



An Audit Report on

The Horse Industry Escrow Account at the Texas Racing Commission

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State Auditor

The Texas Racing Commission (Commission) had processes and related controls in place to allocate funds from the Horse Industry Escrow Account (Escrow Account) in accordance with applicable requirements. However, the Commission did not have a process in place to ensure that the funds were used as required to supplement horse race purses. In addition, it did not review required reports to ensure that funds allocated for horse industry events were expended appropriately.

- [Background](#) | p. 3
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This audit was conducted in accordance with Texas Government Code, Section 321.013.

HIGH

ALLOCATION OF FUNDS TO SUPPLEMENT HORSE RACE PURSES

The Commission had controls in place to allocate funds from the Escrow Account but did not have a review process to ensure that the funds were used for purse supplement payments.

[Chapter 1 | p. 6](#)

MEDIUM

ALLOCATION OF FUNDS FOR HORSE INDUSTRY EVENTS

The Commission had controls over its approval and payment processes for event expenditures. However, it did not review reports related to those expenditures to ensure that funds were used as intended.

[Chapter 2 | p. 12](#)

Summary of Management's Response

Auditors made recommendations to address the issues identified during this audit, provided at the end of each chapter in this report. The Commission agreed with the recommendations.

Ratings Definitions

Auditors used professional judgment and rated the audit findings identified in this report. The issue ratings identified for each chapter were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

PRIORITY: Issues identified present risks or effects that if not addressed could ***critically affect*** the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

HIGH: Issues identified present risks or effects that if not addressed could ***substantially affect*** the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.

MEDIUM: Issues identified present risks or effects that if not addressed could ***moderately affect*** the audited entity's ability to effectively administer the program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.

LOW: The audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks ***or*** effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

For more on the methodology for issue ratings, see [Report Ratings](#) in Appendix 1.

Background Information

The Texas Racing Commission (Commission) was established in 1987 and charged with the regulation and licensing of pari-mutuel wagering involving racehorses and greyhounds¹. In pari-mutuel wagering, people purchase tickets of various denominations on animals entered in races. Wagers for each race are pooled to constitute the purse for that race, which is distributed to holders of tickets on the winning animals.

The Commission oversees the Horse Industry Escrow Account (Escrow Account) to support the growth of the Texas horse industry. House Bill 2463 (86th Legislature) authorized deposits of horse-related sales tax proceeds of up to \$50 million per biennium to fund the Escrow Account. Certain amounts from pari-mutuel wagering pools are also deposited into the Escrow Account.

Between September 1, 2021, and February 29, 2024, four horse racetracks operated in Texas: Gillespie County Fair & Festivals, Lone Star Park, Retama Park, and Sam Houston Race Park (see Figure 1 for racetrack locations).

Figure 1

Locations of Active Racetracks



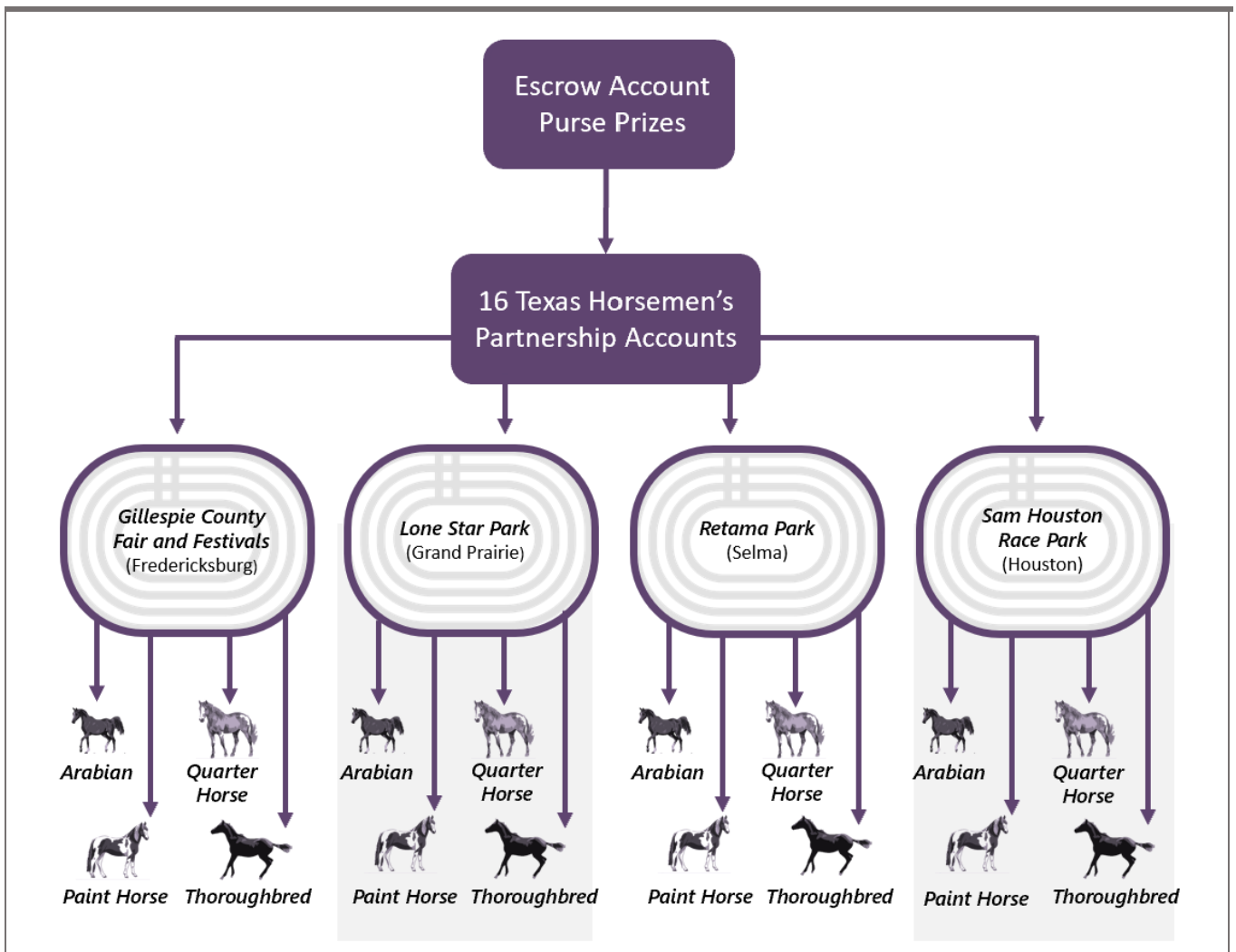
Source: The Commission.

¹ As of March 2020, Texas did not have any active greyhound racetracks.

Races at the four tracks are conducted by racetrack associations, which may apply for money from the Escrow Account to supplement purses. The Commission has identified the Texas Horseman’s Partnership (Partnership) as the racetrack association that receives purse allocations from the Escrow Account and distributes the funds to race winners. Funds are allocated by track and then by horse breed, based on the number of active race days per track and the number of races per horse breed. Figure 2 shows how allocations flow from the Escrow Account to the Partnership’s 16 purse accounts—1 for each of the 4 horse breeds at each of the 4 active racetracks.

Figure 2

Payment Structure Between the Escrow Account and the 16 Texas Horsemen’s Partnership Accounts



Source: The Commission.

Additionally, between September 1, 2021, and February 29, 2024, allocations from the Escrow Account went to four horse breed registries for events that furthered the horse industry in Texas:



These four horse breed registries are officially designated under Texas Occupations Code, Section 2030.002(a). A fifth registry designated under the statute, the Texas Appaloosa Horse Club, did not participate in Escrow Account programs during the scope of the audit.



Chapter 1

HIGH

Allocation of Funds to Supplement Horse Race Purses

The Texas Racing Commission (Commission) allocated funding from the Horse Industry Escrow Account (Escrow Account) in accordance with Texas Occupations Code, Sections 2028.204 and 2028.2041. (See text box for details about the Escrow Account.) The Commission may allocate up to 70 percent of the funds deposited into the Escrow Account to supplement horse race purses. For fiscal years 2022 and 2023 and the first half of fiscal year 2024, the Commission allocated an average of 68 percent of the funds in the Escrow Account—a total of \$42.5 million—to supplement purses. During the same period the Commission allocated the remaining 32 percent of the funds—a total of \$20.4 million—for events held to support the Texas horse industry. Allocation of funds for horse industry events is discussed in [Chapter 2](#).

Although the Commission appropriately allocated the total amount of Escrow Account funds available to supplement horse race purses, it did not verify that the racetrack associations spent the allocated funds on purse prize payments.

Escrow Account

The Horse Industry Escrow Account (Escrow Account) is administered by the Texas Racing Commission and funded by deposits of horse-related sales tax proceeds, up to \$50 million per biennium. Additionally, proceeds from pari-mutuel wagering are also deposited into the Escrow Account. Between September 1, 2021, and February 29, 2024, the Escrow Account received \$61,363,636 in sales tax allocations and \$480,477 from pari-mutuel wagering proceeds.

Horse racetrack associations and authorized horse breed registries may apply for funding from the Escrow Account to supplement purses or host events that further the horse industry in Texas.

Source: Texas Occupations Code, Sections 2028.204 and 2028.2041.

The Commission did not have a process to monitor spending of Escrow Account funds.

Although the Commission had a methodology and process in place for allocating Escrow Account funds to racetrack associations, it did not have a process in place to receive or review documentation to ensure that funds paid to racetrack associations to supplement purse prizes are spent on purses.

While Texas Occupations Code, Section 2028.002, authorizes the Commission to receive audited financial statements from organizations that receive funds generated by live or simulcast pari-mutuel wagering, these audit reports would not provide the Commission with the assurance needed to be able to determine how the Texas Horseman's Partnership (Partnership) spent funds received from the Escrow Account. The Commission does have the authority to request additional documentation from these organizations that should provide the detail needed to verify that the amounts were spent on purse supplements.

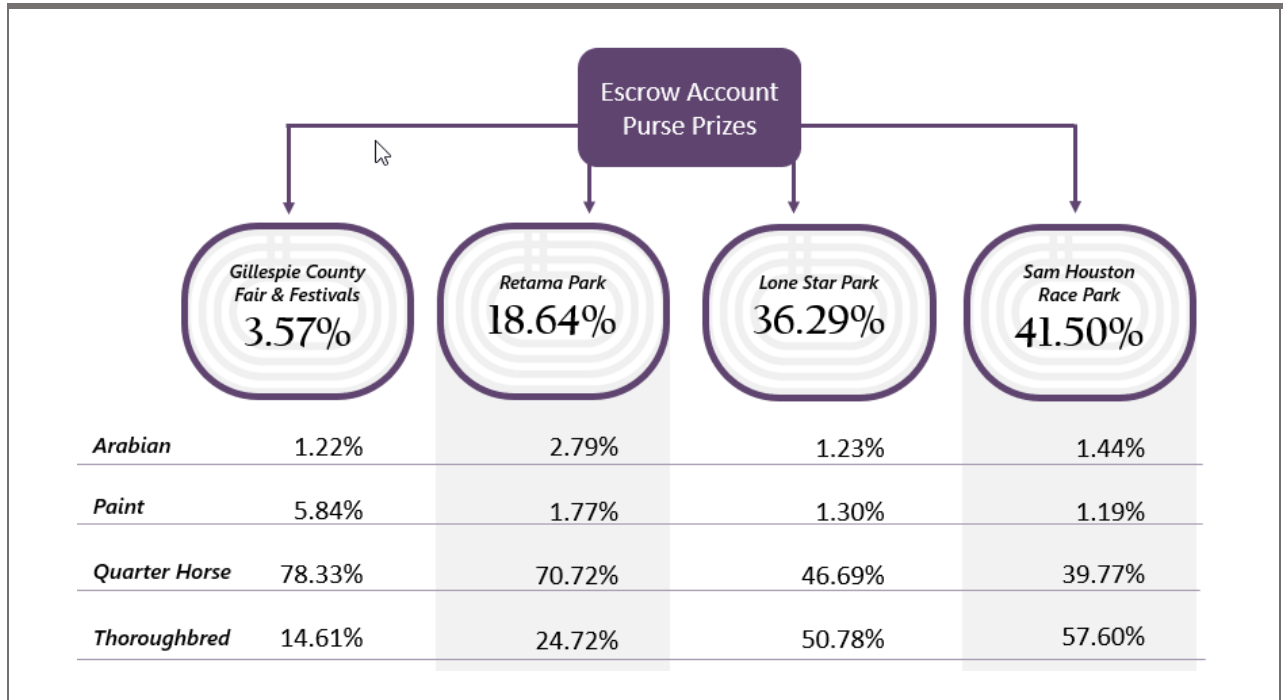
The Commission improved its process for distributing Escrow Account funds in accordance with its agreements between 2022 and 2023.

Although the Commission appropriately allocated the total amount of Escrow Account funds available to supplement horse race purses, those funds were often not distributed in accordance with the agreements between the Commission and the state's racetrack associations. Under the agreements, the Partnership receives purse allocations from the Escrow Account and distributes funds first at a racetrack level, then at a horse-breed level. The Partnership maintains 16 purse accounts—1 for each of the 4 horse breeds at each of the 4 active racetracks.

Figure 3 shows the distribution percentages for the 4 racetracks and the 16 accounts.

Figure 3

Purse Payment Distribution Agreements



Source: The Commission.

Payments to Supplement Calendar Year 2022 Purses. In April 2022, the Commission incorrectly allocated purse payments at 3 of the 4 racetracks, which resulted in 1 racetrack being underpaid by \$142,935 and 2 other racetracks being overpaid by \$128,995 and \$13,940.

The Commission identified this incorrect allocation in May 2022 and worked with the Partnership to correct the allocation errors **at the racetrack level**. Auditors confirmed that the Partnership made the internal transfers to correct the racetrack allocation errors.

However, the Commission also incorrectly allocated purse funds in April 2022 **within the breed-specific accounts** at three of the four racetracks. Figure 4 shows the over-payments and under-payments affecting 12 purse accounts.

Figure 4

CY22 Original Purse Allocation Differences by Track and Purse Account

	Gillespie County Fair & Festivals	Retama Park	Lone Star Park	Sam Houston Race Park
Arabian	(\$1,574)	\$0	\$19,236	\$2,058
Paint	\$269,255	\$0	\$9,677	(\$11,740)
Quarter Horse	(\$248,835)	\$0	\$351,416	(\$473,423)
Thoroughbred	(\$18,846)	\$0	(\$380,329)	\$483,105

Source: The Commission.

Corrections for 2022. In May 2022, when the Commission identified its initial allocation errors, as previously discussed, it also identified the over-payments and under-payments to the 12 purse accounts. The Commission worked with the Partnership to correct these allocation errors for 6 of those 12 purse accounts. The Commission asserted that the Partnership corrected the allocation errors in the remaining 6 purse accounts. However, the Commission did not maintain supporting documentation, so auditors were unable to verify that the corrections occurred. Figure 5 on the next page illustrates the allocation errors for which the Commission did not maintain documentation to show that corrections were made.

Figure 5

CY22 Remaining Purse Allocation Differences by Track and Purse Account

	Gillespie County Fair & Festivals	Retama Park	Lone Star Park	Sam Houston Race Park
Arabian	\$0	\$0	\$19,407	\$0
Paint	\$0	\$0	\$9,859	\$2,426
Quarter Horse	\$0	\$0	\$354,065	\$0
Thoroughbred	\$0	\$0	(\$383,331)	(\$2,426)

Source: The Commission.

Payments to Supplement Calendar Year 2023 Purses. For calendar year 2023, the Commission correctly allocated purse payments to 15 of the 16 breed-specific accounts. A payment of \$15,404 at 1 racetrack was meant to be paid to another breed-specific account at the same racetrack, as shown in Figure 6.

Figure 6

CY23 Purse Allocation Differences by Track and Purse Account

	Gillespie County Fair & Festivals	Retama Park	Lone Star Park	Sam Houston Race Park
Arabian	\$0	\$0	\$0	\$0
Paint	\$0	\$0	\$0	\$0
Quarter Horse	\$0	(\$15,404)	\$0	\$0
Thoroughbred	\$0	\$15,404	\$0	\$0

Source: The Commission.

Recommendations

The Commission should:

- Develop and implement monitoring processes to ensure that Escrow Account funds allocated to racetrack associations to supplement purse prizes are distributed to purse winners as intended.
- Make payments to supplement purse prizes in accordance with its approved methodology.

Management's Response

The agency will implement the recommendations in Chapter 1, regarding the allocation of funds to supplement horse race purses by developing updated procedures for the application, approval, allocation, distribution, and monitoring of escrow funds allocated to racetrack associations to ensure that supplement purse prizes are distributed to purse winners as intended.

Person Responsible: Executive Director

Implementation Date: September 1, 2024

Chapter 2

MEDIUM**Allocation of Funds for Horse Industry Events**

The Commission had a process for reviewing requests for funds and making payments from the Escrow Account for events conducted by authorized horse breed registries (see text box for more information about the allocations to breed registries). However, the Commission should implement a process to obtain and review documentation to provide oversight of event expenditures.

The Commission had controls over its approval and payment processes for event expenditures.

Approval of Expenditures. The Commission had processes in place for the review and approval of applications. Fifty-eight (98 percent) of 59 event-related expenditures tested had applications that contained all required information and obtained the applicable approvals per Commission policies. One application that was submitted did not have a completed economic impact section, as required.

Expenditure Payments. The Commission had controls to ensure that the breed registries received the amounts specified in their approved applications. Breed registries were paid appropriately for 57 (97 percent) of 59 event expenditures tested. For the remaining 2 expenditures (3 percent), the amount paid differed from the amount approved, and the Commission could not provide documentation to support the amount paid.

Allocations to Breed Registries

A breed registry is eligible to request funds from the Horse Industry Escrow Account if it is a recognized breed registry as defined by Texas Occupations Code, Section 2030.002(a). Events funded from the account must serve the public purpose of increasing the development, expansion, or diversification of the economy, employment, growth of enterprise, or tourism of the state, and a breed registry requesting event funds shall do so using forms approved by the executive director.

Source: Texas Administrative Code, Title 16, Section 303.321.

The Commission should strengthen its oversight of event expenditures.

The Texas Administrative Code requires that breed registries receiving funds from the Escrow Account:

- Maintain records of expenses paid out of funds from the Escrow Account for a minimum of five years following the event.
- Submit quarterly reports that include details regarding the amount of funds expended toward the events and certifying statements regarding proper use of funds and maintenance of supporting documentation.
- Submit annual financial statement audits that include (1) funds received and expended from the Escrow Account and (2) an auditor statement attesting to the proper use of the funds.

The Commission did not always ensure that breed registries maintained appropriate documentation and submitted complete reports as required.

Document Retention. Texas Administrative Code, Title 16, Section 303.324(a), authorizes the Commission to request and review documentation of expenses from the breed registries; however, the Commission has chosen not to use this tool to monitor payments. To determine if breed registries were maintaining records of expenses paid from Escrow Account funds as required, auditors selected eight event-related expenditures—two from each breed registry—and requested supporting documentation for those event-related expenditures from the breed registries.

Auditors determined that the breed registries were not maintaining complete or adequate records of the event-related expenditures paid by the Commission and that some Escrow Account funds had been used for lodging costs that were unallowable under Texas Administrative Code, Title 16, Section 303.322.

Specifically:

- \$3,035,420 in Escrow Account fund expenditures were not supported by records provided or had documentation that was insufficient to allow auditors to determine how the funds were used. For example, the documentation provided for one event was a record of a \$1,465,005 bank transfer from the breed registry to a racetrack for event payments. Marketing invoices totaling \$99,863 were provided; however, no

additional documentation was provided to show that the remaining \$1,365,142 in event payments had been made by the racetrack.

- \$1,748,683 in event-related expenditures reviewed by auditors, for which the breed registries provided documentation, included \$7,856 in unallowable lodging costs.

Required Reports. The Commission did not always ensure that required reports from the breed registries were received by applicable deadlines and contained required information. Specifically:

- **Annual Audit Reports.** The Commission did not maintain records of the annual audit reports required to be submitted to them; however, auditors obtained the annual reports for fiscal years 2021 and 2022 from the breed registries. Four (50 percent) of 8 annual audit reports reviewed were not submitted prior to the June 15 deadline. These 4 reports had an auditor opinion date that fell after the June 15 deadline each year. Additionally, of the 8 annual reports tested, 4 (50 percent) did not include funds received and expended from the Escrow Account, and 6 (75 percent) did not have an auditor statement attesting to the proper use of the funds as required by Texas Administrative Code, Title 16, Section 303.324(c).
- **Quarterly Reports.** The Commission asserted that it received quarterly reports from the breed registries, as required under Texas Administrative Code, Title 16, Section 303.325; however, it was unable to provide this documentation to auditors. As a result, auditors could not verify that the Commission maintained records for 39 (98 percent) of the 40 quarterly reports required to be submitted to them between September 1, 2021, and February 29, 2024.

In addition to the one quarterly report provided by the Commission, auditors obtained six quarterly reports from the breed registries. These seven quarterly reports were prepared inconsistently and did not always include the required information. For example:

- Three of the four breed registries completed consolidated quarterly reports for events held during the quarter. The fourth registry prepared a quarterly report for each event held during the quarter.

- Two reports were missing signature pages to indicate when the reports were prepared and were also missing the required certification indicating that the report was true and correct and that Escrow Account funds were spent in accordance with Texas Occupations Code, Section 2028.204.
- Two reports did not include sufficient documentation to support how Escrow Account funds were allocated at the event held by the breed registry or the total amount of funds expended on the event.

The Commission does not have a review process in place for required reports and was not conducting monitoring to ensure that reports included all required information and were received within required timeframes. Not receiving or reviewing documentation needed to monitor payments creates a risk that funds will be expended inappropriately.

Recommendations

The Commission should implement processes to ensure that:

- Documentation of expenses is maintained by the breed registries.
- Requests for changes to event expenditures approved by the Commission are retained as appropriate.
- Escrow Account funds are expended on allowable costs.
- Required reports are obtained and reviewed in a timely manner and contain all required information.

Management's Response

The agency will implement the recommendations in Chapter 2, regarding the allocation of funds for horse industry event by developing updated procedures to ensure that documentation of expenses is maintained by the breed registries, requests for changes to event expenditures approved by the Commission are retained as appropriate, escrow account funds are expended on allowable costs, and that

required reports are obtained and reviewed in a timely manner and contain all required information.

Person Responsible: Executive Director

Implementation Date: September 1, 2024



Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Racing Commission (Commission) has processes and related controls to ensure that the Horse Industry Escrow Account (Escrow Account) is administered in accordance with applicable requirements.

Scope

The scope of this audit focused on processes and controls in place during fiscal years 2022 and 2023 and from September 1, 2023, through February 29, 2024.

The scope also included a review of significant internal control components related to (1) allocation of payments from the Escrow Account and (2) administration and processing of applications for Escrow Account funding for events intended to further the horse industry.

The following members of the State Auditor's staff performed the audit:



- Robert Pagenkopf, MBA, CFE (Project Manager)
- Jules Hunter, CPA, CIA (Project Manager)
- Jessica McGuire, MSA (Assistant Project Manager)
- Alariyah Burr
- Daniel Carr, CFE
- Alex Kipple
- Kevin Mack, CFE
- Jimmy Neil
- Matthew Page
- Ann E. Karnes, CPA (Quality Control Reviewer)
- Michael Owen Clayton, CPA, CISA, CFE, CIDA (Audit Manager)

Methodology

We conducted this performance audit from January 2024 through July 2024 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. In addition, during the audit, matters not required to be reported in accordance with *Government Auditing Standards* were communicated to Commission management for consideration.

Addressing the Audit Objective

During the audit, we performed the following:

- Interviewed management and key staff from the Commission, breed registries, and racetrack associations to gain an understanding of processes and controls related to the Escrow Account.
- Identified the relevant criteria:
 - Texas Occupation Code, Chapters 2028 and 2030.
 - Texas Administrative Code, Title 16, Chapter 303.
 - Commission policies and procedures.
 - Department of Information Resources' *Security Control Standards Catalog*, Version 2.0.
- Analyzed Escrow Account expenditures by payee to determine the percentage of Escrow Account funds allocated for purses and Breed Registry events.
- Analyzed Escrow Account expenditures paid to the Texas Horseman's Partnership to determine whether the Commission complied with the agreed-upon allocation of purse funds.
- Tested 59 event-related expenditures from a population of 142 event-related expenditures paid to breed registries. The selection was designed to test more items from the end of the audit period and fewer from the beginning of the audit period to validate the Commission's

assertion that its processes related to Escrow Account event application processing and approvals improved during the audit period after the hiring of new staff members. The 59 event-related expenditures that we tested consisted of the following:

- A random sample of 30 event-related expenditures that was stratified by fiscal year as follows:
 - 10 items from fiscal year 2024;
 - 15 items from fiscal year 2023; and
 - 5 items from fiscal year 2022.
- One additional event-related expenditure that was selected intentionally from fiscal year 2022 to ensure inclusion of all breed registries for that fiscal year.
- An additional 28 event-related expenditures from fiscal year 2024. These additional 28 event-related expenditures were tested to validate the Commission's assertion related to process and documentation retention improvements.

All 59 event-related expenditures were tested to determine whether they were supported by an application for the event, whether the event application included all required elements, whether the breed registry received the requested funds, and whether the event application was appropriately approved. The samples selected were not necessarily representative of the population; therefore, it would not be appropriate to project test results to the population.

- Tested a sample of 8 event-related expenditures from a population of 142 event-related expenditures paid to breed registries to determine if breed registries maintained records of expenses paid from Escrow Account funds and whether those records were sufficient to determine if event-related expenses were allowable under Texas Administrative Code, Title 16, Section 303.322. The selection methodology for the eight event-related expenditures consisted of (1) the largest expenditure for each breed registry and (2) one other event-related expense per registry, selected at random. The samples selected were not necessarily representative of the population; therefore, it would not be appropriate to project test results to the population.

- Tested quarterly reports to determine if those reports were submitted to the Commission within required timeframes and included all required information elements.
- Tested annual, audited financial statements for each breed registry for fiscal years 2021 and 2022 to determine whether the audited financial statements were submitted to the Commission within required timeframes and whether they included all required elements outlined in Texas Administrative Code, Title 16, Section 303.324(c).
- Tested the Commission's user access to the Uniform Statewide Accounting System (USAS) and the Centralized Accounting and Payroll/Personnel System (CAPPS).

Data Reliability and Completeness

Auditors determined that expenditure data obtained from USAS was sufficiently reliable for the purposes of the audit by (1) extracting data directly from USAS, (2) comparing extracted USAS expenditure data to summary reports obtained from the Office of the Comptroller of Public Accounts' State Internet Reporting System (SIRS), and (3) testing selected general controls over USAS as they related to the Commission and the Escrow Account.

Report Ratings

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.



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The Honorable Greg Bonnen, House Appropriations Committee

The Honorable Morgan Meyer, House Ways and Means Committee

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The Honorable Greg Abbott, Governor

Texas Racing Commission

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Ms. Amy F. Cook, Executive Director



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