	33	38	49
Texas Greyhound Association (as of December 31st):			
Total Number of Awards Paid (1 st Place only)	712	2,186	2,121

Appendix 4

Report Distribution

As required by Gov't Code 2102.0091 copies of this report should be filed with the following:

Governor's Office of Budget and Planning

Attn: Sarah Hicks
Phone: (512) 463-1778
Budgetandpolicyreports@governor.state.tx.us

Legislative Budget Board

Attn: Julie Ivie
Phone: (512) 463-1200
Audit@lbb.state.tx.us

State Auditor's Office

Attn: Internal Audit Coordinator
Phone: (512) 936-9500
iaordinator@sao.state.tx.us

Sunset Advisory Commission

Attn: Ken Levine
Phone: (512) 463-1300
sunset@sunset.state.tx.us

Texas Racing Commission:

John T. Steen III, Chairman
Ronald F. Ederer, Vice -Chair
Gloria Hicks
Margaret Martin
Robert Schmidt, M.D.
There are currently two vacancies

Ex-Officio Members

Steven P. Mach, Chair, Public Safety Commission
Sid Miller, Commissioner of Agriculture

Texas Racing Commission Management

Chuck Trout, Executive Director



TEXAS RACING COMMISSION
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August 1, 2018

Via email & U.S. Mail

MONDAY RUFUS & CO., P.C.
Monday Rufus
608 Morrow St., Suite 101
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Dear Mr. Rufus:

Staff has reviewed the draft Internal Audit Report of the Texas Bred Incentive Programs: Associations (Breed Registries) and Policies & Procedures originally dated March 10, 2018. Following further discussions with you and Mr. Gonzales, staff has completed its review of your final audit draft dated July 3, 2018.

As you recommended, the agency will require the breed registries to review their established policies and procedures to ensure consistent accurate performance measure reporting and will periodically remind them about the importance of submitting accurate information.

Sincerely,

Chuck Trout
Executive Director

CT:mjc

