

ARIZONA DEPARTMENT OF RACING

JANET NAPOLITANO
GOVERNOR



GEOFFREY E. GONSHER
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May 31, 2007

Ms. Debbie Davenport
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Office of the Auditor General
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Phoenix, AZ 85018

Dear Ms. Davenport:

Thank you for conducting the performance audit and sunset review of the Arizona Department of Racing. The findings of the Auditor General are agreed to, and the audit recommendations will be implemented.

We appreciate the favorable overview and positive evaluation of the progress made by the Department and welcome the Auditor General's recommendations as the basis for continuing the successful management and regulatory strategies to maintain the integrity of pari-mutuel racing in Arizona. This document will be an extremely useful resource for the following reasons:

- The report identifies significant improvements and initiatives that have been introduced by Racing during the past four years.
- The report recognizes that some of the improvements and initiatives incorporated into the agency's operations may still require continuing support and attention.
- The audit recommends improvements and initiatives that can be presented to the State Legislature for support and funding for future implementation.
- The audit identifies improvements and initiatives that can be introduced as Racing continues to strengthen its regulatory oversight of the pari-mutuel racing industry.

The past four years have been a period of transition and progress for the Department. The Department introduced several regulatory, management and operational improvements that are consistent with statutory requirements and available resources.

We look forward to continuing this progress in the future.

Sincerely,

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INTRODUCTION

THE RACING DEPARTMENT HAS MADE SIGNIFICANT PROGRESS SINCE 2003.

In 2003, three things were apparent:

- The industry needed regulatory attention.
- The agency needed management attention.
- Both the agency and the industry were in a period of dramatic transition.

Strengthening our regulation is a major part of the change the Department has achieved as a gaming agency. In 2003, the Department had antiquated rules and regulations, an outdated organizational structure, virtually no written policies and procedures, a weak review process for permittee applications, no formal means of customer communications and an ineffective enforcement and investigations process. In many respects, the regulatory scale was out of balance favoring the industry. Our current staff has worked hard to turn this situation around.

AUDITING OVERSIGHT

DESPITE THE LACK OF RESOURCES, THE DEPARTMENT HAS INTRODUCED SEVERAL IMPROVEMENTS TO ITS PARI-MUTUEL OVERSIGHT.

The Department of Racing has been improving its pari-mutuel oversight process for the past four years. In 2003, only one position was assigned to monitor and regulate all commercial and county fair racing sites in every geographical region of the state; all required records were submitted in hard copy; and no professional training was provided to pari-mutuel staff. The following measures have been introduced to improve the oversight of pari-mutuel racing:

- An additional pari-mutuel auditor position has been created and filled.
- Auditing staff has taken advantage of the Department's Education and Training program to attend courses at Pima Community College and the Arizona Government University (AZGU).
- Hard-copy files have been supplemented with electronic files to enable the auditors to have access to information at all work locations.
- Procedural checklists were created to facilitate tote system tests and mutuel department audits.
- Verification spreadsheets have been created to eliminate hand calculations for Net Pool Pricing tote system calculations, audits, and reviews.
- An electronic procedures manual is being prepared to facilitate training for pari-mutuel auditors and to conduct the duties of the pari-mutuel auditor positions.

THE PARI-MUTUEL AUDITORS' EXPERTISE HAS BEEN DIVERTED TO OTHER CRITICAL DEPARTMENT PROJECTS.

As part of the Department's pari-mutuel oversight, the Department's auditors have been assigned several non-auditing projects because of their professional and personal ability to understand technical and financial Racing Department issues. The Department has no other staff with this experience and no funds to contract for the services. The special projects included the following:

- Reviewed the Turf Paradise permit application materials to ensure appropriate analysis of the information examined and considered by the Department for submission to the Racing Commission.
- Chaired the Greyhound Task Force Simulcast Committee to examine Department simulcasting rules.

- Reviewed proposed legislation, rule revisions, Racing Commission reports, and operational policies to provide analysis of the effect on pari-mutuel oversight.
- Reviewed allegations regarding incorrect computation of purse structures and other allegations relating to Tucson Greyhound Park.

Recognizing the Department's limited ability to conduct pari-mutuel auditing at an effective level, the Pari-Mutuel Auditing Manager recommended additional positions, greater oversight of OTB operations, automated examination of data collected through capitulation reports, and analysis of other racing-related areas that could be regulated by pari-mutuel auditors. To achieve these goals, the Department requested additional funds and additional pari-mutuel auditing positions for FY 2008 and FY 2009.

The pari-mutuel oversight recommendations submitted by the Auditor General are enthusiastically welcomed by the Department. The objective is to improve and increase pari-mutuel oversight, improve the monitoring of tote system security, incorporate automated systems into all pari-mutuel related oversight activities, and explore expanding the scope of analysis of monies wagered. Subject to funding, the Department looks forward to introducing these improvements in FY 2008 and FY 2009.

ANIMAL DRUG TESTING AND ENFORCEMENT

THE DEPARTMENT HAS BEEN PROACTIVE AND AGGRESSIVE IN ITS EFFORTS TO IDENTIFY AND ENFORCE ANIMAL DRUG VIOLATIONS.

Since March 2003, the Department has been both proactive and aggressive in its efforts to identify and enforce animal drug violations. As a result of increased testing and enforcement, recorded violations have been minimal. Nevertheless, this regulation remains an issue for which we have been and will remain vigilant.

This is a critical issue throughout the entire horse racing industry, not just Arizona. For decades, rules varied from jurisdiction to jurisdiction, which created uncertainty for owners and trainers and inconsistency in the enforcement of medication issues. Several other regulatory jurisdictions have increased their efforts in this area, and the proposed uniform model rules have been adopted by most states to unify all racing jurisdictions under one standard set of regulations.

Because the model rules, although not new to most of the industry, would be new in Arizona, the Department is recommending their adoption by a Substantive Policy Statement. In this way, both the industry and the Department can evaluate their effectiveness, monitor their impact on the industry and the Department, and analyze their appropriateness in Arizona. After one year, it would be appropriate to commence the formal rulemaking process for permanent implementation of the model rules.

Several initiatives have been taken by the Department during the past four years because drug testing is a priority.

1. More horses are being tested on a daily basis. The Department increased the minimum number of horses tested each race day from 9 to 12, including all winning horses and those identified by the Chief Veterinarian or the Chief Steward for testing.
2. More ELISA tests are being conducted for every sample drawn. The Department increased the number of Enzyme-Linked ImmunoSorbant Assay (ELISA) tests from 15 to 25 to detect new substances and those with low levels of certain substances. The new contract allows up to 45 ELISA tests for racehorses if necessary.
3. Testing for Erythropoietin (EPO) is being conducted. Periodically, four to five race days are selected, and every horse tested on those days are tested for the presence of EPO.
4. Additional GC-MS Screens are being conducted. The Department started to conduct additional Gas Chromatography-Mass Spectrometry (GC-MS) screens of selected horses to identify small amounts of substances.
5. Shock Wave Therapy reports are being submitted. A new policy requires the submission of daily reports referencing horses treated and subsequently prohibited from racing.
6. Increased testing and enforcement during High Stakes Races. The Department increases drug testing and enforcement on high profile stakes race days when purses are significantly higher and more horses are hauled in from other states and private ranches.

7. Prior Animal Medication offenders are subject to additional license review. All license applicants who have been suspended or revoked for animal drug violations are subject to additional review by the Department prior to a license application determination.
8. Off-duty Phoenix Police Officers were retained to monitor action on the Turf Paradise backside and to serve as a visual deterrent to offenders. The officers worked closely with Department investigators to increase the Department's law enforcement presence.
9. New "Detention" signs are placed on all stalls with horses scheduled for daily races at Yavapai Downs and Turf Paradise. The Department implemented the Horseracing Task Force Medication Committee recommendation to post race day signs on the stalls of horses scheduled to race.
10. The stewards' authority has been increased to impose fines up to \$1,000. A revised rule increased the Stewards' ability to fine up to \$1,000, which is consistent with several other jurisdictions.
11. The Department will be adopting new penalty guidelines for medication violations. The Department will adopt fines and penalties that are consistent with the proposed model drug rules and within the authority granted the Department.
12. Test sample pick up and delivery is more secure. To protect the integrity of the chain of custody, a new policy was established to regulate the pick up services for animal drug samples.
13. A professional procurement was conducted to select qualified, capable testing laboratories. Industrial Laboratories Company, Inc. was selected as the primary contractor, and Center for Tox Services and Truesdail Laboratories were selected as secondary contractors.
14. The new animal medication contracts allow the introduction of new testing. Furosemide specific gravity testing may be implemented in the future.
15. The Department has negotiated improved rates for animal medication testing. The cost per sample in the new contract decreased from \$58.30 to \$57.50 per horse tested and from \$16.90 to \$14.00 per dog.
16. Additional funds have been allocated from efficiency savings for horse drug testing. Since 2003, an additional \$224,000 has been designated for increased animal testing, which is an 82% increase in the number of tests. In FY 2002, \$85,340 was spent on 3,276 racehorse drug tests. In FY 2006, \$154,615 was spent for a total of 5,627 tests.
17. The Department has complied with the benchmark testing established by the National Thoroughbred Racing Association. The NTRA Racing Integrity and Drug Testing Task Force reviewed drug testing issues affecting thoroughbred and quarter horse racing and provided a benchmark for race horse testing procedures. The Department of Racing supports the recommendations and increased the number of ELISA tests, proposed uniform drug rules, developed withdrawal guidelines for commonly used therapeutic medications, and contracts with laboratories which participate in the Testing Integrity Program.
18. The Department has maintained a professional Veterinary staff with qualified and dedicated individuals. The Racing Veterinarian staff includes a Chief Veterinarian, two full-time greyhound veterinarians, three part-time greyhound veterinarians, two part-time horse veterinarians, and two full-time and two part-time employees who provide veterinarian support services.
19. Revised threshold levels will be developed. A revised Department listing of Class 3, 4, and 5 drugs was developed to identify and communicate established threshold concentrations, and these levels are consistent with the proposed Model Rules.
20. "Milkshaking" Tests will be conducted. The Department has included a provision in the new medication testing contract to allow a TCO2 testing program on selected horses to determine the existence of pre-race "milkshaking."

DEPARTMENT BUDGET AND ADMINISTRATION

THE DEPARTMENT DOES NOT HAVE SUFFICIENT FUNDING TO REGULATE THE PARI-MUTUEL INDUSTRY IN A SAFE MANNER.

One of the important issues that the Department has been proposing is a new financial structure for regulatory oversight. The Department is required by statute to submit recommendations for increasing state revenues from the regulation of the racing industry while maintaining the financial health of the industry and protecting the public interest.

The Department's recent and current budget situation emphasizes the problems we have been experiencing and communicating to the Legislature, the Racing Commission, and the pari-mutuel industry for the past four years. The Department cannot continue regulating pari-mutuel racing 365 days a year without reducing its oversight and regulatory efforts. Although a critical issue for the safety and integrity of racing in Arizona, the Department's efforts to generate revenue from the industry for regulatory purposes have not been successful.

Although enforcement, responsibilities, and priorities have increased, the Department lost eight positions in 2002, 15% of the employees. During each of the past four years, the Department sought the generation of revenue from the industry to support its statutory, administrative and regulatory duties while eliminating the need for General Fund monies.

In recent years, the Department's regulatory function and ability to adequately protect the industry has been diminished as funding has been significantly reduced. New funding mechanisms to achieve these regulatory objectives must be developed to maintain an acceptable level of safety and integrity. Consequently, the Department will continue to evaluate methods for the industry to provide sufficient funding in the same manner as other regulated industries support their agencies.

Many other Arizona regulated industries provide funding to the state so their agencies can comply with their statutory requirements. It is a common practice not just in Arizona but in almost every other racing jurisdiction in this country. We believe that the Arizona racing industry should provide revenue for this purpose.

The industry has stated that to do so would put them out of business. The financial records reveal otherwise.

- Track owners are earning millions of dollars a year in profit.
- 70% of all pari-mutuel wagering in Arizona is tax-free.
- During the past 6 years, the industry has received \$44 Million in tax exemptions and tax credits.
- Only one out of four commercial racetracks in Arizona has paid any state pari-mutuel taxes for several years.

THE BUDGET SITUATION REQUIRED REGULATORY REDUCTIONS IN FY 2006

When the Department completed the FY 2006 third quarter financial review, it became apparent that the continuation of Department activities at the existing levels would result in a significant end-of-year out-of-balance situation.

1. The Department expenditures for county fair personnel and operations exceeded the statutory appropriation caps. Rather than reduce or cancel scheduled county fair racing, the Department used \$103,600 from the general fund appropriation for county fair activities.
2. The Legislature approved a general fund salary increase for state employees but no funds were appropriated for the Department's County Fair Racing Fund and the Administration Fund. This legislation was introduced and enacted in the third quarter of the fiscal year and could not be anticipated earlier. Because most of the county fairs are scheduled during the second half of the year, this \$20,205 increase had to be absorbed by the Department.
3. The State increased the employee mileage reimbursement rates and hotels increased the lodging rates they charge the Department, but no additional funds were provided to account for this purpose. Because most of the county fairs are scheduled during the spring, and the Department's regulatory duties are in-state travel intensive, an additional \$16,220 was required to reimburse racing employees.

4. The Department experienced emergency computer programming needs for which funds were not available. To acquire replacement equipment and programming services, the Department required an additional \$16,260.

The initial potential deficit was \$156,585. This was reduced to \$55,585 by maintaining staff vacancies, ending off-duty police officer security contracts, limiting attendance at out-of-state conferences, continuing efficiency measures, and promoting website usage. The remainder was eliminated by establishing an alternative method of selecting animal samples for drug testing and reducing certain testing requirements for a brief period through June 30, 2006. This budget situation highlighted the problems we have been experiencing and communicating to the Legislature, the Commission, and the pari-mutuel industry for the past four years.

THE DEPARTMENT HAS REQUESTED FUNDING FOR INCREASED AUDITOR OVERSIGHT, TECHNOLOGY, AND COUNTY FAIR SUPPORT FOR FY 2008 AND FY 2009.

In August 2006, the Department submitted its budget and strategic planning documents for FY 2008 and 2009. It includes the following:

1. The Department needs more auditors and auditing resources to ensure the integrity of wagering.
2. Most of the Department's technology is outdated and antiquated.
3. The Department needs to support county fair racing with funds consistent with the higher revenue cap approved by the Legislature last year.

The House Appropriations, Transportation and Criminal Justice Committee did not support items number 1 and 2 above.

THE DEPARTMENT HAS REDEPLOYED EFFICIENCY SAVINGS TO CRITICAL REGULATORY OVERSIGHT.

During the FY 2002-2006 period, the Department implemented several initiatives that achieved a total of \$689,085 in efficiency savings. The Department's practice has been to redeploy the efficiency savings to other critical areas of operation. During the past four years, these savings have been used for employee salaries, benefits and retirement costs not funded by the Legislature; unfunded employee travel costs; increased security enforcement at permittee sites; increased racehorse drug testing; and improved and emergency technology.

Governor Napolitano's efficiency directive required agencies "to find practical and sensible ways for State agencies and State government as a whole to reduce costs, cut bureaucracy, eliminate duplication, and improve customer service." It is the Department's obligation and intent to continue to fully comply with this directive in every way possible. We will continue to respect the Governor's directive, monitor expenditures, generate savings, and conduct business consistent with our statutory and regulatory responsibilities.

HUMAN DRUG TESTING AND ENFORCEMENT

THE DEPARTMENT HAS INCREASED HUMAN DRUG TESTING, ENFORCEMENT, AND PENALTIES.

The Department of Racing may require licensees to submit to a drug test if there is a reason to believe that the individual is under the influence of or unlawfully in possession of a prohibited substance. This is one of the Department's most important responsibilities as it maintains the health, safety and integrity of the entire industry. An individual who uses or misuses a prohibited drug places not only himself at risk, but other individuals and the animals as well. The Department has the responsibility to monitor all permittee locations and OTB sites and properly enforce the laws of Arizona against all violations and will continue to do so in the future.

During the past four years, the Department has increased human drug testing, penalties, and enforcement activities and adopted a new Human Drug abuse Policy with the following provisions:

1. A first offense for a positive test shall result in a license suspension for up to six months and may result in a license suspension for up to one year.

2. A second offense for a positive test shall result in a license suspension for a minimum of one year and may result in a license suspension up to two years.
3. All offenses after the second positive test shall result in a license suspension for a minimum of two years and may result in additional suspension or license revocation without an opportunity to reapply for up to five years.
4. All drug abuse offenders shall be required to participate in an agency approved drug abuse program, sign a new drug agreement, and submit a negative drug test prior to reinstatement.
5. The Stewards may impose a fine up to \$1,000 for each offense, and the Director may reduce, accept, or increase the fine depending on the circumstances of the case.
6. The Stewards and the Director retain the authority and the prerogative to impose higher penalties to these guidelines if the situation requires.
7. All first-time and repeat offenders will receive a community service requirement.

DRUG-FREE ZONES HAVE BEEN ESTABLISHED AT ALL PERMITTEE LOCATIONS.

It is the Department's statutory and moral responsibility to ensure licensees, the wagering public, and animals are in a safe environment in which to conduct their business. The Department enhanced this commitment by establishing each of the permittee sites as a Drug-Free Zone. Consequently, new "Drug Free Zone" signs have been erected in permittee public areas, jockeys quarters, horsemen's offices, shed rows, kennel areas, grandstands, permittee entrances, and other appropriate areas for both the general wagering public and licensees to see. In addition, the Human Drug Abuse Policy has been provided in both English and Spanish to all permittees, horse and greyhound organizations, and Department employees for posting and distribution purposes, including the Department website.

A NEW DRUG SCREENING POLICY MANDATES PERMITTEES TO CONDUCT PRE-EMPLOYMENT DRUG TESTING

The Department of Racing is mandated by statute and rule to conduct background investigations and to fingerprint license and permit applicants. Fingerprint processing through the Arizona Department of Public Safety and the Federal Bureau of Investigation takes up to six weeks. The Department instituted procedural changes that have reduced the turn-around time, but in reality, an individual with prior criminal history who falsifies an application may be licensed to work at a racetrack until such time as the FBI report is returned and the Department makes a determination that the application has been falsified. The hearing and appeal process may extend the time the individual is still employed for several months, depending on the specific criminal history. This creates a risk for other licensees and the wagering public.

In 2005, a sample of 531 investigation files showed licensees who failed to disclose prior criminal history on their applications. These files showed 45% involved permittee employees, about 70% of the permittee employees worked for horse tracks, and 30% worked for greyhound tracks. Furthermore, 17% of the offenses were for drug-related crimes, 12% involved assault/aggravated assault incidents, and 10% included outstanding warrants and failure to appear warrants.

To prepare investigation reports, prepare and send notices of hearing, conduct hearings and prepare Director's rulings is a time consuming, labor intensive process for the Department. It involves special investigators, stewards, licensing staff, administrative support, the Director and assistance from the Attorney General's Office. The process is governed by statute and requires adequate notice; communication; evidence gathering; hearing preparation; conducting a hearing; decision-making; preparing an order; dissemination of the order; and administrative record-keeping.

This is a very important issue for the Department because there is significant data to show that the permittees have regularly hired employees who have serious criminal background histories. This problem is compounded by no permittee review of applicants' backgrounds prior to hiring. This creates an unsafe environment for all the tracks and OTBs that places the public, other permittee employees, and Department staff at risk, in addition to the real loss of financial assets and potential manipulation of the wagering system.

In order to more effectively manage this process and reduce the number of licensees who may have failed to disclose prior criminal history, the Department adopted a Permittee Pre-Employment Screening Policy. The policy requires the permittees to inform job candidates about the Department's requirements and to contract with a Department-approved company to conduct pre-employment drug screening of all employees who come in contact with animals or humans participating in live racing, who operate machinery, handle money, or serve or sell alcoholic beverages.

The new policy will enable the Department to do the following:

1. Reduce the likelihood of permittees hiring employees with criminal records.
2. Reduce the number of false applications, resulting in cost savings for the State.
3. Enable Department staff to be redeployed to other areas of administration, enforcement and regulation.
4. Reduce the risk of endangerment and liability for the permittees.
5. Strengthen the integrity of pari-mutuel racing.

ENFORCEMENT AND COMPLIANCE

SIGNIFICANT PROGRESS HAS BEEN MADE IN STRENGTHENING DEPARTMENT ENFORCEMENT AND COMPLIANCE POLICES, PERSONNEL, AND RESPONSIBILITIES.

The Department has restructured the Enforcement and Compliance Division with a professional law enforcement approach to conducting business. An impressive foundation of new policies, procedures, practices, and personnel supports the achievement of successful enforcement activities.

1. Assigned investigators to tracks for backside surveillance on dark days to ensure appropriate monitoring and to serve as a deterrent.
2. Instituted new practice to send all human drug test samples to Southwest Laboratories for confirmation of results.
3. Requested permittee daily security reports to be submitted to the Stewards and Director for review.
4. Developed a Department of Racing visitor pass to be provided to all visitors at permittee locations.
5. Reviewed personnel files of permittee security staff to ensure appropriate law enforcement credentials.
6. Instituted requirement that all permittee security licensees, including former law enforcement personnel, are fingerprinted to identify prior criminal history.
7. Developed access to the Arizona Criminal Justice Information System (ACJIS); identified a Department System Security Officer and trained staff to use system.
8. Introduced several fingerprinting procedures and scheduled FBI training to reduce the Arizona Department of Public Safety rejection rate to 5% from 35%.
9. Required Special Investigators to arrange time with trainers, stewards, and veterinarians to observe their daily routines, share information and maintain an open line of communication.

THE DIRECTOR HAS INCREASED REVIEW OF SERIOUS STATUTORY AND CODE VIOLATIONS.

Historically, the Director scheduled hearings once a month and heard only routine matters. The Director's monthly calendar contained an average of 12 cases which required minimal time. In an effort to ensure full compliance with the law, more hearings are scheduled each month, averaging about 30 cases. The 150% increase in caseload is because of increased enforcement of drug and alcohol-related offenses, greater attention to altercation cases, increased focus on prior criminal histories and greater oversight of unlicensed individuals. With greater enforcement, we are also seeing more respondents

represented by legal counsel. In addition, the appeal bond has been replaced with an appearance bond to facilitate the appeal process.

One of the reasons more Director hearings are conducted is because more Stewards' rulings are scheduled for a Director's review. These cases are reviewed because the Stewards' maximum authority to impose a fine or penalty (\$1,000 and/or 60 days suspension) is not sufficient discipline for serious violations. For example, the Stewards do not have the authority to revoke a license, and some cases warrant this action. In a Director's hearing, the respondents have another opportunity to present their case, testify, call witnesses, and provide evidence. This administration's practice has been to review all Stewards' rulings, focusing specifically on human drug violations, altercations, failure to disclose prior criminal history, and serious animal medication issues.

THE DEPARTMENT INTRODUCED A STRICTER POLICY FOR LICENSE APPLICANTS WHO FAIL TO DISCLOSE PRIOR CRIMINAL HISTORY.

The Department is responsible for maintaining the safety, security and integrity of pari-mutuel racing in Arizona. Failure to disclose criminal history in submitting an application to the Department is unacceptable. Individuals who misrepresent, for whatever reason, their background do not reflect positively on the industry. The Department has been diligent in monitoring these abuses and has increased enforcement action and penalties in this regard. Neither the Department nor the industry should tolerate criminal behavior. Individuals submitting false applications should be subject to a sanction, or should not be allowed to retain a license.

Since FY 2004, Director's hearings have been conducted for 465 individuals who failed to disclose their prior criminal history regarding arrests, outstanding warrants, convictions or pending criminal charges when submitting an application for a license. The omissions included felony and misdemeanor offenses such as assault, possession and sale of drugs/drug paraphernalia, receiving/possession of stolen property, theft/burglary, sexual misconduct, homicide, bookmaking, domestic violence, smuggling illegal aliens, driving while under the influence, etc. In many cases, there was more than one incident that was not revealed by the applicant. The failure to accurately and completely disclose this information is a serious violation.

It is hard to accept that an individual who was arrested and charged with the violations mentioned above, and who in many cases was fined, incarcerated, required to complete rehabilitation programs, or placed on probation, would fail to remember them for inclusion on the license application. The questions on the application are very clear and even highlighted in a separate section for response. To ignore these questions or falsely respond to them is unacceptable.

A NEW THREE-YEAR FINGERPRINT REQUIREMENT REVEALS UNDETECTED AND UNDISCLOSED PRIOR CRIMINAL HISTORY.

Historically, the Department has required license applicants to submit fingerprints every other three-year licensing cycle. This meant that many criminal incidents were undetected and not disclosed for up to six years. Consequently, the Department has increased its vigilance in conducting background investigations of license applicants and concluded that the current submission schedule was inadequate to meet our mission to protect racing participants, the wagering public and the State of Arizona.

The Department has adopted a new policy for fingerprint submission. The following are the guidelines:

1. Fingerprints will be submitted by applicants each three-year licensing cycle, effective January 1, 2008.
2. The Department will allow applicants to submit FBI-approved fingerprint cards from other racing jurisdictions or authorized law enforcement agencies.
3. The Department will continue to accept fingerprint submissions associated with an approved National Racing Compact license.
4. The Department will accept a valid Arizona DPS Fingerprint Clearance Card that has been issued in cooperation with state agencies who employ, license or certify individuals who have contact with children or vulnerable adults.

A NEW PENALTIES POLICY STRENGTHENS STATUTORY AND ADMINISTRATIVE CODE VIOLATIONS AND ENFORCEMENT.

Since FY 2003, the Director has experienced a 150% increase in the number of cases heard. In reviewing these types of cases, the Department has attempted to be fair and equitable by imposing consistent penalties. There were, however, no written guidelines for these serious violations, and a new policy was adopted to include the following:

- **Progressive Penalties.** Except in cases in which a summary suspension is made by the Board of Stewards, first time offenders may be suspended “up to” a period of time. This enables the Stewards and the Director to consider the circumstances of each case.
- **Flexibility for Rulings.** The policy provides flexibility for the stewards and the Director in making determinations depending upon the circumstances of each case; i.e. age of respondent, effect on other horse and greyhound owners and trainers, etc.
- **Education Requirement.** The policy includes an education requirement (e.g. anger management classes), where appropriate, for first-time and repeat offenders. This provides an opportunity for offenders to learn how to control their emotions and actions in various situations.
- **Community Service Requirement.** The policy includes a community service option for all first-time and repeat offenders. This provides an opportunity for offenders to make amends to the racing community for committing the offense.

LICENSING

THE LICENSING PROCESS IS MORE EFFICIENT AND CUSTOMER FRIENDLY.

The Department conducted a comprehensive review of the Department of Racing licensing process to develop a revised system that was effective and efficient for both customers and employees. The following is a summary of the improvements to date:

Customer Service

- Joined the National Racing Compact which increased license reciprocity.
- Redesigned the Department website to include licensing forms, procedures, licensing locations, fees, frequently asked questions, industry links and an on-line customer service survey.
- Provided bi-lingual information signage at all licensing locations.
- Provided complaint/suggestion boxes at all county fair sites.
- Established procedures for contacting licensees regarding non-compliance, hearings and rulings.
- Adopted a policy for licensing individuals hired for special events at permittee locations.

Licensing Database

- Purchased new equipment to stabilize licensing database.
- Worked with the Government Information Technology Agency (GITA) to develop a new licensing system that will eventually replace the current licensing database.
- Created databases for officials and stewards.

Licensing Staff Efficiency

- Instituted cross-training and software training for licensing employees.
- Evaluated positions, centralized jobs, redistributed assignments, and initiated position manuals.
- Developed forms, checklists, tracking systems and procedures to increase efficiency, streamline operations, and ensure accuracy and completeness.
- Provided additional equipment and furniture at field locations to enhance task performance and eliminate the need to move equipment from one field location to another.
- Brought in Department of Administration auditors to evaluate and make recommendations regarding internal controls.

A REVISED LICENSE APPLICATION PROVIDES INCREASED INFORMATION FOR REGULATORY PURPOSES.

As the Department has made efforts to improve the licensing application process, our staff noted that the license application was outdated and required revision. It did not include several of the required Arizona Administrative Code and Department policy revisions. The Department consequently revised the document to reflect the following changes:

- Includes new information about Workers' Compensation, citizenship, permanent address, cell phone number, and e-mail address to improve communications with licensees.
- Expands and clarifies prior criminal history questions to include reference to specific judicial actions and criminal violations.
- Provides a Notice of Incomplete License Application, with a comprehensive list of submission deficiencies and explains the review process to the applicant.

LICENSE APPLICATIONS WITH PREVIOUS SUSPENSIONS OR REVOCATIONS REQUIRE ADDITIONAL REVIEW.

All license applicants who have been suspended or revoked by the Director during the prior three years require additional review by the Department prior to final determination. This includes individuals who have been suspended or revoked for animal medication violations, individuals who have had a human drug violation, and individuals who failed to accurately and completely provide prior criminal history information.

PERMITTEE OVERSIGHT

THE COMMERCIAL PERMITTEE APPLICATION PROCESS IS MORE EFFICIENT AND CUSTOMER FRIENDLY.

Both the Department and the permittees worked together to improve the permit application process. The following changes were made to the application process:

- Revised the application form to eliminate unnecessary questions, rearrange the questions in an organized manner, and delete questions that are not relevant to racing.
- Revised the request for the submission of tax information, contracts, and other documents that have previously been submitted and are on file with the Department.
- Required the filing of affidavits regarding accuracy and completeness in lieu of initialing every page of the application.
- Revised the billing process to include monthly statements, additional details of costs, and a limitation on the total amount charged for review and investigation. In addition, a notice of financial responsibility is provided with the application.
- Allowed related corporate entities to consolidate information into one submittal.
- Accepted electronic or CD file of permit application.

THE DEPARTMENT CONDUCTS AN INTENSIVE AND EXTENSIVE ADMINISTRATIVE AND SUBSTANTIVE PERMITTEE APPLICATION REVIEW TO PROTECT RACING PARTICIPANTS AND THE WAGERING PUBLIC.

Another responsibility of the Department is to review all permit applications so the integrity of the pari-mutuel racing industry can be protected through regulatory means.

Conducting a thorough substantive review process is very important considering the applicants request permits that authorize the State of Arizona to approve multimillion-dollar commercial racing operations. Applications of this magnitude require extensive review and analysis before the Department is in a position to provide a recommendation to the Racing

Commission. The ultimate decision made by the Commission significantly impacts the pari-mutuel industry in Arizona plus several thousand people, their employees, and their families.

Historically, the Department had been a rubber stamp for permittee reviews and approvals. In 2003, the Department began conducting more extensive and substantive permit application reviews. The reviews now ensure the submission of all materials required by statute and code, with specific attention to three critical areas: financial position, business continuity and property/ownership structure.

Turf Paradise. In 2004, Turf Paradise improved its short-term and long-term financial position. by providing for capital infusion of \$2 million, increasing the equity by \$1.9 million, and increasing the annual cash flow by \$300,000.

Turf Paradise also assured the operation of the track for the term of the permit by providing the Department a \$300,000 bond to pay the state, purses, salaries, breeders, vendors and others in accordance with the statutory requirements; submitting a letter of intention to continue racing operations under normal conditions at the current location for the duration of the permit; and submitting a letter guaranteeing to notify the Department of any and all zoning and land use actions a minimum of 30 days in advance. The real estate essential to Turf Paradise's operations was also restructured in a manner that ensures ownership operational decisions without encumbrance.

In 2006, the Department concluded that Jerry Simms, Turf Paradise Owner, 1) is unfit to receive renewal applications based on his inappropriate and corrupt personal and business history; 2) that Simms established a dangerous pattern of disregard for the Department of Racing regulatory authority; 3) that Simms placed horsemen, racehorses, jockeys, other licensees and Department employees at physical risk by ignoring the timely and complete correction of health and safety property and operational problems; 4) that Simms continuously ignored and neglected stakeholder needs; 5) that Simms consistently failed to comply with the regulatory requirements of other state and local jurisdictions; 6) that Simms failed to act responsibly during the current permit term; 7) that Simms failed to comply with permit background investigation statutory requirements; and 8) that Simms revealed a personal relationship with the Racing Commission Chairman that creates an impression of impropriety. Although the Department recommended the application be denied, the Racing Commission approved a three-year permit without conditions or requirements for problems to be rectified.

Yavapai Downs. In 2005, the Department mandated the following additional requirements to protect racing participants and the wagering public:

1. The Yavapai financial relationship with Achieve Academy was restructured through formalized agreements to provide for committed reimbursement of management and financial services, rent, utilities and other expenses. In addition, these formalized agreements support financial projections documenting Yavapai's plan to reduce debt and increase cash flow.
2. Yavapai adopted a formal resolution that requires full disclosure and Board of Director approval of all related-party transactions in excess of \$10,000 and other transactions in excess of \$150,000.
3. Yavapai adopted a formal resolution that mandates no funds be borrowed from employees or relatives of employees without an adequate repayment plan and at a prevailing market rate of interest, approved by the Board of Directors.
4. Yavapai obtained confirmation from National Bank of Arizona to permanently waive the current ratio restructure covenant to avoid violation of its loan agreement.
5. Concerns about the condition of the Yavapai Downs track were addressed with continued oversight, increased maintenance, and regular communications with horsemen organizations, jockey representatives, and the Department.
6. Yavapai adopted formal rules, regulations, and policies to ensure the separation and protection of Achieve Academy students under the age of 16 during the racing season.

Phoenix Greyhound Park/Apache Greyhound Park. The review of the Phoenix Greyhound Park and Apache Greyhound Park permit applications included no issues or significant areas of concern. It was noted that the Company's financial presentation was strong, there was a strong management team in place, and profits were positive.

Tucson Greyhound Park. In 2005, the review noted that TGP shareholders had never filed Arizona individual income tax returns and C&Z Management, L.L.C. had never filed Arizona partnership income tax returns. The shareholders communicated their desire to properly address this issue and to be in compliance with all appropriate Arizona tax laws. Consequently, TGP submitted documentation that they are working with the Arizona Department of Revenue to clarify and rectify any outstanding Arizona tax issues.

THE ANNUAL REVIEW OF THE PERMITTEE FINANCIAL STATEMENTS HAS REVEALED TRACK OWNERS ARE PROFITING MILLIONS OF DOLLARS A YEAR.

Turf Paradise. The total racing earnings to the Turf Paradise partners since 2001 was \$10.6 Million. In 2006, Turf Paradise's net income was \$2.95 Million. In addition, Turf Paradise has received a total of \$12.5 Million in tax credits and tax exemptions from the State of Arizona during the past six years.

Yavapai Downs. Yavapai Downs has experienced a total loss of \$33,219 during the past six years. In addition, Yavapai Downs has received a total of \$3.45 Million in tax credits and tax exemptions from the State of Arizona during the past six years.

Rillito Park. Rillito Park has experienced a total loss of \$39,376 over the last six years. In addition, Rillito Park has received a total of \$86,100 in tax credits and tax exemptions over the last six years.

Phoenix Greyhound Park. The management fee paid to Phoenix Greyhound Park's ownership corporation, Delaware North Corporation, was \$8.1 Million since 2001. In 2006, American Greyhound Racing, Inc., for Phoenix Greyhound Park net income was \$312,000. In addition, Phoenix Greyhound Park has received a total of \$18.5 Million in tax credits and tax exemptions from the State of Arizona during the past six years.

Tucson Greyhound Park. The total management fee paid to Tucson Greyhound Park's owners through a contract with ZapCon over the past six years was \$2.2 Million. In addition, Tucson Greyhound Park has received a total of \$7.6 Million in tax credits and tax exemptions from the State of Arizona during the past six years.

A NEW ADMINISTRATIVE POLICY REQUIRES SUFFICIENT TIME FOR DEPARTMENT PERMITTEE REQUEST REVIEW AND DETERMINATION.

The Department identified operational, statutory and customer service issues relating to requests from permittees for permit amendments, changes in officials, adding/deleting races and changes in wagering formats. The issues resulted from last-minute requests that did not allow sufficient time for thorough and accurate Department review.

Historically, the Department approved these requests as soon as possible following the receipt of the request. Because of limited staff, increased workloads and enhanced regulatory activities, Department staff could not process these requests as quickly as in the past. The Department experienced the following challenges:

- Adequate staff time was not available to thoroughly review the request a day or two before the need. Some requests required review by several individuals, including the Attorney General's Office.
- Rushing to prepare responses opened the door for errors and incomplete review of the request. Some requests had been received on Friday for weekend implementation.
- Sufficient background and reasons for the request were not always provided with the request. This information was very important for the Department to make a determination.

Consequently, the Department developed a new Permittee Requests Policy that provides general guidelines for requests submitted for both Department of Racing and Racing Commission consideration and identifies exceptions to the general timeframes. Timeframes set for a specific type of request by statute, rule, or policy and procedure, supersede the general policy.

OTB OVERSIGHT

THE DEPARTMENT HAS INCREASED REGULATION OF OTB OPERATIONS.

One of the Department's major responsibilities is to review, approve, and oversee all OTBs and conduct periodic inspections to ensure full compliance with all statutes and regulations. OTBs are an extension of the pari-mutuel racing activities at the permittee locations, and the Department must be diligent in its oversight of the conditions, operation, and personnel involved in the activities.

A review of prior criminal history cases revealed a significant number of OTB licensees who failed to disclose their prior criminal history on their applications. Consequently, the Department created an OTB application for consistent, complete and accurate information to be submitted by permittees. In addition, OTB recommendations submitted to the Commission now include relevant Department of Liquor information, report of on-site inspections, photographs and layout design of the property and facility, plan of operation, and written approval of local governing body.

The Department needs more auditors to ensure the integrity of wagering at OTB locations. The two current auditor positions cannot effectively monitor all the tracks and wagering locations. Consequently, there is inadequate oversight of more than 80 OTBs. During the past year, the Department has been made aware of incidents of internal theft and corruption. In addition, since 2005, the Department has brought to hearing and sanctioned several OTB employees who failed to disclose prior criminal history on their license applications. These individuals have been arrested for serious crimes including drug-related offenses, assaults, domestic violence, property damage, obstruction of justice, outstanding warrants, fraud and larceny, prostitution, and DUIs.

The Department has required permittees to do the following:

- Inform the Department immediately of any calls to law enforcement agencies for incidents that occur at an OTB site. This should include those that occur within the OTB operation and any other location on the property.
- Provide a written report to the Department within 48 hours, including actions taken by the permittee, police reports, and any internal reports relating to the incident.
- Consider personnel actions for any OTB employee at the location who may have contributed to the offense by not following appropriate policies and procedures, including reimbursement of funds, suspension, or termination.
- Provide the Department of Racing all policies and procedures for the operation of OTB sites.
- Schedule orientation and periodic education sessions for all OTB employees.

FINDINGS AND RECOMMENDATIONS

PARI-MUTUEL OVERSIGHT PROGRAM

Recommendation 1. To improve tote testing, the Department should:

- a. Train its pari-mutuel auditors on general audit practices and how to conduct tote system testing under net pool pricing.
- b. Identify and implement ways to reduce the reliance on manual calculations, such as using testing booklets or spreadsheets.
- c. Complete the development of the pari-mutuel auditing policies and procedures manual and implement it. The Department should ensure that it contains specific guidance for tote testing under both standard and net pool pricing.

Racing Department Response. The finding of the Auditor General is agreed to and the audit recommendations will be implemented.

Recommendation 2. The Department should work with the Legislature to obtain statutory authority to license tote companies.

Racing Department Response. The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation 3. If the Department obtains statutory authority to license tote companies, it then should:

- a. Modify its administrative rules to identify tote companies as a license category.
- b. Include in its administrative rules specific requirements associated with the tote company licensure as recommended in ARCI's proposed additions to its pari-mutuel wagering Model Rules.
- c. Include in its administrative rules for tote company licensure a requirement for a Type II SAS 70 or similar review.

Racing Department Response. The finding of the Auditor General is agreed to and the audit recommendations will be implemented.

Recommendation 4. To improve how it monitors tote system security, the Department should:

- a. Work toward incorporating other aspects of the proposed additions to the ARCI Model Rules, including those related to reviewing and programming changes and access controls, into its administrative rules.
- b. Review ARCI's recommendations related to programming changes, access controls, system security, and other IT control areas, and generally become more familiar with standard IT audit practices.
- c. Incorporate these recommended practices into its pari-mutuel auditing work.

Racing Department Response. The finding of the Auditor General is agreed to and the audit recommendations will be implemented.

Recommendation 5. To improve monitoring of wagering systems for potential anomalies, the Department should explore the feasibility of adopting automated systems. Specifically, the Department should explore the feasibility of implementing the ESI Integrity or RCI Integrity system in Arizona.

Racing Department Response. The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation 6. The Department should explore expanding its scope of financial analyses of the monies wagered in Arizona to strengthen oversight of the distribution of handle to parties that are entitled to a portion of it.

Racing Department Response. The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

ANIMAL DRUG TESTING PRACTICES

Recommendation 1. The Department should continue to move forward to align its drug-testing practices with the Model Rules, and seek consensus with the industry in areas where there are concerns.

Racing Department Response. The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation 2. Once finalized, the Department should put its new equine drug testing policy and penalties into administrative rule instead of solely in department policy.

Racing Department Response. The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

SUNSET FACTORS

Racing Department Response. The finding of the Auditor General is agreed to and the audit recommendation will be implemented.