PERFORMANCE AUDIT

DEPARTMENT OF RACING

RACING COMMISSION

Report to the Arizona Legislature
By the Auditor General
July 1986
86-5

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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

July 14, 1986

Members of the Arizona Legislature
The Honorable Bruce Babbitt, Governor
Timothy A. Barrow, Director
Department of Racing
Fred C. Struckmeyer, Jr., Chairman
Racing Commission

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Department of Racing and Racing Commission. This report is in response to the July 26, 1985 resolution of the Joint Legislative Oversight Committee.

The report addresses weaknesses in several areas. The Department needs to strengthen its drug testing program by increasing the number of samples taken from racing animals and ensuring that adequate analyses are performed on the samples. We also found that the Department needs to conduct electronic data processing audits of racetrack totalisator systems to help deter potential fraud. Finally, we found that the capital improvements program has improved racetrack facilities but has not led to increased wagering as intended by statute.

My staff and I will be pleased to discuss or clarify items in the report.

Respectfully submitted,

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SUMMARY

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Racing and the Arizona Racing Commission. The audit was conducted in response to a July 26, 1985, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes §§41-2351 through 41-2379.

DEPARTMENT OF RACING

The Arizona Department of Racing (ADOR) was established by the Legislature in 1982 with the intent to strengthen the regulation of the racing industry in Arizona. Prior to the creation of the Department in 1982, racing activities were regulated by the Arizona Racing Commission. The Department is headed by a Director appointed by the Governor and its responsibilities include licensing individuals involved in racing meets, collecting pari-mutuel revenues, drug testing, conducting investigations and background checks and conducting administrative hearings on potential racing violations.

This is the third performance audit of racing regulation in Arizona in the past five years. The Department has made substantial progress in implementing recommendations from previous Auditor General reports. Procedures to select the contract drug testing laboratory have been implemented. The licensing and background investigation process has been improved. Several track operations problems involving scales and weighing jockeys have been corrected. In addition, the Department has corrected several accounting related problems.

ADOR Needs To Strengthen And Improve Its Drug Testing Program (see pages 15 through 25)

ADOR should strengthen and improve its drug surveillance program to prevent potential abuses in the racing industry. Our survey indicates that when compared with other racing states, ADOR does not conduct sufficient sampling of horses and greyhounds to adequately ensure that

prohibited substances are not used to alter racing performance. Despite its broad statutory authority to sample, the Department, on the average, samples approximately one horse per race and one greyhound per race, while other racing states contacted sample approximately two or more horses and greyhounds per race.

ADOR has not acted to ensure adequate drug testing analyses. The contract testing laboratory conducts fewer screening tests on equine urine samples than recommended by the National Association of State Racing Commissioners (N.A.S.R.C.) Research and Reference Centers. Failure to conduct the N.A.S.R.C. Uniform Drug Testing procedures could result in some prohibited drugs passing by the contract laboratory undetected. In addition, special testing procedures established by the Department to detect the potential use of exotic drugs in horses are not sufficiently random. Evidence from other racing states indicates that special testing for exotic drugs should be conducted more frequently or on a random basis. Finally, ADOR's programs for evaluating the contract testing laboratory's equine testing performance are not realistic tests of routine procedures because the contract laboratory is aware of when its performance is being evaluated.

To strengthen its drug testing program ADOR should request increased funding to provide for the additional sampling and testing procedures that are needed.

Electronic Data Processing Audits Of Racetrack Totalisator Systems Needed To Help Deter Fraud (see pages 27 through 34)

Electronic Data Processing (EDP) audits of racing facility totalisator computer systems are needed to help deter fraud. Presently, all commercial race tracks in Arizona use a computerized totalisator system to: record the amount of money wagered, post the odds for animals racing and provide information to the public on the odds board. A previous Auditor General report as well as two studies prepared for the Department identified several methods of computer fraud that could result from totalisator system control deficiencies. Such methods include:

- Counterfeiting and cashing unclaimed winning tickets,
- Adjusting teller balances to conceal overages or shortages,
- Failing to enter betting transactions and keeping the money,
- Skimming betting revenues, and
- Underreporting the wagering pool to change the odds and the State's portion of the revenue.

Although considerable hazards have been identified, the Department has never conducted EDP audits of racetrack totalisator systems. Past attempts by the Department to implement EDP auditing have been ineffective due to one totalisator company's failure to comply with the Department's request for information. The Department has not used its full authority to require compliance and protect the wagering public. In addition, the Racing Commission was aware of the Department's problems in implementing EDP audits, yet it has not fully supported the attempts.

ARIZONA RACING COMMISSION

The Arizona Racing Commission was created by the Legislature in 1949. The Commission is comprised of five members appointed by the Governor to five-year staggered terms. The Commission is responsible for setting overall Departmental policy, issuing racing dates, approving capital improvement applications, and promulgating any rules and regulations needed to protect the public safety. In 1982 the Legislature transferred the regulation of racing meets and other duties to the newly created Department of Racing.

The Capital Improvements Program Should Be Terminated (see pages 59 through 67)

The capital improvements program should be terminated prior to its expiration on June 30, 1987, for horse track permittees and June 30, 1992, for dog track permittees. The statutory purpose of the program is to improve race tracks and increase the pari-mutuel handle. Although capital improvements have enhanced racing facilities, the amount of money wagered at two upgraded race tracks has decreased when measured in constant

dollars. The limited effect of capital improvements indicates that other external factors may have more impact on the amount of money wagered. The purse structure, population changes, weather conditions, the number of racing days and competition with the lottery could affect pari-mutuel wagering.

The Racing Commission erroneously approved two capital improvement projects. Statutes require the Commission to review and approve all capital improvement projects submitted by race tracks. Although statutes allow a broad range of projects to qualify for capital improvement withholding, certain restrictions apply. According to the Legislative Council, these restrictions include a minimum project amount and a requirement that components of a project be related in purpose. The Commission erroneously approved two projects that did not meet the minimum expenditure requirement. As a result, the Racing Commission should recover $236,685 of improperly withheld funds.

The Commission also erroneously approved unrelated components in three other projects. However, because the project amounts still met the minimum requirements after the unrelated components were subtracted, only the $53,760 in unrelated components are invalid. The Racing Commission should also recover this amount.

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INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Department of Racing. The audit was conducted in response to a July 26, 1985, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379.

Statutory Authority And Duties

The Legislature created the Arizona Department of Racing in 1982 (HB2470 Chapter 310) "to strengthen the regulation of the racing industry in Arizona for the protection of the public peace, safety and welfare. . . ." The Department is administered by a Director appointed by the Governor. Before the Department was established, racing activities were regulated solely by the Arizona Racing Commission, through an Executive Secretary. Creation of the Department of Racing eliminated the Commission's responsibility for staff activities and the daily operation of the agency. The Department was created in an effort to have daily operations supervised by someone with significant business and administrative experience. The Legislature also intended that the Commission "concentrate their efforts on setting overall department policy, allocation of racing dates and licensing of permittees," as set forth in Legislative Laws, 1982, Chapter 310, §1.

The Department's role is to license personnel involved in racing meets, employ a hearing officer to hear testimony, and collect fees from permittees. In addition, the Department ensures the integrity of pari-mutuel wagering through testing for illegal substances in race animals, investigating alleged crimes and conducting background investigations of license applicants. (Table 1 summarizes activities for fiscal year 1982-83 through 1985-86.)

TABLE 1

DEPARTMENT ACTIVITY
FISCAL YEARS 1982-83 THROUGH 1985-86

	Actual 1982-83	Actual 1983-84	Actual 1984-85	Estimated 1985-86
Race Days	796	822	912	1,029
Races	10,924	12,036	13,142	17,169
Samples Tested	11,855	11,616	13,656	17,150
Hearings	81	100	163	163
Licenses Issued	9,409	5,766	4,069	16,000 (1)

(1) All previous multi-year licenses will be renewed in 1985-86.

Source: Compiled by Auditor General staff from Department of Racing fiscal year 1986-87 Budget Request and 1984-85 Annual Report.

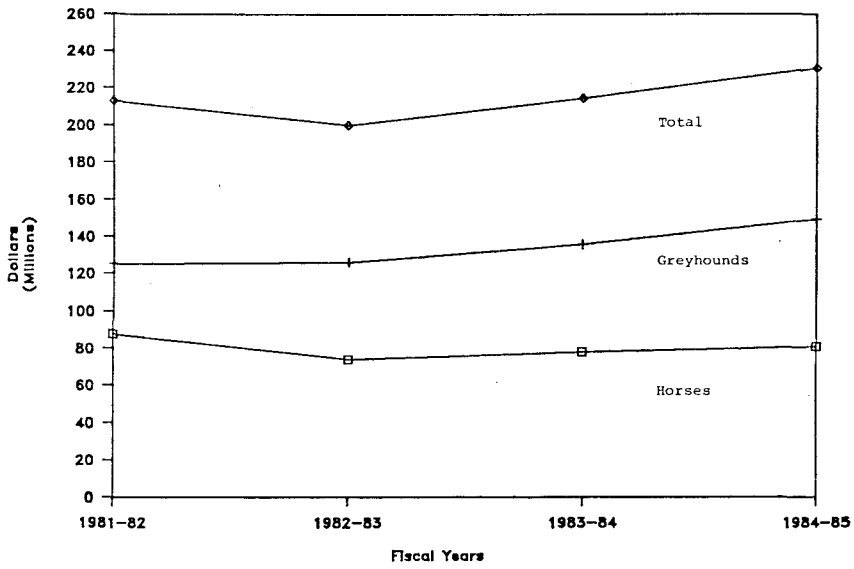
Track Operations

Currently, the Department regulates two commercial horse race facilities and four greyhound parks. The two horse race facilities are Turf Paradise in Phoenix and Prescott Downs in Prescott. Apache Greyhound Park in Apache Junction, Phoenix Greyhound, Tucson Greyhound and Yuma Greyhound Parks are the four commercial greyhound tracks. In addition, 12 counties hold horse races a few days each year.

Within the past few years the number of races held in Arizona has increased. The increase is due to growth in the number of greyhound races, which increased from 7,356 in fiscal year 1981-82 to 11,050 in 1984-85. The number of horse races has declined from 2,536 in fiscal year 1981-82 to 2,092 in fiscal year 1984-85. Wagering trends also reflect this pattern. According to Department records, of the $230,738,814 wagered in Arizona in fiscal year 1985, $81,110,896 was bet on horses and $149,627,918 on greyhounds. In fiscal year 1981-82 money wagered on horses comprised 41 percent of the total bet on pari-mutuel wagering. In fiscal year 1984-85 that total was down to 35 percent, while greyhound racing received 65 percent of every wagering dollar. Figure 1 shows the pari-mutuel wagering handle for horses and greyhounds for the last four fiscal years.

FIGURE 1

PARI-MUTUEL WAGERING HANDLE
COMMERCIAL RACE TRACKS
FISCAL YEARS 1981-82 THROUGH 1984-85



Source: Compiled by Auditor General staff from Department of Racing Annual Reports, fiscal years 1982-83 through 1984-85.

State Revenue From Racing

Arizona receives a specified proportion of monies wagered on horse and greyhound races. For greyhound tracks in counties with populations of 700,000 or more, the State receives 7.5 percent of the total money bet. For dog races run in counties with fewer than 700,000 people, the State receives 5.5 percent for the first $100,000 bet per day and 7.5 percent of amounts over $100,000 per day. For horse races, the State's share also fluctuates. Under current statutes in effect until August 13, 1986, the State receives 3 percent of the first $100,000 wagered daily and 5 percent of any amount over $100,000 for tracks with an average daily handle exceeding $200,000. With the passage of HB2379 in 1986, from August 13, 1986, until July 1, 1987, for race facilities that handle over $200,000 a day, Arizona receives 3 percent of the first $1 million and 5 percent of anything over $1 million. After July 1, 1987, the State will receive 2

percent of the first $1 million wagered daily and 5 percent of wagers over $1 million. For race meets that handle $200,000 or less daily, the State receives 2 percent of the first $200,000 and 5 percent of anything over $200,000.

In 1984-85 Arizona received $8,803,373 in State revenues from greyhound race tracks and $2,704,308 from horse racing facilities. The total amount of revenue collected by the Department of Racing was $11,507,681 in 1984-85 (Table 2).

TABLE 2

STATE REVENUES FROM PARI-MUTUEL WAGERING
FISCAL YEARS 1981-82 THROUGH 1984-85 (1)

Fiscal Year (1)	Greyhounds	Horses	Total
1981-82	$7,009,080	$3,749,903	$10,758,983(2)
1982-83	7,566,411	2,462,312	10,028,723
1983-84	8,061,381	2,613,595	10,674,976
1984-85	8,803,373	2,704,308	11,507,681

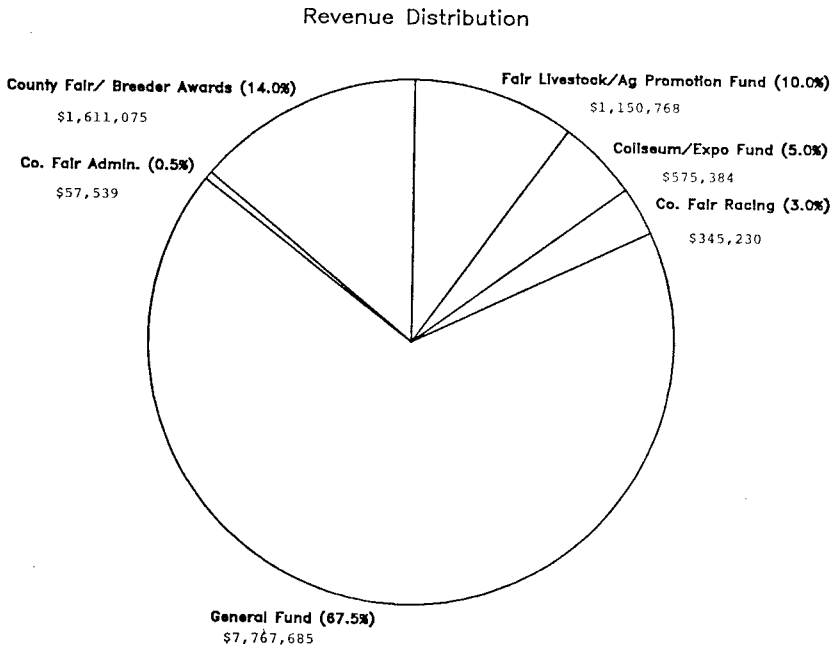
(1) Includes revenues earned in the current fiscal year and received in the next fiscal year.
(2) Excludes charity days for fiscal year 1981-82.

Source: Prepared by Auditor General staff from Department of Racing Annual Reports, fiscal years 1982-83 through 1984-85.

State revenues from racing are distributed to a variety of funds (Figure 2). Two-thirds of the revenue goes to the General Fund. The remaining revenues are allocated to county fair racing, breeders' awards, County Fair Livestock Funds and other purposes.

FIGURE 2

DISTRIBUTION OF FISCAL YEAR 1984-85
PARI-MUTUEL REVENUE FROM
COMMERCIAL RACE TRACKS



Source: Prepared by Auditor General staff from Arizona Department of Racing Annual Report, fiscal year 1984-85.

Staffing and Budget

The Racing Department is funded through General Fund and County Fair Racing Fund appropriations. For fiscal year 1985-86 the Department is authorized 65 full-time equivalent (FTE) positions. The actual number of FTEs in fiscal years 1983-84 and 1984-85 was 61.2. The staff is separated into three sections: commercial racing, county fair racing and county fair administration. For fiscal year 1985-86 there are 58.1 FTEs in commercial racing and 6.9 in county fair racing. In addition, the Department has 2.0 nonappropriated positions for county fair administration. Staffing has increased since fiscal year 1982-83, due in part to the increased number of racing dates. In fiscal year 1982-83 there were 796 commercial race dates. That has increased to an estimated 1,029 in 1985-86. In fiscal year 1984-85, $327,626 was spent on outside services, as shown in Table 3. $288,200 of the outside services expenditures was for lab testing.

TABLE 3

DEPARTMENT OF RACING
EXPENDITURE AND BUDGET DETAIL
FISCAL YEAR 1982-83
THROUGH FISCAL YEAR 1985-86
(UNAUDITED)

	Actual Fiscal Year 1982-83	Actual Fiscal Year 1983-84	Actual Fiscal Year 1984-85	Estimated Fiscal Year 1985-86
FTE Positions	45	61.2	61.2	67.0 (1)
Personal Services	$ 881,115	$ 925,209	$1,052,605	$1,577,400
Employee Related	160,910	184,072	210,951	332,700
Professional and Outside Services	262,763	305,026	327,626	439,200
Travel				
State	80,558	74,802	84,389	92,200
Out-of-State	1,277	2,468	2,670	7,800
Other Operating	82,314	96,253	76,572	151,000
Equipment	44,477	36,903	35,795	43,500
TOTAL	$1,513,414	$1,624,733	$1,790,608	$2,643,800

(1) Includes two nonappropriated positions for County Fair Racing.

Source: Prepared by Auditor General staff from Arizona Department of Racing Annual Report, fiscal year 1984-85.

This is the third performance audit of racing regulation in Arizona in the past five years. Since its creation in 1982 the Department of Racing has implemented many operational changes based on recommendations from previous Auditor General reports (Reports 81-5 and 82-2). Procedures to select the contract drug testing laboratory have been implemented. The licensing and investigation process has been improved. Several track operations problems involving scales and weighing jockeys have been corrected. In addition, the Department has corrected several accounting related problems.

Audit Scope and Purpose

The audit report focuses on the Department's ability to perform its functions effectively and efficiently. The report presents findings and recommendations in two areas.

- The ability of the Department to effectively identify prohibited substances in race animals' systems,
- The need for EDP audits of racing facility totalisator computer systems.

We developed other pertinent information concerning the costs of county fair racing, pari-mutuel racing broadcasts and information dissemination, and testing jockeys for drug usage. Due to time constraints we were unable to address all potential issues identified during our audit. The section Areas For Further Audit Work describes these potential issues.

The Auditor General and staff express their appreciation to the Director and staff of the Department of Racing for their cooperation and assistance during the audit.

SUNSET FACTORS

In accordance with Arizona Revised Statutes (A.R.S.) §41-2354, the Legislature should consider the following 12 factors in determining whether the Arizona Department of Racing (ADOR) should be continued or terminated.

1. The objective and purpose of establishing the Department

On September 30, 1982, the Legislature established the Department of Racing with the intent to "strengthen the regulation of the racing industry in Arizona for the protection of the public peace, safety and welfare. . . ." On that date, all administrative matters before the Arizona Racing Commission were transferred to the newly established Department. The transfer gave the Department the authority to enforce the statutes and the rules and regulations that address racing and pari-mutuel wagering. To this end, the Department licenses, regulates and supervises all racing meets held in the State. In addition, the Department collects the State's share of the pari-mutuel handle from racing facilities and allocates the proceeds to various State funds.

2. The effectiveness with which the Department has met its objective and purpose and the efficiency with which it has operated

The Department has generally met its prescribed objective and purpose. However, some problems remain that adversely impact both the Department's effectiveness and efficiency.

Drug Testing - Current audit work has uncovered problems with the testing procedures and the laboratory's quality assurance program. According to a Department spokesperson, urine samples from all winning horses and approximately 80 percent of winning greyhounds are tested for foreign substances. However:

- The Department does not conduct enough sampling of nonwinning horses or greyhounds,
- The Department does not ensure adequate testing for the presence of exotic drugs in equine samples, and
- The Department's evaluation of the contract testing laboratory is limited (see Finding I, page 15).

Electronic Data Processing Audits - Changes are needed to allow the Department to adequately monitor the wagering activity at the various race track facilities. The Department has been unable to conduct Electronic Data Processing (EDP) audits of the computerized totalisator systems at racing facilities. EDP auditing is necessary: 1) to help ensure that the odds and payoffs are correctly calculated, and 2) to verify that the handle amounts reported by the permittees are accurate (see Finding II, page 29).

3. The extent to which the Department has operated within the public interest

Generally, the Department has operated within the public interest by upholding the integrity of racing and pari-mutuel wagering. Regulatory activities provide owners, breeders and the betting public with fair and competitive racing conditions. However, the Department could further protect the public and the racing industry by strengthening its regulatory authority in the areas of animal drug testing and EDP auditing.

4. The extent to which rules and regulations promulgated by the Department are consistent with the legislative mandate

While the Department has statutory authority to promulgate rules and regulations, none have been initiated. All rules and regulations concerning racing and pari-mutuel wagering have been promulgated by the Arizona Racing Commission (see Arizona Racing Commission audit, page 53).

5. The extent to which the Department has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public

This factor is not applicable since the Department has not promulgated rules and regulations.

6. The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction

The Department investigates and resolves violations of the various rules and regulations pertaining to racing and pari-mutuel wagering. According to the Department's 1984-85 Annual Report, the Department resolved 93 percent of the cases it opened for investigation in that year. Violations ranged from falsified applications to possession of drugs and other criminal activities. Moreover, the Boards of Stewards at the various race tracks issued 559 rulings for violations of horse or greyhound rules and regulations. In addition, the Department employs a full-time Hearing Officer. During the 1984-85 fiscal year, the Hearing Officer held 240 hearings. Any person adversely affected by a decision of a steward or any other Department employee may request a hearing with the Department's Hearing Officer.

Statutes also provide the Department with adequate authority to investigate and resolve complaints brought forth by the public. However, the Department does not keep a record of the nature or the number of complaints it receives from the public.

7. The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under enabling legislation

To date, the Department has not experienced any difficulties with prosecuting actions under its enabling legislation. However, the Department Director and the Department's Assistant Attorney General

representative stated that some of its enforcement statutes may need clarification.

8. The extent to which the Department has addressed deficiencies in the enabling statutes which prevent it from fulfilling its statutory mandate

Since its inception in 1982, the Department has proposed no legislation. However, ADOR staff stated that the current statutes are not presented in an orderly manner. To date, the Department has not addressed this issue.

9. The extent to which changes are necessary in the laws of the Department to adequately comply with the factors listed in the sunset law

Based on our audit work, we recommend that the Legislature consider the following change to the Department of Racing's statutes.

- Clarify A.R.S. §5-107.03.A to ensure that the Department has full access to information needed to conduct EDP audits.

10. The extent to which termination of the Department would significantly harm the public health, safety and welfare

Terminating the Department of Racing would have a deleterious effect on the public health, safety and welfare. A racing regulatory body is needed to uphold the integrity of racing meets and pari-mutuel wagering. Unregulated racing and pari-mutuel wagering could increase the possibility of:

- physical harm to racing participants,
- race-fixing,
- incorrect payoffs to bettors, and
- loss of State revenues due to a decrease in wagering or the amount of the pari-mutuel handle remitted to the State.

11. The extent to which the level of regulation exercised by the Department is appropriate and whether more or less stringent levels of regulation would be appropriate

The current level of regulation exercised by the Department should be increased. The Department should strengthen its regulatory presence in the areas of animal drug testing and EDP auditing. Moreover, reducing the regulatory scope of the Department could result in harm to the public and participants in racing events. All racing and wagering activities must be supervised to ensure that they are conducted properly and benefit the public, racing participants and the State in general.

12. The extent to which the Department has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished

According to the Department, private contractors are used to the extent that such use is practical and cost effective. Private contractors are used in laboratory testing services for the detection of foreign substances in racing animals. In addition, the Department uses the services of a private firm that provides a data base of all racing related rulings from various jurisdictions as a part of the investigation function. We did not identify any other areas where the Department should be using private contractors in the performance of its duties.

FINDING I

THE ARIZONA DEPARTMENT OF RACING NEEDS TO STRENGTHEN AND IMPROVE ITS DRUG TESTING PROGRAM

The Arizona Department of Racing (ADOR) should strengthen and improve its drug surveillance program to prevent potential abuses in the racing industry. The level of sampling conducted by the Department appears too low to provide effective deterrence. In addition, the Department has failed to ensure adequate analyses by the contract testing laboratory. Moreover, ADOR's program of evaluating the contract laboratory's testing performance is weak.

Arizona Revised Statutes (A.R.S.) §5-105 authorizes the Department to employ qualified personnel or contract with private chemical laboratories for analyses of saliva, urine and blood samples of horses and dogs, to ensure that prohibited substances have not been used to alter an animal's performance. Presently, the Department contracts with one laboratory for most of its sample analyses. The Department relies on the expertise and analytical accuracy of the contract laboratory to detect the presence of drugs in racing animals in Arizona. In fiscal year 1986, it is estimated by the Department that more than $332,000 will be expended for the analyses of more than 17,150 samples from racing animals, most of which are urine samples. During fiscal year 1985, approximately $288,200 was expended for analyses of more than 13,650 horse and greyhound samples.

Department Does Not Conduct Enough Sampling

ADOR does not conduct sufficient sampling of horses and greyhounds to adequately ensure that prohibited substances are not used to alter racing performance. The Department needs to increase the number of samples currently taken to provide a greater deterrence to drug usage. However, additional funding will be necessary if more extensive sampling is conducted.

Department needs to take more samples to better deter drug usage - The Department needs to increase the numbers of samples taken to provide a greater deterrence to drug usage. The number of horse and greyhound samples currently taken by the Department is extremely low. Despite its broad statutory authority to sample horses and dogs, the Department samples an average of approximately one horse per race and one dog per race. In comparison, the majority of racing states contacted during our review conduct more extensive sampling. Of the major horse racing states contacted,* seven sample, at a minimum: winners, winners of exotic wagers,** beaten favorites and any horse the judges feel should be tested. Nine of the ten states test approximately two or more horses per race. For example, California requires judges to select seven horses at random every racing day for testing, in addition to the winners. Four greyhound racing states surveyed*** routinely sample a minimum of two dogs per race, with a special focus on winners of exotic wagering races. Connecticut, for example, generally samples and tests all eight dogs participating in a race.

Increased sampling provides a greater deterrence to drug usage. Testing more entries raced than just the winning horse or greyhound broadens the scope of drug surveillance and provides a check on winners in exotic wagers. A majority of states contacted concluded that increased sampling is cost-effective and has provided greater deterrence to drug usage. For example, three states reported that the increased sampling has actually resulted in proportionately fewer samples containing illegal drugs. In addition, a study conducted by the Kentucky Equine Drug Research and Testing Program and published in November 1985 reviewed results from

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* The ten states are: California, Florida, Kentucky, Illinois, Louisiana, Maryland, New Jersey, New Mexico, New York and Ohio.

** Winners of exotic wagers should be tested for two reasons. First, exotic wagering payoffs often represent large sums of money. Second, a horse or dog need not finish first to be an important factor in an exotic wager. For example, to win a quinella pool, wagerers are required to select the first two finishers. Payoffs remain the same regardless of which animal wins and which places second.

*** These states are: Connecticut, Florida, Massachusetts and New Hampshire.

several countries and found that increased sampling initially resulted in a greater percentage of positive samples but after a period of weeks the incidents of prohibited substances were sharply reduced.

Additional funding necessary - Current funding levels are insufficient to allow the testing of additional samples. ADOR will require additional funding if more extensive sampling is to be conducted.

The Department requested funding for 1.15 equine samples and 1.05 greyhound samples per race in its fiscal year 1986-87 budget request. This level of funding appears to be less than is necessary to adequately sample racing animals based on the sampling done in other racing states contacted.

Additional funding will be necessary to conduct more extensive sampling. Based on our survey of other racing states, the Department should, at a minimum, sample an average of two horses and two greyhounds per race. However, the Department could decide to conduct additional sampling per race if further analysis indicated that increased sampling would be beneficial. Based on budget projections for fiscal year 1987, testing two equine and two greyhound samples per race would increase the projected testing budget from approximately $350,100* to $657,500, an increase of approximately $300,000 per fiscal year.

An increased sampling level would require sufficient funding to sample more than just one animal per race. Increased sampling would enhance the enforcement capabilities of the Department by providing a greater deterrence to drug usage. Additional funding would also give the Department sufficient flexibility to test the various combinations of animals in each race that would most effectively discourage illegal drug use.

* This figure represents costs of sampling based on current testing procedures for horse and dog tracks currently under operation.

Department Does Not Ensure Adequate Laboratory Analysis

ADOR has not acted to ensure adequate drug testing analyses. The contract laboratory should conduct additional testing procedures for equine samples, as recommended by N.A.S.R.C. Research and Reference Centers. The Department has not clearly specified minimum testing procedures in its Chemical Analysis Contract with the testing laboratory. In addition, the Department's program to detect exotic drugs in horses is limited. Additional funding may be required to perform adequate drug testing analyses.

Laboratory should perform additional equine testing procedures - The testing laboratory should conduct a sufficient number of testing procedures for horses. The contract laboratory conducts fewer screening tests on equine urine samples than recommended by N.A.S.R.C. Research and Reference Centers. In addition, the laboratory lacks adequate documentation of procedures performed. Not conducting recommended procedures could result in the failure to detect some prohibited drugs.

The contract laboratory performs fewer initial screening procedures for equine samples than recommended by the National Association of State Racing Commissioners (N.A.S.R.C.) Research and Reference (R&R) Centers. According to the contract laboratory's manager, only four Thin-Layer Chromatography (TLC)* tests are routinely conducted on equine samples as initial screening tests. However, the N.A.S.R.C. Uniform Drug Testing procedures recommend additional TLC tests. The N.A.S.R.C. Research and Reference Center** at Ohio State University (OSU) recommends a minimum of

* Thin-Layer Chromatography is so named because the experiment is performed on a thin layer of silica gel or other adsorbent coated on a glass or metal plate.

** These Centers serve, in part, as equine testing research institutions that develop and evaluate analytical drug testing procedures. As a result, the Ohio State and Cornell Research and Reference Centers establish the N.A.S.R.C. Uniform Drug Testing procedures.

six TLC tests, while the Cornell University Research and Reference Center* recommends a minimum of nine TLC tests. The types of tests conducted by the contract laboratory and the N.A.S.R.C. Research and Reference Centers are shown in Table 4.

TABLE 4

ROUTINE TLC SCREENING TESTS CONDUCTED ON EQUINE URINE SAMPLES

CONTRACT LABORATORY	OHIO STATE	CORNELL
1) Base Urine	1) Base Urine	1) Base Urine
2) Base Hydrolysis-Acid Extraction	2) Base Hydrolysis-Acid Extraction	2) Base Hydrolysis
3) Enzyme Hydrolysis	3) Enzyme Hydrolysis	3) Enzyme Hydrolysis
4) Neutral Urine	4) Neutral Urine	4) Neutral Urine
	5) Ion Pair	5) Ion Pair
	6) Acid Urine	6) Acid Hydrolysis
		7) Clenbuterol Bore
		8) Diuretic Urine
		9) Steroid Urine

Source: Compiled by Auditor General staff from contract laboratory procedures manual, Ohio State University equine testing procedures and Cornell University equine testing procedures.

According to the contract laboratory's manager, the four TLC tests routinely conducted by the laboratory were recommended by the director of the OSU R&R Center as the minimum required testing procedures. However, the director of the OSU R&R Center stated in writing to Auditor General staff the OSU recommends a minimum of six TLC tests.

Because the contract laboratory's documentation of daily testing activity is incomplete, it is difficult to determine whether all four TLC tests for equine samples are completed daily. The laboratory's method of recording daily testing makes it difficult for a layperson to determine what tests

* The Equine Drug Testing and Research Program at Cornell University has been a leading institution in the field of equine drug research for many years and has published numerous articles addressing equine drug applications. In addition, the N.A.S.R.C. Uniform Drug Testing and Quality Assurance Program was patterned after a program developed at Cornell University.

are actually conducted. However, statements by laboratory personnel suggest that in the past, only three TLC tests were conducted on days when a large quantity of samples were present for testing.

Failure to conduct testing procedures recommended by the Research and Reference Centers for equine samples reduces the potential effectiveness of the drug surveillance program. Directors of both Research and Reference Centers indicated that fewer tests could result in some prohibited drugs passing undetected. The director of the Cornell Research and Reference Center also indicated that Arizona's omission of one particular TLC test makes it impossible for the laboratory to detect the presence of a certain type of illegal substance in equine samples.*

Department has not clearly defined minimum testing procedures - The Department has not clearly stipulated minimum testing requirements for equine and greyhound samples to ensure adequate and uniform testing. The existing contract clause defining minimum analysis procedures for horses is vague and does not ensure that the laboratory conducts the minimum number of tests recommended by the Department's Research and Reference Laboratory. In addition, ADOR has not stipulated minimum testing procedures for greyhounds in the chemical analysis contract, although greyhounds account for approximately 83 percent of the total samples tested by the contract laboratory.

Furthermore, the N.A.S.R.C. Uniform Drug Testing procedures for horses are not well defined. As mentioned previously, N.A.S.R.C. Research and Reference Centers disagree on the required number of minimum testing procedures. Because no actual consensus exists within N.A.S.R.C. as to what the Uniform Drug Testing procedures are, the Department needs to develop contract language to ensure that the laboratory conducts the minimum number of tests recommended by the Department's N.A.S.R.C. Research and Reference Laboratory.

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* During the course of the audit we informed the Department of the type of substances involved and the test needed to detect them.

Limited testing for exotic drugs - Special testing procedures established by the Department to detect the potential use of exotic drugs* in horses are limited. Testing of samples to detect exotic drugs is not sufficiently frequent or random when compared with other racing states.

The Department's existing procedures for low dose drugs do not appear to be sufficiently frequent or random, and therefore, may not adequately identify or minimize the usage of such drugs. It was not until December 1985 that the Director of ADOR exercised a provision of the chemical analysis contract and instructed the contract testing laboratory to begin special testing under the direction of the Department Veterinarian. A testing schedule was not formally developed and was left to the discretion of the Department Veterinarian and the manager of the testing laboratory. According to the laboratory manager, the decision had been reached to conduct the special tests on horse racing days when a large stakes race is run and on the same day each week when the laboratory does not receive many horse and greyhound samples for testing.

Other racing states conduct special testing on either a more frequent or more random basis. For example, California, New Jersey and Kentucky conduct the special testing of all samples as a part of their daily initial screening procedures. Evidence from other racing states appears to indicate that, at minimum, random special testing for exotic drugs should be conducted. However, because of the technique necessary to conduct the special testing and the associated costs, the tests are best performed on all the horses for a racing day. Therefore, the randomness involves which days would be tested and how often the testing would be conducted.

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* According to experts in the drug testing field, some performance altering drugs used in the horse racing industry require such a low dose to achieve desired effects that existing initial screening procedures cannot detect them. These low dose drugs are commonly referred to as exotic drugs, and include such drugs as etorphine or elephant juice, and fetanyl.

Additional funding may be needed - Additional funding may be needed to perform adequate testing analyses. Currently, the Department pays $18.50 for the four minimum screening tests per sample. Increased screening tests per sample could raise the price. For example, Ohio State charges $20 per sample using six tests to process each sample. In addition, Cornell charges $20 per sample using nine tests to process each sample.

Additional funding may be required for increased testing for exotic drugs. Currently, the testing laboratory charges $18.50 plus $15 to $25 per sample for special tests for exotic drugs. The Department needs to determine the frequency of special tests and then calculate the amount of additional funding needed. New York State's laboratory at Cornell, for example, performs special tests for exotic drugs on 15 to 20 percent of all samples tested.

Procedures For Evaluating Laboratory Performance Ineffective

ADOR's procedures for evaluating the contract testing laboratory's performance are not effective. The Department's current methods of using unknown and split samples to evaluate the contract laboratory's equine testing performance are not realistic tests of routine procedures. In addition, ADOR's efforts to review the procedures of the contract laboratory are not adequate.

The Department primarily evaluates the contract laboratory through unknown and split samples. However, the Department does not use outside reviewers to evaluate the adequacy of laboratory testing procedures.

Unknown and split sample procedures not effective - The Department's method of evaluating the laboratory's performance through unknown and split samples does not accurately simulate routine testing requirements. Procedures for handling these samples allow the contract laboratory to know when its work is being tested. Changes in the administration of unknown and split samples could resolve the weaknesses in these programs.

The contract laboratory is aware when its performance is being evaluated through the N.A.S.R.C. QA program. This occurs because unknown samples from the N.A.S.R.C. QA program* are sent directly to the contract laboratory. In addition to being aware that an evaluation is taking place, the contract laboratory is given a list of possible drugs, one of which will be the unknown in the QA sample. For example, for the QA unknown administered in September 1985, the Ohio R&R Center provided the Arizona contract laboratory a list of eight possible drugs, one of which was present in the unknown QA sample.

The contract laboratory also knows when the Department splits samples to evaluate its performance. When routine samples from Arizona tracks are split between the contract laboratory and OSU, it is the contract laboratory that arranges for the shipment of the split samples.** This occurs because the laboratory, not the State, contracts with OSU. In addition, the contract laboratory rather than the Department is notified by OSU of the testing results on the split samples. Thus, the contract laboratory could devote greater analytical effort to the test samples than it does for routine samples.

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* The N.A.S.R.C. QA program was established in 1982 with the primary purpose of ensuring the competency of the participating laboratories. The program functions through two Research and Reference Centers, one located at Ohio State University and one at Cornell University. Most state racing regulatory bodies contract with one of the Research and Reference Centers, which in turn administers the QA program to the state's equine testing laboratory. According to an OSU R&R Center official, the N.A.S.R.C. QA program works as follows. Each Research and Reference Center maintains a quantity of race horses. Selected drugs are administered to these horses and then blood and urine samples are drawn from the horses. These samples are then analyzed by the R&R Center and the results documented. QA samples are then sent to the participating laboratories as either a known or unknown sample. Approximately once every two weeks known QA samples are sent to the participating laboratories along with the R&R Center's documentation of the sample analysis. Once every 16 weeks an unknown sample and three blank samples (urine samples without foreign substances) are sent to participating labs. The laboratories are evaluated on their procedures to test the known QA samples and their ability to identify the drug present in the unknown QA samples.

** ADOR has established a practice of splitting equine samples from large stakes races. According to the Department Veterinarian, a major reason for splitting the samples is to evaluate the performance of the contract laboratory. In calendar year 1985, 36 samples were split. The splits are sent to Ohio State University for testing.

Changes in the administration of the unknown and split samples could resolve their weaknesses as evaluation methods. Through the chemical analysis contract, the Department could require the QA unknowns to be administered as blind samples to the contract laboratory.* By using a procedure similar to one developed by the Michigan Racing Commission, the Department could direct the contract laboratory to have the N.A.S.R.C. R&R Center send unknown samples directly to the Department Veterinarian. The Department Veterinarian would then submit the unknown samples to the testing laboratory as routine samples, thereby removing the contract laboratory's prior knowledge of an evaluation.

By contracting with either of the N.A.S.R.C. Research and Reference Centers or any other qualified racing laboratory for split sample analysis, the Department could ship samples directly to the laboratory. This would resolve the problem of the contract laboratory knowing which samples are split. Furthermore, the Department could require as part of the contract that the evaluating laboratory notify ADOR of the sample analysis results.

Procedures not reviewed - The Department does not review laboratory testing procedures. Independent review is an important means of ensuring that the laboratory is complying with testing and procedural requirements. For example, California employs a program of periodic evaluations of the contract testing laboratory by a qualified individual. According to the executive director of the California Racing Board, the Racing Board has been successful in using a pharmacologist to evaluate the contract laboratory conducting equine drug testing in California. The executive director said that the individual conducting the evaluations has a doctorate in pharmacology and is a member of the Racing Board's Medication Committee. The individual arrives unannounced at the contract

* As part of the chemical analysis contract, the Department requires the contract laboratory to participate in the N.A.S.R.C. QA Program and to incur the cost of the program.

laboratory approximately once every three months and ensures that required testing procedures are followed and adequate documentation of the testing is maintained. California receives this service for a minimal charge of $250 plus expenses for each evaluation.

The need for periodic evaluations is especially important because the Department has failed to establish an evaluation program for the contract laboratory's testing of greyhound samples. ADOR officials contend that the lack of a national greyhound testing organization has been the cause of their failure to establish an ongoing performance evaluation program. However, a program of periodic evaluations of the contract laboratory by qualified individuals could assist in resolving this problem. In addition, such a program could assist in the evaluation of the laboratory's equine testing performance.

CONCLUSION

The Arizona Department of Racing should strengthen and improve its drug testing program. ADOR's level of sampling appears too low to deter the use of prohibited substances. In addition, the Department has not ensured adequate analyses by the contract testing laboratory nor properly evaluated the laboratory's testing performance. Finally, the Department needs to revise its testing laboratory contract and request additional funding to implement the recommended changes.

RECOMMENDATIONS

The Arizona Department of Racing should:

1. Sample an average of two horses and two greyhounds per race, at a minimum.

2. Revise the chemical analysis contract with the testing laboratory to require the administration of QA unknown samples as blind samples.

3. Contract directly with either of the N.A.S.R.C. Research and Reference Centers or any other qualified racing laboratory for the analysis of split equine and greyhound samples. This procedure should ensure that the transportation of all split samples is arranged by the Department.

4. Develop a program in which the overall testing procedures of the contract laboratory are evaluated at least quarterly by an individual qualified in the area of drug testing or a related field.

5. Develop contract language which will ensure that the contract laboratory conducts the minimum number of tests recommended by the Department's N.A.S.R.C. Research and Reference Laboratory. The contract should also allow for modifications to address new testing developments and new drugs. In addition, the frequency of testing for exotic drugs needs to be determined.

6. Request sufficient funding to:

   - Sample, at a minimum, an average of two horses and two greyhounds per race;
   - Perform defined testing procedures;
   - Conduct sufficient special testing for exotic drugs; and
   - Provide for quarterly evaluations of the contract laboratory.

FINDING II

ELECTRONIC DATA PROCESSING AUDITS OF RACETRACK TOTALISATOR SYSTEMS ARE NEEDED TO HELP DETER FRAUD

The Arizona Department of Racing (ADOR) needs to conduct electronic data processing (EDP) audits of racing facility totalisator computer systems. EDP audits are needed to help protect against fraudulent activity. The Department has not implemented EDP auditing and the Racing Commission has not fully supported Departmental efforts to implement EDP audits.

All commercial race tracks in Arizona use a computerized totalisator system to: record the amount of money wagered, post the odds for animals racing and provide information to the public on the odds board.* Previously, race facilities did not use computers to determine the odds and calculate the payoffs. Information was derived through manual calculation and verified using the same method. Tracks contract for totalisator services from companies that provide both computer equipment and programs. In addition, the totalisator companies provide staff on-site to operate the system.

EDP Audits Needed To Help Protect Against Fraud

The Department needs to conduct EDP audits to help deter totalisator system fraud. A previous Auditor General report noted totalisator system control deficiencies at race tracks. Subsequent studies conducted for the Department have also identified control deficiencies. Finally, other states conduct EDP audits of totalisator systems to verify data generated by the computer.

Computerized fraud can be very significant. In one state, substantial fraudulent activity occurred relating to computer totalisator systems. In 1977 the Flagler Dog Track in Miami, Florida, had several employees embezzle pari-mutuel wagering monies. It was estimated that $1 million

* Some components of the system at Prescott Downs are not computerized.

was stolen from the betting public before the crime was identified. At least eight employees were able to move bets around to winning trifecta combinations. The mutuel manager along with data entry, ticket window and several other employees were involved. Data entry employees entered tickets into the computer system, then after the race assigned the tickets to the winning greyhounds. The manipulation reduced payoffs to legitimate wagerers. The data manipulation went undetected until uncovered by an investigator for the Dade County, Florida, State Attorney's Office.

Previous audit report noted deficiencies - In a previous Auditor General report (Report 82-2) on the Racing Commission, potential problems due to lack of computer system control were identified. Auditor General EDP staff examined track totalisator systems and controls. The analysis was done in 1980 and 1982, and identified a number of system weaknesses, including:

- lack of control over software changes due to poor documentation,
- ability to log onto computers without entering a password,
- lack of software back-up, and
- improper storage of uncashed winning ticket reports.

The report indicated the means by which the identified control weaknesses could increase the potential for fraud.

> Control weaknesses or failure to use existing controls creates the potential for misuse of the totalisator system. For example, inadequate controls identified at one track could allow counterfeiting and cashing of unclaimed winning tickets. At another track, access to the system which allows adjustments to teller balances does not require a password or code for authorization. This could allow concealment of overages and shortages by tellers.

More recent reports indicate serious weaknesses - Two reports prepared for the Department subsequent to the Auditor General's report indicated that serious control weaknesses continue to be present in totalisator computer

systems.* A systems analysis conducted in 1983 identified control problems with totalisator computer systems. A report completed in 1984 concluded that the potential for fraudulent activity at Arizona's race tracks exists.

A 1983 report prepared for the Department indicated that improper data manipulation could occur with computerized totalisator systems. Two Arizona race facilities were examined to determine the impact increased computerization had on regulation of racing facilities. The report found that the computer system at one track could be susceptible to software manipulation via telephone lines. The report recommended that computer software used by totalisator companies should be examined by the State. This examination would help to ensure the integrity of the system and help to prevent manipulation.

Another report conducted for the Department in 1984 determined that there is a likelihood for computer fraud or data manipulation. This report was conducted by an EDP security consultant and identified several methods that could be used to defraud race facilities. The most likely computer fraud to occur is input manipulation. Input manipulation occurs if the data is not entered properly due to human error or intentional manipulation. Therefore, the potential exists to change or manipulate the information being entered into the computer system. For instance, teletrack** wagering information is sent to the computerized totalisator system via regular telephone lines. The 1984 study determined that without protection of computer and phone lines, input manipulation could take place.

Other potential methods to defraud were identified, and included taking money without entering betting transactions into the computer and programming that would alter betting transactions after they have been

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* The 1983 Report analysis was performed by Mr. Hans Krussman. Mr. Krussman was with the Department of Public Safety for 17 years and headed the Special Communication Section which included the electronic surveillance system. The 1984 Report analyses was performed by Ms. Jane Humble, EDP Security Consulting.

** See Other Pertinent Information, page 39, for description of teletracking.

accepted. The consultant rated Arizona's protection against manipulation due to human error, computer system failures, abuse and catastrophe, and gave a poor overall rating to Arizona Commercial Tracks. The consultant recommended that EDP audits be conducted and only verifiable computer programs be used.

Other states conduct EDP audits - To address these potential problems, other states conduct EDP audits of track totalisator systems to provide additional controls in an effort to deter fraud. Florida conducts EDP audits of the four totalisator companies operating at race tracks in Florida in an effort to prevent fraudulent activity. Florida examines systems by obtaining information on quality control used by the totalisator company to ensure that data is not improperly manipulated. The state then verifies that the data generated by the computer is correct. Illinois verifies all calculations done by the totalisator system by simulating a race day and feeding bets and information into the system. California also has access to computer information for auditing purposes. The California Horse Racing Board conducts EDP audits of the one totalisator company on a random basis. California requires race tracks to hire certified public accountants to examine and check reports and the information at the track. The state then verifies the information by placing test information into the system that verifies the integrity of the software.

Racing Department Does Not Audit Electronic Totalisator Systems At Racetracks

In contrast to other states, the Arizona Department of Racing has never conducted EDP audits of racetrack totalisator systems. The Department does not monitor the totalisator system at tracks. Previous Departmental attempts to institute EDP audits have been unsuccessful and lacked Racing Commission support. The current effort to institute EDP auditing will need full Department and Commission support to be successful.

Department does not monitor totalisator system - Currently, the Department does not oversee track totalisator operations. Although the Department has staff to conduct EDP audits, none have been done at commercial

tracks. Arizona has traditionally supported controls on totalisator systems. The Department previously used a pari-mutuel supervisor to verify data generated in the pari-mutuel room. With the onset of computerization, the pari-mutuel supervisor positions became obsolete and were eliminated in 1982.

Previous efforts unsuccessful and lacked Commission support - Past attempts by the Department to implement EDP auditing have been ineffective and lacked Racing Commission support. The Department unsuccessfully attempted to implement EDP auditing in 1984. The Commission was aware of the Department's problems in implementing EDP audits, but has not fully supported its attempts. As a result, the Department has not used its full authority to require compliance.

The Department has attempted to institute EDP audits in the past, but was unsuccessful. The Department initiated its attempt to implement EDP auditing in December 1983 by requesting that permittees and totalisator companies turn over computer generated reports and provide access to the software. At that time two totalisator companies provided computer services in Arizona. No response was received from either company as a result of the December 1983 request, so the Department sent subsequent requests and met with race track and totalisator company officials through September 1984. One company subsequently agreed to comply with the request, but the other company would not comply.

The one company that did not submit the needed information claimed the information was proprietary. In a letter dated May 9, 1984, responding to a Departmental request for computer software and other information, the company pointed out:

> We have had similar requests from other states in the past and have managed to persuade them that the current practice of

> maintaining strict confidentiality (i.e., not disclosing any proprietary information to anyone) is ultimately in the best interests of the state, the racetrack and the public.*

During this time the Commission did not fully support Departmental efforts to implement EDP auditing. The Commission discussed the Department's EDP efforts during its May and September 1984 meetings. However, no official action was taken to support the Department's efforts. During the September 1984 meeting, the Commission discussed a Department directive requesting EDP audit information from the permittees. Some Commissioners questioned whether the permittees could comply with one aspect of the directive and discussed whether all future directives should be reviewed by the Commission. The Director subsequently modified the directive to delete the requirement in question.

The Department has the statutory authority to obtain pari-mutuel information but did not take action to require the totalisator company to comply. Arizona Revised Statutes (A.R.S.) §5-107.03.A requires the tracks to provide accurate information to the State.**

> . . . financial books, statements and records shall be kept and maintained in accordance with generally accepted accounting principles so as to reflect accurately the operations conducted by each permittee and concessionaire who has a proprietary interest in a permit. . . . Such financial books, statements and records shall be open for examination by the director or his designated representative.

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* According to an April 1986 interview with the totalisator company president by Auditor General staff, if Arizona requires EDP auditing a possible solution would be to place a copy of the software in escrow (with a neutral party). This would allow access to it by appropriate Department staff and prevent access by others to the proprietary information. However, this possible solution was not offered during the Department's initial EDP auditing attempt in 1984.

** According to the Department's Attorney General Representative, A.R.S. §5-107.03.A should be clarified to ensure Department access to needed EDP auditing information.

In addition, the Department has statutory authority to take action against any permittee who does not comply with Departmental regulations. If requested documentation is not submitted, A.R.S. §5-107.03.C provides the following penalty.

> Any violation of this section by any permittee is a ground for refusal to renew or for the revocation of a permit. . . .

Although the Department has the authority to penalize any lack of compliance, no action was taken primarily due to two reasons.

According to the Department, it did not penalize noncompliance due to the potential impact on revenues. If the totalisator company lost its license to operate in Arizona, it could no longer provide computer services to a number of Arizona race tracks. These tracks would have to contract with another company, which could take some time. The tracks may have to remain closed while this was taking place, resulting in lost business for the tracks and lost State revenues.

The second reason cited by the Department for not taking any action against the totalisator company was the Departmental perception that the Commission did not fully support the concept of EDP audits. Some Commissioners questioned the Department's need for EDP information and the Director's request for permittees to retain information. Since the Commission may review and modify any Departmental action, any effort to institute EDP auditing could be rescinded by the Commission.

Current attempt requires full support - To be successful, the Department's current attempt to implement EDP auditing will need the full support of both the Department and the Commission. Recently, the Department again tried to obtain the information necessary for EDP auditing from the totalisator companies. The Department sent a letter on March 17, 1986, to the totalisator companies requesting a description of security features and access to software programs. In addition, the Department stated that it would be instituting a formal procedure for approval and implementation of all program changes. If the totalisator companies do not comply the Department needs to use its statutory authority to ensure compliance or

penalize any lack of cooperation. In addition, the Commission needs to fully support EDP auditing for the Department to succeed. Full support is needed because any action taken by the Department to ensure that the totalisator companies comply could eventually be reviewed by the Commission. Recently, the Commission has moved toward supporting the Department's EDP auditing efforts. During the January 1986 meeting the Commission agreed to allow the Department to require permittees to keep uncashed winning tickets for examination. Following this meeting, the Department prepared an EDP audit program that identifies what is needed for implementing EDP audits.

CONCLUSION

The Department has not conducted EDP audits of racing facility totalisator systems, which are needed to deter fraud. Neither the Department nor the Commission have exerted full authority to institute EDP audits.

RECOMMENDATIONS

1. The Racing Department should conduct EDP audits. The Department and Commission should work together to develop and implement an EDP auditing plan.

2. The Department should exercise authority, as necessary, to obtain access to information needed to conduct EDP audits. The Department should request the Legislature to consider clarifying A.R.S. §5-107.03.A to ensure that the Department has full access to EDP auditing information.

OTHER PERTINENT INFORMATION

During the audit, other pertinent information was developed regarding the costs of county fair racing, broadcasts of horse and greyhound races, and jockey drug testing.

Costs Of County Fair Racing

The Arizona Department of Racing (ADOR) is directed by statute to regulate and administer State funding for county fair racing. This regulation and subsidization of county fair racing costs the State of Arizona nearly $1 million a year. According to Department officials, county fair racing is currently the major arena for quarter horse racing in the State, and provides a racing opportunity for thoroughbred horses that might not otherwise run at commercial tracks.

Arizona Revised Statutes §5-110.G. authorizes ADOR to regulate racing and pari-mutuel wagering activities at county fair race meets. To this end, the Department provides a county fair supervisor, three stewards, a State veterinarian, a clerk of scales, a sample collector, a camera operator, a money room supervisor, a horse identifier, a paddock judge and a pari-mutuel supervisor, as well as licensing and investigative personnel to each of the county fair races. Table 5 summarizes county fair racing activity for fiscal year 1985.

The costs of county fair racing are shared by the State and the various county fair associations. In fiscal year 1985, more than $1.8 million was expended by the State and 12* county fair associations to conduct these races.

* Although Maricopa County conducted county fair races at Turf Paradise during fiscal year 1985, a financial report has not as yet been submitted to ADOR.

TABLE 5

COUNTY FAIR RACE MEETS
FISCAL YEAR 1984-85

County	Days of Racing	Number of Races	Mutuel Handle
Apache	4	38	$ 167,362
Cochise	4	40	222,616
Coconino	4	38	458,420
Gila	4	39	199,012
Graham	4	40	185,474
Greenlee	4	39	143,612
Mohave	4	45	266,010
Navajo	4	39	196,244
Santa Cruz	4	43	400,314
Yuma	4	39	197,198
Maricopa(1)	4	44	1,968,180
Yavapai(1)	3	36	525,231
TOTAL	47	480	$4,929,673

(1) Denotes meets held at commercial tracks. According to Department officials, pari-mutuel revenue at these races is divided between the county fair organization and the commercial track.

Source: Compiled by Auditor General staff from ADOR annual report for fiscal year 1984-1985.

The State of Arizona provides nearly half of the funding for county fair racing. As illustrated in Table 6, in the last three fiscal years the State expended an average of approximately $900,000 per year for the regulation and promotion of county fair racing. All of these funds are generated from the State's share of pari-mutuel wagering revenues from commercial horse and dog tracks. In addition, the State relinquishes its share of the pari-mutuel wagering revenues to the county fair association where the races are conducted. This amounted to an average of approximately $161,500 for each of the last three fiscal years.

TABLE 6

STATE'S COST OF COUNTY FAIR RACING
FISCAL YEAR 1982-83 THROUGH FISCAL YEAR 1984-85
(UNAUDITED)

	Fiscal Year 1982-83	Fiscal Year 1983-84	Fiscal Year 1984-85
County Fair Racing Fund/ General Fund (1)	$143,986	$164,393	$175,157
Administration of the County Fair Racing and Breeders' Award Fund (2)	34,393	42,094	40,640
County Fair Racing and Breeders' Award Fund (3)	759,593	613,058	717,453
TOTAL	$937,972	$819,545	$933,250

(1) The County Fair Racing Fund was created in fiscal year 1985. It represents 3 percent of the revenues collected by the Department from commercial horse and dog track operations, and is used by the Department to regulate county fair racing. Prior to fiscal year 1985, county fair racing was funded with General Fund and County Fair Racing and Breeders' Award Fund monies.

(2) The Administration of the County Fair Racing and Breeders' Award Fund represents one-half of 1 percent of the revenues collected by the Department from commercial horse and dog track operations, and is a nonappropriated fund used by the Department to cover costs associated with administering the County Fair Racing and Breeders' Award Fund.

(3) The Arizona County Fair Racing and Breeders' Award Fund represents 14 percent of the revenues collected by the Department from commercial horse and dog track operations. After all breeders' awards have been paid, remaining monies may be distributed by the Department to county fair racing associations through purse subsidies, promotion and betterment grants, and capital improvements grants. The figures presented here represent only those monies distributed to county fair racing associations. Legislation enacted in the 1986 Legislative Session affected the methods revenues will be distributed to this fund (see Introduction and Background, Page 1).

Source: Compiled by Auditor General staff from ADOR Annual Report for fiscal year 1985 and State of Arizona Appropriations Report for fiscal year 1985.

The county fair associations provide the remaining funding for county fair racing. According to financial reports submitted by 11 of 12 county fair associations, in total approximately $945,000 was expended by these

organizations to conduct county fair races in fiscal year 1985. The majority of this money, more than $780,000, was generated from the races (i.e., pari-mutuel wagering revenues). The remaining expenditures consist of estimated costs of services donated by local governments, county fair associations and community organizations.

Pari-Mutuel Racing Broadcasts And Information Dissemination

A.R.S. §5-111 allows teletrack broadcasts of horse and greyhound races. In addition, A.R.S. §5-112 allows reception of horse race broadcasts from outside Arizona. Broadcasting horse and greyhound races from a racing facility in Arizona to another location in the State is known as teletracking. Transmission or reception of race signals to or from out-of-State locations is simulcasting. Wagering takes place at both the host track where the races are actually run and the facility receiving the transmission. Currently, several Arizona tracks transmit or receive race broadcasts. Phoenix Greyhound Park telecasts races to Apache Greyhound Park in Apache Junction. Tucson Greyhound Park transmits simulcasts of greyhound races to Las Vegas, Nevada. Turf Paradise receives simulcast broadcasts from various horse racing facilities throughout the racing season.

Teletracking and simulcasting can create possibilities for unauthorized activity through either delayed or intercepted signals. The transmission signal can be delayed before broadcasting, allowing illegal wagering. Delay of signals could lead to illegal wagers being made at a location receiving a broadcast after a race has run but before the results are officially announced.

The signal and other information can be intercepted and used for illegal wagering. Signal protection attempts to minimize or prevent the illegal use of signals. Signals can be protected by encoding (also known as encryption) or scrambling the signal from point of transmission to reception. Encoding applies a mathematical formula to the signal that must be properly decoded to receive the signal. The encoding formula can be changed frequently to increase the difficulty of interception. Scrambling is done using a very high or very low frequency to distort the

signal. Equipment to scramble a track's signal would cost between $20,000 and $50,000. Encoding a signal requires a minimum investment of $10,000 to $25,000.

Arizona does not currently require racing permittees to protect their signals. According to the Department's Director, no problems exist in Arizona teletracking that warrant imposing costly requirements on permittees. The lack of illegal bookmaking appears to support the Department's decision. None of the law enforcement officials we interviewed were aware of any illegal activity involving stolen race signals. A recent illegal bookmaking operation uncovered in Arizona involved other sporting activities but not horse or greyhound racing. Some officials believe the relatively small amount of money involved in pari-mutuel wagering in Arizona is not large enough to provide the incentive to purchase the equipment needed to intercept a signal for illegal bookmaking. If problems with teletracking arise in the future, the Department's mandate to protect the integrity of racing and the public allows it to promulgate rules and regulations to protect signals and racing information.

Drug Testing Of Jockeys

Other racing states have recently developed drug testing programs for jockeys. ADOR has the authority to conduct drug testing of jockeys and has used this authority in the past.

The use of illicit drugs by jockeys can present a hazard to those involved in the race and potentially affect the outcome of the race. For example, a recent article on cocaine and its use by jockeys indicated that a rider under the influence of cocaine would be a definite danger to other jockeys and horses on the track.* According to the article, if cocaine is used immediately before a race, the euphoria and exaggerated sense of self-confidence produced by the drug could lead to clouding of judgment and excessive risk taking. Beyond the physical hazards associated with the

* Thomas F. Burks, "Cocaine and the Jockey," The Jockey News, May 1985.

use of cocaine, its use and the use of other illicit drugs can bring jockeys into contact with undesirable figures who frequently attempt to maneuver drug users into compromising situations and unethical acts.

Other racing states, including Illinois, New York, Maryland, New Jersey and Ohio have recently developed some form of drug testing program for jockeys. These programs vary from daily testing of jockeys at random (Maryland) to the submission of samples during annual physical examinations (Illinois). Illinois recently completed a pilot program for drug testing of thoroughbred jockeys and harness drivers. During 1985, a total of 819 urine samples were tested on a population of 730 individuals: 568 harness drivers and 162 thoroughbred jockeys. Of those tested, 122 (70 drivers and 52 jockeys) tested positive for cocaine, THC (marijuana metabolite) or both substances. This resulted in a total positive rate of 17 percent. According to an Illinois racing official, preliminary plans are to continue the testing program.

All the states surveyed have indicated that a primary purpose of drug testing is to ensure safety on the racing tracks. In most of these states, those jockeys testing positive are ordered into a drug rehabilitation program. Subsequent positive tests can result in license revocation.

The Department has the authority to conduct drug testing of jockeys. Arizona Racing Commission rule R4-27-109 states, in part: "The stewards or their designee may require that any jockey provide blood or urine samples for analysis upon request." In 1985 ADOR requested advice on the subject of jockey drug testing from the Attorney General's Office. The Department's Attorney General representative at that time advised the Department that because random sampling techniques for possible testing were not planned, the stewards should only order urine analysis testing when there is a reasonable suspicion that the jockey is using drugs or alcohol.

The Department has used its authority to conduct drug testing of jockeys once in the last four years. In 1982, as the result of a telephone tip, a

Turf Paradise steward ordered the testing of six jockeys. One jockey tested positive for cocaine and received a 30 day suspension. According to Department officials, since that time no further testing of jockeys has occurred.

AREAS FOR FURTHER AUDIT WORK

During the course of the audit we identified several potential issues that we were unable to pursue because they were beyond the scope of our audit or we lacked sufficient time.

- Does the Arizona Department of Racing (ADOR) conduct the type of investigations necessary to identify illegal activities and criminal elements in the Arizona Racing Industry?

The Department maintains an investigations staff statutorily charged with the responsibility for investigative matters relating to the proper conduct of racing and pari-mutuel wagering. These responsibilities include: barring undesirables from racing, conducting undercover investigations, fingerprinting persons licensed by the Racing Commission and reviewing license applications. However, our review of Investigations Section's records indicated that a vast majority of cases worked since 1982 involved the investigation of individuals submitting false information on licensing applications. Beyond two investigations of organizations applying for permits to operate tracks, most investigations during this period have been limited to assault and drug related cases. However, DPS and FBI officials stated that they have not been asked to participate in a major Arizona racing investigation in more than five years, although they indicate that serious violations may be occurring in the Arizona racing industry. In addition, an Attorney General investigator expressed concern over the Department's ability to conduct financial background investigations of individuals and corporations applying for permits to operate Arizona horse and greyhound tracks. Further audit work is needed to determine whether adequate investigations are being conducted by the Department.

- Should the Department of Racing address financial collection cases through its administrative hearing process?

Currently, the track stewards and the Department's Hearing Officer devote a considerable amount of time to hearing financial collection cases.

These cases involve a creditor, often a feed dealer seeking payment from a debtor, and generally an owner or trainer who is licensed by the Department and has incurred a financial obligation in connection with racing in Arizona. Creditors use the Department's administrative hearing process in hopes of having the debtor's license suspended until the debt is paid. According to the Department's Hearing Officer, in many of these cases the creditor has not received a court judgment against the debtor.

In 1984 the Department Director acted to restrict the Department's involvement in financial collection cases by requiring that creditors have court judgments before bringing a case before track stewards. However, the Racing Commission overruled the Director's decision and instructed stewards and the Hearing Officer to hear all financial collection cases. Further audit work is needed to determine what involvement, if any, the Department should have in financial collection cases.

- Does the Department adequately ensure the integrity of the Breeders' Award Program for greyhounds?

Breeders' awards, established by A.R.S. §5-114, were created to promote and improve the breeding of horses and greyhounds within the State. The award is equal to 40 percent of every first place purse won by a horse or dog bred in Arizona. The award is paid to the owner of the dam of the animal at the time the animal was foaled or whelped. Thirty percent of the funding for breeders' awards is derived from a percentage of the State's share of pari-mutuel wagering revenue at horse and dog tracks, and 10 percent is paid by the track permittee.* In fiscal year 1985, $854,879 was distributed by the Department in breeders' awards: $317,173 to horse breeders and $537,706 to greyhound breeders. Approximately $285,000 was distributed in breeders' awards by track permittees during this time period.

* Legislation enacted in the 1986 Legislative Session empowers the Racing Commission to establish, by administrative rules, the amount of award to be distributed by the State.

ADOR is responsible for administering the Breeders' Award Program. However, according to a Department official, because of the difficulty in verifying and documenting a greyhound's place of birth, there is some question as to whether some greyhound breeders receiving awards actually bred the animals in Arizona. Further audit work is needed to determine whether the Department has adequate controls to verify the eligibility of those receiving breeders' awards.

- Are the permissible levels established for the foreign substances procaine and barbiturates in greyhound urine excessive?

According to the Department Veterinarian, permissible levels of procaine and barbiturates were established because these compounds are often found in the feed given to greyhounds and can then appear as foreign substances in the screening of greyhound urine. The trace levels were established by the Racing Commission several years ago as the result of a study conducted by the Department Veterinarian.

Recently, however, officials in Connecticut whose permissible levels of procaine and barbiturates are similar to levels used in Arizona, have begun a study of these levels. In addition, the Manager of the ADOR contract testing laboratory has indicated that existing trace levels for these substances may be too high. Further audit work is needed to determine whether the existing levels are excessive.

ARIZONA DEPARTMENT OF RACING

July 2, 1986

JUL 1986
RECEIVED
AUDITOR
GENERAL

Douglas R. Norton
Auditor General
2700 North Central Ave., Suite 700
Phoenix, Arizona 85004

Dear Mr. Norton:

I would first like to express my appreciation to your staff for the manner in which they conducted the audit. The inquiry was thoughtful and complete and the staff conducted themselves in a professional manner at all times.

The resulting audit report is evidence of the validity of the sunset process. The identification of deficiencies, not observed by the Department, by the Auditor General's staff and the subsequent implementation of the recommendations by the Department will improve our effectiveness, a primary goal of the sunset legislation.

FINDING I: THE ARIZONA DEPARTMENT OF RACING NEEDS TO STRENGTHEN AND IMPROVE ITS DRUG TESTING PROGRAM

The Department agrees that improvements are needed in sampling and quality control procedures. However, we disagree with one of the recommendations and propose alternative corrective action.

The administration of QA unknowns as blind samples is a change which will be made. However, this can be accomplished administratively rather than through a contract modification. The contract requires the laboratory to participate in the NASRC quality assurance program; the manner in which samples are obtained is not specified. Hence, the Department can and will direct the laboratory to have the unknowns sent to the Department veterinarian, who will then submit them as routine samples from the tracks.

Subsequent to discussions with the audit staff, the Department has taken steps to clarify the procedures requirements of the contract and will implement the recommendations regarding split samples and reviews by an independent contractor. Specifically, the contract has been revised to state that the laboratory must use both the number of tests and procedures for each test required by NASRC.

800 W. Washington
Room 400
Phoenix, Arizona 85007
(602) 255-5151

"EQUAL EMPLOYMENT OPPORTUNITY/AFFIRMATIVE ACTION EMPLOYER"

The Department will incorporate written verifications of procedures from the NASRC quality assurance certification committee into the contract and periodic reviews by a contractor employed by the Department will serve to determine compliance with this provision. The Department will further investigate your finding that the laboratory has not performed all necessary tests to determine if further action is needed.

The Department concurs with all other findings and recommendations in the drug testing area. As noted in the report, the Department lacks sufficient funding to implement all recommendations during fiscal year 1986-87. Corrective action not requiring additional funding will be taken immediately. The other recommendations will be prioritized, funding will be requested and action will be taken as funds become available.

FINDING II: ELECTRONIC DATA PROCESSING AUDITS OF RACETRACK TOTALISATOR SYSTEMS ARE NEEDED TO HELP DETER FRAUD

The Department agrees that EDP auditing is vital to ensuring the integrity of totalisator systems and is moving forward in developing a viable audit function. Statutory changes to ensure that all needed data is available to the Department will be sought in the next session. We share the Auditor General's concern over the lack of control over teletrack wagering systems and hope to incorporate reviews of wagering data transmissions into the auditing program.

In addition to implementing the recommendations, the Department will request that the Joint Legislative Oversight Committee direct the Auditor General's office to conduct reviews of the Department, especially the drug testing program, at three year intervals. As this audit has demonstrated, review by an objective third party can reveal problems which management may not be able to identify due to time and staffing constraints and the tendency to become too close to day-to-day operations. We recognize that a full audit may not be possible due to the Auditor General's workload. However, a mini-review to identify problem areas which the Department could investigate fully and resolve with its own staff would ensure that deficiencies such as those reported here do not occur again.

Again, I would like to thank you and your staff for their conscientious and courteous efforts during the audit.

Sincerely,

Timothy A. Barrow

TIMOTHY A. BARROW
Director

TAB:va

INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Arizona Racing Commission. The audit was conducted in response to a July 26, 1985, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379.

Statutory Authority And Duties

The Arizona Racing Commission was created by the Legislature in 1949. The Commission is comprised of five members appointed by the Governor to five-year staggered terms. State law limits the horse racing industry and the dog racing industry to one representative each. Until 1982 an Executive Secretary hired by the Commission administered the daily operation of the Commission. In 1982 the Department of Racing was created with a Director appointed by the Governor. Since that time the Commission has had no direct responsibility for the daily operations of the agency.

The Racing Commission's role as stated in A.R.S. §5-104.A. is to:

> . . . issue racing dates and prepare and promulgate such complete rules and regulations to govern the racing meetings as may be required to protect and promote the safety and welfare of the animals participating in such racing meetings, to protect and promote public health, safety and the proper conduct of racing and pari-mutuel wagering. . . .

In addition to setting racing dates and promulgating rules, the Commission is responsible for accepting and evaluating applications for capital improvement projects. Race tracks make requests to the Commission for permission to withhold a portion of the State's share of pari-mutuel wagers for capital improvement projects. The Commission may also amend, approve or deny any decision made by the Director of the Department of Racing. Commission activities from fiscal year 1982-83 through 1985-86 (estimated) are shown in Table 7.

TABLE 7

COMMISSION ACTIVITIES
FISCAL YEARS 1982-83 THROUGH 1985-86

	Actual 1982-83	Actual 1983-84	Actual 1984-85	Estimated 1985-86
Meetings held	16	18	18	20
Cases heard/ rulings Issued	28	0	2	10
Rules adopted	*	*	6	12
Permits granted	8	7	2	8
Approved capital improvement applications	4	1	0	1

* All rules revised to reflect changes resulting from creation of Department of Racing

Source: Compiled by Auditor General staff from Arizona Department of Racing 1984-85 Annual Report and capital improvements ledger.

Staffing And Budget

The Racing Commission does not have staff. Upon creation of the Department of Racing in 1982, all staff members were placed under the authority of the Department Director. The Commission's major expenditures are for travel and outside services, as shown in Table 8. In-State travel funds pay the costs of the Commissioners attending Commission meetings. Out-of-State travel funds are used to attend National Association of State Racing Commissioner conferences and other professional conferences. The outside services monies are for court reporting services to record meeting minutes.

TABLE 8

RACING COMMISSION EXPENDITURES
FISCAL YEARS 1984-85 THROUGH 1985-86 (1)
(UNAUDITED)

	Actual Fiscal 1984-85	Estimated Fiscal 1985-86
Professional and outside services	$ 3,418	$ 8,400
Travel		
In-State	1,798	3,100
Out-of-State	2,172	1,500
Other operating	4,500	4,200
TOTAL	$11,888	$17,200

(1) Expenditures prior to fiscal year 1984-85 were included in the Racing Department's expenditures.

Source: Compiled by Auditor General staff from Department of Racing Annual Report, fiscal year 1984-85.

Audit Scope And Purpose

The audit report focuses on the Commission's ability to perform its functions effectively and efficiently. The report presents one finding and recommendations regarding the capital improvements program.

The Auditor General and staff express their appreciation to the members of the Racing Commission for their cooperation and assistance during the audit.

SUNSET FACTORS

In accordance with Arizona Revised Statutes (A.R.S.) §41-2354, the Legislature should consider the following 12 sunset factors in determining whether the Arizona Racing Commission should be continued or terminated.

1. The objective and purpose of establishing the Commission

The enabling statutes for the Arizona Racing Commission state that the purpose of the Commission is to:

> . . . issue racing dates and prepare and promulgate such complete rules and regulations to govern the racing meetings as may be required to protect and promote the safety and welfare of the animals participating in such racing meetings, to protect and promote public health, safety and the proper conduct of racing and pari-mutuel wagering and any other matter pertaining to the proper conduct of racing within this state.

Statutes authorize the Commission to conduct hearings on applications for racing permits, to issue racing permits, to conduct rehearings on licensing and regulatory decisions made by the Director of the Department of Racing, and to review applications to construct capital improvements at race tracks.

2. The effectiveness with which the Commission has met its objective and purpose and the efficiency with which it has operated

The Commission has generally met its objective and purpose. The Commission has issued racing permits and set racing dates. In addition, the Commission has approved several capital improvement projects and promulgated rules and regulations. However, the Commission has not completely supported the Racing Department's attempts to institute an Electronic Data Processing (EDP) auditing program (see Department of Racing audit, Finding II, page 29). EDP auditing is necessary to help ensure that the odds and payoffs on pari-mutuel wagers are correct. In addition, the Commission has

erroneously approved projects or components of several capital improvement projects (see Racing Commission Audit, Finding I, page 63).

Moreover, the Commission has neither adopted formal procedures nor set policy for the administration of the capital improvements program. Since the Commission has no staff and meets an average of once a month, it relies on Racing Department personnel for assistance in administering the capital improvements program.

3. The extent to which the Commission has operated within the public interest

Generally, the Commission has operated within the public interest. However, the Commission should endorse an EDP auditing program to help ensure the integrity of racing and pari-mutuel wagering.

4. The extent to which rules and regulations promulgated by the Commission are consistent with the legislative mandate

The Commission has promulgated rules and regulations that are generally consistent with its legislative mandate. Since the 1982 performance audit, the Commission has rewritten and reorganized all the rules and regulations pertaining to racing. In addition, the Commission adopted or amended a number of rules regarding pari-mutuel wagering.

5. The extent to which the Commission has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public

The Commission has adequately encouraged input from the public before promulgating its rules and regulations. Any proposed rule is placed on a regular Commission meeting agenda for consideration. After the proposed rule is printed in the "Administrative Digest," a public hearing is held. Finally, the rule is placed on a regular Commission meeting agenda for final adoption.

6. The extent to which the Commission has been able to investigate and resolve complaints that are within its jurisdiction

Between July 1982 and April 1983, the Commission heard 28 cases. However, since the Department of Racing was created in fiscal year 1982-83, the number of cases heard by the Commission has decreased. This is because the Director of the Department of Racing and the Hearing Officer began resolving cases and complaints. The Commission currently hears only appeals but a proposed rule, which is pending certification, will allow the Commission to review any licensing or regulatory decision made by the Director of the Department of Racing.

7. The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under enabling legislation

According to the Chairman of the Racing Commission, statutes provide the Attorney General with adequate authority to prosecute actions under the Commission's enabling legislation.

8. The extent to which the Commission has addressed deficiencies in the enabling statutes which prevent it from fulfilling its statutory mandate

The Commission has not proposed any legislation since 1982. However, one Commissioner stated that he believes the Commission's laws should be revised to allow three members of the Commission to be selected from the racing industry. He believes this will provide the Commission with a better working knowledge of racing issues.

9. The extent to which changes are necessary in the laws of the Commission to adequately comply with the factors listed in the sunset law

Based on our audit work, we recommend that the Legislature consider the following change to the Racing Commission's statutes.

- o Repeal A.R.S. §5-111.02 and A.R.S. §5-111.03, thereby terminating the capital improvements program.

10. The extent to which the termination of the Commission would significantly harm the public health, safety or welfare

Terminating the Arizona Racing Commission would not have an immediately identifiable effect on the public health, safety or welfare. Since the Commission has no staff and meets an average of once a month, the Department of Racing, in fact, regulates the racing industry on a day-to-day basis. However, Racing Commissioners contend that a Racing Commission is needed in Arizona. Racing Commissioners stated that because racing involves gambling this increases the need for an independent Commission that represents the general public. They believe the absence of a Commission may vest too much authority in a single individual. In addition, one Commissioner stated that the Commission is necessary for the ongoing supervision of the Department of Racing.

If the Commission is terminated, the following activities would have to be transferred to the Department:

- issuance of racing permits,
- issuance of racing dates, and
- approval of capital improvement projects (terminating the program will eliminate this function).

11. The extent to which the level of regulation exercised by the Commission is appropriate and whether less or more stringent levels of regulation would be appropriate

The current level of regulation exercised by the Commission should be increased. The Commission should strengthen its regulatory presence by adopting rules and regulations that provide the Department with clear authority to conduct Electronic Data Processing audits of the various permittees (see Department of Racing audit, Finding II, page 29).

12. The extent to which the Commission has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished

According to the Chairman, the Racing Commission has not used private contractors in the performance of its duties because the nature of its activities preclude the use of private sector contractors. The services for regulating racing and pari-mutuel wagering are not available in the private sector. However, the Commission does employ a court reporting service to transcribe the minutes of its public meetings and proceedings. We did not identify any other areas where the Commission should be using private contractors in the performance of its duties.

FINDING I

THE CAPITAL IMPROVEMENTS PROGRAM SHOULD BE TERMINATED

The capital improvements program should be terminated. Although the capital improvements program has improved racing facilities, State revenues have not increased as a result of the program. In addition, the Racing Commission has erroneously approved two capital improvement projects and components of three projects.

Background

To encourage the improvement of race track facilities, Arizona Revised Statutes (A.R.S.) §§5-111.02 and 5-111.03 were enacted. The statutes establish two purposes for the capital improvements program. Those purposes are: 1) to improve racing facilities for the benefit of the public, breeders and horse or dog owners, and 2) to increase the revenue to the State through an increase in pari-mutuel wagering resulting from such improvements.

The program grants permittees a 1 percent reduction in the amount of the handle* paid to the State for undertaking capital improvement projects. Permittees continue withholding 1 percent of the handle until the total cost of the project is recouped.** As of April 1986 all commercial permittees were withholding capital improvement monies. Based on historical growth of racing handles, withholding for currently approved projects will continue until at least 1993 - beyond the program's scheduled expiration.*** Moreover, permittees have until the expiration

* Handle is defined as the total amount of money wagered at a race track.

** Prior to October 1, 1982, only horse track permittees could apply for the capital improvement reduction. Also, each project was subject to a ten-year withholding limitation. However, A.R.S. §111.02 was amended and the 10 year limit was eliminated.

*** The capital improvements program is scheduled to expire on June 30, 1987, for horse track permitees. With the passage of HB2379 in 1986, the program for dog track permittees is now scheduled to expire on June 30, 1992.

have until the expiration date to seek approval for additional capital improvement projects. While it is not possible to estimate the amount of future requests, American Greyhound Racing, Inc. submitted preliminary plans to the Commission for a project estimated at approximately $8.4 million. Thus, the estimated payoff for capital improvement projects approved before June 30, 1987, could extend beyond March 1993.

TABLE 9

CAPITAL IMPROVEMENTS PROJECT WITHHOLDING
THROUGH APRIL 1986
AND ESTIMATED PAYOFF DATES
(UNAUDITED)

Permittee	Amount Approved	Amount Withheld	Remaining Balance	Estimated Payoff Date (1)
Turf Paradise	$14,327,695	$ 5,746,196	$ 8,581,499	3/93
Prescott Downs	206,963	179,904	27,059	7/86
Rillito Downs	242,427	182,987	59,440	11/88 (2)
American Greyhound (3)	3,232,847	3,069,533	63,314	6/86
Gillett Greyhound (4)	3,669,288	1,301,723	2,367,565	12/90
TOTALS	$21,679,220	$10,480,343	$11,198,877	

(1) Estimated payoff dates based on historical withholding patterns.
(2) Facility ceased operations in 1982. According to the Department, it is unknown when the facility will reopen. Since the project was approved under the previous capital improvement statutes, payoff must be completed within ten years of the project approval date.
(3) Operates Apache, Phoenix and Yuma Greyhound Parks.
(4) Operates Tucson Greyhound Park.

Source: Compiled by Auditor General staff from Department of Racing capital improvements ledger.

Improved Facilities Have Not Increased State Revenues

It is difficult to determine whether the State has directly benefited from capital improvements at racing facilities. Although capital improvements meet the statutory intent of enhancing race tracks, the pari-mutuel handle when measured in constant dollars has decreased at Turf Paradise and

Tucson Greyhound Park. In addition, while statutes indicate that capital improvements should increase the State's revenue via an increase in pari-mutuel wagering, it is difficult to accurately assess this relationship.

Capital improvements have enhanced race track facilities - Capital improvements financed through the 1 percent withholding have improved racing facilities, as mandated by A.R.S. §§5-111.02 and 5-111.03. In addition, the projects have met the statutory requirement to "promote the safety, convenience or comfort of the people and be in the best interest of horse or dog racing and this state generally." The following projects are examples of capital improvements that have increased the comfort of the public and are in the best interest of racing.

- Grandstand alterations and additions at Turf Paradise - This project enabled Turf Paradise to accommodate more fans by the addition of bleachers and the construction of additional mutuel windows.
- Installation of a turf track at Turf Paradise - According to a track official, pari-mutuel wagering on races run on the turf exceeds the amount bet on races run on the dirt by approximately 25 percent.
- Grandstand renovation at Phoenix Greyhound Park - This project was undertaken to provide a more comfortable environment for summer racing performances.
- Grandstand enclosure and remodeling at Tucson Greyhound Park - This project was done to replace a temporary tent facility that had been destroyed by a storm.

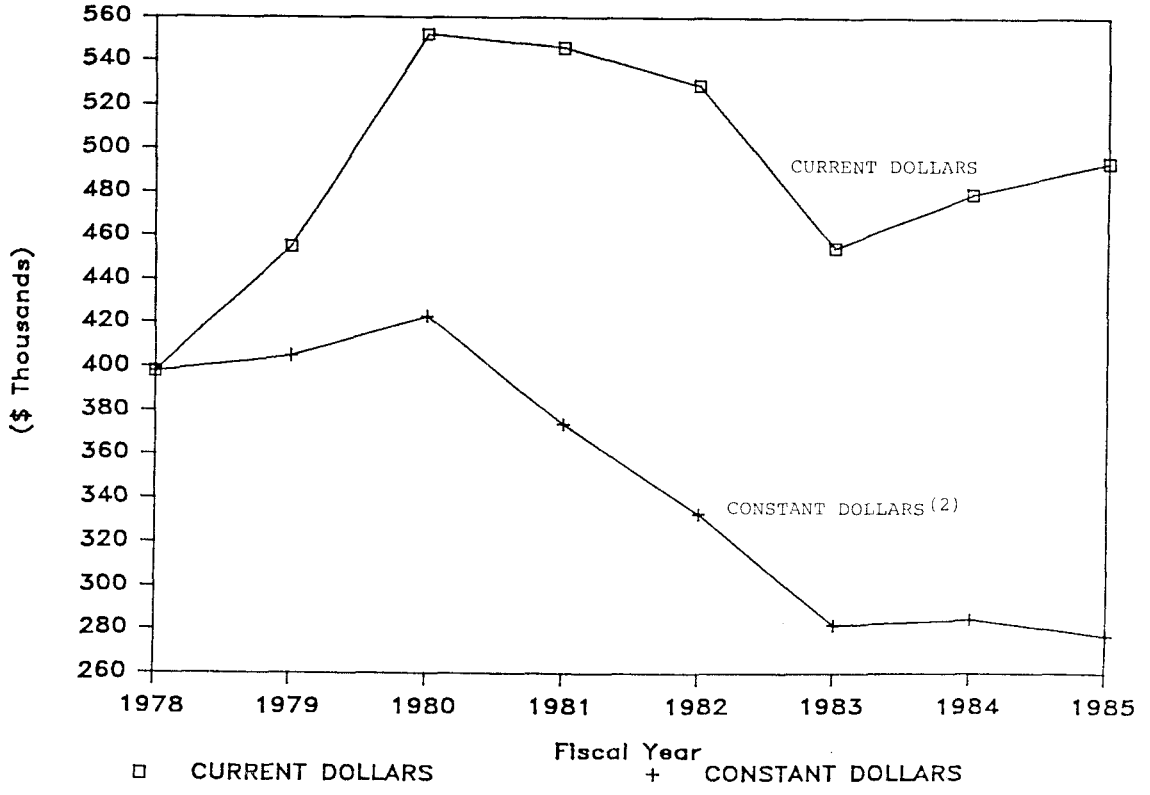
Handles at Turf Paradise and Tucson Greyhound Park have decreased - Although race track facilities have improved as a result of capital improvements, the handles at Turf Paradise and Tucson Greyhound Park have not increased.* When measured in constant dollars, the average daily handle at Turf Paradise has decreased $146,000 since fiscal year 1979-80. Moreover, the increase in the pari-mutuel handle at Tucson Greyhound Park has not kept pace with inflation.

* The effect of capital improvements on the handle at Phoenix Greyhound Park was not analyzed because its first project was not substantially completed until late 1984.

In constant dollars, the average daily handle at Turf Paradise has decreased $146,000, more than 34 percent, during the past five years, as shown in Figure 3. Since 1979, however, more than $14 million of capital improvement projects were completed at Turf Paradise.

FIGURE 3

AVERAGE DAILY HANDLE AT TURF PARADISE (1)
FISCAL YEARS 1978 THROUGH 1985



(1) Includes Turf Paradise and Arizona Downs racing meets.
(2) Base year is fiscal 1978.

Source: Average daily handle figures were obtained from Arizona Racing Commission and Arizona Department of Racing Annual Reports, 1979 through 1985. CPI data was provided by the Bureau of Business and Economic Research, Arizona State University.

In addition, the increase in the pari-mutuel handle at Tucson Greyhound Park has not kept pace with inflation. As of April 6, 1986, the average daily handle was $178,953, up from $166,625 for the 1982-83 racing

season. This corresponds to an average annual increase of approximately 2.7 percent. However the inflation rate for Arizona increased about 5.2 percent per year from fiscal year 1983 to 1985. As a result, it is questionable if capital improvements had any positive impact on Tucson's average daily handle.*

Difficult to confirm the relationship between capital improvements and handle - The limited impact of capital improvements on the pari-mutuel handle suggests that factors other than a track's facilities affect the pari-mutuel handle. External factors such as population changes, weather conditions and the number of racing days can affect a track's total handle. Further, the lottery has increased competition for the gambling dollar and this might negatively impact the effect of capital improvements on a track's handle.

Variables other than track facilities and external factors may also have a more direct effect on pari-mutuel wagering. Racing officials, track officials and breeders indicate that purse structures affect wagering. Larger purses attract better horses and better horses lead to increased wagering.**

Some Improvements Erroneously Approved By The Racing Commission

Two capital improvement projects and components of several other projects that were approved by the Racing Commission do not qualify for capital improvement status.*** Although the capital improvement statutes allow a

* The majority of the capital improvement projects at Tucson Greyhound Park were completed by January 1984. The remodeling of the grandstand was completed during August 1984.

** House Bill 2379 passed in 1986, changed the take-out structure and increased the amount of handle that permittees must allocate to purses.

*** The Racing Commission has erroneously approved capital improvement projects in the past. A previous Auditor General report (81-5) found that the Commission improperly approved over $220,000 in capital improvements for the purchase of rolling stock (tractors and trucks) at Turf Paradise and Prescott Downs. The Turf project was disqualified before any withholding began. The Attorney General directed the Commission to recoup the funds withheld by Prescott Downs.

wide range of projects to qualify, the projects must meet certain requirements. However, the Commission approved two projects that did not meet the statutory minimum expenditure requirement. In addition, the Commission erroneously approved some components of three other capital improvement projects.

Many projects qualify but restrictions apply - While the statutory definition of a capital improvement allows a wide range of projects to qualify, certain restrictions apply. According to A.R.S. §§5-111.02(F) and 5-111.03(G), a capital improvement is "an addition, replacement or remodeling of a race track facility. . . ." Since the term "facility" is not defined in statute, a Legislative Council interpretation was requested. The Council concluded that "facility" was broad and included the operational aspects of a race track as well as the structure itself. As a result, items such as computer hardware, telephone systems and two-way radios can be considered capital improvements.

Although the statutes allow a wide range of projects to qualify, the Legislative Council determined that all capital improvement projects must meet specific criteria regarding minimum expenditures.* While A.R.S. §§5-111.02 and 5-111.03 allow a permittee to consolidate more than one capital improvement project on one application, each project must still meet the statutory minimum expenditure requirement. Further, the Legislative Council stated that individual components of projects costing less than the minimum amount can be combined to receive approval only if the components are closely related to the project's overall intent.

Projects failing to meet the minimum expenditure requirement - The Racing Commission approved two capital improvement projects that do not meet the statutory minimum expenditure requirement. In one instance, the Commission approved the project despite the Department's warning that the project did not qualify.

* In counties with a population of less than 180,000 a project must cost at least $100,000 to qualify for capital improvement status. In counties with a population of at least 180,000 the minimum expenditure requirement is $200,000.

- Phoenix Greyhound Park Project - Total Cost $134,760

  This project entailed converting the old ginny pit* into administrative offices. However, the total cost of the project is less than the $200,000 required by laws for counties with a population of at least 180,000. Department staff informed the Commission that the project did not qualify, but the Commission granted approval.**

In another instance, the Racing Commission approved a capital improvement project in which unrelated components were combined in order to meet the statutory minimum expenditure requirement. Based on the Legislative Council's interpretation, the project was erroneously approved.

- Prescott Downs Project - Total Cost $101,925

  This project consisted of the following unrelated items.

Video/Sound Equipment	$ 91,925
Harrow	$ 10,000

  The video and sound equipment is for the convenience of the public, the harrow is not. A harrow is used to drag the dirt on the race track. Eliminating either component drops the project below the minimum expenditure requirement of $100,000.

Projects containing unrelated components - At least three projects approved by the Racing Commission met the statutory expenditure requirements but included certain components that were not closely related to the overall project. Based on the Legislative Council opinion, those components should not have received approval.

- Yuma Greyhound Park - Total Cost $207,900

  The Racing Commission erroneously approved $25,336 for unrelated items in this project. Most of the amount approved was spent on

* A new ginny pit was constructed in a previously approved capital improvement project. A ginny pit is the building where greyhounds are sequestered prior to a racing performance.

** Although the Commission considered this project to be a component of a larger project, American Greyhound Racing, Inc. has never submitted an application for the overall project as required by statute. Estimates of the overall project were revised from over $14 million to approximately $4.5 million and finally to over $8.4 million. The Commission has never approved a set amount.

grandstand items that contribute to the public's convenience - an escalator, restroom renovations and video equipment. However, included in the application was $25,336 for the construction of two kennels. The kennels are unrelated components of the overall project and were incorrectly granted capital improvement approval.

- Tucson Greyhound Park, Phase I - Total Cost $ 406,632

  More than $25,000 was improperly approved by the Racing Commission for unrelated items in this project. Most of the amount approved for the project was spent on remodeling the paddock area and resurfacing the parking lot. However, included in the application was $13,518 for a tractor, and $12,000 for automatic box openers and a remote controlled brake for the mechanical lure. Those items are not closely related components of the overall project and were erroneously granted capital improvement status by the Commission.

- Tucson Greyhound Park, Phase IV - Total Cost $926,396

  The Racing Commission improperly approved $2,906 for an unrelated component in this project. The majority of the amount approved for the project was spent on remodeling the grandstand, installing air conditioning in the grandstand and constructing additional betting windows. However, included in the application was $2,906 for the purchase of a scale to weigh the greyhounds before each race. The scale is a completely unrelated item and was incorrectly afforded capital improvement status by the Commission.

CONCLUSION

The capital improvements program should be terminated. While capital improvement projects have enhanced racing facilities, their impact on the pari-mutuel handle and State revenues is questionable. Also, the Racing Commission has erroneously approved some capital improvement requests.

RECOMMENDATIONS

1. The Legislature should consider repealing A.R.S. §5-111.02 and A.R.S. §5-111.03 thereby eliminating the capital improvements program.

2. The Racing Commission should use the following criteria for reviewing any future capital improvement applications.

a. If more than one capital improvement is consolidated on one application, each must meet the statutory minimum expenditure requirement.

b. Individual components of projects costing less than the required minimum amount can be combined to receive approval only if the components are closely related to the project's overall intent.

3. The Racing Commission should recover the amount of improperly withheld funds from permittees whose capital improvement projects do not meet the statutory requirements. Funds should be recouped from the following permittees.

• American Greyhound Racing, Inc. - Phoenix Greyhound Park Project	Administrative Offices	$134,760
Yuma Greyhound Park Project	Kennels	25,336
	TOTAL	$160,096
• Prescott Downs Limited Partnership - Prescott Downs Project	Video/Sound Equipment	$ 91,925
	Harrow	10,000
	TOTAL	$101,925
• Gillett Greyhound Racing, Inc. - Tucson Greyhound Park Project, Phases I and IV	Tractor	$ 13,518
	Box Openers and Brake	12,000
	Digital Scale	2,906
	TOTAL	$ 28,424

The Commission should apply the amount of improperly approved funds to each permittee's current capital improvement balance. If the permittee does not have an adequate balance to absorb the adjustment, the Commission should recoup the funds directly from the permittee.

ARIZONA DEPARTMENT OF RACING

July 11, 1986

Mr. Douglas R. Norton
Auditor General
2700 North Central Ave., Suite 700
Phoenix, Arizona 85004

Dear Mr. Norton:

The Commission has reviewed the draft report of the Auditor General's performance audit of the Arizona Racing Commission. The Commissioners wish to thank you and your staff for the courteous and professional manner in which the audit was conducted and the opportunity for the Commission to respond to the audit before it was made public.

In view of the fact that the Department will respond to that part of the audit pertaining to the Department, the Commission will respond only to that part of the audit concerning the Commission.

The performance audit in Sunset Factors 2, 3 and 11 urges the Commission to more fully support the Department's efforts to begin an electronic data "EDP" program. As Chairman, I intend to have the Commission revisit this issue in the near future. I share the concern of the Auditor General and of the Department that some sort of EDP auditing program is needed to help ensure the integrity of the industry and the proper financial returns to both bettors and the State of Arizona.

In Sunset Factor 8, the report mentions that the Commission has not proposed any racing legislation since 1982. Because the Commission has no staff, it is difficult for it to spend much time lobbying in the Arizona Legislature. The Department and the racing industry are well equipped to spend considerable time lobbying for legislation pertaining to the industry.

We would like to point out that the Racing Commissioners have made several appearances at the Legislature regarding their own views on proposed industry legislation.

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"EQUAL EMPLOYMENT OPPORTUNITY/AFFIRMATIVE ACTION EMPLOYER"

The report's Factor 10 is not exactly a ringing endorsement of the continued existence of the Arizona Racing Commission. We think it would be disastrous for the welfare of the State of Arizona if the Commission were to disappear and all regulatory authority over racing were to reside in one individual. The stakes in this heavily regulated industry are financially very high. Almost a quarter of a billion dollars is wagered annually in Arizona on pari-mutuel racing, and proper protection of the overall public in general and the betting public in particular requires that there be a body who can oversee the activities of the Department on a regular basis. We think that body should be the Arizona Racing Commission.

Finally, one of the concluding recommendations of your report is, "The Commission should recover the amount of improperly withheld funds from permittees whose capital improvement projects do not meet the statutory requirements." As Chairman of the Commission, I will seek the Commission's consent at its next meeting to provide the Attorney General with the report's conclusions about improperly withheld capital improvement funds and ask that the Attorney General institute legal action for the recovery of those funds if he deems it appropriate.

Again, I would like to thank you and your staff for the courteous and professional manner in which the audit was conducted.

Sincerely,

Fred C. Struckmeyer, Jr.

FRED C. STRUCKMEYER, JR.
Chairman

FCS:va