



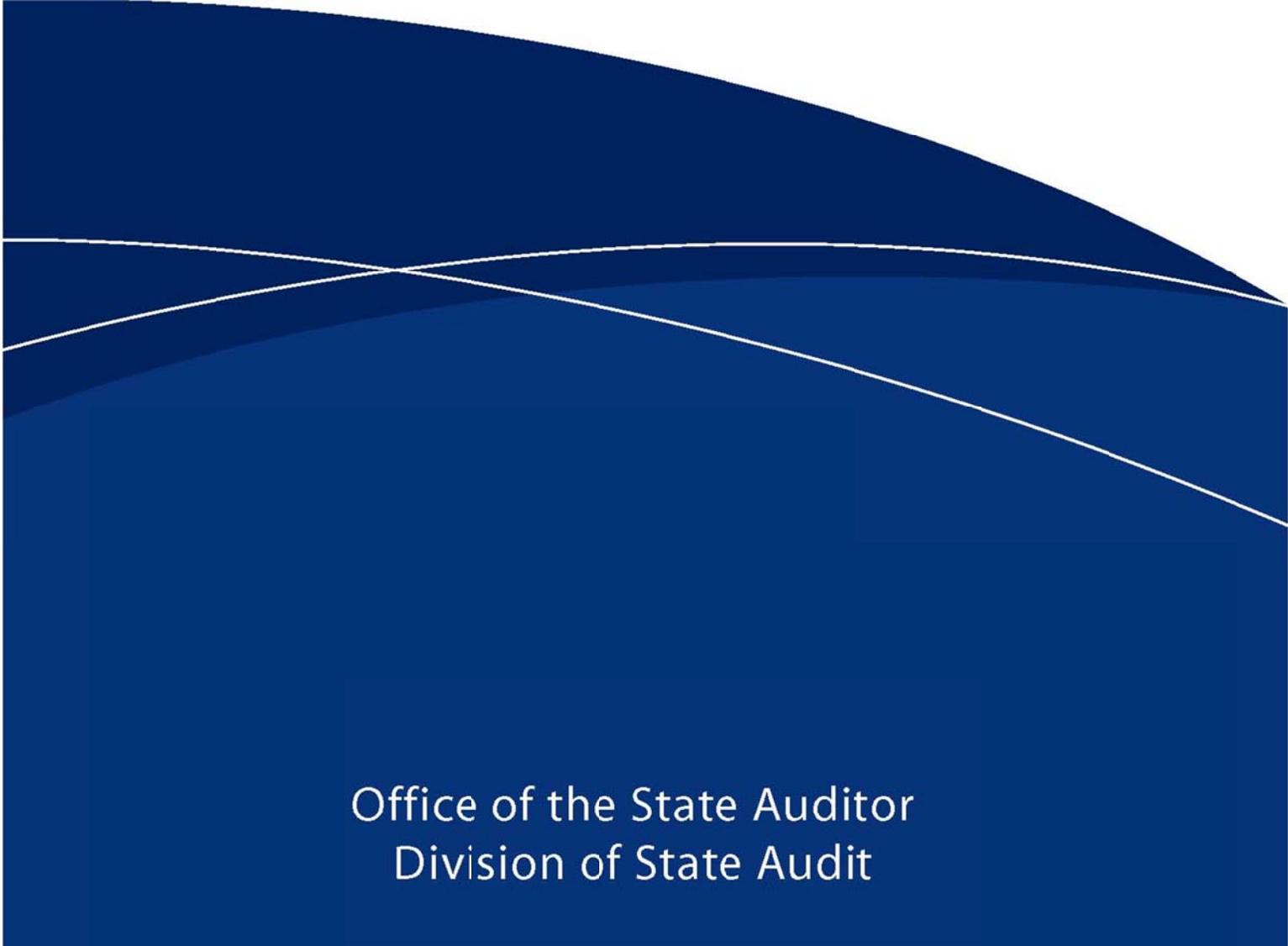
North Dakota Racing  
Commission

BISMARCK, NORTH DAKOTA

**Audit Report**

For the Biennium Ended  
June 30, 2009

ROBERT R. PETERSON  
STATE AUDITOR



Office of the State Auditor  
Division of State Audit

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STATE CAPITOL  
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BISMARCK, NORTH DAKOTA 58505

## *Transmittal Letter*

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June 16, 2010

The Honorable John Hoeven, Governor  
Members of the North Dakota Legislative Assembly  
Mr. Winston Satran, Director of Racing

We are pleased to submit this audit of the North Dakota Racing Commission for the biennium ended June 30, 2009. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Kevin Scherbenske, CPA. Sarah Kuntz and Dan Cox, CPA, were the staff auditors. Fred Ehrhardt, CPA, was the audit supervisor. Inquiries or comments relating to this audit may be directed to the audit supervisor by calling (701) 328-2241. We wish to express our appreciation to Director Satran and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Bob Peterson".

Robert R. Peterson  
State Auditor

# *Executive Summary*

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## ***Introduction***

The North Dakota Racing Commission is the regulatory body in charge of regulating live and simulcast racing in North Dakota and administers three special funds for the benefit of the horse racing industry in North Dakota. The Commission is made up of five members appointed by the Governor and the office staff consists of a Director of Racing and Administrative Staff Officer.

## ***Responses to LAFRC Audit Questions***

### *1. What type of opinion was issued on the financial statements?*

Since this audit followed the performance audit standards, rather than the financial statement audit standards, an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

### *2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?*

Yes.

### *3. Was internal control adequate and functioning effectively?*

Other than our finding addressing the "fraud risk assessment" (page 9), we determined internal control was adequate.

### *4. Were there any indications of lack of efficiency in financial operations and management of the agency?*

Other than our work addressing "continuance of declining fund balance" (page 12) there were no indications of lack of efficiency in financial operations and management of the North Dakota Racing Commission.

### *5. Has action been taken on findings and recommendations included in prior audit reports?*

The North Dakota Racing Commission has not implemented two of the recommendations included in the prior audit report addressing "fraud risk assessment" and "continuance of declining fund balance" (page 14).

### *6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 15 of this report, along with management's response.

## **LAFRC Audit Communications**

7. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

8. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The North Dakota Racing Commission's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

10. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

11. *Identify any serious difficulties encountered in performing the audit.*

None.

12. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

13. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

14. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance and Human Resource Management System (HRMS) are high-risk information technology systems critical to the North Dakota Racing Commission.

# ***Audit Objectives, Scope, and Methodology***

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## ***Audit Objectives***

The objectives of this audit of the North Dakota Racing Commission for the biennium ended June 30, 2009 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the North Dakota Racing Commission's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the North Dakota Racing Commission and are they in compliance with these laws?
3. Are there areas of the North Dakota Racing Commission's operations where we can help to improve efficiency or effectiveness?

## ***Audit Scope***

This audit of the North Dakota Racing Commission is for the biennium ended June 30, 2009. 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.

The North Dakota Racing Commission's sole location is its Bismarck office which was included in the audit scope.

## ***Audit Methodology***

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.
- Interviewed appropriate agency personnel.

- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed North Dakota Racing Commission's processes and procedures.

In aggregate there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

## ***Discussion and Analysis***

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The accompanying financial statements have been prepared to present the North Dakota Racing Commission's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the biennium ended June 30, 2009, operations of the North Dakota Racing Commission were primarily supported by tax revenue collected on pari-mutuel wagering. This is supplemented by appropriations from the state's general fund.

### ***Financial Summary***

Revenues consisted primarily of racing tax revenue, as well as license fees and interest. Total revenues were \$543,259 for the year ended June 30, 2009 as compared to \$671,590 for the year ended June 30, 2008.

Racing tax revenue decreased from \$545,446 for the year ended June 30, 2008 to \$400,962 for the year ended June 30, 2009.

The decrease is due to the drop in the tax rates to each of the three North Dakota Racing Commission funds (breeders fund, purse fund, promotions fund) after a threshold is met. On the first \$11,000,000 of wagering handle the North Dakota Racing Commission receives .5% for each of their three funds. After the \$11,000,000 amount is reached, the North Dakota Racing Commission receives .0625%. Since the \$11,000,000 cap resets each biennium, the first \$11,000,000 wagered in the year ended June 30, 2008 was taxed at the higher rate, causing the fluctuation in revenue.

The total simulcast wagering handle for the year ended June 30, 2008 was \$26,433,087 as compared to \$50,049,069 for the year ended June 30, 2009. The \$11,000,000 cap was reached on March 9, 2008. This compares to the total wagering handle for the year ended June 30, 2006 of \$57,758,750 and \$75,585,764 for the year ended June 30, 2007.

Total expenditures for the North Dakota Racing Commission were \$1,527,924 for the year ended June 30, 2009 as compared to \$1,338,892 for the prior year. All expenditures remained fairly constant.

# *Financial Statements*

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## *Statement of Revenues and Expenditures*

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
<b><u>Revenues:</u></b>		
Racing Taxes	\$400,962	\$545,446
Licenses and Registration Fees	42,580	33,188
Unclaimed Winning Tickets / Reimbursement for Simulcast Auditor	52,997	45,261
Breeders Administrators Fund Closing Proceeds	32,192	
Interest	14,528	47,695
<b>Total Revenues</b>	<u>\$543,259</u>	<u>\$671,590</u>
<b><u>Expenditures:</u></b>		
Grants to Tracks	\$1,176,483	\$990,807
Breeders Award Payments	92,257	104,795
Salaries and Benefits	140,272	131,338
Fees – Professional Services	64,025	55,837
Travel	14,779	14,391
Contractual Fees	11,136	11,578
Rent of Building Space	8,512	8,348
Miscellaneous Expenses	20,460	21,798
<b>Total Expenditures</b>	<u>\$1,527,924</u>	<u>\$1,338,892</u>

## Statement of Appropriations

For The Biennium Ended June 30, 2009

<b>Expenditures by Line Item:</b>	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Racing Commission	\$ 407,290	\$ 76,565	\$ 483,855	\$ 420,455	\$ 63,400
<b>Totals</b>	<u>\$ 407,290</u>	<u>\$ 76,565</u>	<u>\$ 483,855</u>	<u>\$ 420,455</u>	<u>\$ 63,400</u>
<b>Expenditures by Source:</b>					
General Fund	\$ 120,592	\$ 82	\$ 120,674	\$ 120,674	
Other Funds	286,698	76,483	363,181	299,781	\$ 63,400
<b>Totals</b>	<u>\$ 407,290</u>	<u>\$ 76,565</u>	<u>\$ 483,855</u>	<u>\$ 420,455</u>	<u>\$ 63,400</u>

### Appropriation Adjustments:

\$476 of the appropriation adjustment was due to additional appropriation authority granted by Senate Bill 2189 of the 2007 session for market equity increases for classified state employees.

\$76,089 of the appropriation adjustment was approved by the Emergency Commission for legal fees.

### Expenditures Without Appropriations Of Specific Amounts:

The Breeders' Fund has a continuing appropriation authorized by NDCC section 53-06.2-11 (\$539,261 of expenditures for this biennium).

The Purse Fund has a continuing appropriation authorized by NDCC section 53-06.2-11 (\$1,261,750 of expenditures for this biennium).

The Racing Promotion Fund has a continuing appropriation authorized by NDCC section 53-06.2-11 (\$645,348 of expenditures for this biennium).

## ***Internal Control***

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In our audit for the biennium June 30, 2009, we identified the following areas of the North Dakota Racing Commission's internal control as being the highest risk:

### ***Internal Controls Subjected to Testing:***

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate noting a certain matter involving internal control and its operation that we consider to be a significant deficiency.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiency in internal control. We also noted another matter involving internal control that we have reported to management of the North Dakota Racing Commission in a management letter dated June 16, 2010.

### ***Fraud Risk Assessment (Finding 09-1)***

The North Dakota Racing Commission does not have a system in place to identify possible instances of fraud or fraudulent activities in the agency's financial and operational areas.

The most important guidance relating to internal control is contained in *Internal Control – Integrated Framework* published by the Committee of Sponsoring Organizations of Treadway Commission (COSO). This guidance dictates that a Fraud Risk Assessment program be established and practiced to identify risks of fraudulent type activities including when special circumstances arise, when changing operating environments, and for restructuring. In addition, the North Dakota Racing Commission does not have the necessary control activities designed/documented to ensure significant fraud exposures are identified and mitigated.

**Recommendation:**

We recommend the North Dakota Racing Commission:

- Establish and perform a fraud risk assessment on a recurring basis.
- Design and document the necessary control activities to ensure that each significant fraud exposure identified during the risk assessment process has been adequately mitigated.

**North Dakota Racing Commission Response:**

*Agree with this finding. The North Dakota Racing Commission enacted a Fraud Risk Assessment plan on September 7, 2010.*

## *Compliance With Legislative Intent*

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In our audit for the biennium ended June 30, 2009, we identified and tested North Dakota Racing Commission's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

- Collection and depositing of the proper amounts for taxes on pari-mutuel racing (North Dakota Century Code section 53-06.2-11).
- Awarding of contract for administration of the breeders' registry (North Dakota Century Code section 53-06.2-04.1).
- Payments for breeders' awards (North Dakota Administrative Code section 69.5-01-09-10).
- Proper use of the following legally restricted funds:
  - Breeders' fund.
  - Purse fund.
  - Promotion fund.
- Compliance with appropriations (2007 North Dakota Session Laws chapter 24).
- Compliance with OMB's Purchasing Procedures Manual.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

*Government Auditing Standards* require auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that has occurred or is likely to have occurred.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the North Dakota Racing Commission in a management letter dated June 16, 2010.

## ***Operations***

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Our audit of the North Dakota Racing Commission identified the following area of potential improvement to operations, as expressed by our operational objective:

- Are the North Dakota Racing Commissions current operations sustainable? The criteria used for this operational improvement will be the North Dakota Racing Commission's revenues, expenses, and the resulting trend of its fund balances.

### ***Continuance of Declining Fund Balance (Finding 09-2)***

We noted certain areas of concern in regards to the continued declining fund balance in the three funds run by the North Dakota Racing Commission.

#### ***Background:***

Based on review of the year-end fund balance amounts for the three North Dakota Racing Commission funds (breeders', purse, and promotion), the continued decline in the fund balance presents future concerns regarding the ability of the North Dakota Racing Commission to continue functional operations – including payments to tracks and breeders.

If the fund balance decline continues, it appears the North Dakota Racing Commission will not be able to continue its current funding pattern. For the 2010 racing season, the North Dakota Racing Commission has not approved or funded any races at the Fargo Horse Park. This reduction in the North Dakota racing season was due to issues at the horse park, not availability of funding.

The Fund Balance Table on the following page shows the balances for the North Dakota Racing Commission's funds as of calendar year-end from 2003- 2009.

#### ***Operational Improvement:***

We recommend the North Dakota Racing Commission implement a plan that allows for sustained future operations.

#### ***North Dakota Racing Commission Response:***

*The Racing Commission has taken several steps to insure financial management of the agency. There has been decreasing financial support of the race meets which will assist in stabilizing the Racing Commission Funds.*

*The Racing Commission also spearheaded an effort to reduce the taxes charged to Account Deposit Wagering during the 2009 Legislative Session. Senate Bill 1551 reduced the taxes charged for account deposit wagering which made conducting business in North Dakota more attractive to start up and existing account deposit wagering companies. Presently there are five licensed companies with three license applications pending. The addition of the new account deposit wagering companies increases the handle significantly which generates increased income to conduct racing business within the State and stabilize the Commission.*

**Fund Balance Table**

	Calendar Year Ended						
	2003	2004	2005	2006	2007	2008	2009
<b><u>Breeders Fund 278</u></b>							
Beginning Fund Balance	\$ 2,179,879	\$ 2,369,555	\$ 1,939,451	\$ 1,676,001	\$ 1,327,612	\$ 742,784	\$ 676,677
Income	593,129	30,136	135,352	77,612	82,016	101,578	62,695
Expenses	(403,453)	(460,240)	(398,802)	(426,001)	(666,844)	(167,685)	(119,740)
Ending Fund Balance	<u>\$ 2,369,555</u>	<u>\$ 1,939,451</u>	<u>\$ 1,676,001</u>	<u>\$ 1,327,612</u>	<u>\$ 742,784</u>	<u>\$ 676,677</u>	<u>\$ 619,632</u>
<b><u>Purse Fund 290</u></b>							
Beginning Fund Balance	\$ 2,247,388	\$ 2,415,584	\$ 2,010,078	\$ 1,746,488	\$ 1,355,275	\$ 917,610	\$ 535,308
Income	591,593	30,705	137,030	80,288	84,389	70,200	66,141
Expenses	(423,397)	(436,211)	(400,620)	(471,501)	(522,054)	(452,502)	(454,554)
Ending Fund Balance	<u>\$ 2,415,584</u>	<u>\$ 2,010,078</u>	<u>\$ 1,746,488</u>	<u>\$ 1,355,275</u>	<u>\$ 917,610</u>	<u>\$ 535,308</u>	<u>\$ 146,895</u>
<b><u>Promotion Fund 339</u></b>							
Beginning Fund Balance	\$ 2,778,429	\$ 1,943,744	\$ 1,420,890	\$ 1,144,174	\$ 873,268	\$ 556,931	\$ 337,515
Income	1,003,420	80,170	243,165	188,788	164,566	207,794	225,999
Expenses	(1,838,105)	(603,024)	(519,881)	(459,694)	(480,903)	(427,210)	(432,487)
Ending Fund Balance	<u>\$ 1,943,744</u>	<u>\$ 1,420,890</u>	<u>\$ 1,144,174</u>	<u>\$ 873,268</u>	<u>\$ 556,931</u>	<u>\$ 337,515</u>	<u>\$ 131,027</u>
TOTAL FUNDS	\$ 6,728,883	\$ 5,370,419	\$ 4,566,663	\$ 3,556,155	\$ 2,217,325	\$ 1,549,500	\$ 897,554

## ***Prior Recommendations Not Implemented***

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### **Fraud Risk Assessment (Finding 07-3)**

#### **Recommendation:**

We recommend the North Dakota Racing Commission:

- Establish and perform a fraud risk assessment on a recurring basis.
- Design and document the necessary control activities to ensure that each significant fraud exposure identified during the risk assessment process has been adequately mitigated.

**Status:** Not implemented – see page 9

### **Continuance of Declining Fund Balance (Finding 07-1)**

#### **Recommendation:**

We recommend the North Dakota Racing Commission implement a plan that allows for sustained future operations. This plan should not be based on any assumption of future increased revenue – either through increased pari-mutuel betting through simulcast or account wagering sites or increased gambling opportunities presented at the Horse Park.

**Status:** Not implemented – see page 12



STATE OF NORTH DAKOTA  
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## *Management Letter (Informal Recommendations)*

June 16, 2010

Mr. Winston Satran  
Director of Racing  
North Dakota Racing Commission  
500 N. 9<sup>th</sup> Street  
Bismarck, ND 58501

Dear Mr. Satran:

We have performed an audit of the North Dakota Racing Commission for the biennium ended June 30, 2009, and have issued a report thereon. As part of our audit, we gained an understanding of the North Dakota Racing Commission's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

## CASH

Informal Recommendation 09-1: We recommend the North Dakota Racing Commission have an individual, without access to cash, perform reconciliations of cash received to cash deposited on PeopleSoft.

## LEGISLATIVE INTENT

Informal Recommendation 09-2: We recommend the North Dakota Racing Commission follow State Procurement's Purchasing Procedures as outlined in NDCC 54-44.4-02 and the OMB Purchasing Manual.

Management of North Dakota Racing Commission agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

A handwritten signature in black ink that reads "Kevin Scherbenske". The signature is written in a cursive, slightly slanted style.

Kevin Scherbenske  
Auditor in-charge

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