THOMAS P. DiNAPOLI
STATE COMPTROLLER

110 STATE STREET
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

June 15, 2007

Mr. Charles Hayward
President and Chief Executive Officer
The New York Racing Association, Inc.
P. O. Box 90
Jamaica, NY 11417

Re: Report 2006-F-51

Dear Mr. Hayward:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 208 of the New York State Racing, Pari-Mutuel Wagering and Breeding Law, we have followed up on the actions taken by officials of the New York Racing Association Inc. (NYRA) to implement the recommendations contained in our audit report, *New York Racing Association, Inc. Travel and Entertainment Expenses (*Report 2004-S-40), issued January 11, 2005.

Background, Scope and Objective

NYRA is a not-for-profit association with an exclusive franchise from New York State to conduct racing and pari-mutuel betting at the Aqueduct, Belmont Park and Saratoga racetracks. Section 208 of the Racing Pari-mutuel and Breeding Law requires NYRA to operate in a sound, economical, efficient and effective manner to produce a reasonable revenue for the support of (State) government. In return for this exclusive franchise, NYRA is required to pay the State a pari-mutuel tax figured as a percentage of on-track handle, and an annual franchise fee based on its Federal corporate taxable income adjusted for certain excessive expenses noted in the statute. NYRA is governed by a 28-member Board of Trustees, some of which are appointed by the Governor. NYRA's current franchise is scheduled to expire on December 31, 2007.

NYRA's travel and entertainment expenses, which totaled about $2 million during our prior audit period (January 1, 2002 to May 31, 2004), are subject to NYRA's Travel and Expense Policy (Policy). Our prior audit found that NYRA's Policy was not comprehensive or consistent with the Internal Revenue Code (Tax Code) requirements, and had not been distributed to all employees. We found that NYRA's Policy, though updated in 2000 in response to criticism from the State Comptroller, was still incomplete. Among the items omitted from the Policy were dollar limits for employee meals and lodging while on travel status, and Saratoga per diem allowances for top NYRA executives. (Saratoga per diem costs totaled $1.7 million in 2003 alone.) We also determined that NYRA reimbursed, and incorrectly deducted on its federal corporate tax return, unsupported and

inappropriate travel and entertainment expenses totaling approximately $953,000; and spent more than $80,000 for excessive expenses NYRA could not afford. In fact, former top NYRA officials and Board members often benefited from NYRA's lax controls over travel and entertainment expenses. For example, NYRA spent $42,672 for calendar years 2002, 2003 and 2004 country club membership costs for two top executives. In addition, unsupported travel and entertainment costs included items such as meals in the Trustees' Dining Room, golf outings for the wives of certain former NYRA executives, and $95,070 for press luncheons. When we tested a sample of 2004 expenses, we found that little had changed: more than half the transactions tested were found to be unsupported or inappropriate. We recommended that NYRA enhance its Policy to address the deficiencies noted in our report, revise its tax returns submitted for prior years, and remit any additional franchise fees owed. We also recommended that NYRA deduct only those expenses allowed by the Tax Code.

The objective of our follow up, which was conducted in accordance with generally accepted government auditing standards, was to assess the extent of implementation, as of January 26, 2007, of the 10 recommendations included in our initial report.

Summary Conclusions and Status of Prior Audit Recommendations

Of our 10 prior audit recommendations, NYRA officials have implemented seven recommendations, partially implemented one recommendation, and have not implemented two recommendations.

Follow-Up Observations

Recommendation 1

Establish a control environment that, as the primary element in an adequate system of internal control, fosters ethical values, competence and commitment to compliance with the Racing Law, the Tax Code and relevant NYRA policies.

Status - Implemented

NYRA Action - The control environment established by NYRA's current management team is greatly improved from that created by NYRA's former management. Current management is very cooperative with, and responsive to, our audits, and have initiated controls and management oversight practices (e.g., policies, procedures, internal audits, etc.) to help ensure compliance with the Racing Law, Tax Code and relevant NYRA policies. Further, NYRA officials have issued a comprehensive Code of Ethics, as well as a revised manual to govern travel and entertainment expenses.

Recommendation 2

Require that all NYRA employees sign and date a NYRA Code of Ethics, and enforce compliance with the terms of the Code of Ethics.

Status - Implemented

NYRA Action - NYRA officials have developed a comprehensive Code of Ethics which has been distributed to their employees. Our sample of 50 NYRA employees selected from a recent payroll register found that 47 of the 50 have signed and dated forms indicating their acknowledgement of the Code of Ethics. NYRA could not locate the forms for three of our sampled employees.

Recommendation 3

Develop a comprehensive written Travel and Entertainment Policy whose provisions conform to requirements of the Tax Code and the Racing Law. Provisions should include, but not be limited to, the following:

- *the identification of travel and entertainment expenses that are reimbursable, as well as the documentation employees must submit to obtain reimbursement;*
- *the identification of practices/costs that NYRA does not reimburse (e.g., parking tickets and country club memberships, neither of which are deductible);*
- *the definition of amounts and types of expenses (e.g., luxury car rental) that NYRA will not pay for because they are excessive; and*
- *reimbursement schedules for Saratoga travel for all NYRA employees.*

Status - Implemented

NYRA Action - As noted above, NYRA officials have developed a comprehensive Travel and Entertainment Policy. Our review of the Policy found that it addresses the issues and concerns outlined in our initial report. For example, the Policy identifies specific non-reimbursable expenses such as parking tickets and club memberships.

Recommendation 4

Distribute the Policy to all NYRA employees and train employees to ensure they understand the Policy's provisions.

Status - Implemented

NYRA Action - To evidence distribution of the revised Policy to NYRA employees, and associated employee training, NYRA officials provided us with several communications regarding the distribution of said Policy, a presentation for training purposes, dates of training, and attendee rosters.

Recommendation 5

Ensure that employees who process travel costs consistently review submitted expenses for conformance to the Policy before reimbursing travelers.

Status - Partially Implemented

NYRA Action - We selected a sample of 10 paid travel vouchers submitted by NYRA employees subsequent to our prior audit. We found that, although each of the vouchers evidenced supervisory approval, three of them did not comply with NYRA's Policy. Two of the vouchers reimbursed employees for lodging rates exceeding the federal per diem without justification or evidence of cost comparisons. The third voucher did not explain or support the business nature or attendees for reimbursed food and beverages. We did see evidence, however, that selected expenses were questioned prior to payment.

Recommendation 6

Require that nondeductible travel and entertainment expenses are reported as such, and not carried through to NYRA tax returns.

Status - Implemented

NYRA Action - Our review of NYRA's federal corporate tax returns for calendar years 2004 and 2005, found that NYRA is deducting its travel and entertainment expenses in compliance with limits mandated by the Tax Code. The supporting documentation for our conclusion includes NYRA's general ledger travel and entertainment account activity, and worksheets applying the required 50 percent adjustment to those expenses.

Recommendation 7

Correct the inappropriate travel and entertainment account entries for calendar year 2003 to avoid calculating an understated federal income tax and State franchise fee for that period.

Status - Not Implemented

NYRA Action - According to NYRA officials, they will not be visiting this area until the Internal Revenue Service completes its multi-year audit of NYRA's federal corporate tax returns which includes the year in question.

Recommendation 8

Revise NYRA's federal corporate tax return for calendar year 2002 by the amount noted above to obtain NYRA's correct federal tax and State franchise fee obligation for that period. Remit the appropriate payments. Revisit the corporate tax returns for the previous two years (2001 and 2000), at a minimum, to determine whether similar unallowable deductions were taken. If so, correct underpayments of federal tax and the State franchise fee that resulted therefrom.

Status - Not Implemented

NYRA Action - See NYRA Action for Recommendation 7.

Recommendation 9

Establish an independent level of review to monitor the propriety, deductibility and accuracy of travel and entertainment expense payments.

Status - Implemented

NYRA Action - NYRA's Internal Audit staff has established a multi-year audit plan which includes periodic reviews of NYRA's travel and entertainment expenses. Their first audit was performed in 2006 and identified several questionable transactions which were followed up on and corrected. We also noted Accounts Payable staff returning certain requests for reimbursement to the claimant due to missing required information.

Recommendation 10

To the NYRA Board of Trustees

As NYRA stakeholders, fulfill the Board's governance responsibilities by taking active steps to ensure NYRA's compliance with the Racing Law and the Tax Code.

Status - Implemented

NYRA Action - To support the implementation of this recommendation, NYRA officials gave us Board of Trustee minutes evidencing discussions of our initial audit (Report 2004-S-40) between NYRA's Audit Committee, its then Chief Financial Officer, and Internal Auditor. We were also given evidence that NYRA's Audit Committee requested that a continuous monitoring process of travel and entertainment expenses be instituted.

Major contributors to this report were Frank Patone, Stuart Dolgon, Jeffrey Marks and Kamal Elsayed.

We would appreciate your response to this report within 30 days indicating any actions planned to address the unresolved issues herein. We also thank the management and staff of NYRA for the courtesies and cooperation extended to our auditors during our follow up audit.

Very truly yours,

William P. Challice
Audit Director

cc: Lisa Ng, Division of the Budget