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STATE COMPTROLLER



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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

March 21, 2001

Mr. Terrence Meyocks
President and Chief Operating Officer
New York Racing Association, Inc.
P.O. Box 90
Jamaica, NY 11417

Re: Report 2000-F-38

Dear Mr. Meyocks:

Pursuant to the State Comptroller's Authority as set forth in Article V, Section 1 and Article X, Section 5 of the State Constitution and Section 208 of the New York State Racing, Pari-mutuel Wagering, and Breeding Law, we have reviewed the actions taken by New York Racing Association (NYRA) officials, as of October 10, 2000, to implement the recommendations contained in our audit report, *Audit of the Annual Franchise Fee* (Report 98-S-6). Our report, which was issued on September 3, 1999, addressed NYRA's calculation of the annual franchise fee for calendar years 1995, 1996, and 1997.

Background

NYRA, organized in 1955, was granted an exclusive franchise to operate the State's three major thoroughbred racetracks (Aqueduct, Belmont Park, and Saratoga), and to conduct racing and pari-mutuel betting at these tracks. NYRA's franchise is currently set to expire on December 31, 2007.

NYRA's major direct fiscal contribution to the State is the pari-mutuel tax, calculated as a percentage of NYRA's gross racing handle (wagering revenue). NYRA is also required to pay an annual franchise fee to the New York State Thoroughbred Racing Capital Investment Fund (Fund) as reimbursement for outstanding loans.

NYRA reported an operating deficit in 1995 and therefore did not pay a franchise fee for that year. However, it did pay the Fund \$3.6 million for 1996 and \$268,000 for 1997.

Summary Conclusions

Our prior audit found that, contrary to Internal Revenue Service Tax Code rules for travel and entertainment expenses, NYRA deducted \$77,000 worth of expenditures during calendar years 1996 and 1997 to reimburse its senior officials for meals they shared with industry-related personnel and their spouses or guests. In addition, NYRA did not have supporting documentation for 19 sampled expense items. The sampled items, totaling \$114,192, included payments made for consulting services and business-related travel and entertainment. We also found that NYRA continued to provide a number of its officials and staff with costly perquisites, such as leased automobiles and free gasoline, which we believe did not contribute to NYRA's financial viability and may not have been warranted. Furthermore, we determined that \$2.5 million worth of prior years' OTB revenue received by NYRA in 1998, and \$63,660 in over-accrued and duplicate expenses pertaining to calendar years 1996 and 1997, were posted inappropriately to NYRA's 1998 books of record, instead of entering them as adjustments to the corresponding prior years' books, tax returns, and franchise fees. In addition, we identified NYRA several employees who had been misclassified as independent contractors.

In our follow-up review, we found that NYRA officials have made progress in implementing the recommendations contained in our prior report. They have developed a formal policy for travel and entertainment expenses, reviewed their policy and controls over employee perquisites, developed a system to monitor NYRA's share of OTB revenues, and revised the status and work relationships of individuals previously classified as independent contractors. NYRA officials have also enhanced their record-keeping maintenance and retrieval practices. However, NYRA continues to deduct certain expenses that are not ordinary and necessary to its business operations, and has not revised its records and returns for the prior period, as we had recommended in our prior audit.

Summary of Status of Prior Audit Recommendations

Of the 10 prior audit recommendations, NYRA officials have implemented five recommendations, have partially implemented three recommendations, and have not implemented two recommendations.

Follow-up Observations

Recommendation 1

Develop clear definitions for expenses that should be classified as advertising/promotional.

Status – Implemented

Agency Action – NYRA officials have prepared formal definitions for their advertising and promotional expenses based on the definitions outlined in the governing statute. They have also committed to reviewing this issue with a newly-engaged outside audit firm to determine whether further clarification is warranted.

Recommendation 2

Ensure that only properly-classified advertising and promotional expenses are exempt from the 106-percent statutory expense cap.

Status – Implemented

Agency Action – Our follow-up review found that, in general, NYRA has been categorizing expenses accurately. We did find that a couple of expense items had been misclassified as promotional, but they were immaterial to NYRA’s overall financial operations and did not affect the franchise fee calculation.

Recommendation 3

Ensure that operating expenses are justified by sufficient documentary evidence. If expenses cannot be reasonably supported, recover the corresponding payments and remit them to the Fund as a revision to the franchise fee.

Status – Partially implemented

Agency Action – NYRA now scans all of its vouchers and supporting documents into a computerized record-keeping system, making it significantly easier for NYRA staff to maintain and retrieve records as needed. However, during our current audit (Report 2000-S-18), we found several expenses that were not supported by sufficient documentary evidence.

Recommendation 4

Adjust the prior period accounting records and tax returns for the \$61,600 over-accrued and the \$2,060 duplicate payment noted in this report. Remit the combined total to the Fund as a revision to the franchise fee.

Status – Not implemented

Agency Action – NYRA officials said they consider the \$61,600 over-accrual as immaterial in the accounting sense and have not adjusted their prior period accounting records. Further, although NYRA was reimbursed for the \$2,060 duplicate payment, it has neither revised its franchise fee calculation nor remitted any additional monies to the Fund.

Recommendation 5

Ensure that all NYRA expenses are ordinary and necessary to its normal business operations.

Status – Partially implemented

Agency Action – The majority of expenses we sampled during our follow-up review met the requirements of the Federal tax code, which governs NYRA’s deductible expenses for franchise fee purposes. However, we did identify some expenses, such as lobbying costs, which are not ordinary or necessary to NYRA’s normal business operations.

Recommendation 6

Develop a formal policy for governing and documenting deductible travel and entertainment expenses that will help ensure compliance with the Federal Income Tax Code and NYRA’s statutory mandate to operate in a sound, economical, and efficient manner.

Status – Implemented

Agency Action – NYRA has developed such a policy and has distributed it to appropriate personnel.

Recommendation 7

Review the current policy and controls over employee perquisites to ensure that NYRA’s limited financial resources are expended only on bona fide business purposes.

Status – Partially implemented

Agency Action – NYRA officials informed us that they reviewed their current policy and controls over employee perquisites and concluded that they have consistently exercised appropriate business judgment and corporate governance in these areas. We note that as a result of their review, enhanced controls have been implemented over the dispensing of gasoline to NYRA employees. However, the lack of justification for certain other employee perquisites (e.g., leased vehicles for selected administrative staff) continues to exist.

Recommendation 8

Adjust the appropriate prior-year franchise fee calculations to include the monies received from the Catskill OTB, and remit the proper share to the Fund.

Status – Not implemented

Agency Action – NYRA received prior period revenues of approximately \$2.5 million from Catskill OTB in calendar year 1998 and credited its books for the same period. As a result, the Fund did not receive its fair percentage of these monies for the periods in which NYRA reported an operating profit (e.g., 1996 and 1997). NYRA officials stated that they consider their handling of these receipts to be proper and consistent with statute and generally accepted accounting principles. However, they have agreed to discuss this issue with their new outside auditor.

Recommendation 9

Implement a monitoring system to help ensure the receipt of the proper share of OTB revenues.

Status – Implemented

Agency Action – NYRA officials have implemented a system for monitoring OTB revenues that includes periodic audits by NYRA’s internal audit staff, external-audit revenue-confirmations, and a requirement that all OTB regional offices submit monthly revenue reports to NYRA.

Recommendation 10

Revisit the status and work relationships of the independent contractors noted in this report. Work with the New York State Racing and Wagering Board to ensure that these individuals are classified properly.

Status – Implemented

Agency Action – NYRA officials have made the appropriate reclassifications for the individuals identified in our prior report.

The major contributors to this report were Frank Patone and Harry Maher.

We would appreciate your response to this report within 30 days, indicating any additional actions planned or taken to address any unresolved matters discussed in this report. We also thank the management and staff of the New York Racing Association for the courtesies and cooperation extended to our auditors during this review.

Very truly yours,

William P. Challice
Audit Director

cc: Charles Conaway