

VIRGINIA RACING COMMISSION

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2012**



AUDIT SUMMARY

Our audit of the Virginia Racing Commission for the year ended June 30, 2012, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- matters involving internal control and its operations necessary to bring to management's attention; and
- instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

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AUDIT FINDINGS AND RECOMMENDATIONS

Use Supported Database Software

The Commission continues to use an unsupported version of the Oracle database system software for its central licensing, veterinary records management, and financial management applications. Industry best practices require that the information system software that supports agencies' essential business functions should be a version that the vendor currently supports and maintains. The impact of not having currently supported systems software places the Commission's information systems at risk for data breach and exposure, loss of availability, and loss of data integrity.

Although the Commission is using the current unsupported database software, the Commission does have manual processes for use in case of an application failure. The location of the database at the Commonwealth Enterprise Solutions Center does mitigate the risk of loss of this sensitive information, since the Commonwealth Information Technology Infrastructure Partnership (Partnership) houses the servers and provides logical access control to the network and monitors server activity.

We recognize, however, that the Commission is currently testing a new and supported Oracle database software release. The Commission anticipates full implementation of the new database software by December 31, 2012. Therefore, we recommend that the Commission continue to dedicate the necessary resources to ensure a timely implementation.

Verify and Test Application and Database Backups

The Commission does not perform periodic tests to verify that its application and database backups are complete and reliable. While the Partnership has responsibility for backing up the Commission's data, it is the Commission's responsibility to conduct joint exercises with the Partnership to ensure that its applications and databases restore successfully.

We recommend that the Commission designate an employee to receive and review the daily backup log from the Partnership to ensure successful completion. Further, we recommend that the Commission schedule periodic joint tests with the Partnership that can verify successful restoration of its applications and databases.

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 10 satellite wagering facilities. Currently, there are nine satellite facilities operated by Colonial Downs, which are located in Alberta, Chesapeake, Hampton, Martinsville, Richmond (three), Scott, and Vinton. The Commission monitors each of these facilities as a part of their regulatory oversight.

ADVANCE DEPOSIT WAGERING

Section 59.1-369(5) of the Code of Virginia directs the Racing Commission to collect a licensing fee for any provider wishing to offer advance deposit wagering (ADW) to its customers. ADW includes online or other electronic forms of wagering on horse races simulcast from around the world. Once the provider verifies the wager's Virginia residency to establish an ADW account, the customer must deposit funds into the account, from which the provider deducts any race wagers. Total wagers from ADW accounts, less any refunds and cancellations, yields gross handle. The Commission ensures that the ADW licensees who operate in Virginia pay a 10 percent source-market fee based on the gross ADW handle from Virginia residents. Half of the 10 percent fee goes to the unlimited licensees, and the other half to the Virginia Harness Horse Association and Virginia Thoroughbred Association. The Commission also collects one percent of the gross ADW handle from Virginia residents from the ADW licensees and deposits these funds into the Virginia Breeders Fund.

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 0.50 to 2.75 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 Appropriation 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 Appropriation Act contains language allowing the Commission to carry forward a portion of its unspent appropriation for 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, 2012, the Commission had a cash balance of \$224,791 in its operating fund. The Commission transferred \$511,978 to the General Fund as required by the Appropriation Act.

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 2012, the Commission made payments totaling \$1,722,144 from the Breeders Fund consisting of \$1,457,144 in incentives to owners and breeders, and \$265,000 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 \$508,843. The cash balance does not revert to the General Fund.

The results of the fiscal year 2012 financial operations of the Virginia Racing Commission are on page four. The total amount wagered on horse racing in the Commonwealth increased from fiscal year 2011 to 2012. The amount of tax revenue in the operating fund generated from wagering on horse racing increased 4.3 percent from 2011 compared to a decline of 9.6 percent in revenue from fiscal years 2010 to 2011. Breeders Fund revenue increased 8.1 percent from 2011 compared to the 9.1 percent increase in revenue from fiscal years 2010 to 2011. This is mostly attributable to growth in advance deposit wagering. The 2012 cash balance increased by \$130,206 mostly due to a decrease in the general fund transfer from the Commission's Operating Fund, set by Chapter Two of the 2012 Virginia Acts of Assembly Special Session.

VIRGINIA RACING COMMISSION
SCHEDULE OF REVENUES, EXPENSES, AND CHANGES
IN CASH BALANCES - BUDGET AND ACTUAL
For the Twelve Months Ending June 30, 2012

	Budget	Actual			Total Variance
	Total Budget	Breeders Fund	Operations Fund	Total	Positive/ (Negative)
Revenues:					
Taxes and pari-mutuel wagering	\$ 3,400,000	\$ 1,660,993	\$ 2,110,558	\$ 3,771,551	\$ 371,551
Application fees	180,000		199,065	199,065	19,065
Interest	15,000	-	-	-	(15,000)
Total revenues	<u>3,595,000</u>	<u>1,660,993</u>	<u>2,309,623</u>	<u>3,970,616</u>	<u>375,616</u>
Expenses:					
Personal services	914,800	-	817,439	817,439	97,361
Contractual services	469,794	-	370,876	370,876	98,918
Supplies and materials	17,250	-	13,068	13,068	4,182
Incentive and marketing payments	2,114,000	1,722,144	286,082	2,008,226	105,774
Continuous charges	119,800	-	118,823	118,823	977
Total expenses:	<u>3,635,644</u>	<u>1,722,144</u>	<u>1,606,288</u>	<u>3,328,432</u>	<u>307,212</u>
Transfers out:					
General fund	<u>506,356</u>	<u>-</u>	<u>511,978</u>	<u>511,978</u>	<u>(5,622)</u>
Total transfers	<u>\$ 506,356</u>	<u>-</u>	<u>511,978</u>	<u>511,978</u>	<u>(5,622)</u>
Revenues over (under) expenses and transfers out	<u>\$ (547,000)</u>	<u>(61,151)</u>	<u>191,357</u>	<u>130,206</u>	<u>\$ 677,206</u>
Cash balance at June 30, 2011		<u>569,994</u>	<u>33,434</u>	<u>603,428</u>	
Cash balance at June 30, 2012		<u>\$ 508,843</u>	<u>\$ 224,791</u>	<u>\$ 733,634</u>	

Source: Commonwealth Accounting and Reporting System



Commonwealth of Virginia

Auditor of Public Accounts

Walter J. Kucharski
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

September 5, 2012

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable John M. O'Bannon, III
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, 2012. 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 Commission's internal controls, and test compliance with applicable laws and review corrective actions of audit findings from prior year reports.

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
License and permit fees
Purchases including Purchase Card and eVA Controls

Payroll expenses
Application Controls
Database Security

We performed audit tests to determine whether the Commission'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, eVA controls, payroll records, 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 certain matters involving internal control and its operation and compliance with applicable laws and regulations that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

Exit Conference and Report Distribution

We discussed this report with management on September 13, 2012. Management's response to the findings identified in our audit is included in the section titled "Commission Response." We did not audit management's response and, accordingly, we express no opinion on it.

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

LJH: alh



COMMONWEALTH of VIRGINIA

Virginia Racing Commission

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New Kent, Virginia 23124
(804) 966-7400; FAX (804) 966-7418*

August 22, 2012

Mr. Walter J. Kucharski
Auditor of Public Accounts
101 North 14th Street, 8th Floor
Richmond, VA 23219

Dear Mr. Kucharski:

Thank you for your reminder of the necessity to provide updated information regarding progress in replacing our unsupported database software system. As you are aware, I have attempted to become compliant and have investigated several licensing systems in the last year, seeking one that would meet the needs of the Racing Commission and be relatively inexpensive. We race very few days and like all state agencies, function with a very limited budget, requiring the Racing Commission to remain efficient yet frugal presents a constant challenge. This difficulty is shared by all Racing Commissions as well. The Virginia Racing Commission by virtue of membership in the Association of Racing Commissioners International (ARCI) may participate in a universal licensing system that will be used by all member jurisdictions. This will be a collaborative venture and will be offered at no additional fee, which obviously makes it highly acceptable to the ARCI membership.

Kevin Crum, IT and Database Administrator for ARCI assures me that he is in the final stages of implementation and it will be ready to meet our licensing needs for 2013. At the conclusion of the Virginia Standardbred racing season we will convert our database during the non active racing period to this new system. In response to verify and test application and database backups, the Virginia Racing Commission has taken corrective action to add Kimberly Carter as the designated recipient of the backup reports and removed Dennis West.

Sincerely,

A handwritten signature in dark ink, appearing to read "Bernard J. Hettel".

Bernard J. Hettel
Executive Secretary

VIRGINIA RACING COMMISSION

Stuart Siegel
Chairman

J. Sargeant Reynolds, Jr.
Vice Chairman

Mark T. Brown
Carol G. Dawson
David C. Reynolds

Bernard J. Hettel
Executive Secretary

David Lermond, Jr.
Deputy Executive Secretary