VIRGINIA RACING COMMISSION

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2010

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Virginia Racing Commission for the year ended June 30, 2010, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System;

- no matters involving internal control and its operations necessary to bring to management's attention; and

- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

Audit Observation:

We found a significant disparity between the amount contractors received as an administrative fee and the total incentive payments Virginia breeders received under these contracts. While the Virginia Thoroughbred Association and Virginia Harness Horse Association register horses as Virginia-bred in addition to distributing incentive payments, the administrative fees associated with these services reduce the Breeder Funds available to pay incentives by $240,000, or roughly sixteen percent of the total fund each year.

Since the majority of incentive payments go directly to Colonial Downs as a supplement to the winners' purse for Virginia-bred horses placing in stakes races, the Commission appears to be paying a considerable administrative fee for the funds distributed. With the substantial decline in wagering revenue and subsequent decline in funds available to the Commission to provide incentives for Virginia breeders, the Commission may wish to re-evaluate the scope and cost of its contracts with the Virginia Thoroughbred Association and Virginia Harness Horse Association.

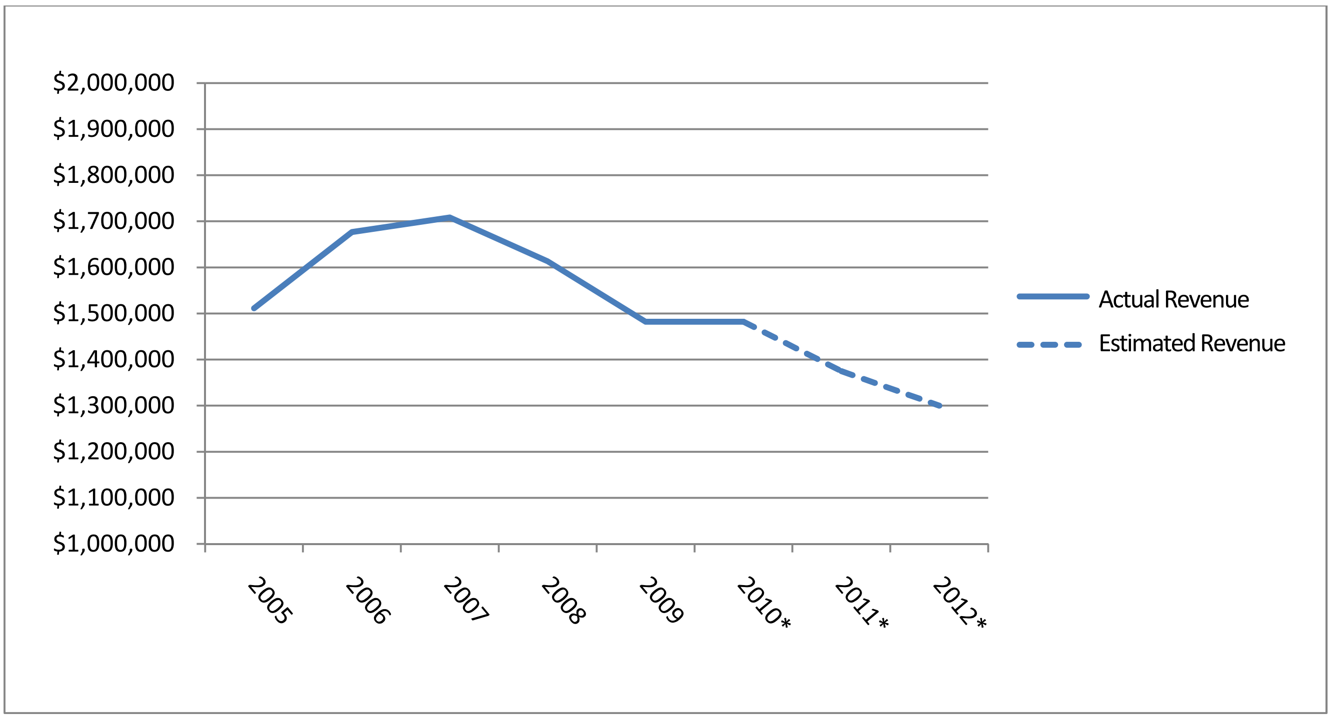
– T A B L E O F C O N T E N T S –

Audit Observation:

Re-evaluate Contracts with Thoroughbred and Harness Horse Associations

Breeders Fund revenues declined about 7% each of the past two years and are expected to remain unchanged this year only due to legislation allowing a one-percent fee on all advance-deposit wagering (online wagering) in Virginia not previously collected. Below is an analysis of the deposits to the Breeders fund since 2005, including estimated revenue for the last half of 2010 and all of 2011 and 2012 on a calendar year basis.

Graph A: Total Breeders Fund Revenue (Actual and Projected)



Source: Commonwealth Accounting and Reporting System; Virginia Racing Commission – Breeders Fund 2010, 2011, and 2012 Revenue Estimates.

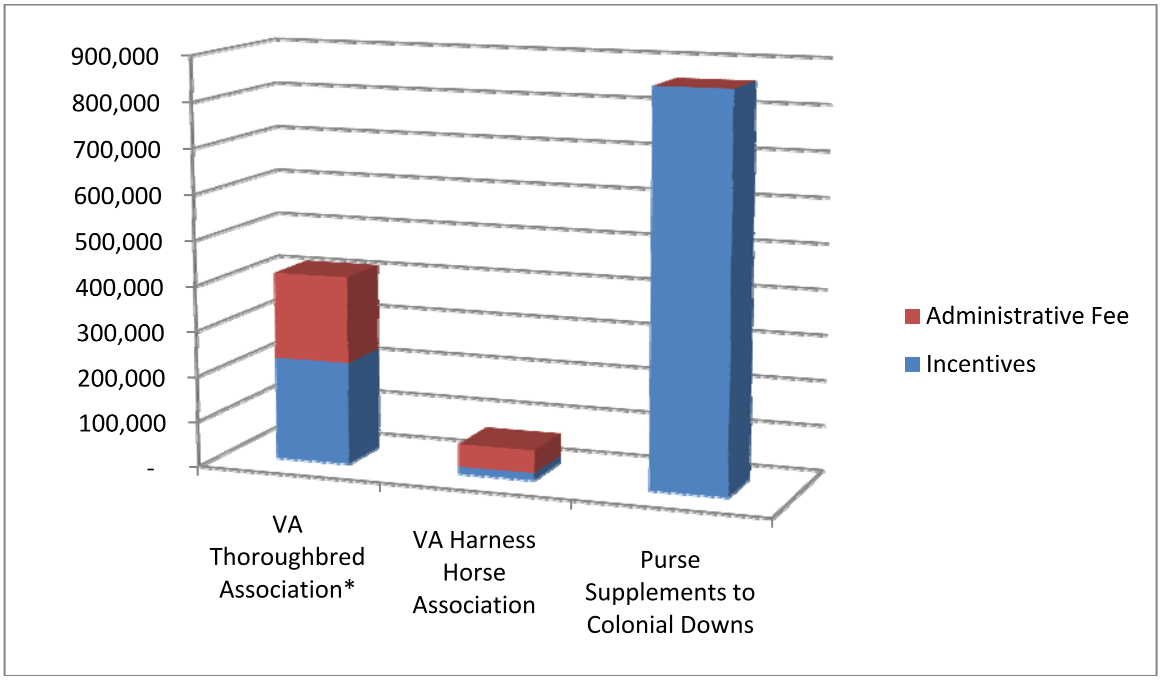
*Breeders fund revenue estimates are based on assumptions that race track and off-track betting center wagering will continue to decline 15% annually, while advance deposit wagering will continue to increase 10% annually.

An advisory committee appointed by the Commission decides how to allocate the Breeders Fund awards. That committee consists of a member of the Virginia Thoroughbred Association and one from the Virginia Harness Horse Association. These Associations allocate the funds in a way that promotes the breeding of Virginia-bred race horses. The fund receives one percent of all pari-mutuel betting in the state and the committee determines how to distribute the funds to Virginia bred race winners. The Breeders Fund administration is separate from the Racing Commissions' operations.

We found a significant disparity between the amount contractors received as an administrative fee and the total incentive payments Virginia breeders received under these contracts. For 2010, the Racing Commission paid an administrative fee of $50,000 to the Virginia Harness Horse Association (VHHA) to pay incentives of only $15,800 to Virginia harness-horse breeders, and the Virginia Thoroughbred Association received an administrative fee of $190,000 to pay incentives of $225,000 to Virginia thoroughbred breeders.

The Commission paid an additional $858,000 directly to Colonial Downs to supplement race purses for Virginia bred winners using data maintained by VTA and VHHA to confirm the registration of horses as "Virginia bred." Below is the distribution of Breeders Funds for 2010.

Chart A: Disbursement of Breeders Fund – 2010



Source: Commonwealth Accounting and Reporting System

*A contract payment ($47,500) from the prior contract year was excluded from the total VTA administrative fees as it relates to a prior year but was paid during fiscal year 2010.

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COMMISSION HIGHLIGHTS

The Virginia Racing Commission (Commission) controls and prescribes regulations and conditions for all horse racing with pari-mutuel wagering privileges in the Commonwealth. It licenses horse racetracks and satellite facilities, and ensures that all their employees have valid Commission permits. The Commission also issues permits to anyone associated with horse racing, including horse owners, trainers, jockeys, grooms, veterinarians, and blacksmiths. Pari-mutuel horse racing began in the Commonwealth in September 1997 at Colonial Downs, a privately held racetrack in New Kent County. The Code of Virginia permits up to ten satellite wagering facilities. Currently, there are ten satellite facilities operated by Colonial Downs, which are located in Alberta, Chesapeake, Hampton, Martinsville, Richmond (four), Scott, and Vinton. The Commission monitors each of these facilities as a part of their regulatory oversight.

SYSTEM UPGRADE

The Commission uses its TRACS-V system for a number of managerial functions, including tracking veterinary records for horses; reconciling wagering data from the Colonial Downs race track; tracking fines, penalties, and suspensions; and tracking ongoing investigations. In 2006 the Commission engaged Oracle USA, Inc. (Oracle) to upgrade their TRACS-V reports and racing application. Oracle did not deliver the upgrade to the satisfaction of the Commission and the contract was terminated. The Commission settled with Oracle for $116 thousand for the work performed by Oracle. The Commission still wishes to replace its aging application, but due to budgetary constraints, has no immediate plans to do so.

FINANCIAL SUMMARY

The Code of Virginia directs the distribution of the funds in the horse racing wagering pools. The percentage distribution varies based on factors such as the type of wagering, whether the race took place within or outside of the Commonwealth, and whether the wagering occurred at the racetrack or at a satellite facility. The Commonwealth retains as a license tax a portion of the wagering pools ranging from 0.75 to 2.25 percent as directed by the Code of Virginia. All revenues received by the Commission go to a special fund known as the State Racing Operations Fund. The Appropriations Act requires the Commission to transfer any funds in excess of the Commission's operating expenses to the General Fund of the Commonwealth. However, the Appropriations Act contains language allowing the Commission to carry forward a portion of its unspent appropriation related to the promotion and marketing, sustenance and growth of the Virginia horse industry as long as it makes its required transfer to the General Fund. At June 30, 2010, the Commission had a cash balance of $216,014 in its operating fund related mostly to unspent marketing funds. The Commission transferred $607,182 to the General Fund as required by the Appropriations Act and transferred $16,950 to the Literary Fund.

The Code of Virginia also created the Virginia Breeders Fund to support an incentive program to foster the industry of breeding racehorses in Virginia. It receives a one percent distribution of the horse racing wagering conducted in the Commonwealth. The Commission contracted with the Virginia Thoroughbred Association and the Virginia Harness Horse Association to manage the funds. The incentive program provides purses for races restricted to Virginia bred or sired horses, and awards to the owners and breeders of Virginia bred horses that win or earn purse money in races designated by the Commission. During fiscal year 2010, the Commission made payments totaling $1,387,261 from the Breeders Fund consisting of $1,147,261 in incentives to owners and breeders, and $240,000 in management fees to the Virginia Thoroughbred Association and the Virginia Harness Horse Association. At year-end, the cash balance in the Breeder's Fund was $423,936. The cash balance does not revert to the General Fund.

The results of the fiscal year 2010 financial operations of the Virginia Racing Commission may be found on page 5. There was a decline in the amount wagered on horse racing in the Commonwealth primarily due to the poor ecomomy. The amount of tax revenue generated from wagering on horse racing was down more than 16 percent from 2009. The incentive and marketing budget from operations was reduced in the amended budget bill Chapter 781 from $700,000 to $0 for 2010.

VIRGINIA RACING COMMISSION

SCHEDULE OF REVENUES, EXPENSES, AND CHANGES

IN CASH BALANCES - BUDGET AND ACTUAL

For the Year Ending June 30, 2010

		Actual			
	Total Budget	Breeders Fund	Operations Fund*	Total	Total Variance Positive/ (Negative)
Revenues:					
Taxes and pari-mutuel wagering	$ 3,481,000	$ 1,409,273	$ 2,237,651	$ 3,646,924	$ 165,924
Application fees	150,000	-	177,413	177,413	27,413
Fines and assessments	15,000	-	18,350	18,350	3,350
Interest	25,000	1,213	303	1,516	(23,484)
Total revenues	3,671,000	1,410,486	2,433,717	3,844,203	173,203
Expenses:					
Incentive and marketing payments	1,686,000	1,387,261	243,381	1,630,642	55,358
Personal services	1,275,474	-	906,909	906,909	368,565
Contractual services	329,974	-	620,193	620,193	(290,219)
Supplies and materials	16,000	-	15,323	15,323	677
Continuous charges	42,650	-	117,918	117,918	(75,268)
Equipment	21,239	-	-	-	21,239
Total expenses:	3,371,337	1,387,261	1,903,724	3,290,985	80,352
Operating revenue over (under) expenses	$ 299,663	$ 23,225	$ 529,993	$ 553,218	$ 92,851
Transfers out:					
General fund		-	607,182	607,182	
Literary fund		-	16,950	16,950	
Total transfers		-	624,132	624,132	
Revenues over (under) expenses and transfers out		23,225	(94,139)	(70,914)	
Cash Balance at July 1, 2009		400,711	216,014	616,725	
Cash Balance at June 30, 2010		$ 423,936	$ 121,875	$ 545,811	

* Operations Fund includes amounts collected and directly deposited to the literary fund, which were transferred out.

Source: Commonwealth Accounting and Reporting System

Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

September 16, 2010

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Virginia Racing Commission** for the year ended June 30, 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions in the Commonwealth Accounting and Reporting System, review the adequacy of the Commision's internal controls, and test compliance with applicable laws and regulations.

Audit Scope and Methodology

The Commission's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered significance and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

Tax and pari-mutuel wagering revenues
Incentive and marketing payments
Purchases and Purchase Card Controls
Application Controls
License and permit fees

We performed audit tests to determine whether the Commmission's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, and observation of the Commission's operations. We inspected documents including reconciliations, deposit slips and certificates, wagering reports provided by Colonial Downs, revenue summary reports and contracts. We tested transactions and performed analytical procedures.

Conclusions

We found that the Commission properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Commission records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted no matters involving internal control and its operation that we consider necessary to be reported to management. The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Exit Conference and Report Distribution

We discussed this report with management on September 24, 2010.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

AWP/alh

VIRGINIA RACING COMMISSION

Peter C. Burnett
Chairman

Clinton Miller
Vice Chairman

Mark T. Brown
Stuart Siegel
David C. Reynolds

Victor Harrison
Executive Secretary

David Lermond, Jr.
Deputy Executive Secretary