State of New Mexico
OFFICE OF THE STATE AUDITOR

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Via Email, Facsimile and U.S. Mail

Larry Kennedy, Chair
State Fair Commission
and
Dan Mourning, General Manager
EXPO New Mexico
P.O. Box 8546
Albuquerque, NM 87198

Re: Risk Advisory – State Fair Commission – 2011-2012 Fiscal Year Financial Audit Report– Prepared by Griego Professional Services

Dear Chairman Kennedy and Mr. Mourning:

On Thursday, January 9, 2014, my office officially released the State Fair Commission's (EXPO) fiscal year 2012 financial audit report to EXPO's management and governing body. I trust that EXPO management has distributed copies of the audit report, which is now public by law, to all State Fair Commission members. The audit report is also available on our website at www.osanm.org. The audit was performed by Griego Professional Services, LLP, EXPO's independent public accountant (IPA). In our comprehensive risk review of the final 2012 financial audit report, OSA staff noted that EXPO continues to be operationally insolvent and multiple financial problems remain unresolved. The IPA also noted certain deficiencies in the procurement process administered by EXPO for a long-term lease for the management of a racetrack and casino (Racino). As exhibited throughout this risk advisory, the State Fair Commission and EXPO's management must take immediate corrective action to address numerous significant audit findings uncorrected from prior years. Most importantly, however, the results of the audit demonstrate the urgent need for action to improve oversight, increase accountability, and reform and strengthen EXPO's operations. It is imperative that the Legislature, working together with EXPO, resolve the persistent financial problems that plague EXPO and threaten its long-term economic viability. The conclusion of this risk advisory outlines certain recommendations related to potential reform.

As State Auditor, it is my duty under the Audit Act (Section 12-6-1 NMSA 1978 et seq.) to provide New Mexico's citizens with an independent opinion of all government

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agencies' financial affairs in a greater effort to increase transparency, promote accountability, and eliminate financial fraud, waste and abuse. Therefore, my office actively worked with your IPA throughout the audit process to ensure the financial affairs and transactions of EXPO for fiscal year 2012 were thoroughly examined. The audit work included the IPA's review of the status of numerous prior-year audit findings that identified material weaknesses and significant deficiencies in EXPO's operations. Additionally, the IPA assessed and tested certain risks related to EXPO's fiscal year 2012 procurement of a long-term lease for a Racino. Finally, prior to release of the report, an OSA audit review team conducted an extensive quality control review of the IPA's working papers and the audit report. This review process benefited EXPO and the users of the audit report by ensuring the IPA complied with governmental auditing, accounting and financial reporting standards.

With regard to the audit's results, I am alarmed by EXPO's ongoing operational insolvency. The fiscal year 2012 audited financial statements show that EXPO could only cover 66 cents for each dollar in current liabilities. In addition, EXPO's unrestricted net assets decreased to a deficit of approximately $3 million as of June 30, 2012. Further, as detailed in Finding 12-01, EXPO violated state law by spending nearly $1.6 million in excess of its legal budgetary authority in fiscal year 2012. The IPA classified this finding as a material weakness and noted that EXPO failed to make "the appropriate budgetary adjustment requests and transfers" prior to the end of the fiscal year. The effect of this violation of law, as stated by the IPA, is that EXPO compromised the control over the use of budgets which "may result in unnecessary usage of operating funds to cover the over-expenditures." Moreover, to cover its operational expenses, EXPO has not paid over $1.8 million in insurance coverage to the Risk Management Division of the General Services Department (Note 5 of the Notes to Financial Statements, fiscal year 2012 annual financial audit report). This "loan" dates back to fiscal year 2009.

In addition to its budgetary troubles, EXPO received multiple concerning audit findings in fiscal year 2012 which exhibit poor fiscal management and failure to establish and adhere to internal controls within EXPO. A number of findings were identified in prior years, but have yet to be remedied. Given the importance of certain deficiencies and the associated risks to public funds, several findings deserve discussion here. For example:

- In Finding 08-03, the IPA found that EXPO management was unable to provide supporting documentation for I-9 forms (a federal form used to verify the identity and employment authorization of individuals hired for employment in the United States) for 9 out of 25 employees tested. As stated by the IPA, EXPO is not in compliance with federal law, specifically the Immigration Reform and Control Act of 1986 (IRCA), by failing to maintain supporting documentation for the I-9 forms. IRCA made it unlawful for employers to knowingly hire or continue to employ unauthorized workers, and it requires that employers ensure the I-9 form is completed accurately and timely in order to verify employment eligibility status. The form's components include the employer's certification that the employee's documents of identity and work authorization appear to be genuine and belong to

the employee. EXPO's failure to fully comply with ICRA may subject it to federally mandated fines and other legal risks. Additionally, the IPA found that EXPO management was unable to provide W-4 forms (a federal form completed by an employee so the employer can withhold the correct federal income tax from the employee's pay) for 5 out of 25 employees tested. It is troubling that EXPO has failed to resolve this finding since 2008, and EXPO must establish effective procedures to ensure its personnel actions have the required supporting documentation as required by federal law.

- As referenced above, in Finding 12-01 the IPA found EXPO violated state law and state regulation by spending nearly $1.6 million in excess of the State Fair Commission's budgetary authority. This finding is a material weakness in EXPO's control over the use of budgets which "may result in unnecessary usage of operating funds to cover the over-expenditures." The IPA stated that EXPO "must establish a policy of budgetary review at year end and . . . All BARs [budget adjustment requests] and or adjusting journal entries should be requested through the proper process at the Department of Finance and Administration and be approved prior to year end."

- In Finding 11-03, the IPA noted that EXPO lacks a current comprehensive documented internal control structure. The finding, which initially was reported in EXPO's fiscal year 2011 financial audit report, states that EXPO has failed to update procedural manuals, including key internal control procedures, on a timely basis. Documented internal controls are the foundation of sound fiscal management, protection of resources, deterrence of fraud and continuity of operations when personnel turnover occurs.

- EXPO's investment in capital assets represents more than 99% of total net assets; however, the IPA identified a significant deficiency in EXPO's controls over capital assets. In Finding 09-02, the IPA noted that EXPO's management failed to complete an annual physical inventory of its capital assets as required by the Audit Act and the Audit Rule, specifically Section 2.2.2.10(Y) NMAC. Additionally, the IPA stated that the inventory listing EXPO did have did not appear to be a complete inventory of all capital assets. EXPO's exposure to asset misappropriation increases significantly when there is a lack of accounting and tracking of capital assets.

- As demonstrated by two prior-year findings which the IPA classified as significant deficiencies, EXPO lacks the proper segregation of duties to properly process transactions and protect the agency's resources. Finding 08-01, which has been included in EXPO's financial audit report for the past five fiscal years, notes a deficiency in EXPO's review and approval of payroll transactions and maintenance of required supporting documentation. Since the payroll supervisor position was vacant, EXPO's controller was processing payroll. As a result, there was not proper segregation of duties and the controller's payroll work was not reviewed and approved. Additionally, as noted by the IPA in Finding FS 11-02, the controller

completed many daily processing tasks rather than performing the internal control functions of review and approval. This failure to maintain proper internal controls exposes EXPO to potential fraud and undetected errors.

- As identified by the IPA in Finding 12-08, there is no documentation that the State Fair Commission approved the promotion of EXPO's Interim Deputy Director to the position of General Manager, which is required by state law. The finding notes that the Commission authorized the Interim Deputy Director to "run day-to-day operations of the State Fair" on July 29, 2011, but there is no documentation that the Commission approved the hiring of the Interim Deputy Director into the position of General Manager, which occurred on May 12, 2012. Section 16-6-4 NMSA 1978 provides that the Commission, as EXPO's governing body, "shall determine the duties, compensation and tenure of office of all of its officers and employees." Therefore, state law mandates that the Commission properly approve personnel actions within EXPO, such as the hiring of EXPO's top management position.

The IPA also noted certain significant deficiencies in the procurement process administered by EXPO for a long-term Racino lease. Prior to and during the IPA's performance of the fiscal year 2012 audit process, my office received various complaints regarding the fiscal year 2012 Racino procurement process, EXPO's award of the 25-year multimillion dollar lease to the Downs at Albuquerque, Inc. (Downs), and EXPO's compliance with the current and prior leases with the Downs. As a result, OSA staff carefully assessed the issues raised in the complaints, conducted an extensive risk assessment of EXPO's financial audits from prior fiscal years, and reviewed the LFC's Program Evaluation of the New Mexico State Fair dated October 20, 2011. Certain issues raised in the complaints did not fall within the State Auditor's jurisdiction or were not appropriate for review during EXPO's annual financial audit. However, OSA staff did identify specific areas of concern which my office referred to the IPA for inclusion in the audit test work. The IPA was also required to test certain aspects of EXPO's compliance in this area due to the material significance of the contract award. Prior to release of the audit report, an OSA audit review team performed an audit report and working paper review to inspect whether the IPA properly addressed the specific areas of concern. The IPA's findings and recommendations in these areas included the following:

- In Finding 12-03, the IPA found that the Racino RFP was a "complex proposal" that would require a bidder response time longer than the minimum 30 days EXPO provided for proposal responses. As stated in the finding, "sound fiscal management would require additional time for bidders to respond to a complex proposal" and state procurement regulation "indicates a longer period of time for complex proposals." Specifically, state procurement regulation 1.4.1.31(D) NMAC, provides the following: "Thirty calendar days between the date of issue and the proposal due date is the recommended minimal preparation time. A longer preparation time may be required for complex procurements or for procurements that require substantial offeror resources to prepare an acceptable proposal." The IPA stated that EXPO complied with the "recommended minimal preparation time" under state regulation

when it allocated a response time of 30 days for the Racino RFP; however, the IPA found the Racino RFP was "very complex and involved multiple facilities, construction, revenue sharing and other potential aspects." Because EXPO only allowed 30 days for proposal responses, the Racino proposal "required further clarification and oral presentations from each potential awardee to finalize the evaluations and the decision process." The IPA recommended that EXPO "establish a policy to ensure offerors are provided a reasonable amount of time to respond to complex proposal processes and thus provide the potential for additional respondents to participate in the process."

- As noted in Finding 12-04, EXPO did not utilize conflict of interest forms for the evaluation committee members who evaluated the Racino bids. According to the IPA, the use of conflict of interest forms would ensure independence of the committee members and "would mitigate and deter any questionable actions" during the selection process. The IPA did not cite a violation of law for EXPO's failure to use conflict of interest forms; rather, the IPA recommended that EXPO use the forms for to "strengthen the organization's internal controls and improve the evaluation process" for complex RFPs.

- With regard to the evaluation committee established to review and score the Racino proposals, the IPA found significant deficiencies in the committee member selection process. First, as detailed in Finding 12-05, the IPA noted that the evaluation committee for the Racino RFP was not established prior to the due date for receipt of the Racino proposals, which is a violation of state procurement regulation. Additionally, the IPA identified audit evidence that indicates EXPO did not select the evaluation committee members. State procurement regulation, specifically 1.4.1.38(B) NMAC, requires that "state agency management [EXPO's management] shall appoint an evaluation committee prior to the due date for receipt of proposals." However, the IPA stated in the condition of Finding 12-05 that the "audio and narrative minutes for the State Fair Commission's September 1, 2011 and November 9, 2011 meetings indicate that EXPO did not select the evaluation committee." The IPA further states that these violations of state procurement regulation "may result in litigation, inappropriate selection of contractors and potential liabilities relating to old and new contract agreements."

I am concerned by certain audit findings which unfortunately generate doubts about key aspects of the Racino procurement process administered by EXPO. For example, Finding 12-03 calls into question whether the 30 day proposal response window was an adequate time period for offerors to prepare and submit proposals for this highly complex, multimillion dollar, long-term transaction. Most significantly, however, the audit evidence highlighted in Finding 12-05 indicates EXPO management did not select the evaluation committee members who recommended the award of the lease to the Downs. Given its duties under state procurement regulations, the evaluation committee played a powerful role in the procurement process by interviewing the offerors, scoring the proposals, ranking the offerors, and deciding which proposal is most advantageous to the state. This

specifically included comparisons and determinations regarding the management expertise of the offerors, the financial strengths of the offerors and related fiscal benefits to the State Fair, the offerors' marketing plans, and the proposed integration of the offerors' operations and capital improvements with the State Fair. The integrity of the Racino evaluation committee should have been zealously safeguarded due to these highly influential responsibilities.

Agency management has the sole discretion to select evaluation committee members and the selection process should be independent, free from undue influence and consistent with the explicit purposes of the Procurement Code. That Code, specifically Section 13-1-29 NMSA 1978, provides that the "purposes of the Procurement Code are to provide for the fair and equitable treatment of all persons involved in public procurement, to maximize the purchasing value of public funds and to provide safeguards for maintaining a procurement system of quality and integrity." For these reasons, I am troubled by EXPO's violations of state procurement requirements related to the evaluation committee. It is essential that information regarding who selected the committee members and how they were selected be wholly transparent to the public. These disclosures are critical in order to minimize risks, increase transparency, and eliminate the appearance of any conflicts of interest.

The IPA's complete findings and comments are included in the audit report on pages 20-28, and the State Fair Commission and EXPO's management have a shared duty to ensure financial accountability. Auditing standards provide that management, along with those charged with governance, bear the responsibility of making certain that all of EXPO's financial affairs are properly reported in the financial statements and that fraud does not occur within EXPO. The State Fair Commission should be involved in the financial reporting process and ensure management is taking corrective action to address audit findings. With regard to EXPO's management, it should establish adequate internal controls over financial reporting, implement measures to prevent and detect fraud, and implement corrective action for findings in a timely manner.

While your agency should swiftly implement corrective action for all findings, the ongoing problems and risks evidenced by the fiscal year 2012 audit report also verify the urgent need for action to remedy the crisis of confidence in EXPO's financial operations. In fact, the LFC's 2011 Program Evaluation Report of EXPO indicated that a "combination of management and legislative actions are needed to increase accountability and oversight to ensure the New Mexico State Fair continues to fulfill its vital and economic and cultural role within the state of New Mexico." The results of EXPO's fiscal year 2012 audit bolster that proposition, and it is my hope that these oversight agencies will evaluate and enforce all options allowable under law to assist in resolving your agency's adverse fiscal condition.

I would recommend these options include a review of the State Fair Commission's enabling statutes, with an eye towards structural reform of the Commission. EXPO's enduring financial problems, in addition to the improper personnel action and Racino evaluation committee appointment deficiencies cited in the 2012 financial audit, should

provoke debate about the independence and expertise needed for the Commission. The Legislature should also consider options for effective legislative oversight of the Commission's operations, perhaps similar to the New Mexico Finance Authority Oversight Committee. Most notably, the overwhelming majority of statutes that create the State Fair Commission and grant the Commission its powers and duties have not been amended in 20 years or more. In an ever-evolving economic environment that requires innovative adaptation, the Legislature should revisit whether the current statutory design for the New Mexico State Fair fully supports the growth and proper function of EXPO's enterprise operations. I believe this statutory review would be best accompanied by a comprehensive performance audit or further program evaluations of EXPO's enterprise and government functions. Any performance audit or evaluation should also review key provisions of the Racino lease and independently determine whether the terms of the lease are structured in the best interest of the state. These reports would be extremely valuable tools for government officials and stakeholders who will need that information to make informed decisions about EXPO's future.

My staff will also continue to monitor EXPO's progress and I appreciate your cooperation throughout the fiscal year 2012 audit process. As is our practice, my office will share information about your audit with any oversight agencies that may inquire about the audit results, findings and recommendations.

Respectfully,

Hector H. Balderas
State Auditor

cc: Griego Professional Services, LLP
State Fair Commission Members
Bill Nordin, Chief Financial Officer, EXPO
Representative Luciano "Lucky" Varela, Chairman, LFC
Senator John Arthur Smith, Vice Chair, LFC