



A REPORT  
TO THE  
ARIZONA LEGISLATURE

Financial Audit Division

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Procedural Review

# Arizona Department of Racing

As of September 10, 2008

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**Debra K. Davenport**  
Auditor General

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**STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL**

**DEBRA K. DAVENPORT, CPA**  
AUDITOR GENERAL

**WILLIAM THOMSON**  
DEPUTY AUDITOR GENERAL

March 13, 2009

Luis A. Marquez, Director  
Arizona Department of Racing  
1110 West Washington, Suite 260  
Phoenix, AZ 85007

Dear Mr. Marquez:

We have performed a procedural review of the Department's internal controls in effect as of September 10, 2008. Our review consisted primarily of inquiries, observations, and selected tests of internal control policies and procedures, accounting records, and related documents. The review was more limited than would be necessary to give an opinion on internal controls. Accordingly, we do not express an opinion on internal controls or ensure that all deficiencies in internal controls are disclosed.

Specifically, we reviewed cash receipts, cash disbursements, transfers, payroll, purchasing, equipment, and statutory compliance.

As a result of our review, we noted certain deficiencies in internal controls that the Department's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our recommendations concerning them are described in the accompanying summary.

This letter is intended solely for the information and use of the Department and is not intended to be and should not be used by anyone other than the specified party. However, this letter is a matter of public record, and its distribution is not limited.

Should you have any questions concerning our procedural review, please let us know.

Sincerely,

Jay Zsorey, CPA  
Financial Audit Director

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## The Department should follow required competitive purchasing procedures and monitor contract costs

In order to perform required applicant background investigations prior to issuing permits or licenses, the Department contracts with investigators and in so doing, is required to comply with the State's competitive purchasing rules and regulations. Although, the actual expenses related to these contracts are paid directly by the applicants, the Department controls the extent and direction of the investigations. As a result, the Department has a responsibility to ensure that it gets the best value for the money it spends on behalf of the applicants and that all vendors have a fair chance at obtaining state business. However, the Department did not always fulfill this responsibility since it didn't always comply with purchasing rules and regulations. For example, several times since April 2003, the Department has requested and received the Arizona Department of Administration's State Procurement Office's approval to obtain and renew "competition impractical" agreements for a private investigator and an accountant. A "competition impractical" agreement normally applies to investigations that would be compromised by alerting the investigation's subject when advertising for bids or proposals. In the case of the investigator and accountant in question, the Department did not provide sufficient justification for not following the competitive purchasing requirements for a "competition impractical" agreement. In addition, the private investigator under contract was a former employee whose initial billing rate was \$25 an hour in fiscal year 2004 and was \$100 an hour in fiscal year 2007. Finally, these two "competition impractical" agreements exceeded \$100,000 in total.

To strengthen controls over competitive purchasing, to comply with the State's competitive purchasing rules and regulations, and to help ensure that the license applicants are charged only fair and reasonable fees, the Department should only use "competition impracticable" agreements when compliance with Arizona Revised Statutes (A.R.S.) §§41-2533, 41-2534, 41-2538, or 41-2578 is impractical, unnecessary, or contrary to the public interest. For example, if an investigation needs to be kept confidential to avoid compromising its effectiveness, then the Department should consider a "competition impractical" agreement. At that time, the chief procurement officer must submit a written request for approval of such to the state procurement administrator. That request must contain the following:

- An explanation of the “competition impractical” need and the unusual or unique situation that makes compliance with appropriate statutes impractical, unnecessary, or contrary to the public interest;
- A definition of the proposed procurement process to be used and an explanation of how this process will foster as much competition as is practical;
- An explanation of why the proposed procurement process is advantageous to the State; and
- The scope, duration, and estimated total dollar value of the contract.

## The Department should implement and enforce policies and procedures for tracking administrative fees and costs

The Department collects administrative fees from applicants for costs related to the application process. These administrative fees are paid by the applicants in advance based on the Department’s estimates. However, the Department failed to maintain records of the actual costs and the time spent on these projects. In addition, the Department did not prepare written reconciliations of the actual administrative costs incurred and estimated fees received from the applicants. As a result, some applicants may have paid too much and some may have paid too little.

To help ensure that accurate and proper fees are paid by applicants, the Department should perform the following:

- Implement and enforce policies and procedures to maintain records of employees’ time and other costs for each permit application.
- Prepare timely written reconciliations of the Department’s actual costs and the estimated fees received to calculate over- or underpayments. The Department should then collect amounts due and refund over payments.

## The Department should improve controls over cash receipts

The Department licenses all individuals involved in racing throughout the State and collects cash receipts at several locations. Since cash receipts can be easily lost, stolen, or misused, it is essential that the Department have effective internal controls

over cash receipt transactions at the various locations. However, the Department did not have effective procedures to ensure that all cash receipts collected were safeguarded and accurately recorded. For example, some employees had incompatible responsibilities, such as receiving cash and making deposits. Also, undeposited receipts were kept in a locked file cabinet assessable by several employees, and cash receipts transactions were not consecutively numbered. Further, passwords to the licensing computer system were often shared among employees, were written near the computers, and were not regularly changed.

The Department should establish proper cash-handling and recordkeeping policies and procedures, and periodically monitor that those procedures are being followed and are operating effectively. These procedures should include the following:

- Separate cash-handling responsibilities among employees to ensure that no one employee is responsible for receiving cash, reconciling cash receipt transactions, preparing bank deposits, and recording cash receipts in the accounting records.
- Provide a separate cash drawer for each cashier to establish accountability and require cashiers to lock cash drawers when absent. Furthermore, undeposited cash should be locked in a drawers or a safe and a limited number of keys issued only to a few employees.
- Prepare written monthly reconciliations of licenses issued to cash received at each location by the 10th of the following month. Complete the Deposit with State Treasurer form in a timely manner to ensure deposits are recorded in the proper accounts.
- Perform necessary maintenance or upgrade procedures for the licensing computer system to ensure that each licensing location produces reports with only locally-issued licenses. Also, have computer programmers correct other deficiencies in the licensing system so that consecutively numbered licenses can be issued for each location and license technicians will be unable to void transactions.
- Develop a policy and procedure to require employees to change their passwords periodically, and have the computer system programmed to force users to do so. Further, develop additional policies and procedures that require each employee to have their own password and not share their password with coworkers. Conduct periodic training sessions for employees that stress the importance of computer security.

## The Department needs to establish procedures to identify potential conflicts of interest

A.R.S. §38-503 requires all public officers and employees to disclose any potential conflicts of interest in the agency's official records. Also, financial accounting standards require that financial statements include disclosures of related party transactions. In addition, A.R.S. §5-103.01 requires that a department employee or commission appointee may not enter into any business dealing, venture, or contract with an owner or lessee of a race track or any permittee; be employed in any capacity by any race track or permittee; or participate as an owner-trainer, trainer, or jockey in any racing meeting conducted in this State. However, the Department did not have written procedures for identifying potential conflicts of interest and disclosing related party transactions.

To comply with A.R.S. §§38-503 and §5-103.01, the Department should establish written procedures to identify possible conflicts of interest by annually requiring all employees and commissioners to disclose any personal or family relationships with vendors and maintaining records of such disclosures. Further, the Department should accumulate transactions with related vendors and identify all material transactions that would require disclosure in the State's financial statements.

## The Department should ensure that payments to vendors are accurate

Prudent business practice and the *State of Arizona Accounting Manual* require agencies to pay vendors only after invoices have been compared to purchase orders for terms, prices, and quantities. However, the Department did not always follow those procedures and, as a result, overpaid one vendor by approximately \$7,000. For 8 months, the Department paid invoices for animal drug testing services at higher rates than those contractually agreed upon. These overpayments continued even after the employee discovered the rates were above the contracted rates. However, the Department determined the amount of excess payments made and subsequently recovered the overpayments.

To help ensure accurate vendor payments and prevent future gifts of public monies in violation of the Arizona Constitution, the Department should verify the rate on each contractor's invoice and pay only the contractually agreed-upon rate.



# The Department should properly account for its equipment

The Department has invested approximately \$155,000 in equipment. In order to protect its investment, the Department should have an accurate list of these assets to help ensure that they are properly identified, accounted for, and safeguarded. However, the Department did not accomplish this objective since it did not maintain a complete and accurate equipment listing and did not update information on the State's capital assets system. Auditors noted that the Department did not update its internal listing or the State's system for approximately \$66,000 of newly-acquired assets and \$30,000 of asset disposals. In addition, although a physical inventory was performed last year, the Department did not reconcile it to the capital assets listing and make the necessary corrections. Further, employees responsible for maintaining the capital assets listing also performed the periodic physical inventory.

The following procedures can help the Department improve controls over equipment items and ensure that its list is accurate and complete:

- Record equipment purchases and disposals in the State's capital assets system and adjust the Department's internal listing within 5 working days of the transaction.
- Perform an annual physical inventory of all equipment items and update the asset listings based on the inventory results. This inventory should be performed by an employee who has no custodial responsibilities for equipment.

# ARIZONA DEPARTMENT OF RACING

JANICE K. BREWER  
GOVERNOR



LUIS A. MARQUEZ  
DIRECTOR

February 19, 2009

Debbie Davenport, Auditor General  
Office of the Auditor General  
2910 North 44<sup>th</sup> Street, Suite 410  
Phoenix, AZ 85018

**Subject: Procedural Review Letter**

Dear Ms. Davenport:

The Arizona Department of Racing & Boxing has examined the Procedural Review Letter provided by your office and we are grateful for the opportunity to respond.

The Department generally agrees with the findings of the Auditor General's Office and has already implemented corrective action to resolve most of the deficiencies discussed. Furthermore, the Department will continue to review its procedures to enhance those areas of concern that may still require Department attention.

The following discussion summarizes the Department's actions to address each finding:

- The Department should follow required competitive purchasing procedures and monitor contract costs. The Department takes its fiscal and regulatory responsibilities very seriously and strives to perform its duties in a manner consistent with established requirements. The Department, in requesting authorization to perform a competition impracticable procurement regarding investigative and financial review of permit applications, provided the Arizona Department of Administration with all the information requested by the State Procurement Office (SPO) in order for that office to make a determination regarding this matter. Although, the Auditor General's Office states that "...the Department did not provide sufficient justification for not following the competitive purchasing requirements...", the Department provided SPO with all the information that SPO requested to make a decision and approve the Department's request. SPO did not solicit additional information and did not require a competitive procurement be conducted when the Department's competition impracticable request was approved. The Department would have provided additional justification or conducted a competitive procurement had SPO required it. After this matter was brought to the Department's and SPO's attention, SPO asked the Department to conduct a competitive

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procurement for similar services in the future. Therefore, the Department has conducted a competitive process and hired a consulting investigative firm to perform permit application reviews and licensee investigations as may be needed. Additionally, according to ARS § 41-705, the Department will deposit monies from permit applicants to pay for the cost of permit reviews into a new Fund created for that purpose. The Arizona Department of Administration will disburse payments to the vendor from this Fund, as requested by the Department. Additionally, the Department will review each procurement request carefully to ensure that appropriate procedures and sufficient information is provided to SPO to make sufficiently informed decisions in the future.

- The Department should implement and enforce policies and procedures for tracking administrative fees and costs. The Department is writing and will shortly implement a policy to address these matters as recommended by the Auditor General's Office. The Department will monitor staff activity more closely to ensure timely and effective monitoring and reporting of these administrative costs.
- The Department should improve controls over cash receipts. The Department reviewed its cash-handling procedures and implemented additional supervisory controls to safeguard cash receipts and monitor staff's activities. Although some recommendations by the Auditor General's Office may not be implemented as suggested, the Department will enhance its procedures to ensure that the most effective controls are in place considering current limited Department resources.
- The Department needs to establish procedures to identify conflicts of interest. The Department is writing a new policy to address conflict of interest and related party transactions issues, as recommended by the Auditor General's Office. The new policy will be implemented shortly.
- The Department should ensure that payments to vendors are accurate. The Department revised its practices to ensure proper compliance with the *State of Arizona Accounting Manual* and staff has been instructed to compare all invoices to purchase orders. In this manner, only invoices that are correct are paid. It is important to note, however, that this \$7,000 overpayment was accrued over a period of eight months from small discrepancies in multiple invoices and the total contract payments totaled more than \$200,000 for the year. The approximately \$7,000 overpayment has been recovered. The Department will continue to monitor these activities to ensure compliance with established procedures and avoid overpayments in the future.
- The Department should properly account for its equipment. The Department is reviewing and will shortly issue a revised policy to properly conduct a physical inventory of its equipment, correct any discrepancies in the State's capital assets system, and update Department databases as equipment is either acquired or disposed. The revised policy will also address proper procedures to follow when conducting the Department's annual inventory, as recommended by the Auditor General's Office.

Debbie Davenport, Auditor General

February 19, 2009

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We are grateful to the Office of the Auditor General and its staff for their time and efforts to assist us enhance Department procedures ensuring compliance with established procedures and recommending implementation of best practices. The Department will continue to correct its deficiencies and perform its responsibilities as required.

Should you have any questions, please do not hesitate to contact me at (602) 364-1695.

Sincerely,

Luis A. Marquez, CPM

Director

cc: Joyce Cozby, Assistant Director/Management Review  
Amy L. Besco, Fiscal Unit Supervisor