

**State of Arizona
Office
of the
Auditor General**

PERFORMANCE AUDIT

**ARIZONA
DEPARTMENT OF
RACING
AND
ARIZONA RACING
COMMISSION**

**Report to the Arizona Legislature
By Douglas R. Norton
Auditor General
August 1997
Report No. 97-12**



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August 28, 1997

Members of the Arizona Legislature

The Honorable Fife Symington, Governor

Mr. Jim Higginbottom, Director
Arizona Department of Racing

Mr. A. Melvin McDonald, Chairman
Arizona Racing Commission

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Arizona Department of Racing and Arizona Racing Commission. This report is in response to a May 29, 1995, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the Sunset review set forth in A.R.S. §§41-2951 through 41-2957.

The report addresses both the Department's and the Commission's effectiveness in regulating horse and greyhound racing in the State. We found that the Capital Improvement Program overseen by the Commission has not met, and is not likely to meet in the future, its objective of increasing state revenues. Further, the Commission has inappropriately approved approximately \$500,000 in capital improvement project items.

We also found the Department can improve its regulation of the industry. The Department does not do enough to ensure that the \$251 million wagered at commercial tracks is properly protected. It also does not assign enough staff to adequately supervise several important functions at the greyhound tracks. Finally, commercial horse racing tracks have been improperly exempted from paying taxes on the racing handles from the county fair race meets that the tracks conduct.

In addition to the findings and recommendations presented in this report, this audit noted that tax relief legislation enacted in 1994 has reduced pari-mutuel tax revenues from over \$8 million annually to \$2.8 million in fiscal year 1995-96.

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

This report will be released to the public on August 29, 1997.

Sincerely,

Douglas R. Norton
Auditor General

Enclosure

SUMMARY

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Racing and Arizona Racing Commission pursuant to a May 29, 1995, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the Sunset review set forth in A.R.S. §§41-2951 through 41-2957.

The Arizona Department of Racing (Department) is responsible for the day-to-day oversight of all racing activities within the State. The 5-member Arizona Racing Commission (Commission) is responsible for setting overall Department policy, allocating racing dates, and issuing permits to conduct racing.

The Capital Improvement Program Should Be Terminated (See pages 11 through 17)

The Legislature should consider terminating the Capital Improvement Program (Program) because it has not met its intent nor is it likely to in the future. The Legislature created the Capital Improvement Program to encourage improvements to racetrack facilities for the benefit of the public and racing participants and to increase state revenues from the additional wagering anticipated to result from those improvements. However, state revenues have not increased as a result of track improvements, a fact which led the Auditor General to recommend terminating the Program in a 1986 performance audit of the Racing Commission (see Auditor General Report 86-5). A recent shift to off-track betting further suggests that monies spent on improving facilities will not lead to an increase in state revenue.

Regardless of whether the Program is terminated, the Commission should recover \$500,000 in capital improvement tax credits that it inappropriately approved. Despite guidelines identified by the Legislative Council and outlined in the Auditor General's 1986 performance audit and an opinion from the Attorney General regarding statutory requirements for project approval, the Commission approved \$500,000 in unallowable capital improvement project items since 1990. As a result, in accordance with a 1981 Attorney General opinion, the Commission should recover these monies. This opinion states that upon discovery of the error, a racetrack is obligated to repay and the State is obligated to recover any public monies incorrectly withheld, regardless of any approval that was previously granted.

**The Department Should
Do More to Protect the
Wagering Public's Money
(See pages 19 through 24)**

Currently, the Department does little to ensure that the \$251 million wagered at commercial tracks is properly protected and distributed. Commercial tracks use a computerized totalisator system to record the amount of monies wagered, compute odds and payoffs, and distribute the dollars wagered to winning patrons, racing participants, and the State. However, the Department does not actively monitor these systems for the accurate calculation and distribution of these monies. For example, the Department rarely visits tracks to assess controls or test system transactions to ensure accurate calculations.

Although not a frequent occurrence, errors involving incorrect calculations of payouts have occurred at Arizona tracks. One totalisator system incorrectly calculated payouts as recently as December 1996. Additionally, other states have encountered fraud involving the re-creation of unclaimed winning tickets. The Department should either devote a staff position to properly monitor pari-mutuel activities or consider contracting with an independent auditor.

**The Department Should
Improve Oversight of
Greyhound Tracks
(See pages 25 through 29)**

To better ensure the integrity of greyhound racing and the dogs' safety, the Department needs to increase its oversight at greyhound tracks. Track personnel perform several important regulatory functions without any supervision by state officials. These functions include determining entries for upcoming races to ensure all greyhounds receive equal opportunities to compete, weighing the dogs to ensure they do not deviate from established weights that can affect performance, and identifying greyhounds to ensure the animal entered actually runs.

The Department can improve its oversight of greyhound racing by better using its existing staff at greyhound tracks and adding a part-time staff person at each greyhound track. For example, by increasing the number of hours worked by racing stewards, these stewards could supervise the race entries process and the weigh-in of greyhounds, and examine the racing surface prior to races to ensure animal safety. Adding a part-time staff person at each track will allow the Department to monitor racing activities such as the weigh-in and identification of greyhounds when both stewards are required to conduct hearings or observe the races.

The Department Should Collect Pari-Mutuel Taxes from Commercial Tracks That Conduct County Race Meets (See pages 31 through 34)

The Department should ensure that commercial tracks pay pari-mutuel taxes on the racing handle generated from county fair race meets the tracks conduct. Currently, the Commission grants race permits and dates to all 15 counties, but allows counties to sell their race dates to commercial tracks. For the fiscal year 1996-97 county fair racing season, 6 of the 15 counties sold their race dates to commercial tracks.

To date, commercial tracks have not paid pari-mutuel taxes on the racing handle generated during county fair race dates. According to statute, racing meetings conducted by county fair racing associations are exempt from the payment of pari-mutuel tax, an exemption that commercial tracks have similarly applied when conducting county race meets. For example, Turf Paradise did not pay pari-mutuel taxes of \$147,000 on the \$7.35 million it generated in pari-mutuel handle on the county race days it conducted in 1997. Turf Paradise also enhanced its hardship tax credit status by \$172,000. The hardship tax credit provides a tax credit against the pari-mutuel tax for tracks that have suffered declines in business as measured by pari-mutuel handle. By excluding the pari-mutuel handle generated on county race days from the hardship tax credit calculation, Turf Paradise receives a bigger credit. However, A.R.S. §5-110(F) stipulates that a county fair racing meeting conducted by an individual, corporation, or association other than the properly authorized county fair racing association shall be considered the same as a commercial meeting. Thus, commercial tracks owe, and the Department should assess and collect, pari-mutuel taxes on the operation of county fair race meets by commercial tracks. The Department should also solicit advice from the Attorney General regarding the collection of pari-mutuel taxes owed on the operation of county fair race meets by commercial tracks in previous years.

The Department Should Remedy Improper Payroll Practices (See pages 35 through 37)

The Department has engaged in improper payroll practices. First, the Department has allowed its employees assigned to greyhound tracks to record their time as performances (a performance refers to one session of racing), with 5 performances worked equaling a 40-hour work week. However, based on auditors' observations and interviews with these employees and Department management, a performance usually requires only 6 to 7 hours of work. Thus, a full work week may be only 30 hours of actual work, but these employees receive pay for 40 hours.

Second, the Department recorded one employee's time and paid him in a manner that improperly allowed the employee to continue receiving state retirement benefits.

Other Pertinent Information
(See pages 39 through 43)

During the audit, other pertinent information was also collected regarding the impact recent tax relief legislation has had on pari-mutuel tax revenues. While pari-mutuel tax revenues were over \$8 million annually from fiscal years 1991-92 through 1994-95, tax relief the Legislature enacted caused these revenues to drop to \$2.8 million in fiscal year 1995-96. As a result, revenues are insufficient to meet the \$3.6 million in funding requirements for the eight statutorily established funds the pari-mutuel tax helps support, and the State now pays the full cost to regulate the commercial racing industry. Prior to tax relief, the pari-mutuel tax, along with nominal revenues from license fees and fines, more than covered the cost of regulation and funded the eight statutorily established funds.

Table of Contents

	<u>Page</u>
Introduction and Background	1
Finding I: The Capital Improvement Program Should Be Terminated.....	11
Background.....	11
Capital Improvement Program's Intent Not Being Met.....	12
Commission Inappropriately Approved Projects.....	13
Commission Should Recover Monies for Ineligible Project Item.....	16
Recommendations.....	17
Finding II: The Department Should Do More to Protect the Wagering Public's Money	19
Background.....	19
Oversight of Pari-Mutuel Activities Inadequate at Commercial Tracks	19
Monitoring Needed to Protect Against System Error and Fraud.....	22
Recommendations.....	24

Table of Contents (cont'd)

	<u>Page</u>
Finding III: The Department Should Improve Oversight of Greyhound Tracks	25
The Department's Regulation at Greyhound Tracks Does Not Fully Protect Participants	25
The Department Can Do More to Better Ensure the Integrity of Greyhound Racing.....	27
Recommendations.....	29
Finding IV: The Department Should Collect Pari-Mutuel Taxes from Commercial Tracks That Conduct County Race Meets.....	31
Background.....	31
Commercial Tracks Do Not Pay Taxes on County Fair Race Dates	31
Excluding Pari-Mutuel Handle Affects Tax Credit Status and Revenue Distribution	32
Department Should Assess and Collect Pari-Mutuel Taxes.....	33
Recommendations.....	34

Table of Contents (cont'd)

	<u>Page</u>
Finding V: The Department Should Remedy Improper Payroll Practices	35
Some Employees Receive Inflated Pay.....	35
The Department Allowed Improper Payroll Agreement	35
Recommendations.....	37
Other Pertinent Information	39
Sunset Factors	
Arizona Department of Racing	45
Arizona Racing Commission	51
Agency Response	

Table of Contents (concl'd)

	<u>Page</u>
Tables	
Table 1: Arizona Department of Racing Pari-Mutuel Handle Reported by Commercial Tracks Years Ended June 30, 1994 through 1996 (Unaudited)	2
Table 2: Arizona Department of Racing Statement of Revenues, Expenditures and Changes in Fund Balances Years Ended June 30, 1995 through 1997 (Unaudited)	5
Figures	
Figure 1: Arizona Department of Racing Source and Distribution of Nonappropriated Racing Revenues Years Ended June 30, 1995 and 1996 (Unaudited)	3
Figure 2: Arizona Department of Racing Racing Handle Generated by On-Track Versus Off-Track Wagering Years Ended June 30, 1992 through 1996 (Unaudited)	13
Figure 3: Arizona Department of Racing Pari-Mutuel Handle Generated by Live Versus Simulcast Race Wagering Years Ended June 30, 1992 through 1996 (Unaudited)	42

INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Racing and Arizona Racing Commission pursuant to a May 29, 1995, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the Sunset review set forth in A.R.S. §§41-2951 through 41-2957.

The Arizona Department of Racing (Department) and the Arizona Racing Commission (Commission) have existed separately since 1982, at which time the Legislature created the Department. Prior to 1982, the regulatory activities the Department now performs were performed solely by the Arizona Racing Commission, through an executive secretary. By establishing the Department, the Legislature intended to strengthen regulation of the racing industry by placing the Department in charge of day-to-day oversight of racing activities. The Commission concentrates its efforts on setting overall Department policy, allocating racing dates, and issuing permits to conduct racing.

Racing in Arizona

Arizona is one of only 11 states that features both horse (thoroughbred and quarter horse) and greyhound racing, which occurs at 6 commercial tracks in the State. Horse racing is conducted at Turf Paradise in Phoenix, Prescott Downs in Prescott, and Rillito Park in Tucson. Greyhound racing is conducted at Phoenix Greyhound Park, Apache Greyhound Park in Apache Junction, and Tucson Greyhound Park. In addition to commercial racing, nine counties in the State conduct horse racing.

Pari-mutuel handle (the monies wagered on horse and greyhound racing), determines the industry's success. As illustrated in Table 1 (see page 2), Arizona commercial racetracks generated \$251.1 million in pari-mutuel handle during fiscal year 1995-96. County fair racing generated an additional \$12 million in pari-mutuel handle. Combined, Turf Paradise and Phoenix Greyhound Park accounted for approximately 77 percent of the pari-mutuel handle generated during fiscal year 1995-96, with each track generating over \$96 million.

Recent developments in the racing industry, including off-track betting (OTB) and simulcast races (out-of-state races received via satellite), have allowed the industry to maintain pari-mutuel handle at its current level for the past three fiscal years despite competition from the state lottery and Indian gaming casinos. For example, racetracks significantly expanded the number of OTB sites in the State from 1991 through 1993, which in turn has dramatically changed attendance and wagering patterns. Currently, 60 percent of pari-mutuel handle is generated at these sites, as compared to 25 percent generated in fiscal year 1991-92. Similarly, the percentage of pari-mutuel handle

derived from simulcast races has significantly increased in the last three years. In fiscal year 1991-92 it was 8 percent, as compared to 44 percent in fiscal year 1995-96.

Table 1
Arizona Department of Racing
Pari-Mutuel Handle Reported by Commercial Tracks
Years Ended June 30, 1994 through 1996
(Unaudited)

	1994	1995	1996
Apache Greyhound Park	\$ 5,475,298	\$ 7,275,403	\$ 8,355,626
Fort Tuthill Downs ¹	798,671	648,383	
Phoenix Greyhound Park	94,649,424	97,582,245	96,778,177
Prescott Downs	17,490,826	20,510,512	23,646,521
Rillito Park	2,112,114	1,912,466	2,371,906
Tucson Greyhound Park	27,918,424	21,523,676	23,643,705
Turf Paradise	101,467,993	97,767,117	96,357,212
Yuma Greyhound Park ¹	88,240		
Total	<u>\$250,010,990</u>	<u>\$247,219,802</u>	<u>\$251,153,147</u>

¹ Fort Tuthill Downs did not conduct commercial racing in fiscal year 1995-96, and Yuma Greyhound Park ceased racing activities after fiscal year 1993-94.

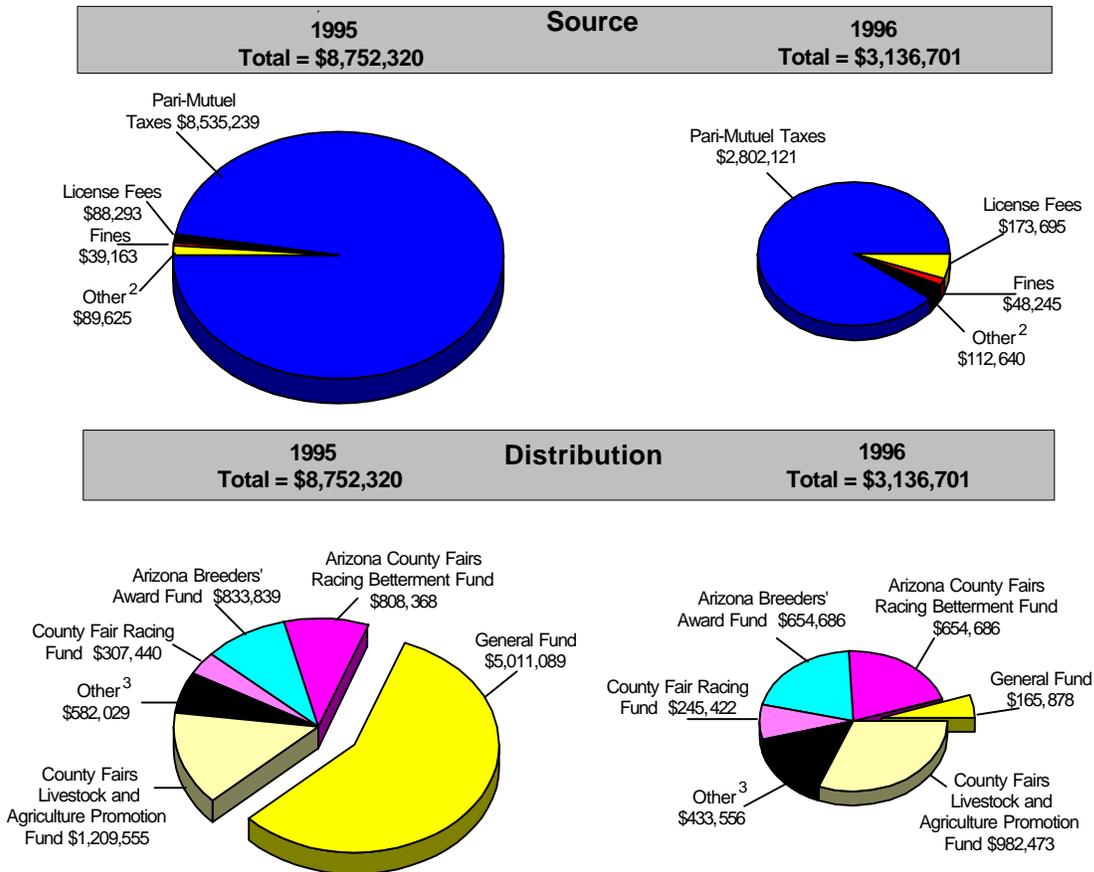
Source: Department of Racing's Annual Report for fiscal year 1995-96.

State Revenues Generated from Racing

The Department collects revenues from racing industry participants for deposit into the State's general fund and nine other funds specifically established in statute. While an average of 77.5 percent of pari-mutuel handle is returned to the wagering public as winnings, the track retains the remaining handle, which consists of purse monies paid to the owners of winning horses and greyhounds, track revenue, and pari-mutuel taxes paid to the State. As illustrated in Figure 1 (see page 3), the State received over \$8.5 million in pari-mutuel tax revenue in fiscal year 1994-95. However, as a result of tax relief legislation passed in 1994, pari-mutuel tax revenues dropped to \$2.8 million in fiscal year 1995-96 and contributions to the State General Fund decreased from over \$5 million annually to \$165,878. Recently, the Department reported a further decrease in pari-mutuel tax revenues, since the tax only generated \$2.63 million in fiscal year 1996-97. (See Other Pertinent Information, pages 39 through 43 for additional information on funding decreases.)

Figure 1

**Arizona Department of Racing
Source and Distribution of Nonappropriated Racing Revenues¹
Years Ended June 30, 1995 and 1996
(Unaudited)**



¹ Amounts do not include General Fund appropriations or expenditures from them.

² This category includes pari-mutuel taxes paid by racetracks for such tax liabilities incurred in the previous fiscal year and fees paid by horse and greyhound breeders to certify their eligibility for breeders' awards.

³ This category includes the following funds: Agriculture Consulting and Training, Arizona Coliseum and Exposition Center, Arizona Stallion Award, Greyhound Adoption Fund, and the Administration of the Arizona County Fairs Racing Betterment Fund, the Arizona Breeders' Award Fund, the Arizona Stallion Award Fund, and the Greyhound Adoption Fund.

Source: The Uniform Statewide Accounting System *Revenues and Expenditures by Fund, Program, Organization, and Object* reports for the years ended June 30, 1995 and 1996.

Budget

The Legislature appropriates monies from the General Fund to regulate commercial racing and support the Arizona Racing Commission. Additionally, the Department receives legislative appropriations from the County Fair Racing Fund to conduct and regulate county fair horse race meets. Finally, the Department relies on nonappropriated monies from the Administration of the Arizona County Fairs Racing Betterment Fund, the Arizona Breeders' Award Fund, the Arizona Stallion Award Fund, and the Greyhound Adoption Fund to provide additional personnel to assist with county fair race meets and breeders' awards.¹ Table 2 (see page 5), presents the Department's actual revenues and expenditures for fiscal years 1994-95, 1995-96, and 1996-97.

Commission and Department Organization and Staffing

The Arizona Racing Commission, which consists of five members appointed for five-year terms by the Governor, establishes policy for the regulation of racing in Arizona. As such, the Commission has several specific statutory responsibilities. First, the Commission sets all racing dates in the State, including dates for commercial and county race meets. The Commission also promulgates rules to govern racing meetings. Additional Commission responsibilities include approving permits to conduct racing meetings, reviewing appeals of licensing and regulatory decisions made by the Department Director, and approving all capital improvement applications racetracks submit.

The Department of Racing, which assists the Commission in fulfilling many of its responsibilities, is authorized 55.4 FTEs to provide direct oversight of racing activities in the State. The Department has organized these personnel into several divisions, including:

Investigations/Licensing Division The investigative staff consist of certified peace officers who investigate offenses committed by license applicants or licensees. The Department has authority to investigate any matter involving racing, including testing licensees for drug and alcohol abuse. Examples of investigative work this division performs include background checks of license applicants and investigations involving violations of racing regulations. During fiscal year 1995-96, the Department conducted 1,137 investigations and performed 102 human drug or alcohol tests.

¹ Breeders' awards are monetary awards the Department distributes to the breeders of winning horses or greyhounds foaled or whelped in Arizona.

Table 2
Arizona Department of Racing
Statement of Revenues, Expenditures and Changes
in Fund Balances
Years Ended June 30, 1995 through 1997
(Unaudited)

	1995	1996	1997
Revenues:			
General Fund appropriations ¹	\$ 2,254,458	\$2,358,928	\$2,365,064
Pari-mutuel taxes	8,535,239	2,802,121	2,606,325
License fees	88,293	173,695	58,146
Fines	39,163	48,245	47,155
Other	<u>103,291</u>	<u>143,895</u>	<u>54,490</u>
Total Revenues	<u>11,020,444</u>	<u>5,526,884</u>	<u>5,131,180</u>
Expenditures:			
Personal services	1,348,758	1,447,137	1,399,263
Employee related	322,603	337,983	332,942
Professional and outside services	479,548	471,214	449,189
Travel, in-state	158,064	167,741	137,459
Travel, out-of-state	9,710	6,307	6,509
Other operating	197,487	204,159	274,502
Equipment	<u>58,242</u>	<u>47,098</u>	<u>33,908</u>
Total operating expenditures	2,574,412	2,681,639	2,633,772
Transfers to other funds ²	3,383,195	2,683,662	2,437,041
Transfers to State General Fund ³	<u>5,089,327</u>	<u>234,442</u>	<u>68,300</u>
Total operating expenditures and transfers	<u>11,046,934</u>	<u>5,599,743</u>	<u>5,139,113</u>
Excess of expenditures over revenues and transfers	(26,490)	(72,859)	(7,933)
Fund balances, July 1 ⁴	<u>181,423</u>	<u>154,933</u>	<u>82,074</u>
Fund balances, June 30 ⁴	<u>\$ 154,933</u>	<u>\$ 82,074</u>	<u>\$ 74,141</u>

¹ Amounts for fiscal year 1994-95 and 1995-96 include administrative adjustments for the prior fiscal year.

² Includes transfers to the following funds: Agriculture Consulting and Training, Arizona Breeders Award, Arizona Coliseum and Exposition Center, Arizona County Fairs Racing Betterment, Arizona Stallion Award, County Fairs Livestock and Agriculture Promotion, and Greyhound Adoption.

³ Amounts also include boxing revenues of \$13,666, \$31,255, and \$19,135 in fiscal years 1994-95, 1995-96, and 1996-97, respectively; and transfers from the County Fair Racing Fund of \$64,572 and \$37,309 in fiscal years 1994-95 and 1995-96, respectively.

⁴ Because the Department only expends monies from the County Fair Racing Fund and the Administration of the Arizona County Fairs Racing Betterment Fund, the Arizona Breeder s Award Fund, the Arizona Stallion Award Fund, and the Greyhound Adoption Fund, in addition to its General Fund Appropriations, only these funds balances were included.

Source: The Uniform Statewide Accounting System *Revenues and Expenditures by Fund, Program, Organization, and Object* and *Trial Balance by Fund* reports for the years ended June 30, 1995 and 1996; the *State of Arizona Appropriations Report* for the years ended or ending June 30, 1997 and 1998; and a statement of revenues, expenditures, and changes in fund balance for the year ended June 30, 1997, as compiled by the Department of Racing.

The Department also licenses all personnel involved in racing in the State, including horse and greyhound owners, trainers, jockeys, grooms, exercise riders, track management and officials, concessionaires, and pari-mutuel workers. During fiscal year 1995-96, the Department issued 6,576 licenses.

In addition to these licensing and investigative duties, the Department conducts inspections of all greyhound kennels and farms in the State to ensure the safety and well-being of racing greyhounds. Additionally, the Department inspects and monitors pari-mutuel wagering activities at all OTB sites in the State. OTB site inspections ensure that management and workers are licensed and that pari-mutuel wagering operations are conducted in accordance with racing regulations.

Steward and Veterinarian Divisions The Department must supervise and regulate all live races and pari-mutuel wagering conducted at commercial tracks in the State. Located at each commercial track, these personnel not only supervise actual live racing, but also should either perform or supervise all activities that occur before, during, and after race meets, such as animal identification to ensure the correct animal actually runs, the race entry process, the weigh-in of greyhounds and horse jockeys to ensure appropriate weights, and the testing of animals for prohibited substances that can affect race outcomes. (See Finding III, pages 25 through 29 for additional information on Department oversight of greyhound racing.)

County Fair Racing Division The Department conducts and regulates all county horse race meets in the State. The Department's responsibilities for county fair racing exceed its responsibilities for commercial racing in that the Department provides the staff necessary to conduct the races. For commercial meets, the commercial track s staff performs many of the racing activities and conducts racing while the Department supervises these activities.

In addition to the personnel in each of these divisions, the Department employs administrative and clerical staff, accounting staff, and computer support staff.

A final Departmental responsibility involves collecting and accounting for revenues for the State Boxing Commission, including the collection of licensing fees and a tax levied on gross receipts earned from boxing events. For fiscal year 1995-96, the Department collected over \$31,000 in boxing-related revenues, which it remitted to the State General Fund. However, a recently issued Auditor General report on the Arizona State Boxing Commission found that the Department does not adequately fulfill its responsibilities for the collection of taxes owed on boxing event revenues (see Auditor General Report 96-14).

1986 Report and Follow-up

As part of the current audit, concerns identified in the Auditor General's 1986 performance audit of the Arizona Department of Racing and Arizona Racing Commission (Auditor General Report 86-5) were reviewed. The 1986 report recommended that the Department improve its drug surveillance program for horses and greyhounds, including testing at least two animals per race for prohibited drugs, and conduct electronic data processing audits of racetracks' pari-mutuel wagering systems. The audit also recommended termination of the Capital Improvement Program because it did not increase revenues for the State.

While the Department responded to some of the recommendations made in the 1986 report, many of the recommendations have not been implemented. For example, citing budgetary constraints, the Department currently tests the winning horse or greyhound for all races and will only test additional animals if the performance of those animals deviates from expectations. However, the Department has increased the number of drug tests performed on each horse and greyhound sample and currently contracts with a laboratory that participates in quality assurance and testing integrity programs. Additionally, the Department does not conduct electronic data processing audits of racetracks pari-mutuel wagering systems (see Finding II, pages 19 through 24). Finally, although the Legislature terminated the Capital Improvement Program in June 1992, it reinstated the program in 1994 for horse tracks in counties with a population of less than 500,000. Nonetheless, the Legislature should again consider terminating the Capital Improvement Program prior to its scheduled expiration in 1999 since the Program will not generate additional revenues for the State (see Finding I, pages 11 through 17).

Audit Scope and Methodology

This audit focuses on efforts by both the Department and the Commission to fulfill their respective responsibilities regarding the regulation of horse and greyhound racing in the State. Specifically, the audit focused on the Capital Improvement Program, the Department's oversight of pari-mutuel wagering and greyhound racing, the current condition of county fair racing in the State, Department compliance with state personnel and payroll requirements, and revenues generated by the pari-mutuel tax.

Several methods were used to study the issues addressed in this audit, including:

Interviewing various individuals involved in racing and the regulation of the industry including management and operational staff at Turf Paradise, Phoenix Greyhound Park, Tucson Greyhound Park, and Prescott Downs; several county fair managers; horse and greyhound owners; all four Arizona Racing Commission

members; and Department management and staff, including horse and greyhound stewards, investigators, and licensing staff;

Reviewing all capital improvement projects the Commission has approved since 1990 to determine if projects met statutory criteria for approval and were adequately monitored;

Observing county fair race meets in two counties, and commercial horse and greyhound race meets at five of the six commercial tracks, to determine the Department's role in regulating racing activities, including pari-mutuel wagering;

Analyzing pari-mutuel handle and revenues generated through the pari-mutuel tax since fiscal year 1991-92 to assess the impact of tax-relief legislation;

Reviewing profit and loss statements and racing programs from county fair race meets to analyze attendance, horse entries, handle, and profitability trends; and

Surveying 19 other states' Racing Department, Commission, or Board; the Racing Commissioner's International (a clearinghouse for racing information and guidelines); and the National Greyhound Association regarding the regulation of pari-mutuel racing.¹

This report presents findings and recommendations in five areas:

The Legislature should consider terminating the Capital Improvement Program because its statutory intent to increase revenues to the State has not been met, nor will it likely be met in the future.

The Department needs to monitor pari-mutuel wagering activities in the State to reduce the potential for fraud and abuse and ensure that the public and the State receive accurate payouts.

The Department should increase the level of oversight provided at greyhound racetracks.

The Department should collect any pari-mutuel taxes owed from county fair race meets conducted by commercial tracks.

¹ Nineteen states having similar characteristics to Arizona's regulation of racing activities were identified and contacted, including Arkansas, California, Colorado, Florida, Iowa, Kansas, Maine, Massachusetts, Montana, New Hampshire, New Jersey, New Mexico, New York, Oklahoma, Oregon, Texas, Washington, West Virginia, and Wisconsin. Nine of these states regulate multiple greyhound racetracks. Six states have counties that conduct race meets. The remaining four states reported similar or higher pari-mutuel handle figures than Arizona.

The Department needs to remedy improper payroll practices.

In addition, the report contains an Other Pertinent Information section regarding the impact of the pari-mutuel tax relief legislation passed in 1994, as well as responses to the 12 Sunset review factors for the Department and for the Arizona Racing Commission.

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the Director and staff of the Arizona Department of Racing and the members of the Arizona Racing Commission for their cooperation and assistance throughout the audit.

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FINDING I

THE CAPITAL IMPROVEMENT PROGRAM SHOULD BE TERMINATED

The Legislature should consider terminating the program it established in 1978 to aid horse and greyhound racetracks in improving their facilities. Although the Capital Improvement Program was intended to encourage improvement in racetrack facilities that would increase attendance and ultimately increase state revenues, it has not met this statutory intent. Regardless of any legislative action to terminate the Program, the Commission should recover \$500,000 in tax credits it improperly allowed through the Program and monitor all remaining projects for compliance with the approved application and statute.

Background

The Legislature created the Capital Improvement Program to achieve two primary objectives: 1) to encourage improvements in racetrack facilities to benefit the public and racing participants; and 2) to increase state revenue from the rise in wagering anticipated to result from such improvements. The State subsidizes the Program by reducing pari-mutuel taxes for tracks undertaking capital improvement projects. Once the Commission approves a project, racetracks pay for the project's initial cost, but reduce pari-mutuel taxes owed until the entire project cost is recovered. Specifically, tracks can reduce the taxes owed to the State by 1 or 2 percent of the monies wagered.¹ The Legislature terminated the Program in June 1992, but reinstated it in 1994, retroactive to June 1992, for horse tracks in counties with a population of fewer than 500,000 persons. The Program is now scheduled to expire in June 1999. Prescott Downs is the only track eligible to apply for new capital improvement projects under the current law.

¹ For counties with a population of 500,000 or more, taxes due to the State are reduced by 1 percent of the total pari-mutuel handle. In all other counties, taxes are reduced by 2 percent of the total pari-mutuel handle.

Capital Improvement Program's Intent Not Being Met

Despite the benefits commercial tracks have realized by participating in the Capital Improvement Program, the Legislature should consider terminating the Program because it has not met its statutory intent nor is it likely to in the future. While the Program is intended to increase state revenues, historically, state revenues have not increased as a result of track improvements. The Auditor General's 1986 performance audit of the Racing Commission found that racing handles at Turf Paradise and Tucson Greyhound Park had decreased, when measured in constant dollars, despite capital improvements to these facilities (see Auditor General Report 86-5). Moreover, the audit found that a variety of other factors, such as population changes, number of racing days, and increased competition for the gambling dollar, are more likely to affect racing handle. Therefore, the need for the State to support capital improvements at commercial tracks for that purpose was questionable. Consequently, the Auditor General recommended terminating the Capital Improvement Program.

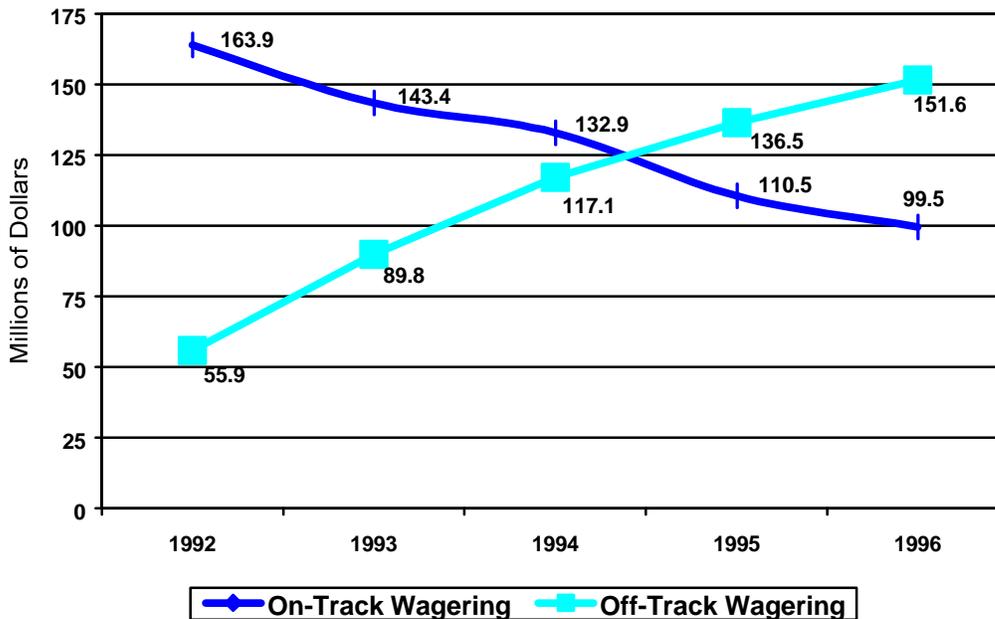
The need for a capital improvement program is still questionable, since racing patrons' current wagering preferences suggest that monies spent on improving facilities will not lead to an increase in state revenue. While racing handle generated by commercial tracks increased 14 percent, from \$219.8 million in fiscal year 1991-92 to \$250 million in fiscal year 1993-94, it remained at that level for the subsequent two fiscal years, 1994-95 and 1995-96. However, during this time, the wagering that generates this pari-mutuel handle shifted dramatically from on-track to off-track wagering. As illustrated in Figure 2 (see page 13), on-track pari-mutuel handle declined from \$163.9 million in fiscal year 1991-92 to \$99.5 million in fiscal year 1995-96, a decrease of 39 percent. In contrast, off-track betting increased over 170 percent during this time and accounted for 60 percent of the \$251.1 million in racing handle generated in fiscal year 1995-96. Additionally, almost as many people now attend off-track betting sites as they do racetracks. The following examples illustrate this point:

Since fiscal year 1991-92, Tucson Greyhound Park (TGP) has received almost \$900,000 worth of tax credits for capital improvements such as refurbishing its grandstand, starting box lounge, and concession stand and bar. These improvements, however, did not prevent a decrease in on-track attendance or on-track handle. In just four years, TGP's annual on-track attendance fell from 317,199 to 137,360 in fiscal year 1995-96. Furthermore, on-track handle dropped from \$33.6 million to \$12.5 million for the same time period.

For Prescott Downs, the only track now eligible for new capital improvement projects, off-track wagering comprises 88 percent of its total racing handle. Thus, new improvements to the facility are unlikely to result in an increase in on-track handle since most bettors never even visit the track.

Figure 2

Arizona Department of Racing
Racing Handle Generated by
On-Track Versus Off-Track Wagering
Years Ended June 30, 1992 through 1996
(Unaudited)



Source: Department of Racing's Annual Report for fiscal year 1995-96.

Commission Inappropriately Approved Projects

In addition to the Capital Improvement Program not meeting the intent to increase revenues for the State, the Commission has inappropriately approved several project items for tax credits under the Program. Despite specific guidelines outlined by the Legislative Council and reiterated by the Attorney General, the Commission improperly approved over \$500,000 in ineligible project items since 1990.

Projects must meet specific criteria—Although statutes allow a broad range of projects to qualify for the Capital Improvement Program, all must meet certain guidelines. In conjunction with the 1986 performance audit of the Racing Commission (see Auditor General Report 86-5), the Legislative Council identified two key criteria for approving

projects. In 1989, the Department requested an Attorney General opinion regarding project approval criteria and the Attorney General established the same guidelines offered by the Legislative Council. These criteria remain applicable today:

Minimum Expenditure Requirement While A.R.S §§5-111.02 and 5-111.03 allow a racetrack facility to consolidate more than one capital improvement project on one application, *each* project must still meet the minimum expenditure requirement of \$50,000.

Related Components 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.

In addition to the criteria identified by the Legislative Council, statute requires the Commission to consider several other factors before approving capital improvement projects. Specifically,

Racetracks must submit a capital improvement project application This application should include projected costs, an estimate of additional pari-mutuel revenues accruing to the State as a result of the project, a description of any public safety concerns to be resolved by the project, and a management and construction plan.

Projects must promote safety The Commission must determine whether the capital improvement project will promote the safety of racing horses or dogs or increase the safety, convenience, or comfort of the people attending the racetracks.

Projects must meet definition of capital improvement Statute defines a capital improvement as an addition, replacement, or remodeling of a racetrack facility including architectural and design expense. Capital improvements do not include the cost of repairs and maintenance to keep a racetrack facility in ordinary operating condition and do not include operational expenses. However, racetracks may include water truck and tractor purchases as capital improvements.

Commission inappropriately approved \$500,000 in project items—Despite the guidance offered by the Legislative Council, the Attorney General's Office, and statute, the Commission inappropriately approved \$501,125 in tax credits for project items that did not meet statutory requirements. Specifically, 5 of the 6 projects approved since 1990 contained items that were inappropriately approved. While many of the project items may have qualified as capital improvements, the lack of documentation supporting their relationship to an overall project and failure to individually meet the minimum

expenditure requirement precludes them from tax credit consideration. Specifically, the Commission approved the following:

1996 Prescott Downs project This project involved the installation of a safety rail around the track and other items for a total approved cost of \$189,291. However, included in this approved cost were \$67,842 in unrelated items such as a coin counter and packager, computer and printer, gift shop extension and awning, and three utility vehicles.

1995 Prescott Downs project This project included a variety of unrelated items for a total approved cost of \$216,413. Only two of the items in this project met eligibility requirements, with the remaining items ineligible because they did not meet minimum expenditure requirements and were unrelated to the two eligible items. The cost of the ineligible items totaled \$58,047.

1990 Prescott Downs project This \$199,633 project consisted of widening two turns on the track to enhance overall safety. However, the Commission also approved two addendums to the project totaling \$74,631, which were unrelated to the original project's overall intent. These addendums included upgrading the concession stand and re-roofing the manager's office, items that on their own did not meet minimum expenditure requirements.

1992 Tucson Greyhound Park project This \$409,344 project consisted of constructing an exterior wall to surround the property as well as purchasing items to enhance the clubhouse. However, \$198,946 of the tax credit was granted for eight additional items, including back-up power for tote equipment and new restrooms, that did not qualify because they did not individually meet the minimum expenditure requirement and were not related to the other projects.

1991 Tucson Greyhound Park project This \$462,653 project consisted of remodeling grandstand areas, the starting box lounge, and the concession stand and bar. However, this amount included \$78,275 of food equipment that the Attorney General's Office deemed ineligible because it did not meet the definition of a capital improvement. Furthermore, the project included an unrelated item to construct a canopy for greyhound vehicles at a cost of \$23,384. While this canopy would qualify as a capital improvement on its own merit, it did not meet the minimum expenditure requirement and, therefore, was ineligible.

Although the Department contends its Attorney General representative reviewed and approved each of these projects, documentation contained in project files or provided by the Department only support Attorney General review for three of the five projects. Of these three projects, the Attorney General representative only approved the 1990 Prescott Downs project, and did so after expressing doubts as to whether the items

were related. The Attorney General representative did not approve the inappropriate items in the other two projects. The remaining two project files did not contain any evidence of Attorney General review or approval.

In addition to not meeting statutory criteria for project approval, many of the capital improvement applications submitted to the Commission failed to demonstrate the extent to which such improvements would meet the Program's overall intent. For example, some capital improvement project applications did not provide an indication that revenue increases would result from the project, while others even acknowledged that revenues would not increase, but were needed to maintain revenues at current levels.

Commission Should Recover Monies for Ineligible Project Item

Even if the Legislature terminates the Program, the Commission still needs to take action in two areas. First, the Commission should recover monies for project items that were inappropriately approved and granted tax credit. Second, both the Commission and the Department should monitor all remaining or anticipated capital improvement projects for compliance with the approved application and statute.

Commission should recover monies—The Commission should recover monies for the projects it has improperly approved and revoke any remaining, unused tax credits. In two previous reports, the Auditor General cited the Racing Commission for improperly approving projects, each time recommending recovery of the monies and/or cancellation of any remaining tax credits resulting from the projects. Specifically, in 1981 and 1986 (see Auditor General Reports 81-5 and 86-5), improper project approvals were documented totaling \$229,044 and \$290,445, respectively. While the Commission did take action to recover monies or cancel remaining tax credits, it could not provide documentation evidencing recovery of all tax credits improperly approved. However, in 1981, the Attorney General issued opinion I81-100 (R81-108) which requires recovery of incorrectly withheld public monies. In this opinion, the Attorney General maintains that, upon discovery of the error, a racetrack is obligated to repay and the State is obligated to recover any public monies that were incorrectly withheld, regardless of any approval that was previously granted.

Commission/Department should ensure proper oversight of projects—In addition to recovering monies for improperly approved projects, the Commission should ensure proper oversight of any remaining or anticipated projects. According to A.R.S §§5-111.02 and 5-111.03, the Director of the Department of Racing is required to conduct periodic inspections of capital improvements at least monthly during the construction period in order to ascertain compliance with the track's application. The Director indicated that he relies informally on the state stewards to provide him with status updates of construction projects that are in progress. Although statute allows the

Director to delegate this responsibility, project files contained no evidence of any inspections.

Statute also requires the Commission to verify all project costs for tax credit consideration upon completion of the project. The Commission can either request the Auditor General to conduct this review of project costs or approve an independent certified public accountant. Despite this requirement, none of the six files reviewed contained evidence of a final review. Additionally, some files did not contain canceled checks to confirm that racetracks actually incurred expenses for the project as presented to the Commission in their application. As a result, the Commission lacks documentation to support the tracks' qualification for tax credits. Therefore, the Commission should verify the costs for all completed projects and obtain sufficient documentation to warrant the tax credits it has granted.

Recommendations

1. The Legislature should consider repealing A.R.S. §5-111.02 to terminate the Capital Improvement Program because it has not met its statutory intent and is not likely to in the future.
2. In accordance with Attorney General opinion I81-100 (R81-108) which requires recovery of incorrectly withheld public monies, the Racing Commission should recover \$501,125 in tax credits it improperly approved.
3. Both the Commission and the Department should obtain sufficient documentation for all previously approved projects to verify completion of the project according to the approved application and to verify project costs.

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FINDING II

THE DEPARTMENT SHOULD DO MORE TO PROTECT THE WAGERING PUBLIC'S MONEY

The Department of Racing should do more to protect the monies that are wagered on horse and dog racing in the State. Despite statutory requirements to monitor all pari-mutuel activities, the Department does not regularly oversee these activities at commercial tracks. Without sufficient monitoring, the potential for error and fraud increases, jeopardizing the wagering public's money. The Department can do more to ensure the accuracy of both payouts to the public and taxes due to the State, as well as minimize the risk of illegal activities, by developing a plan for regular monitoring activities and assigning sufficient resources to carry out the plan.

Background

Racetracks use a computerized totalisator system to record the amount of money wagered for each race, compute the odds and estimated payoff associated with each race, and to calculate the payout to the public, the State, and the racetrack. Tracks typically contract with totalisator companies to provide both computer equipment and programs as well as to supply on-site staff to operate the system. Currently, two totalisator companies operate in Arizona. One company serves tracks operating in the Tucson area while the other serves tracks operating in the Phoenix area and Prescott.

Totalisator machines essentially act as the track's accounting system, processing approximately \$251 million per year in monies wagered at Arizona commercial racetracks. As such, the numerous parties involved in racing, such as winning bettors, tracks, the State, and horse and greyhound owners, rely on the totalisator system's accuracy to properly allocate monies wagered.

Oversight of Pari-Mutuel Activities Inadequate at Commercial Tracks

Currently, the Department does little to ensure that the \$251 million wagered at commercial tracks is properly protected and distributed. For example, the Department has not ensured that tracks employ necessary electronic data processing (EDP) controls to protect against unauthorized access and safeguard monies wagered. Additionally,

until recently, it did not verify the wagering information provided by tracks to ensure proper calculation of pari-mutuel taxes due to the State. Finally, although required by statute to monitor wagering activities and pari-mutuel departments at all race meets, the Department does not use its auditor position to conduct such activities at commercial tracks.

Inadequate controls for safe and accurate distribution of wagers—The Department does not ensure that necessary controls are in place to ensure safe and accurate processing of the wagering public's money in a computerized environment. A secure computerized environment contains measures that minimize the risk of unauthorized access as well as strategies that detect data manipulation. Avoiding unauthorized access can be achieved by screening employees before allowing them system access and limiting system access to only those employees who are critical to operations. Detecting data manipulation can be accomplished by monitoring the integrity of computer programs, procedures, and data. The Department does not provide adequate oversight in either area:

System access not limited The Department has not taken adequate measures to limit system access. Currently, the only mechanism the Department has in place to monitor access to the totalisator system is to license personnel associated with processing wagers. Through the licensing process, the Department can screen potential employees for criminal backgrounds and deny unsuitable applicants. However, the Department may not be consistently licensing these individuals. A review of mutuel tellers at two tracks revealed that as many as four tellers from one track were unlicensed. Additionally, by not monitoring these systems, the Department cannot determine the extent of unlicensed activity.

In addition, the Department does not ensure that tracks have taken adequate measures to limit system access. For example, on the two occasions auditors visited Phoenix Greyhound Park, one entrance into the room containing the totalisator system was completely unsecured, with no mechanism such as a card key system or log-in sheet to track or control those who entered.

Insufficient transaction testing The Department inadequately tests the accuracy of transactions handled by the totalisator systems. Because totalisator companies may make operational changes to the system several times a month, regular transaction testing by the Department is warranted to ensure the system accurately calculates payouts after changes have been made. Historically, the Department has limited its efforts in this area to testing the system programming and not actual transactions. The Department's tests consisted of entering hypothetical wagers into the system to determine if it performed calculations correctly. This type of review assumes that if the system calculates correctly under hypothetical conditions, it will calculate correctly under authentic conditions. While valuable for detecting program calculation errors, it cannot identify instances where an unauthorized individual

gained access to the system or where data was manipulated to fraudulently alter calculations. Furthermore, a review of Department files suggests that Department staff conducted these programming tests too infrequently to be an effective monitoring strategy. While operational changes are made to these systems several times each month, the Department tested hypothetical transactions at one track only five times between 1990-1995. Additionally, the Department tested transactions at two other tracks less than three times in that same time period, and three tracks were not tested at all.

The Department did not verify figures used to calculate taxes—While the Department infrequently tests totalisator transactions and does not ensure the adequacy of electronic data processing controls, until recently, it also did not verify figures used to calculate taxes due to the State. Currently, the Department requires all tracks to submit various wagering figures at the end of each race day for statistical compilation and tax calculation. The Department receives this information in two formats: a one-page summary sheet completed by the track's mutuel supervisor, which includes the track's calculation of taxes due; and numerous data reports generated by the totalisator system to support the information provided on the summary sheet. However, as of February 1997, the Department did not verify the numbers provided on the track's summary sheet to those on the totalisator reports. Therefore, the Department could not ensure that the tax liability the track calculated was accurate. Additionally, by not verifying the accuracy of calculations performed by the totalisator system, the Department could not ensure the accuracy of information provided in the totalisator system reports.

The Department does not use its auditor position(s) to monitor commercial tracks—The Department has limited its ability to oversee pari-mutuel activities by not using its auditing position(s) to monitor commercial tracks. A.R.S 5-106 requires that the Director of the Department appoint a supervisor of mutuels to monitor wagering activities and pari-mutuel departments at *all* race meets. While the Department has a pari-mutuel supervisor, he currently only monitors pari-mutuel wagering activities at county fair races, which comprise less than 5 percent of all monies wagered on horse and greyhound racing in the State. Furthermore, the Department abolished a full-time auditor/inspector position in 1994 in exchange for an administrative assistant position. Although the new position assumed some of the auditing duties, the person in this position does not monitor pari-mutuel wagering activities.

Until recently, the Director of the Department of Racing did not acknowledge the need to monitor pari-mutuel wagering activities, claiming that the advent of automated totalisator systems lessened the need for auditors. However, the Director recently directed the pari-mutuel supervisor to monitor wagering activities at commercial tracks. Since October 1996, the pari-mutuel supervisor has visited two separate racetracks to monitor and review a single day of wagering activities at each track, but this has been the extent of his monitoring activities at commercial tracks. The pari-mutuel supervisor also works as a greyhound steward from November through March

and in another state between June and September, which prevents him from devoting additional time to monitoring wagering activities at all commercial tracks.

Monitoring Needed to Protect Against System Error and Fraud

To protect the wagering public and the State's interests, the Department should actively monitor pari-mutuel wagering. Past instances of system error and fraudulent activity in Arizona as well as in other states reveal the need for regular oversight. Therefore, given the continued potential for error and the amount of money involved in pari-mutuel wagering in this State, the Department should employ monitoring strategies similar to those used in other states.

System error and fraudulent manipulation are possible—Because of the potential for system error and fraudulent manipulation, proper oversight of pari-mutuel activities is important. Although not a frequent occurrence, system errors have occurred at Arizona tracks. For example, in April and May 1995, Department staff discovered system errors at a Tucson track while testing the totalisator system's programming. When entering hypothetical bets into the system, the totalisator machine calculated the wrong payout for two types of wagers under certain scenarios. Although totalisator personnel and Department staff were told to verify the payouts if the same conditions occurred during an actual race performance, the Department did not send anyone out to test the system again for over a year and a half. A more recent error occurred at the same track during an actual race performance. In December 1996, the track's assistant mutuel manager discovered the totalisator system had incorrectly calculated a payout for one type of wager during a race, an error the racetrack could not explain. While the track did detect the error and take appropriate action, this example illustrates the potential for errors, which can affect race payouts, and the need to monitor these systems.

In addition to system error, totalisator machines are susceptible to fraud. Audit staff discussed this potential with an official at the University of Arizona Racetrack Industry Program, which is one of only two programs in the country that trains individuals to perform racing-related activities. According to this official, it is important to regularly monitor the security around pari-mutuel activities due to the potential for fraudulent activities. In addition, he indicated that an auditor must be familiar enough with a track environment to be able to identify unusual activities if they were to occur. Such unusual activities have occurred in other states. For example, in two states, totalisator company employees re-created unclaimed winning tickets and redeemed them for cash. These employees had access to unclaimed winning ticket information and the knowledge to replicate these tickets. By restricting access to this information or constantly monitoring trends in the numbers of unclaimed winning tickets redeemed for cash, a racetrack and/or auditor might prevent or detect this activity.

Department should develop plan to monitor pari-mutuel wagering activities—To protect against such occurrences at Arizona racetracks, the Department should perform a variety of pari-mutuel monitoring activities similar to those used in other states. Twelve states that generate at least \$100 million in pari-mutuel handle were contacted and it was found that ten of these states monitor pari-mutuel activities. Although the degree of auditing varies, all ten test transactions to ensure that the totalisator system accurately calculates information such as odds and payouts. This testing consists of checking the system's programming before each race meet and after every programming change and/or randomly recalculating payouts. Some states with a large racing industry, such as California, Florida, and New Jersey, verify every payout computed by the totalisator system at every track to ensure the accurate distribution of monies wagered. While not indicating the frequency of problems with inaccurate payouts, these states do indicate that a sufficient number of inaccurate payout calculations do occur to justify verifying every payout. Additionally, of the ten states that audit, all rely on the figures generated by the totalisator system, not the tracks, to calculate revenue due to the State.

In addition to ensuring the accuracy of totalisator calculations, other states use a variety of strategies to avoid unauthorized system access and to detect fraudulent manipulation should it occur. Methods used by other states to avoid unauthorized access include locking the totalisator system room and assigning user access codes, ensuring that unclaimed ticket information is secure, and ensuring that all pari-mutuel employees receive a background check. For detecting unusual activity or fraudulent schemes, some states review totalisator system logs that show the type of activity, the person performing the activity, and the time of the activity. In addition, some states conduct audits to identify patterns of unusual teller activities, such as an abundance of cashed tickets and numerous canceled tickets.

Following the examples of other states, the Department should develop a plan to properly monitor pari-mutuel wagering activities and ensure that the necessary resources are devoted to carry out this plan. As mentioned earlier, the Department has not consistently utilized its existing positions to monitor pari-mutuel activities at commercial tracks since staff previously assigned to perform monitoring also have other job responsibilities. Therefore, the Department needs to devote its existing pari-mutuel auditing position(s) to conducting monitoring activities at commercial tracks on a regular basis. Alternatively, the Department could study the possibility of hiring an independent auditor to perform this function if it believes it does not have the auditing expertise in-house or cannot devote a full-time position to conduct audits. Two other states contacted, California and Washington, rely on contracted auditors to perform a significant portion of their pari-mutuel monitoring activities.

Recommendations

1. The Department should develop a plan to properly monitor pari-mutuel activities at all Arizona racetracks. The plan should include:

Measures to minimize the risk of unauthorized totalisator system access;

Strategies to detect fraudulent data manipulation of the totalisator system should it occur;

Methods to test the accuracy of totalisator-calculated payouts; and

Methods to ensure the accuracy of amounts submitted by tracks for tax liability calculation.

2. The Department should ensure sufficient resources are dedicated to monitoring pari-mutuel activities at all commercial racetracks by assigning at least one staff person to perform this function on a regular basis or consider hiring an independent auditor to perform the necessary monitoring activities.

FINDING III

THE DEPARTMENT SHOULD IMPROVE OVERSIGHT OF GREYHOUND TRACKS

To better ensure the integrity of greyhound racing, the Department needs to increase its oversight of greyhound tracks. The Department's limited supervision of greyhound tracks can threaten the safety of both animals and licensees, as well as the confidence of the wagering public. The Department could strengthen oversight of greyhound racing by improving its use of existing staff at greyhound tracks and adding part-time staff to perform several critical regulatory functions.

The Department's Regulation at Greyhound Tracks Does Not Fully Protect Participants

The Department's oversight at greyhound tracks does not adequately protect the public, the animals, or the licensees. Currently, track personnel perform several important racing activities without any supervision by state officials. An insufficient number of staff and their limited job responsibilities contribute to the Department's lack of oversight.

The Department inadequately supervises several key regulatory functions—Although the regulation of greyhound racing is necessary to protect animal safety and ensure the confidence of the wagering public, the Department inadequately monitors several racing activities. Key racing activities that lack Department oversight occur in the paddock area, where greyhounds are held prior to and during race performances, and track offices. Additionally, the Department does not ensure consistent and safe racing by inspecting the condition of the racing surface. Currently, the Department either allows track personnel to perform the following tasks without Department supervision or simply neglects the activity altogether:

Race entry selection The selection of race entries occurs in the racing secretary's office and involves the selection of dogs for upcoming races and the determination of their starting positions in these races. Despite an administrative rule requiring the Department's attendance during entry selection, the Department does not supervise track personnel who perform this function. Oversight of this activity is important to ensure that all greyhounds, trainers, and owners receive equal opportunities to compete.

Weigh-in/Weigh-out This activity, which occurs upon each greyhound's arrival in the paddock (weigh-in) and prior to each greyhound's race (weigh-out), is performed to provide assurance to the public and racing officials that greyhounds run within one-and-one-half pounds of their established race weights.¹ This process is important because any significant weight gain or loss can affect an animal's performance. However, the Department does not supervise this activity to ensure greyhounds are accurately weighed.

Identification This paddock activity occurs prior to racing and helps assure that the proper dogs are running, protecting the interests of the wagering public and the animals themselves. Recent incidents at two greyhound tracks demonstrate the need for Department supervision, since the track official responsible for identifying each greyhound allowed misidentified dogs to run races. For instance, in September 1996, one track's official allowed two greyhounds to race wearing the wrong number blankets. One of the greyhounds involved actually won the race, resulting in an incorrect payout of money to the public. In another instance, a track official inaccurately identified two dogs, allowing them to run under each other's name from November 1996 until January 1997. While wagering remained unaffected, since neither greyhound finished first, second, or third in any of the races they competed in, the potential to adversely affect the betting public still existed.

Track maintenance Despite an administrative rule requiring that greyhound stewards promote safe conditions at tracks, the Department does not require stewards to examine track surfaces prior to racing. Moreover, despite arriving at the track two hours prior to race time, observations of steward activities, coupled with interviews of Department management, indicate that the Department stewards spend no time examining the track to ensure safe racing conditions.

Although the Department recently established a Track Condition Advisory Committee at one greyhound track for greyhound owners, trainers, and track management to discuss track conditions, concerns persist regarding track maintenance. Injury reports the Department compiled during calendar year 1996 reported 214 injuries at one greyhound facility and 193 injuries at another, many of which a greyhound owner and veterinarian attribute to substandard track conditions.

Insufficient staff hinders supervision—The Department's limited presence at greyhound tracks results primarily from the insufficient number of staff assigned and the limited job responsibilities of those staff. Currently, the Department only assigns two stewards

¹ Greyhounds are weighed twice because some animals may lose weight from the time they enter the paddock to the time they must race.

and one veterinarian to each greyhound track in the State. Although greyhound stewards arrive two hours prior to race time, they devote much of their time to performing administrative duties, such as licensing and conducting occasional hearings for violation of racing regulations. Consequently, the Department's greyhound stewards do not provide oversight of any pre-race activities in the paddock. Likewise, because both greyhound stewards must observe the actual races, they cannot monitor racing activities in the paddock during race meets. The veterinarian, meanwhile, has specific responsibilities relating to the collection of greyhound samples to test for prohibited drugs. Because state veterinarians are responsible for the collection, custody, and shipment of animal testing samples for analysis prior to and during live racing, their duties preclude them from monitoring the paddock area.

The Department Can Do More to Better Ensure the Integrity of Greyhound Racing

The Department can strengthen its regulation of greyhound tracks. Unlike other greyhound racing states, and its own level of horse racing regulation, the Department currently devotes too few staff to oversee greyhound racing. Consequently, the Department should better use existing staff and add a part-time staff person to greyhound tracks.

Other states and Department regulation of horse racing require greater supervision— Compared to other states, and its own level of horse racing regulation, the Department lacks personnel to adequately monitor greyhound racing activities. Nine states similar to Arizona were surveyed, each of which regulates multiple greyhound tracks. Of these nine states, seven employ more state officials at their respective tracks than Arizona does. The number of assigned staff ranges anywhere from four to ten state officials per greyhound track and includes more licensing technicians, investigators, and paddock personnel. Further, eight of the nine states contacted require the presence of a state official in the paddock area during greyhound weigh-in. Additionally, Kansas racing regulations require racing officials to walk the race surface prior to each day's racing to ensure the surface is safe.

Department staffing at greyhound racetracks also appears inadequate when compared to its staffing at horse racetracks. Currently, the Department allocates nine staff to each commercial horse track as compared to the three staff it assigns to each greyhound facility. Similar to greyhound tracks, the Department assigns two stewards and one veterinarian to each horse track, but also assigns a licensing technician, two investigators, one identifier, one administrative assistant, and one veterinarian assistant. While the greater number of licensees involved in horse racing might partially warrant this staffing discrepancy, the Department still must ensure the same level of animal safety and public confidence for each type of race. As such, regulations governing horse and greyhound racing often mirror each other. For example,

regulations require both greyhound and horse stewards to observe the selection and determination of dogs' and horses' starting positions for upcoming races. Additionally, stewards must be aware of any weight rule violations or any attempt to alter specified weights for both greyhounds and horses. The Department's absence in the paddock area for greyhounds makes it more difficult to monitor these activities.

Department may need additional staff to adequately oversee greyhound racing — In order to adequately oversee greyhound racing, the Department can better use its existing staff at greyhound tracks, but may also need to add a part-time staff person at each greyhound track. As indicated in Finding V (see pages 35 through 37), greyhound stewards might only work 30 hours per week, yet receive compensation for a 40-hour week. As such, the Department has some flexibility to increase the number of hours worked by stewards and thus provide additional staff time to monitor or perform racing activities that are conducted before actual racing begins. For example, stewards could supervise the race entries process and the weigh-in of greyhounds, and examine the racing surface prior to racing, while still performing licensing and other administrative duties. However, since both Phoenix and Tucson Greyhound Parks conduct racing seven days a week, the Department might need an additional part-time state racing official at each greyhound track to provide coverage for staff days off. Additionally, since both stewards must conduct hearings and observe actual racing, a part-time state official could monitor racing activities occurring simultaneously with hearings or actual racing. Specifically, this additional part-time position could:

Perform licensing and other administrative duties prior to racing, allowing a steward to consistently observe the selection and starting position of dogs for upcoming racing performances and the weigh-in process;

Observe the weigh-in process when both stewards are required to conduct hearings;
and

Monitor the weigh-out and identification process in the paddock area when racing commences, since both stewards must observe actual races during this time.

Adding a part-time position at Phoenix Greyhound Park and Tucson Greyhound Park will cost the Department between \$19,000 and \$22,500 per position. Since Apache Greyhound Park only operates for four months during the year, the addition of a part-time position will cost between \$6,500 and \$7,800.

Recommendations

1. The Department should improve its scheduling of greyhound stewards to adequately monitor all greyhound racing activities, including the race entries process, the verification of greyhound weights, and the examination of track surfaces.
2. The Department should consider requesting the necessary funding to add a part-time position at each of Arizona's three greyhound tracks to adequately monitor all greyhound racing activities.

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FINDING IV

THE DEPARTMENT SHOULD COLLECT PARI-MUTUEL TAXES FROM COMMERCIAL TRACKS THAT CONDUCT COUNTY RACE MEETS

The Department should ensure that commercial tracks pay pari-mutuel taxes on any county fair race meets they conduct. Currently, commercial tracks avoid paying pari-mutuel taxes on the pari-mutuel handle generated from these county race meets. In addition, these tracks also enhance their hardship tax credit status, a credit against the payment of pari-mutuel taxes, and reduce the amount of pari-mutuel tax revenues available for distribution to the eight funds supported by the tax. The Department should enforce the statute and ensure that commercial tracks pay the appropriate taxes.

Background

A.R.S. §5-111(E) provides that any county fair racing association may apply to the Commission for one racing meeting each year, and the Commission shall set the number of days and dates of such meetings. While some counties conduct their own race meets, the Commission also allows counties to forgo conducting their own meets by selling their race dates to commercial tracks. Currently, 6 out of the 15 counties sell race dates. Specifically, in fiscal year 1996-97, Cochise, La Paz, Maricopa, Navajo, and Pinal Counties sold their race meet dates to Turf Paradise, while Yuma County sold its dates to Prescott Downs. In return for selling these dates to commercial tracks, counties contract for a percentage of the pari-mutuel handle generated by the commercial tracks on the racing dates sold. In recent years, this percentage has yielded between \$14,000 and \$39,000 for counties, allowing these counties to generate revenue without incurring the expense of conducting a race meet.

Commercial Tracks Do Not Pay Taxes on County Fair Race Dates

To date, commercial tracks have not paid pari-mutuel taxes on the pari-mutuel handle generated during county fair race dates. According to statute, racing meets conducted by county fair racing associations are exempt from the payment of pari-mutuel tax. As

such, counties that conduct their own race meets do not pay taxes on the pari-mutuel handle that is generated from these meets. Commercial tracks have similarly applied this statutory exemption when calculating their tax liability to the State. Specifically, when commercial tracks have purchased county race dates, they have not paid pari-mutuel taxes on the pari-mutuel handle generated from those race dates. Since these county race dates do not extend a commercial track's race meet, but instead replace the track's originally scheduled commercial days, tracks reduce the amount of pari-mutuel taxes paid. For example, Turf Paradise generated \$7.35 million in taxable, live pari-mutuel handle on county race days conducted in 1997, but did not pay pari-mutuel taxes of \$147,000 that it normally would have by operating commercial race days.

While statute exempts county fair racing associations from the payment of pari-mutuel taxes on pari-mutuel handle generated from county race meets, this exemption does not apply to other entities conducting county race meets. According to A.R.S. §5-110(F), a county fair racing meeting conducted by an individual, corporation, or association other than the properly authorized county fair racing association shall be considered the same as a commercial meeting. Thus, commercial tracks should not exempt the pari-mutuel handle they generate on county race dates from pari-mutuel taxes, since they are actually conducting the county race meet and under this statute, the meet would be considered a commercial meet, subject to pari-mutuel taxes.

Excluding Pari-Mutuel Handle Affects Tax Credit Status and Revenue Distribution

In addition to avoiding the payment of taxes, other implications result from commercial tracks not paying taxes on the racing handle generated from county fair race dates. First, by excluding this racing handle from the payment of taxes, commercial tracks can enhance their hardship tax credit status, which further reduces the amount of pari-mutuel taxes paid. Second, revenues available for distribution to the funds supported by the pari-mutuel tax and the State's General Fund are reduced.

Commercial tracks receive increased hardship tax credits—In addition to avoiding the payment of pari-mutuel taxes on county race days, commercial racetracks also enhance their hardship tax credit status. Established as a result of tax relief legislation passed in 1994, the hardship tax credit provides a tax credit against the pari-mutuel tax for tracks that have suffered declines in business as measured by pari-mutuel handle. To determine eligibility for this credit, the Department compares a track's previous year pari-mutuel handle to a base year pari-mutuel handle figure. If the previous year is lower than the base year, the track becomes eligible for a hardship tax credit, which is then calculated based on a statutory formula. Tracks can then use this credit to reduce their current year tax liability. By purchasing county dates, tracks have excluded the total pari-mutuel handle generated on these dates from the hardship calculation. Thus, a lower annual pari-mutuel handle figure as compared to the base year will either

increase the likelihood of a track's eligibility for the tax credit or increase the amount of the tax credit. For example:

Turf Paradise generated \$14.3 million in total pari-mutuel handle on county race days conducted in fiscal year 1996-97, which it will be able to exclude from the hardship tax calculation. By excluding this amount, Turf Paradise's total hardship tax credit is \$411,000. However, if Turf Paradise included the pari-mutuel handle from county race days in its hardship tax credit calculation, its tax credit would only be \$239,000. Thus, excluding the pari-mutuel handle generated on county race days provides Turf Paradise with \$172,000 in additional hardship tax credits.

State and various fund beneficiaries receive less revenue—Another impact of commercial tracks avoiding payment of pari-mutuel taxes is a reduction in the amount of revenues available for distribution to the eight funds supported by the pari-mutuel tax and the General Fund. Each of the eight funds receives a specified percentage of the pari-mutuel tax revenue, with any remaining amounts distributed to the General Fund. For example, the County Fairs Racing Betterment Fund, from which the Department disburses purse and betterment monies to counties that conduct race meets, receives 21 percent of pari-mutuel tax revenues generated by commercial tracks. However, by replacing commercial dates with county fair race dates, Turf Paradise has avoided a tax liability of \$147,000 and enhanced their hardship tax credit status by \$172,000. As a result, the pool of monies available for distribution is potentially reduced by \$319,000, ultimately negating approximately \$67,000 that might have otherwise been deposited into the betterment fund. The other seven funds would be similarly affected, depending on the percentage of pari-mutuel tax revenues to which they are entitled.

Department Should Assess and Collect Pari-Mutuel Taxes

The Department should determine commercial tracks' pari-mutuel tax liability on racing handle generated from county race meets and collect any taxes owed. While Department officials indicated that the Department has been unclear on whether county race meets conducted by commercial tracks qualified for tax exemption status, the statute appears clear that the racing handle generated from these meets should be taxed. As such, the Department should assess and collect any pari-mutuel taxes owed from the operation of county meets by commercial tracks in fiscal year 1997-98, as well as in future years.

In addition, the Department should solicit advice from the Attorney General regarding the collection of any pari-mutuel taxes owed from the operation of county meets by commercial tracks in years prior to fiscal year 1997-98.

Recommendations

1. According to A.R.S. §5-110(F), the Department should assess and collect any pari-mutuel taxes commercial tracks owe from the operation of county fair race meets in fiscal year 1997-98 and in future years.
2. The Department should seek advice from the Attorney General regarding the collection of pari-mutuel taxes owed from the operation of county fair race meets by commercial tracks prior to fiscal year 1997-98 .

FINDING V

THE DEPARTMENT SHOULD REMEDY IMPROPER PAYROLL PRACTICES

During the audit, several improper applications of state payroll regulations were discovered that require the Department's immediate attention. These areas include using a payroll time recording system that may inflate actual hours worked for some employees and entering into an inappropriate payroll agreement with one employee.

Some Employees Receive Inflated Pay

Currently, Department management allows its employees at greyhound tracks to record their time as performances rather than actual hours worked, a method that inflates the hours worked by these employees. A performance refers to one session (either a daytime matinee or evening session) of racing conducted by a racetrack that requires supervision by state employees. According to the time sheets submitted by these employees, 5 performances per week equals a 40-hour work week. However, a performance does not always require employees to work for 8 hours. Instead, based on observations of these employees at greyhound tracks and interviews with these employees and department management, a performance usually requires only 6 to 7 hours of work. Thus, during a given work week, these employees may work only 30 hours a week, but receive pay for 40 hours.

According to Department officials, this time recording practice for employees at greyhound tracks is a longstanding tradition within the Department that facilitates scheduling. However, there does not appear to be a need to record time in this manner since the Department's employees at horse tracks record actual hours worked rather than performances.

The Department Allowed Improper Payroll Agreement

Until recently, the Department has permitted an unusual payroll arrangement for one of its employees to possibly allow this employee to receive state retirement benefits. Beginning in 1990, the Department entered into an agreement with one employee allowing him to accumulate time worked without receiving pay and then compensating him during certain times of the year for those hours previously earned. Specifically,

beginning each fiscal year, this employee would report actual hours worked, but the Department did not pay him for these hours. Instead, the Department manually tracked the accumulated hours until the end of December, when it then began generating paychecks for this employee. At that time, the employee would receive pay for 79 hours of work, no matter how many hours he reported working. For example, in 2 separate pay periods, this employee reported working no hours and 7 hours, respectively, yet received pay for 79 hours of work. The Department would continue to generate payroll checks reflecting 79 hours of work each pay period until the accumulated balance was exhausted. The employee and Department would then repeat this practice every fiscal year.

This agreement presented several problems. First, the employee did not receive compensation based on the number of hours actually worked in a given pay period. Statute requires that all state employees receive compensation within five days of the pay period worked. Second, the Department created time reports to reflect the 79 hours of work for which this employee was paid, even though this employee did not report working 79 hours during a pay period. The Department would either alter a time report submitted by this employee or create a new time report reflecting the number of hours for which he was paid. Third, Arizona State Retirement System guidelines allow an employee to work the entire year and continue receiving retirement benefits as long as the employee does not exceed 20 hours of work per week for more than 19 weeks in the fiscal year. For those 19 weeks, the employee can even work full-time. However, if this limit is exceeded, the employee may not receive retirement benefits, and both the employee and state agency must contribute to the State's retirement fund. A review of this employee's time cards indicates that his retirement benefits should have been halted and he should have been a contributing member to the State's retirement fund in fiscal years 1993-94 and 1995-96.¹ For these two fiscal years, the employee reported working more than 20 hours for 23 and 24 weeks, respectively.

While the Department halted this practice in November 1996 and now pays this employee for the time actually worked in each pay period, it should comply with state retirement guidelines and withhold retirement contributions. Additionally, the Department should determine the extent to which the employee should have been contributing to state retirement and require him to pay that amount to the state retirement system.

¹ The Department could not produce this employee's fiscal year 1994-95 time records for auditors to review.

Recommendations

1. The Department should establish a uniform method for recording hours worked to ensure that all employees are paid only for the time they worked.
2. The Department should work in conjunction with the State Retirement Office to determine the retirement status of the employee with the unique payroll arrangement and take any corrective action required.

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OTHER PERTINENT INFORMATION

During the audit, other pertinent information was collected regarding the pari-mutuel tax structure and the impact recent tax relief legislation has had on pari-mutuel tax revenues.

Commercial Tracks Receive Tax Relief

In 1994, faced with the prospect of increased competition from Indian gaming casinos and a possible reduction in racing profits, the commercial racing industry lobbied for and received reductions in pari-mutuel taxes. Effective July 1, 1995, the Legislature provided an assortment of tax breaks to the industry, including:

Tax reductions for greyhound tracks incrementally reduces the pari-mutuel tax levied on pari-mutuel handle greyhound racetracks generate from 7.5 percent (the effective tax rate at the time the legislation was passed) to 5.5 percent beginning in fiscal year 1997-98. Depending on the location of the track, the incremental rate reduction differs slightly.

Exempting simulcast pari-mutuel handle from taxation exempts all pari-mutuel handle generated from wagering on telecasts of out-of-state races from the pari-mutuel tax. This provision applies to all commercial racetracks in Arizona, but does not include telecasts of live races these tracks conduct.

Creation of a hardship tax credit provides a tax credit against pari-mutuel taxes for tracks that have suffered declines in business as measured by pari-mutuel handle. To determine eligibility for this credit, the Department compares a track's previous year pari-mutuel handle to its base year pari-mutuel handle figure. The base year figure is the highest annual pari-mutuel handle figure reported to the Department for one of the five fiscal years between fiscal years 1989-90 to 1993-94. If the previous year's pari-mutuel handle is lower than the base year pari-mutuel handle, the track becomes eligible for the hardship tax credit, which is then determined based on a statutory formula.

Tax Relief Impacts State Revenues

Tax relief has significantly reduced the revenues generated for the State by the pari-mutuel tax. Contributions to the State's General Fund have decreased from over \$5 million annually to \$165,878 in fiscal year 1995-96, requiring the State to now pay for the regulation of the industry. Additionally, pari-mutuel tax revenues are insufficient to meet the minimum funding requirements of eight statutorily established funds, prompting the beneficiaries of these funds to pursue additional monies from unclaimed property.

State revenues have declined—Tax relief has significantly reduced state revenues from the pari-mutuel tax. For the four fiscal years prior to the tax relief legislation (i.e. fiscal years 1991-92 through 1994-95), the pari-mutuel tax generated over \$8 million annually. However, in fiscal year 1995-96, the first year of tax relief, state revenues from the pari-mutuel tax totaled approximately \$2.8 million, representing a 67 percent decrease from fiscal year 1994-95 pari-mutuel tax revenues as illustrated in Figure 1 (see page 3). Pari-mutuel tax revenues for fiscal year 1996-97 decreased even more, totaling only \$2.63 million. Additionally, based on Department estimates, the amount of revenues generated by the pari-mutuel tax will only increase slightly. Specifically, the Department projects that the pari-mutuel tax will generate an average \$3.2 million annually for fiscal years 1997-98 and 1998-99.

Reduction in revenues for General Fund requires State to pay for regulation—As a result of tax relief, the pari-mutuel tax now generates insufficient revenues to cover the cost of regulating the commercial racing industry. Prior to tax relief, the pari-mutuel tax provided monies to support eight statutorily established funds as well as contribute revenues to the State's General Fund. For the four fiscal years prior to fiscal year 1995-96, the pari-mutuel tax, plus nominal revenues from license fees, breeders' award fees, pari-mutuel taxes paid for liabilities incurred in the previous fiscal year, and fines, contributed over \$5 million annually to the State's General Fund, after distributions were made to the eight statutorily established funds.¹ This contribution more than covered the Department's budget for regulating the industry, which averaged \$2.26 million annually during the same time period. However, because the majority of revenues generated by the pari-mutuel tax were required to support the eight statutorily established funds, the General Fund contribution in fiscal year 1995-96 dropped to \$165,878 (see Figure 1, page 3). Moreover, the Department projects that the General Fund will not receive any pari-mutuel tax revenues for the three fiscal years 1996-97 through 1998-99. Therefore, the State must fully subsidize the cost for regulating the commercial racing industry.

¹ Revenues from license fees, breeders' award fees, pari-mutuel taxes paid for tax liabilities incurred in the previous fiscal year, and fines have ranged from \$178,000 to \$332,000 annually for the past 5 years.

Alternative funding sources sought to support statutorily established funds—While no steps have been taken to address declines in contributions to the General Fund, the Legislature has passed additional legislation to address revenue shortfalls for the eight statutorily established funds.¹ Initially, statute provided that pari-mutuel tax revenues support eight specific funds requiring a total minimum funding level of \$3.6 million annually. However, as illustrated in Figure 1 (see page 3), the \$3.1 million in tax revenues generated from the pari-mutuel tax, fees, and fines in fiscal year 1995-96 fell short of these funding requirements. As a result, with the exception of one fund, which receives 1 percent of pari-mutuel tax revenue, each fund did not receive sufficient revenues. For example, two funds should have received a minimum of \$800,000; however, each received \$654,686 in fiscal year 1995-96. Additionally, another fund should have received at least \$1.2 million, but instead received \$982,473.

Various interests, realizing that these funds would experience shortfalls, successfully obtained an additional source of revenue. Specifically, in 1996, the Legislature passed House Bill 2151, which as of July 1, 1997, authorizes 20 percent of the monies received from unclaimed property to be allocated to the eight funds that receive pari-mutuel tax revenues. The legislation specifies that these funds can receive revenues from the pari-mutuel tax and unclaimed property, but caps the amount each fund can receive at its statutory minimum amount or the aggregate total of \$3.6 million. Pari-mutuel tax and unclaimed property revenues received in excess of this amount will be deposited in the State's General Fund.

Other Side Effects Realized by Commercial Tracks Due to Tax Relief Legislation

Additional provisions of the tax relief legislation have yielded some interesting effects, including the possible incentive for tracks to increase use of simulcast wagering and transfer of hardship tax credits. Moreover, after applying the provisions of the revised tax structure, three tracks did not pay pari-mutuel taxes in fiscal year 1995-96, with Phoenix Greyhound Park accounting for almost 98 percent of the pari-mutuel taxes paid to the State.

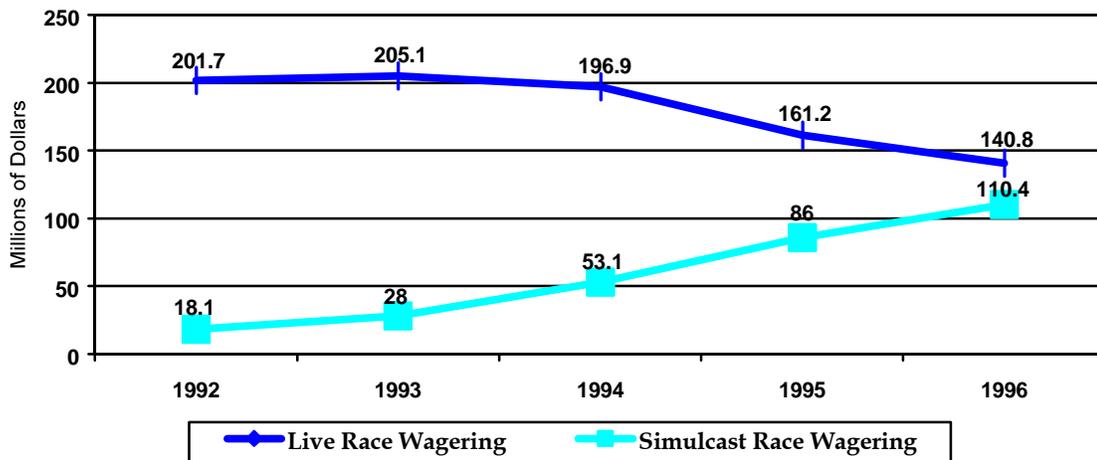
Greater percentage of pari-mutuel handle generated from simulcast wagering—The non-taxable status of simulcast racing may provide incentives to tracks to generate a greater

¹ These eight funds are the Arizona Breeders' Award, Arizona County Fairs Racing Betterment, Arizona Stallion Award, Arizona Coliseum and Exposition Center, County Fairs Livestock and Agriculture Promotion, Administration of the Arizona County Fairs Racing Betterment Fund, the Arizona Breeders' Award Fund, the Arizona Stallion Award Fund, and the Greyhound Adoption Fund, County Fair Racing, and the Agricultural Consulting and Training Fund.

percentage of their pari-mutuel handle from these races. As illustrated in Figure 3, commercial tracks simulcasted only 314 races in fiscal year 1991-92 and generated \$18.1 million in pari-mutuel handle for those races. During that same year, commercial tracks offered 17,287 live races, which yielded a pari-mutuel handle of \$201.7 million, or approximately 92 percent of total pari-mutuel handle. At that time, the State taxed all pari-mutuel handle. However, since the tax relief legislation was passed, the number of races held and the proportion of revenues generated by each type of racing has

Figure 3

**Arizona Department of Racing
Pari-Mutuel Handle Generated by
Live Versus Simulcast Race Wagering
Years Ended June 30, 1992 through 1996
(Unaudited)**



Source: Department of Racing s Annual Report for fiscal year 1995-96.

reversed. During fiscal year 1995-96, the number of live races offered by commercial tracks declined to 12,999 and generated \$140.8 million in pari-mutuel handle. By comparison, commercial tracks offered 79,799 simulcast races and generated \$110.4 million in nontaxable pari-mutuel handle. Thus, whereas simulcast wagering once represented less than 10 percent of total pari-mutuel handle, it now represents 44 percent of all pari-mutuel wagering in the State.

Hardship tax credit transferred between tracks—The availability of the hardship tax credit may benefit tracks that have not experienced significant hardship. As mentioned earlier, each commercial track can qualify for a hardship tax credit based on a statutory formula. In most cases, the tax credit has been applied to individual tracks. However, two racetracks (Phoenix Greyhound Park and Apache Greyhound Park) are owned by the same company and received approval from the Commission to transfer unused hardship credits from one track to another. Current statutory language permits this hardship tax credit transfer between tracks. Specifically, Apache Greyhound Park has not incurred enough of a tax liability to apply its total hardship tax credit. Therefore, the Commission allowed Apache Greyhound Park to transfer its racing operations, and thus its unused hardship tax credit, to Phoenix Greyhound Park. For fiscal year 1995-96, the transferred hardship credit totaled \$373,865.

Most tracks did not pay taxes—Based on the tax relief provisions currently available to commercial tracks, three tracks did not pay pari-mutuel taxes and two incurred only minimal tax liabilities in fiscal year 1995-96.¹ Even after applying the transferred hardship tax credit, Phoenix Greyhound Park was the only track to pay a significant amount of pari-mutuel taxes in fiscal year 1995-96, paying almost 98 percent of the \$2.8 million in pari-mutuel taxes paid to the State. For fiscal year 1996-97, Phoenix Greyhound Park paid 99 percent of the \$2.63 million in pari-mutuel tax revenues generated in that year.

¹ Prescott Downs and Tucson Greyhound Park each paid small tax amounts.

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SUNSET FACTORS

Arizona Department of Racing

In accordance with A.R.S. §41-2954, the Legislature should consider the following 12 factors in determining whether the Arizona Department of Racing should be continued or terminated.

1. Objective and purpose in establishing the Department.

The Legislature created the Arizona Department of Racing (Department) in 1982 to regulate and supervise pari-mutuel racing and wagering conducted in Arizona. Laws 1982, Ch. 310, §§1 and 48 state:

The Arizona legislature intends by this act to strengthen the regulation of the racing industry in Arizona for the protection of the public peace, safety, and welfare through the strengthening of the Arizona racing commission and creation of an Arizona department of racing administered by a director with significant business and administrative experience.

As such the Department is responsible for regulating all commercial and county fair horse racing meetings, greyhound racing meetings, and pari-mutuel wagering. Additionally, the Department collects pari-mutuel taxes and other fees for distribution to the General Fund and eight statutorily established funds.

2. The effectiveness with which the Department has met its objectives and purposes and the efficiency with which the Department has operated.

The Department has generally met its objectives and purposes by:

Licensing all participants and officials involved in racing in the State, including horse and greyhound owners, trainers, jockeys, grooms, exercise riders, track management, concessionaires, and pari-mutuel workers;

Conducting investigations of all license applicants and racing violations to enforce compliance with racing statutes and rules;

Assigning personnel to supervise actual horse and greyhound races and other track activities, such as collecting urine samples from horses and greyhounds to ensure the absence of banned substances that may affect the outcome of races; and

Conducting inspections of greyhound kennels and farms to ensure the safety and well-being of Arizona's racing greyhound population.

However, we found that the Department can more effectively meet its objectives by:

Monitoring pari-mutuel wagering activities in the State to reduce the potential for fraud and abuse. Such supervision would also ensure that the public and the State receive accurate payouts (see Finding II, pages 19 through 24).

Increasing the level of oversight provided at greyhound tracks. Currently, the Department's minimal supervision of greyhound racing activities threatens both the safety of animals and licensees, as well as the confidence of the wagering public (see Finding III, pages 25 through 29).

Determining commercial tracks' tax liability on pari-mutuel handle generated from county fair race meets they conduct and collecting any taxes owed. Currently, commercial tracks do not pay pari-mutuel taxes and enhance their hardship tax credit status when conducting county fair race meets (see Finding IV, pages 31 through 34).

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 pari-mutuel racing and wagering and protecting the health and safety of racing animals, participants, and the public. However, the public interest could be better served if the Department monitored pari-mutuel wagering activities (see Finding II, pages 19 through 24), improved the level of regulatory oversight at greyhound tracks (see Finding III, pages 25 through 29), and collected pari-mutuel taxes owed from commercial tracks' operation of county fair race meets (see Finding IV, pages 31 through 34).

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

The Department does not have the authority to promulgate rules and regulations. Instead, this authority rests with the Commission.

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.

Concerns exist regarding the Department's compliance with open meeting law requirements at steward hearings. Since stewards maintain responsibility for ensuring compliance with racing laws and regulations, they often make rulings against licensees for various racing law violations. Although the hearings conducted on such violations are open to the public, final decisions and discussions leading to the decisions often occur behind closed doors. According to the Attorney General's Agency Handbook, §7.4.1 all meetings of a public body shall be public, and all persons desiring to attend shall be permitted to attend and listen to the deliberations and proceedings. Therefore, the Department should ensure that all aspects of steward hearings are open to the public.

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

The Department receives complaints in different forms. For instance:

Complaints filed with stewards Because stewards maintain responsibility for ensuring compliance with all racing regulations at tracks, they must mediate and resolve disputes regarding racing activities. Although stewards attempt to settle matters informally when possible, complaints involving rule violations are investigated and result in steward hearings. During fiscal year 1995-96, Department stewards, at both horse and greyhound tracks, issued 889 rulings for violations of racing laws and rules. Based on a limited review of these rulings, it appears the Department adequately investigates and resolves complaints submitted to stewards.

Complaints filed with the Department In addition to complaints filed with stewards, the Department receives complaints against Department officials. Administrative rules provide that complaints against an official or employee of the Department shall be filed with the Deputy Director in writing within

five days of the alleged act. While the rules stipulate a five-day limit, the Department generally investigates complaints submitted after this time limit. Since 1994, the Department has received eight complaints against Department personnel. Investigations of these complaints appear to be timely and thorough. However, the Department should formalize its process for receiving and investigating complaints to better ensure public access to this information. For instance, the Department should develop and maintain a complaint log that describes when the complaint was received, the nature of the complaint, the complainant's name, and the disposition of the complaint.

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

Racing statutes provide sufficient authority for the Attorney General to prosecute actions that violate statutes. A.R.S. §5-115 establishes circumstances under which individuals may be prosecuted for a class 4 felony. For example, A.R.S. §5-115(A)(4) provides that a person is guilty of a class 4 felony if they knowingly commit any corrupt or fraudulent practice in relation to racing that may affect the result of a race. Similarly, under A.R.S. §5-115(B)(1), it is a class 4 felony for an owner or trainer to enter an animal they know is drugged. Moreover, A.R.S. §5-115(D) indicates that anyone conducting a racing meeting or operating an additional wagering facility without first complying with statutes and rules regarding licensing is guilty of a class 2 misdemeanor.

Further, A.R.S. §5-108.05(A) authorizes the Department to revoke, suspend, and/or impose a civil penalty on licensees that violate racing rules or regulations.

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

The Department actively pursues legislative changes that will allow it to better fulfill its statutory mandate. For example, in 1993 the Department sought legislation regarding the humane treatment of greyhounds that gave the Department the responsibility and authority to regulate the breeding, training, housing, and transportation of racing greyhounds. During the 1997 legislative session, the Department successfully pursued several statutory changes, including:

Authorizing that 100 percent of the revenues from kennel/farm licensing be provided to greyhound adoption agencies;

Eliminating the requirement that stewards complete a qualifying examination in lieu of certification as a steward by a national organization approved by the Department; and

Imposing restrictions to prohibit immediate family members of Department employees from wagering on horse and greyhound races.

9. The extent to which changes are necessary in the Department's laws to adequately comply with the factors listed in the subsection.

Other than the legislative changes currently being pursued by the Department, we identified no additional changes that are necessary in the Department's laws to comply with the statutory requirement of protecting animal, licensee, or public health and safety.

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

Termination of the Department could adversely impact the safety and welfare of licensees, animals, and the wagering public. The regulation of racing and pari-mutuel wagering currently undertaken by the Department is vital to protecting these interests. If the Department were discontinued, dangers involving physical harm to human and animal participants, as well as fraudulent wagering activities, could result.

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

The Department's level of regulation appears appropriate, except for its regulation of greyhound racing. The Department should increase the level of oversight it provides at greyhound tracks (see Finding III, pages 25 through 29).

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

The Department currently contracts with Industrial Laboratories Inc., of Denver, Colorado, to conduct all testing of greyhound and horse samples. During fiscal year 1995-96, a total of 16,418 samples were submitted to this lab to enforce compliance with laws and regulations governing the use of medications and drugs in greyhounds and horses. The Department contracts with the National Institute of Drug Abuse/Substance Abuse Mental Health Services Administration laboratory to analyze samples of licensees suspected of drug and/or alcohol violations. During fiscal year 1995-96, the Department conducted 54 human drug tests, resulting in 16 positive tests for prohibited substances. Similarly, the Department administered 48 breath/alcohol tests, resulting in 17 positive tests for alcohol at prohibited levels.

In addition to these contracts that the Department maintains, it could consider hiring an independent auditor to monitor pari-mutuel wagering activities at all Arizona racetracks (see Finding II, pages 19 through 24).

SUNSET FACTORS

Arizona Racing Commission

In accordance with A.R.S. §41-2954, the Legislature should consider the following 12 factors in determining whether the Arizona Racing Commission (Commission) should be continued or terminated.

1. Objective and purpose in establishing the Commission.

Created by the Legislature in 1949, the Commission handled the day-to-day regulation of racing activities in the State until 1982, when the Legislature established the Department of Racing. The enabling statutes for the Arizona Racing Commission state that the purpose of the Commission is to:

. . . issue racing dates, . . . prepare and adopt such complete rules 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.

Additionally, statutes authorize the Commission to conduct hearings on applications for racing permits, issue racing permits, review appeals of licensing and regulatory decisions made by the Director of the Department of Racing, and review applications to construct capital improvements at racetracks.

2. The effectiveness with which the Commission has met its objectives and purposes and the efficiency with which the Commission has operated.

The Commission has generally met its objectives and purposes. However, we found the Commission has not effectively fulfilled its responsibility in providing adequate oversight for the Capital Improvement Program. This Program provides tax credits to commercial tracks that undertake approved capital improvement projects to improve their facilities, benefiting participants and the wagering public, and increasing state revenues as a result of these improvements. However, the Commission has inappropriately approved over \$500,000 in capital improvement tax credits for projects that did not meet statutory requirements.

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

The Commission generally operates within the public interest by promulgating rules and regulations to govern racing that protect and promote the safety and welfare of racing participants, as well as to ensure the integrity of racing for the people of Arizona. However, the Commission has not necessarily served the interest of Arizona taxpayers by providing tax credits to commercial tracks for capital improvement projects that did not qualify for the credits (see Finding I, pages 11 through 17).

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

Pursuant to A.R.S. §5-104(A)(2), the Commission may adopt rules . . . to protect and promote the safety and welfare of the animals in such racing meetings, to protect and promote public health, safety and proper conduct of racing and pari-mutuel wagering, and any other matter pertaining to the proper conduct of racing in this state. Commission rules, as specified in the *Arizona Administrative Code* section R19-2-101 through R19-2-523, are consistent with the purposes outlined in Arizona statute.

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 had promulgated rules and regulations as needed. For example, the Commission recently approved rules regarding the method for paying breeders' awards to greyhound and horse breeders. With the Department's assistance, the Commission informs the public as to its actions and solicits public input prior to adopting rules. Additionally, the Commission's rules underwent a five-year rule review in September 1995.

Overall, the Commission appears to comply with open meeting law requirements regarding public input at meetings. Further, the Commission actively meets with constituents, including animal owners and trainers, racing permit holders, and other interested parties, on matters pertinent to pari-mutuel racing in Arizona. Finally, our review indicates that Commission meeting notices are posted in a timely manner and in accordance with the statement filed with the Secretary of State.

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

The Commission's responsibility for investigating and resolving complaints lies primarily in the appeal of decisions made at the Department level. Specifically, A.R.S. §5-104(A)(3) allows for the Commission to review appeals of licensing and regulatory decisions made by the Director of the Department. The Commission only heard one such appeal during fiscal year 1995-96.

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

Statutes provide sufficient authority for the Attorney General to prosecute actions that violate statutes. A.R.S. §5-115 establishes circumstances under which individuals may be prosecuted for a class 2 misdemeanor, class 4 felony, or class 6 felony.

Additionally, A.R.S. §5-108.02 provides circumstances under which the Commission can revoke the permit of any permittee.

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

Although not currently pursuing any statutory changes, the Commission has pursued legislative changes in the past to better fulfill its mandate. For example, in 1993 the Commission sought legislation authorizing it to provide grants to non-profit groups whose programs promote greyhound adoption. This legislation passed as part of the 1993 Greyhound Humane Treatment mandate.

9. The extent to which changes are necessary in the Commission's laws to adequately comply with the factors listed in the subsection.

Based on our audit work, we recommend that the Legislature consider repealing A.R.S. §5-111.02 to terminate the Capital Improvement Program since its statutory intent to increase revenues to the State has not been met, nor will it likely be met in the future (see Finding I, pages 11 through 17).

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

While terminating the Commission would not significantly harm the public's health, safety, or welfare, the Commission serves a role by establishing policies to govern and regulate racing. For instance, the Commission determines who will conduct racing meetings and when they will be conducted. Additionally, the Commission provides a forum for parties to address concerns about decisions made by the Department.

If the Commission were terminated, the following statutory responsibilities would have to be transferred to the Department:

Promulgation of rules,

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 stringent levels of regulation would be appropriate.

The current level of regulation exercised by the Commission appears appropriate.

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

Because the Commission functions primarily as a policy-setting body and appeal board, there appears to be little opportunity to effectively use private contractors in the performance of its duties. The Commission does, however, use a court reporting service to transcribe the minutes of its public meetings and proceedings.

Agency Response

August 14, 1997

Douglas R. Norton
Auditor General
2910 North 44th Street
Phoenix, AZ 85018

Dear Mr. Norton:

The Arizona Department of Racing has reviewed the preliminary report draft of the performance audit conducted by the Office of the Auditor General concerning the Arizona Racing Commission and the Arizona Department of Racing. We appreciate the opportunity to respond to that report.

We believe that the Department of Racing operates effectively and efficiently as it undertakes its legislative mandate to regulate pari-mutuel horse and greyhound racing for the protection of the public peace, safety and welfare. We also recognize that it is critical to pursue progression and improvement. To that end, the Department would like to acknowledge the work undertaken and findings reported by the audit team. We welcomed the opportunity to review and discuss the agency's operations with your staff, and certainly have learned more about our activities as a result of this process.

In general, the Department already has corrected, or will in the near future correct, deficiencies pointed out in the report. Due to the likelihood of significant policy ramifications associated with two recommendations, the Department and/or Commission wants to obtain guidance from the Legislature as to the appropriateness of its response in these areas.

The response of the Department corresponds to the organization of the Report of the Office of the Auditor General (hereinafter Report).

In conclusion, let me again note our appreciation of the work compiled by you and your staff. We look forward to working with the audit team, the Legislature, the regulated industry and others as we continue in our efforts to more effectively and efficiently supervise Arizona's pari-mutuel industry.

Respectfully submitted,

Jim Higginbottom
Director

Introduction and Background

Department Responsibilities Associated with Boxing (Page 6)

In the summary of the Department's responsibilities, the Report refers to Auditor General Report 96-14, a performance audit of the State Boxing Commission. The Department is responsible for collecting revenues (gross receipts taxes, license fees and fine payments) associated with boxing matches. While Report 96-14 was critical of the Department, the Department has implemented several changes to improve the collection of boxing revenues owed the State. Working with the Boxing Commission, the Department developed new procedures to monitor promoter compliance with tax collection requirements. The Department has no enforcement authority in boxing matters; consequently, it must rely on the Boxing Commission to pursue sanctions against promoters for noncompliance. In the eight months since these procedures have been in effect, the Department has issued five letters of promoter noncompliance dealing with eight separate violations. In addition, the Department has collected all tax revenues owed to the State by promoters of 12 fights.

1986 Report and Follow-up (Page 7)

The Report refers to the Auditor General's 1986 performance audit of the Department and Commission, and suggests that the Department has not responded to some of the recommendations made at that time. One of the matters cited is the Department's drug surveillance program for horses and greyhounds. The Department respectfully disagrees with the impression that may be left by these comments.

The Department secured legislative changes in 1995 to provide clarification regarding the number of animals tested per race. Drug testing is the second largest component (behind personal services) of the Department's budget, and since the 1995-96 fiscal year has been a below-the-line item. The number of animals tested per race is limited by the Department's appropriation for testing. More animals per race can be tested, but not without a substantial increase in expenditures.

The Department has responded to the 1986 recommendations by enhancing the quality of its testing laboratory, and the number of tests per sample run by that laboratory. The Department contracts with a nationally accredited laboratory, which is an industry leader in efforts to improve testing. For each horse sample, this laboratory routinely runs four thin layer chromatography (TLC) screens that can identify signs of hundreds of drugs. Each horse sample also routinely is subject to ELISA testing for 15 specific compounds that are sometimes abused in racing. Any indication of a prohibited substance generates additional confirmation testing. Each greyhound sample is processed through two TLC extractions and five specific ELISA tests. Finally, the quality of equine and canine testing has improved substantially in recent years as laboratories have implemented advancements developed through research and other refinements.

FINDING I-THE CAPITAL IMPROVEMENT PROGRAM SHOULD BE TERMINATED

Capital Improvement Program s Intent not Being Met (Page 12)

The stated legislative intent of the capital improvement program (to increase state revenues) contrasts with the incentives the program itself allows. A.R.S. § 5-111.02 and § 5-111.03 allows permittees tax breaks during terms while approved projects are being paid off. Hence, the State loses revenues through this program. As the Report indicates, the capital improvement program was repealed in 1990 (with a 1992 expiration date), but reinstated in 1994 in a manner that provides benefit primarily to just one racetrack permittee. When the program was reinstated in 1994, we believe that the industry represented the capital improvement provision as being just one component of the larger tax relief package. Consequently, although the language in the law regarding intent may not have changed, the actions of the Legislature in reinstating the program could have signaled a different message.

Commission Inappropriately Approved Projects (Pages 13-16)

The Report suggests that the Commission may have inappropriately approved \$500,000 in ineligible project items since 1990. As a matter of course, the Department has routinely sought advice from the Attorney General s Office as it evaluated capital improvement applications. Although the Department cannot locate evidence of such review for all applications, we know that it did occur. Given our knowledge that applications were reviewed by the Department s and Commission s assigned legal counsel, we believe that the Commission was acting in a manner it believed consistent with the law and its intent in approving the projects it did. And if, in fact, there are problems with the programs approved, we believe that the Attorney General s office shares some of the blame.

The Department and Commission, aware that the Auditor General was scrutinizing this program, acted to ensure that a capital improvement application considered early in 1997 clearly met the statutory criteria. We note that the Report found no problems with this capital improvement application the Commission approved in February 1997.

Commission Should Recover Monies for Ineligible Project Items (Pages 16-17)

The Report suggests that more than \$500,000 in improperly approved projects be recovered from two permittees. As noted earlier, legal counsel reviewed applications prior to Commission consideration. Furthermore, the Commission approved each of the applications. The permittees withheld monies based on the Commission s approval of the projects.

In these cases, the Department and Commission will seek guidance from counsel in order to determine what actions can and should be taken in response to this recommendation. In the event the Attorney General s office agrees that the monies

should be repaid, we will utilize that office to assist in such collection.

Whatever the remedy suggested by counsel, the Department and Commission would like the Legislature to understand our anticipated course of action and approve of the manner by which we proceed.

Finally, the Department will implement procedures outlined in the Report to ensure additional oversight of capital improvement projects.

FINDING II-THE DEPARTMENT SHOULD DO MORE TO PROTECT THE WAGERING PUBLIC'S MONEY

The Department does not dispute this finding generally, and will implement changes consistent with the Report's recommendations. The Department established a position of Racing Pari-Mutuel Auditor, and has hired a full-time Racing Pari-Mutuel Auditor as of July 21, 1997. The Racing Pari-Mutuel Auditor will work to develop a plan to monitor pari-mutuel activities at Arizona tracks. As the plan is implemented, the Racing Pari-Mutuel Auditor will verify that suggested levels of monitoring and testing are approved by audit staff of the Office of the Auditor General.

Oversight of Pari-Mutuel Activities Inadequate at Commercial Tracks (Pages 19-22)

The Department would like to challenge the impression this section of the Report may leave with readers. As indicated, we do not dispute the value of having a full-time staff person assigned to oversee the distribution of monies wagered by the public. However, we do not believe that the public, or others who benefit from wagering in Arizona, have been victimized or received anything less than what they were owed.

Although the Report suggests that not enough is being done to provide security and limit unauthorized system access, we are not aware of any incident where system access has been compromised. Totalizator systems are constructed with a myriad of firewalls and other protections that severely restrict who may enter the system, and, once in the system, what may be done to it.

While the Report alludes to past instances of system error and fraudulent activity, we are unaware of any Arizona system error problems that have compromised the public's money. And certainly, we know of no local instances where the totalizator system has been used in conjunction with the commission of a fraud.

The Department believes that those extremely rare problems that occur do so largely because of human error. As we point out below in comments regarding oversight of greyhound racing, it is impossible to supervise every function, and the appointment of a Pari-Mutuel Auditor cannot prevent every human mistake.

The Department will certainly take note of the suggestions and recommendations in the Report, and in doing so work to ensure that every effort is made to keep Arizona's record spotless in this regard.

FINDING III-THE DEPARTMENT SHOULD IMPROVE OVERSIGHT OF GREYHOUND TRACKS

The Department does not dispute this finding generally, and will implement changes consistent with the Report's recommendations. The Department will add staff to monitor activities that the Report suggests merit more attention.

The Department's Regulation at Greyhound Tracks Does Not Fully Protect Participants (Pages 25-27)

The Department would like to address several issues cited in this section. The Report indicates that track personnel perform several important functions without any supervision by State officials. The Department cannot supervise every activity undertaken by track officials. Instead, track officials are accountable to the board of stewards for each of their actions, who directly and indirectly oversee all aspects of a racing meeting. All officials must be approved by the Department for the specific duty they are to perform. The qualifications of all would-be officials are carefully reviewed prior to their approval. In the event an official or other employee fails to properly perform his/her duties, or acts in a manner that is contrary to law or rules, that individual is accountable for his/her actions. For any such noncompliance, the board of stewards is authorized to pursue actions against any officials or track employees. In the case of incidents cited on page 26, disciplinary action was taken against officials who failed to do their job.

For the State to take on direct supervision, the State would incur a substantially higher cost to regulate racing. The increase in costs associated with such a plan would not generate a corresponding increase in a more effectively regulated industry, and regulation would certainly be less efficient. That notwithstanding, the Department will take a more active role in overseeing the activities noted in the Report; but the Department will also continue to rely on officials and track employees to do their jobs properly without extensive supervision, and hold them accountable for their actions.

The Department recognizes the importance of track safety, and we have been actively involved in efforts to ensure that permittees comply with requirements to maintain the track in safe condition. On occasion, the stewards have insisted that a permittee improve track conditions or racing would be canceled. The Department now requires its officials to walk the track and observe its condition prior to each performance. We have also reminded stewards of their obligation to demand corrective actions if a track's condition is found to be unacceptable.

The Report suggests that an owner and a veterinarian attribute some injuries to substandard track conditions. We know that injuries occur, especially as track conditions change. However, track conditions do change. Permittees have an interest in maintaining a track that is not only safe, but consistent as well. We believe that permittees do work to maintain safe track conditions. Injuries are an unfortunate, but inevitable, aspect of greyhound racing. Nevertheless, the Department will step up its

efforts to closely monitor track conditions to keep injuries at a minimum.

The Department Can Do More to Better Insure the Integrity of Greyhound Racing (Pages 27-28)

The Report compares Department staffing at horse tracks with that at greyhound tracks. We do not believe that this comparison is an accurate reflection of the Department's work and staffing needs. At horse tracks, the Department staff includes an identifier and veterinarian assistants. At greyhound tracks, the permittee hires one official to serve as identifier and two who serve as veterinarian assistants. The Department's administrative assistant at horse tracks administers a program related to controlled medications; no similar program exists in the greyhound community, so such an employee is not needed. The licensing technician and investigators at horse tracks are there because of the substantially higher number of licensees in the horse community. Of the 22,674 licenses issued in the past five years, 17,351 (or more than 76%) were affiliated with horse racing. Investigators are assigned to greyhound tracks periodically, and as the need arises. We also should note that the Department has two investigators who work exclusively with greyhound-related issues, licensing off-site greyhound facilities and conducting inspections of greyhounds whelped in the state.

FINDING IV-THE DEPARTMENT SHOULD COLLECT TAX FROM COMMERCIAL TRACKS THAT CONDUCT COUNTY RACE MEETS

The Department of Racing does not dispute this finding generally, but it is concerned with the manner in which it proceeds. This issue is complicated, and decisions and actions could impact not just county fair racing, but county fairs in general as well. Because certain actions have not been challenged and were allowed to continue over time, the practice of county fairs conducting fair racing meets at commercial tracks has gained legitimacy.

Commercial Tracks Do Not Pay Taxes on County Fair Race Dates (Pages 31-32)

County Fair racing in Arizona has been conducted since 1950. As far back as 1972, counties were conducting races at tracks in other counties. According to Department records, Maricopa County first conducted fair races at Turf Paradise in 1979. Beginning in the 1988-89 fiscal year, several fair racing meets annually were conducted at commercial tracks. In 1996-97, six county fair meetings were conducted at commercial tracks. These fairs applied for permits to the Commission, which approved county fair racing meetings.

The Department Should Assess and Collect Pari-Mutuel Taxes (Pages 33-34)

The Department acknowledges that statutory language appears to indicate that county fair meetings not conducted by fair associations should be considered commercial meetings. However, for at least eight years, the Department has not assessed tax to the commercial track for any approved county fair meeting. We are not opposed to collecting tax, as the statute appears to suggest is required, provided that the Legislature agrees with this action. Since any action by the Department in this regard will generate controversy, we want to verify that our actions are acceptable to and approved by the Legislature.

In short, any assessment of tax is likely to eliminate the so-called sale of dates. In practice, commercial tracks pay county fair associations a share of monies that the tracks otherwise would pay in taxes. If those tracks were to incur tax liability for those racing days, the source of monies typically paid to fairs would vanish. In all likelihood, several county fair associations would have nowhere to race their county fair meetings, resulting in the loss to the fairs of an important source of revenue.

On the other hand, assessing and collecting tax associated with these meetings would help reduce the incentive for fairs to consider selling their dates. Three county fairs that had conducted county fair racing meetings as recently as fiscal year 1995-96 chose to sell dates to commercial tracks in FY 1996-97. As noted above, imposing taxes could eliminate the feasibility of the sales and, to race, county fairs would have to conduct their own meetings. At least three counties do not have the facilities at which to race.

We are uncertain about the Department's authority to assess tax that might be associated with fair racing at commercial tracks conducted and approved as county fair racing, especially given the history behind such approval. As it proceeds in this matter, the Department will seek guidance from counsel in order to determine what actions should be taken, both with regard to past meetings and in the future.

As we noted above, due to the significant public policy implications of this decision, we would like the Legislature to consider and ratify the Department's actions in this regard.

FINDING V-THE DEPARTMENT SHOULD REMEDY IMPROPER PAYROLL PRACTICES

The Department does not dispute this finding generally, and has already implemented or, in the immediate future, will implement changes consistent with the Report's recommendations.

Though the Report has found fault with these practices, the Department believes it sought guidance from State officials in developing these procedures. The pay-per-performance system has been a common method to pay officials in the racing industry. We believe approval was obtained prior to the implementation of the system. In any case, these employees are now reporting actual hours worked as the Report recommends.

The arrangement for the other employee was discussed with the Department of Administration and State Retirement System before the employee undertook these duties. In this case, there appears to have been some miscommunication. The inquiry should have concerned seasonal, rather than part-time work. As the Report indicates, this arrangement ceased in November 1996. The Department will work with the State Retirement Office to determine if further actions are required of the Department or employee in question.

SUNSET FACTORS-ARIZONA DEPARTMENT OF RACING

Factor 6-The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction (Pages 47-48)

The Report recommends that the Department act to formalize its procedures for receiving and investigating complaints. The Department has developed a set of procedures that is now in place. The procedures address two different types of complaints: general complaints of any nature and more specific complaints against Department officials or employees. Consequently, the Department will better be able to monitor complaints. The procedures require the Department to provide complainants with a response indicating the outcome of any investigation or inquiry.

Factor 12-The extent to which the Department has used private contractors (Page 50)

The Report notes that the Department contracts for canine and equine sample testing, and human sample testing. The Department would like to point out that it also currently contracts for services to certify Arizona stallions, and to certify horses as Arizona-bred. Additionally, the Department pursued legislation in 1997 that expands the authority of services related to awards programs for which it can contract with outside vendors. In the past, the Department has contracted for services of some racing officials.

SUNSET FACTORS-ARIZONA RACING COMMISSION

Factor 10-The extent to termination of the Commission would significantly harm public health, safety or welfare (Page 54)

We believe that termination of the Commission, and transfer of the statutory responsibilities to the Department, could result in the reduced efficiency and effectiveness of the Department. The Commission's several roles are important. Because of the division between the two entities, the Department is able to operate largely without regard to or consideration of politics. The Department can focus on its day-to-day duties and operations because the Commission is vested with authority to deal with the larger and broader policy issues.