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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

December 5, 2005

Carole E. Stone
Chair
Non-Profit Racing Association Oversight Board
50 Wolf Road
Albany, NY 12232

Re: Review of Internal Controls
Over Financial Operations
Report 2004-S-71

Dear Ms. Stone:

Pursuant to Article X, Section 5 of the State Constitution, we have reviewed the New York State Thoroughbred Racing Capital Investment Fund's (Fund) system of internal controls over its financial operations for the period January 1, 2003 through May 31, 2004. Recently enacted legislation replaced the Fund with the Non-Profit Racing Association Oversight Board (Racing Oversight Board) established by the Governor.*

A. Background

The New York State Thoroughbred Racing Capital Investment Fund (Fund) was established by legislation in 1983 as a public benefit corporation that serves as an infrastructure bank to provide low interest loans (4 percent per annum) for financing capital improvements to thoroughbred racing facilities operated by the New York Racing Association, Inc. (NYRA). The Legislature declared in establishing the Fund that it desired to protect and promote the legitimate interests of the various components of the racing industry in New York State and that it intended to dedicate a portion of the revenues derived from high quality thoroughbred racing conducted by NYRA to the financing of capital improvements at its three racing facilities (Belmont Park, Aqueduct Racetrack and Saratoga Race Course) in accordance with an orderly, on-going multi-year capital planning process. The establishment of an infrastructure bank allows the State to make loans at favorable interest rates that otherwise would not be available to NYRA and thus protect and promote the legitimate interests of the various components of the racing industry. The Fund reviews and approves capital plans submitted by NYRA, authorizes NYRA participation in credit agreements and can loan money to NYRA for planned capital improvements. The Fund secures such loans and credit extensions by a mortgage on Aqueduct Racetrack.

* As noted, the Fund has been replaced by the Racing Oversight Board. However, throughout this report we still refer to the Fund, as that was the entity in existence during the scope of the audit.

In 1995, the Fund deposited $8.5 million with the Racing Preservation Fund which in turn transferred the money to the New York State Urban Development Corporation (UDC). UDC then loaned the money to NYRA; the loan will become due when NYRA's franchise expires on December 31, 2007. NYRA makes monthly repayments to UDC and UDC makes quarterly payments to the Fund, net of a small service charge.

The Fund is administered by a Board of Directors consisting of nine members. Members include the New York State Director of the Budget, the Chairman of the State Racing and Wagering Board, and seven additional members appointed by the Governor; one upon nomination of the Temporary President of the Senate, one upon nomination of the Speaker of the Assembly, one upon nomination of the minority leader of the Senate, and one upon the nomination of the Minority Leader of the Assembly. A Chairman is designated among the sitting members by the Governor. The Chairman serves at the pleasure of the Governor. The seven appointed members of the Board serve for two years without compensation. At the time of our audit, three of the seats on the Board were vacant.

The Fund is authorized to hire whatever employees are required to administer its infrastructure banking operation, including an Executive Director. The Fund is currently staffed by one employee who serves as the Administrative Director, and the Chairman who serves in an unpaid position. The Fund hires an outside accountant, an outside counsel, and a certified public accounting firm to render an opinion on its annual financial statements. The Administrative Director records Fund transactions. The Executive Director position has been vacant since October 2003. The former Executive Director monitored the implementation of the approved capital plan submitted by NYRA and the progress of capital improvement projects. The Chairman of the Board and the Fund's attorney has since assumed some of the Executive Director's responsibilities.

B. Review Scope, Objectives and Methodology

Pursuant to the New York State Governmental Accountability, Audit and Internal Control Act of 1987 (Internal Control Act), as revised in 1999, the Fund's management is responsible for establishing and maintaining an effective system of internal controls and a program of internal control review. In addition, in accordance with New York State Division of the Budget Policy and Reporting Manual Item B-350, State agencies and public authorities must annually certify their compliance with important provisions of the Internal Control Act, and submit this certification of compliance to the Division of the Budget. We reviewed the Fund's system of internal controls over its financial operations for the period January 1, 2003 through May 31, 2004. The objectives of our review were to assess the adequacy of the Fund's system of internal controls over its financial operations and to express an opinion on the certifications.

To accomplish these objectives, we interviewed Fund officials and reviewed applicable policies and procedures governing the following significant financial operations: Board oversight and governance, revenue and collections, cash and investments, payroll, procurement and contracting, equipment and asset management, budgeting and expenditure control, and accounting and information systems. We interviewed Fund staff responsible for these financial operations and performed limited compliance testing to provide assurance that Fund employees follow established policies and procedures.

Our review commenced as an audit, which would require, among other protocols, that we provide a copy of the draft audit to the Chairman for his written response and that we include any written response with the release of the final report. However, it became impractical to finalize the engagement as an audit after we identified improprieties on the part of certain Fund officials, including the Chairman, which potentially violated the law. We also became aware that the New York County District Attorney's Office was investigating some of the matters covered by our examination. Subsequently, that investigation was expanded as a result of information uncovered during the course of this review, which was turned over to the District Attorney by staff of the Office of the State Comptroller.

In light of the unique circumstances presented, including the nature of our findings, the potential relevance of those findings to the investigation being conducted by the District Attorney's Office and the need to create a public record documenting the results of our examination, we determined that the most appropriate course of action was to conclude the examination as a review.

It should also be noted that the Chairman was presented with our findings during the course of the examination. Further, we conducted an exit conference in September 2004 where our findings were discussed with the Chairman as well as other Fund officials who were afforded, at that time, the opportunity to comment and to provide additional information. We received no additional information.

C. Results of Review

In our opinion, because of the material internal control weaknesses described below, management's certification of compliance for the two years ended March 31, 2003 and March 31, 2004 are not fairly stated based on the criteria set forth in the Internal Control Act and the Division of the Budget Policy and Reporting Manual Item B-350. These material internal control weaknesses were not identified in the certifications of compliance submitted to the Division of Budget for the years ended March 31, 2003 and March 31, 2004. A material weakness is a condition that precludes the entity's internal controls from providing reasonable assurance that material errors or irregularities will be prevented or detected on a timely basis. In fact, we found several instances of improper or inefficient use of Fund resources by Fund officials. We also questioned the Fund's continued ability to meet its mission because NYRA has made minimal repayment of amounts it owes to the Fund thus – limiting the ability of the Fund to continue to finance future capital improvements for NYRA.

Ethical business practices need to pervade both the financial affairs and the personal conduct of all employees, executives and Board members charged with controlling the Fund's financial spending and legislatively-mandated mission and operations. Our review disclosed a failure of management to ensure that funds were spent efficiently and strictly for Fund-related business. We found numerous examples of improper spending. Several expenses are personal expenses of past or present employees and the Chairman. We also found that the Chairman operates other business enterprises out of the Fund's offices, making extensive use of Fund staff and resources. Several expenses charged to the Fund are expenses associated with the management and operations of his outside business enterprises. We conclude that the Chairman has demonstrated poor stewardship of public resources entrusted to his management and care. We further found that the Board of

Directors failed to detect the existence of ineffective internal controls and to oversee the expenditures.

Much of the spending by the Fund is for salaries, office rental and outside professional services. An outside counsel provides legal services at an hourly rate of $150. We found that while the outside counsel billed the Fund approximately $200,000 a year during our review period, no one questioned what legal services were provided to justify this cost. Consultant expenditures were reported in financial statements in a transparent manner, but there was no indication that the Board questioned this high spending. One reason may be that the Board meets only once or twice a year. The infrequency of Board meetings suggests that Board oversight of finances and operations is cursory at best. We also found that the outside counsel routinely submits billing invoices for payment just under $2,000 - the dollar value threshold requiring additional approval of the Board's Vice Chairman, who is also the Chairman of the New York State Racing and Wagering Board. This practice of split-payments to legal counsel circumvents Board review and approval of individual transactions.

Sound internal controls alone cannot prevent or detect fiscal improprieties if there are managerial shortcomings. In the end, much depends on the personal integrity of the persons involved. Our review disclosed that, while the Fund reported some of its internal control weaknesses pursuant to the Internal Control Act, the absence of diligent and critical oversight has allowed the misuse of public funds to go unchecked. We concluded that, despite technical compliance with the reporting requirements of the Internal Control Act, the oversight of Fund's business affairs was deficient and stronger oversight is sorely needed.

1. Questionable Ability to Finance Future Capital Projects

Fund policy is to obtain a promissory note from NYRA for each loan. NYRA is to pay accrued interest at the rate of four percent on the outstanding principal each year. Since 1992, NYRA has not paid the principal and interest due on the loans on time. In 1997, an amendment to the law required that NYRA pay the Fund annually an amount based on NYRA's income to reduce its debt. As a result of this amendment, through December 31, 2003, NYRA paid the Fund $8,026,465. However, NYRA's repayments are significantly less than the rate required to repay the notes by their final due date, which is December 31, 2007, the expiration date of the franchise. NYRA reports that it owes the Fund about $67.8 million and that $38.7 million has been categorized by the Fund as past due principal and interest. The purpose of the Fund is to loan money to NYRA for capital improvements at its three thoroughbred racetracks. However, the Fund's ability to loan money for capital improvements is dependent on NYRA's ability to repay its outstanding loans. In 1990, the Fund loaned $15.6 million to NYRA. During the ten-year period ending in December 31, 2003 loans to NYRA were from about $319,000 to $2.8 million per year, and there were three years (1994, 1997, and 2003) when the Fund loaned no money to NYRA. In 1997, legislation was passed that authorized the Fund and NYRA to restructure all outstanding debt. However, as of September 2004, the parties had not agreed to a debt restructuring plan. The uncertainty and lack of NYRA repayment of loans made by the Fund causes us to question whether the Fund remains financially able to make loans. We also note that the Fund's certified public accounting firm has declined to issue an opinion of the Fund's financial statements because the Fund is unable to document the collectability of the notes receivable and did not obtain a valuation of the collateral securing the notes receivable. Clearly, the Fund needs to establish a restructuring plan with NYRA to ensure that

the loans are repaid by the expiration date of the franchise. Neither the governing Board nor other oversight entities have taken any action to resolve this matter.

2. Misuse of Resources

We found a number of instances where fund resources were not properly or efficiently used. Our detail findings are as follows:

- A major responsibility of the Fund's Executive Director was to monitor NYRA's capital projects. He submitted bi-weekly travel statements for payment. We reviewed all of his travel vouchers for the five-month period from January 2, 2003 through June 4, 2003, which totaled about $19,500. The Executive Director resigned on October 10, 2003. The Executive Director's travel statement's indicated that every weekday during the five-month period, and sometimes on Saturday and Sunday, he traveled six, seven or eight times a day back and forth from Belmont to Aqueduct. The statements did not indicate arrival and departure times. Occasionally, he reported that he also traveled to the Fund's office in Manhattan. His travel statements showed an average of 240 miles traveled every day and he was paid a total of $10,170 for mileage at the rate of 32 cents per mile. We asked the Fund's Chairman, who authorized all of these payments, to explain why the Executive Director traveled back and forth from Belmont and Aqueduct several times a day. The Chairman felt that the Executive Director is in a responsible position and the costs seemed related to his work duties, so he did not question these travel costs. We asked for documentation for the capital projects at NYRA facilities that were underway at that time. However, the Fund did not provide us with such documentation. We question the appropriateness of these travel expenses because the Executive Director would have had to spend an unreasonable amount of his time traveling instead of performing administrative responsibilities at the Fund's Manhattan office or observing or monitoring the construction projects.

- The Executive Director's travel vouchers also showed that he was paid between $250 and $350 each week - a total of $6,261 - during the five-month period for what appeared to be entertainment expenses. The documentation always indicated that the expense was for a married couple, such as Mr. and Mrs. Jones. The supporting documentation for these expenses was inadequate; it was only a hand written statement on a standard petty cash form. There were no invoices (e.g., restaurant bills) to support the nature of these expenditures. We asked the Fund's Chairman who these couples were and what was the nature of these expenses. The Chairman told us that he assumed the people were associated with racing, but did not know whether the expenses claimed were for meals or some other type of entertainment. We concluded that these are not Fund-related expenses and that the Fund should not have paid for these expenses because the Fund has only one customer - NYRA.

- Petty cash disbursements totaled $24,619 for our review period. We judgmentally selected 4 petty cash fund disbursements made during January of 2003 for review. There was proper documentation supporting the expenses paid, such as receipts or invoices, but the documentation was not date stamped and marked paid by the Fund to prevent reuse and duplicate payment. We noted that, for the payments we selected, $1,015 (76 percent) was for food and beverages, such as deli sandwiches and coffee. We found that it was routine

practice for Fund staff to order lunch from a local diner and to pay for the food and beverages with petty cash. This is an unauthorized fringe benefit for Fund staff.

- The Fund paid $3,483 for car transportation services during the 14 months ended May 4, 2004. We reviewed all of these transportation payments. The Fund was not able to furnish supporting documentation for 5 payments totaling $1,029. The Fund paid $997 for a total of 17 trips made by three non-Fund personnel. In another example, the Fund paid $1,221 for 12 trips made by the Fund's Administrative Director generally to LaGuardia Airport. We were advised that the purpose of these trips was to arrange to have the documents flown to the Chairman for his review while at his Florida residence. It would have been less costly if the documents were simply mailed from the Fund's Manhattan office. The invoices for the transportation services did not document any business related purpose of these trips.

- Payments for office supplies totaled $5,364 for our 17-month review period. We questioned $1,804 (34 percent) of these costs. For example, the Fund paid $655 for green stock paper that was used to print advertising for a bed and breakfast inn in Manhattan that is owned by the Chairman. We also noted $438 was paid for gold stock paper to print advertising for a Mexican restaurant that is owned by the Chairman.

- The Fund paid Federal Express shipping charges totaling $15,127 for our 17-month review period. We reviewed $9,525 of these payments made during 2003 and questioned the propriety of $2,287 (24 percent) of these payments. For example, the Fund paid $510 for 18 packages mailed by either the former Executive Director, the Administrative Director, or the Chairman to gift shops that the former Executive Director's wife was associated with; the Fund paid $617 for 9 packages mailed by the Fund's Administrative Director to her husband; the Fund paid $365 for 18 packages mailed by individuals who are not Fund employees including one individual who, according to a brochure, is associated with the aforementioned bed and breakfast inn; and the Fund paid $349 for 16 packages that appeared to be related to personal business such as packages that were mailed to a hair salon, a traffic violations bureau, a watch repair company, and the repair department of a cigarette lighter manufacturer.

- The Fund used two oil company credit cards, one of which was used exclusively by the Chairman. We found that the Chairman did not submit any documents to account for his travel. The Chairman and the Executive Director shared the other credit card. We had the following exceptions with the use of this card. The Fund paid $8,689 for fuel during our review period, but there was no documentation to justify this cost and the Chairman could not tell us who incurred these fuel charges. If these charges were incurred by the Chairman, he should have submitted documentation to show that the travel which required the fuel was Fund related. If these charges were incurred by the former Executive Director, the expense was inappropriate because he was already reimbursed for fuel in the standard 32 cents mileage rate claimed on his travel vouchers during the period. The shared credit card also included "non-fuel" purchases totaling $2,558, but there was no documentation to show the nature of these charges.

- The Fund pays for a full-time Administrative Director, but she frequently worked on activities related to the Chairman's outside businesses. For example, we found that this

individual generally spent several hours daily on the telephone dealing with issues related to the Chairman's bed and breakfast inn.

- The Fund has a contract with an outside attorney for legal services. The attorney charges $150 an hour for such services. During our 17-month review period, the Fund paid the attorney $285,267. This is an average of about 25 hours each week. The attorney's invoices reported that he frequently performed administrative work as well as legal work for the Fund. The explanation given for doing administrative work is that the attorney was asked to handle some matters typically handled by the former Executive Director. Several months have passed, but the Fund has not hired another Executive Director. We question the cost effectiveness of paying an attorney to perform administrative work that could be performed by an administrator at a lesser cost. We also asked Fund management for the attorney's contract. They provided a contract for the period December 5, 1990 through December 4, 1991. There is no renewal clause in the contract and no new contract for legal services by the outside attorney had been presented to the Board for approval during our review period. Accordingly, the Board has not formally authorized the attorney's employment since 1990. There is similarly no valid contract between the Fund and its accountant ($24,000 per year).

3. Internal Control Weaknesses

We noted a number of instances where the Fund could either improve its system of internal controls, or strengthen the adherence to existing policies and procedures. (A summary table addressing specific questions related to each of the Fund's basic financial operations is attached as Table I.)

1. The Fund's Board of Directors is supposed to have nine members. However, three of the Board seats that are filled through the Governor's office have been vacant since March 2001. Fund officials told us that they phoned the Governor's Office a few times to request that these positions be filled, but there was no documentation at the Fund related to such requests. A full Board complement is necessary because the Fund's enabling legislation states that an affirmative vote of at least five Board members is needed to conduct Fund business. The Fund's Board met very infrequently: only once in 2003 and once in 2004 (through May 2004). Both meetings were held as telephone conference calls. As a public entity, the Fund must adhere to the State's Open Meetings Law. Although the Fund's By-Laws allow for telephone participation, the Department of State's Committee on Open Government has consistently ruled that a Board member cannot cast a vote unless he or she is physically present at a Board meeting or is participating by video conferencing. As a result, actions taken at the Fund's Board meetings may not be valid.

2. According to the Fund's By-Laws, the Chairman is also the Fund's Chief Executive Officer and, in the event of a vacancy in the office of the Executive Director, he is authorized to exercise the duties and responsibilities of the Executive Director. We view this as inappropriate separation of duties because the primary responsibility of a governing board, headed by its chairman, is overseeing the organization's chief executive and other senior management in the effective and ethical management of the organization.

3. Public Authorities Law (PAL) Section 2925 requires that the Board annually review and approve the Fund's investment and procurement policies and procedures. The Board did not formally review and approve the Fund's investment policies and procedures in 2003.

4. The Fund's enabling legislation limits the aggregate salaries of officers, agents and employees, and payments for attorneys, auditors and financial advisors at $250,000 a year. For 2003, the Fund paid more than $458,000 for salaries and consultants ($184,000 for employees; $274,000 for consultants).

5. The Board has not established a formal ethics policy for its members and Fund employees.

6. The Fund has failed to provide the public accountability required by various legislation. For example, the Fund's audited financial reports were due by March 31, 2004, as required by PAL Section 2800 but the Fund had only sent draft financial statements to the Office of the State Comptroller on July 6, 2004. The Investment Report required by PAL Section 2925 was filed late and did not have the investment audit report required PAL 2925(3f). Furthermore, the Fund sent in other reports late e.g. Procurement Report required by PAL Section 2879. This Report is filed with the Division of Budget, the Office of the State Comptroller, the Senate and the Assembly Committees.

7. The Fund does not have written policies and procedures for loan collections, cash handling, time and attendance recordkeeping, payroll changes, routine purchases, travel, equipment acquisitions and dispositions, and budget preparation and monitoring.

8. According to NYRA's promissory note with the Fund, NYRA is supposed to pay the Fund semi-annually; there is a two percent penalty if the principal and interest is not paid within fifteen days of the payment due date. For 2003, NYRA made only one payment ($1,598, 802), but the Fund did not assess NYRA the two percent penalty for overdue principal and interest.

9. The Fund has one checking account which is covered by the Federal Deposit Insurance Corporation (FDIC) up to $100,000. During our review period the checking account balance periodically exceeded $100,000. As an example, for one ten-day period the account balance was as high as $951,592 because the proceeds of a certificate of deposit that had matured were deposited to the account. However, the Fund did not obtain collateral when the account balance exceeded $100,000.

10. The Fund invests money not needed for immediate use in Certificates of Deposit. Our test for December 31, 2003 showed that the Fund obtained sufficient collateral for its investments. However, the collateral was held by the same bank from whom the Fund purchased the certificates of deposits instead of an independent third party. OSC's Investment Guidelines for Public Authorities state "The collateral should be segregated in the Authority's name and should be in the custody of the Authority or a third party custodian."

11. Currently the Fund has one employee. The employee does not prepare a time sheet each pay period to document the time worked and any leave taken. At the end of the year, the employee calculated her accruals and noted them on a summary record.

12. The Fund's internal control procedures require that the Chairman must sign/approve all checks of $2,000 or less; checks exceeding $2,000 must be co-signed by the Fund's Vice-Chairman (who is also the Chairman of the New York State Racing and Wagering Board). The Fund's By-Laws require that payments exceeding $10,000 be approved by at least four Board members. During our 17-month review period, the Fund issued 159 checks to its outside attorney totaling $285,267. None of the checks exceeded $2,000. On 66 different dates, two to four checks were prepared on the same day to this attorney, but each check was for less than $2,000. If only one check had been prepared for each of these dates, each check would have exceeded the $2,000 limitation and, according to the Fund's By-Laws, two signatures would be required. It appears that the Fund is circumventing the requirement that the Vice Chairman co-sign checks exceeding $2,000.

13. The procurement guidelines require that the Fund enter into a written agreement for goods or service expenditures estimated to exceed $5,000. The Fund shares office space with the New York State Thoroughbred and Breeding Development Fund (TBDF). TBDF pays the full rent to the landlord and the Fund pays TBDF for its share of office space - $7,500 each calendar quarter. The Fund does not have a contract with TBDF for this arrangement.

14. The Fund has office equipment on hand with a recorded acquisition value of $55,000. The Fund has not established an equipment inventory control system. The Fund does not maintain detailed inventory records, tag equipment for identification purposes, or conduct annual physical inventories.

15. The Fund does not prepare an annual budget because, according to Fund officials, it is difficult to predict how much NYRA will repay for the upcoming year. The Fund should prepare a budget to more effectively monitor and control actual revenues and expenditures.

16. Accounting information and reports are kept manually and stored at the Administrative Director's desk. As a result, the Fund does not have an adequate back-up system for its business records.

Recommendations

1. *Enter into negotiations for a loan restructuring plan with NYRA.*

2. *Strengthen the controls over travel as follows:*
   - *Establish travel guidelines,*
   - *Require that employees, the Chairman, and consultants submit detailed travel expense reports for travel expenses incurred in conjunction with Fund business,*
   - *Review the travel statements more closely,*
   - *Ensure that the travelers submit appropriate receipts and sufficiently explain the business nature of the expenses, and*

- *Determine who was responsible for the credit card charges totaling $11,247 and obtain reimbursement if appropriate.*

3. *Discontinue the practice of using Fund money to pay for:*
   - *Food for individuals not in travel status,*
   - *Transportation service not associated with Fund business,*
   - *Office supplies and other items not associated with the Fund's business,*
   - *Mail (Federal Express) for personal business, and*
   - *Entertainment expenses.*

4. *Reimburse the Fund the related value of such Fund staff and resources used by the Fund's Chairman for his personal business enterprises.*

5. *Determine the extent for which outside legal and accounting services are needed and enter into formal contracts for such services.*

6. *Arrange for obtaining the necessary senior management administrative services.*

7. *Formally request that the Governor's office fill the three vacancies for the Board of Directors.*

8. *Remind Board members of their obligation to be physically present at Board meetings or to participate by video conference.*

9. *Amend the Fund's By-Laws to bar the Chairman of the Board from having administrative duties at the Fund.*

10. *Require that the Board review and approve the Fund's investment and procurement policies and procedures annually.*

11. *Keep the total cost of employee salaries and consultant fees within the limits established by the Fund's enabling legislation.*

12. *Establish a code of ethics for Board members and Fund staff.*

13. *Prepare and timely submit all required reports to various State oversight bodies in accordance with statutory requirements.*

14. *Establish written policies and procedures for the Fund's various business processes.*

15. *Assess NYRA the two percent penalty for overdue principal and interest.*

16. *Obtain additional collateral when the Fund's checking account balance exceeds $100,000.*

17. *Require that collateral for investments be held by an independent third party.*

18. *Date stamp and mark paid the petty cash receipts or invoices.*

19. *Require that employees prepare a time sheet for each pay period to document time worked, leave taken, and leave accruals. The Chairman of the Board of Directors, or his designated representative, should review and approve the time sheets.*

20. *Obtain approval from the Vice Chairman of the Board to pay the Fund's independent counsel. Stop issuing multiple checks for less than $2,000 to the same payee and thus avoiding review and approval by the Vice Chairman.*

21. *Establish a formal agreement with the Thoroughbred Breeding and Development Fund for office rental payments.*

22. *Maintain equipment inventory records. Tag or number equipment placed under inventory control and conduct physical inventories of equipment at least annually.*

23. *Prepare an annual budget and monitor actual operating results against budget estimates.*

Preliminary findings of the matters contained in this report were discussed with New York State Thoroughbred Racing Capital Investment Fund officials. Their comments have been considered in preparing this report.

Within 90 days after final release of this report, we request that the Chairman of the Racing Oversight Board report to the Governor, the State Comptroller, and the leaders of the Legislature and its fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Major contributors to this review were Gerald Tysiak, Roger C. Mazula, Kenneth Ring, Brenda Maynard, and Daniel Towle.

We wish to thank the management and staff of the New York State Thoroughbred Racing Capital Investment Fund for the courtesies and cooperation extended to our auditors during this review.

Very truly yours,

Carmen Maldonado
Audit Director

cc: Robert Barnes
Cheryl Buley

TABLE I

NEW YORK STATE THOROUGHBRED RACING CAPITAL INVESTMENT FUND
REVIEW OF CONTROLS OVER FINANCIAL OPERATIONS

A colored "traffic light" legend is included in the table below to assist management in focusing an appropriate level of attention on the issues summarized in the table. As part of our review, we sought answers to a series of questions and reviewed selected Fund records related to certain basic financial operations. Our questions in each area, along with a summary of the Fund's activities and our comments concerning these activities, are included in the table.

Legend:

	Activities/Comments contain matters that should be of immediate concern to management.		Activities/Comments contain matters which management should consider correcting.		Activities/Comments do not contain issues that require management's immediate consideration.

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
Board Oversight & Governance			
	Does the Fund's Board of Directors function in a manner that promotes an ethical business climate within the organization and encourages and supports full compliance with all applicable laws, rules, and regulations?	The Fund's Board is supposed to have nine members including the Director of the Budget, the Chairman of the New York State Racing and Wagering Board, and seven other members who shall be appointed by the Governor, including four members who shall be nominated by leaders of the Senate and Assembly. The Governor shall designate the Chairman from among the sitting members.	Three of the nine Board seats, whose appointments are made through the Governor's office, have been vacant since March 2001. We were advised that, on more than one occasion, the Fund has notified the Governor's office of the vacancies, but there was no documentation to show when the requests were made.
		The Board meets when necessary.	The Board met only once in 2003 and once in 2004 (through May 2004). Several Board members participated in these meetings over the telephone in accordance with the Fund's By-Laws. However, the Department of State Committee on Open Government has ruled that Board members must be physically present at Board meetings or be participating by video conference to conduct Fund business and, accordingly, the Board decisions at

TABLE I (Cont'd)

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
		State law requires that the Board annually review and approve the Fund's investment and procurement policies and procedures. The Fund's enabling legislation limits expenditures for officers, agents and employees, and for the services of consultants, counsel, auditors and financial advisers to $250,000 per year.	those meetings may not be valid. For our review period the Board did not formally review and approve the Fund's investment and procurement policies and procedures. In 2003, the Fund paid more than $449,000 for salaries ($184,000) and consultant services ($265,000), thus exceeding the maximum allowable by $199,000.
	Has the Fund's Board of Directors established appropriate controls that promote the economic, efficient, and effective operation of the Fund consistent with its statutory public benefit mission and that provide for transparency and accountability in pursuing its strategic business objectives?	The Board should have a formal ethics policy for its members and Fund employees. Ethics policies help ensure the independence of Board members in the stewardship of public funds. The Fund is required to prepare and send various operating and financial reports to State oversight groups.	The Board has not established a code of ethics for itself or Fund employees. The Fund has failed to provide the public accountability required by various legislation. For example, the Fund's audited financial reports were due by March 31, 2004, but the Fund had only sent draft financial statements to the Office of the State Comptroller on July 6, 2004. Furthermore, the Fund sent in other required reports late and did not have the required investment audit report.
Revenue & Collections:			
	Do the Fund's policies and procedures provide assurance that revenues are billed timely and accurately and are recorded properly in the accounting records?	The Fund has three revenue sources: interest from notes receivable with NYRA, interest from a loan made to NYRA through the New York State Urban Development Corporation (UDC), and interest from short-term investments. The Fund does not bill NYRA or UDC. For 2003, the Fund received interest from loans totaling $2.2 million and interest from investments totaling almost $43,000. It is Fund policy to obtain a promissory note from NYRA for each loan. These notes are supposed to accrue interest at the rate of four percent per annum. In 1995, the Fund deposited $8.5 million with the Racing Preservation Fund which in turn transferred the money to UDC. UDC then loaned	NYRA has not paid the principal and interest due on the loans timely. Fund records indicate that NYRA owes about $67.8 million in principal and interest as of December 31, 2003. The Fund categorizes $38.7 million as past due principal and interest. Currently, when NYRA makes a payment, the Fund credits all of the money to the principal amount due. None of the money is applied to interest due. Also, the Fund does not penalize NYRA by assessing interest for the principal not paid on time. UDC pays the Fund the correct amounts on schedule.

TABLE I (Cont'd)

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
		the money to NYRA; the loan becomes due when NYRA's franchise expires on December 31, 2007. NYRA makes monthly repayments to UDC and UDC makes quarterly payments to the Fund, net of a small service charge.	
	Do the Fund's policies and procedures provide assurance that revenues are being collected timely?	The Fund does not have written policies and procedures for collections. The note receivable agreements call for NYRA to pay the Fund twice a year and, if the payment is more than 15 days late, NYRA is supposed to pay a 2 percent penalty on the principal and interest. The interest payments from UDC are due quarterly.	The Fund should establish written collection policies and procedures. During 2003, NYRA paid the Fund once ($1,598, 802). NYRA generally defers payments due to the Fund; however, the Fund has never granted a formal deferral nor assessed NYRA the 2 percent penalty for overdue principal and interest. Interest payments from UDC to the Fund have been timely.
Cash & Investments:			
	Do the Fund's policies and procedures provide assurance that cash and investments are properly safeguarded, accounted for, and deposited into the appropriate accounts?	The Fund does not have written procedures for cash handling. The Fund's Administrative Director handles a minimal amount of cash because most of the money received by the Fund, including payments from NYRA and UDC and certificate of deposits that mature, are wire transferred directly to the Fund's checking account. The Fund's general checking account is covered by the Federal Deposit Insurance Corporation (FDIC) up to $100,000. Money not needed for the foreseeable future is invested in certificates of deposit.	Since the Fund currently has only one employee, it is not possible to separate duties among employees so that no one employee has too much control over the cash handling process. However, there are compensating controls in place because the Fund's outside accountant reviews the cash receipts and disbursement journals and performs the monthly bank reconciliations. During our review period, the checking account balance periodically exceeded $100,000; however, the Fund did not obtain collateral beyond the FDIC's protection. As an example, during one ten-day period, the account balance exceeded $950,000 because a certificate of deposit had matured and was not immediately reinvested. Contrary to Fund investment guidelines, the Fund purchases its certificates from the same bank that it has its general checking account. It does not solicit bids before purchasing or renewing certificates. Our test for December 31, 2003 showed that the Fund had obtained sufficient collateral for its certificates of deposits.

TABLE I (Cont'd)

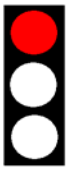
	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
			However, the collateral is not held by an independent third party.
	Do the Fund's policies and procedures provide assurance that cash disbursements are properly authorized and recorded?	The Fund does not have written cash disbursement procedures.	We judgmentally selected 12 disbursements during our review period for review. We found that the disbursements were properly approved and documented. However, we had questions about the reasonableness and/or propriety of some of these disbursements; consequently we expanded our review to include more transactions.
		The Fund has a contract with an attorney for legal services at $150 an hour. During our 17-month review period, the Fund paid this attorney about $285,267. The Fund's former Executive Director had broad administrative responsibilities but he spent most of his time in the field. He resigned in October, 2003 but the Fund has not hired a replacement as of July 2004.	According to the invoices provided by the attorney, he worked continuously for the Fund and averaged about 25 hours per week. The invoices showed that he frequently worked at the Fund's offices and performed administrative duties as well as legal work related to the Fund. The attorney does much of the administrative work, at a much higher salary than what the Executive Director made. Additionally, the Fund's By-Laws authorize the Fund's Chairman to function as the Executive Director if the position is vacant, but this is an inappropriate role for the Chairman because the Board is supposed to oversee how the chief executive and other senior management run the organization.
		The Fund's former Executive Director was supposed to monitor the capital projects which NYRA had obtained loans from the Fund. Between January 2, 2003 and June 4, 2003, he was paid about $19,500 in travel expenses. After June 4, 2003, the Executive Director worked at Belmont Racetrack until he resigned on October 10, 2003.	The Executive Director submitted travel reimbursement reports to the Fund. These reports list the amount of miles submitted for reimbursement each weekday during the five-month period, and sometimes on Saturday and Sunday. The Executive Director traveled six, seven, or eight times a day between Belmont and Aqueduct, occasionally visiting the Fund's Manhattan office. The mileage reports do not note arrival and departure times. The Executive Director averaged 240 miles of travel every work day and the Fund paid all of the reported miles, without question, at 32 cents per mile – a total of about $10,170 for mileage during the five-month period. Although the Fund's Chairman approved payment of these travel

TABLE I (Cont'd)

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
			vouchers, he asserts that the Executive Director is in a responsible position and the expenses appeared related to his work duties. Therefore, he did not question why the former Executive Director needed to travel back and forth from Belmont and Aqueduct several times a day (the equivalent of between 5 and 6 hours in his car each day).
		The Fund paid the former Executive Director an average of $284 a week for what appeared to be entertainment expenses. The documentation always indicated that the expense was for a married couple, such as Mr. and Mrs. Jones. The Fund paid him a total of $6,261 during the five-month period.	The supporting documentation for the former Executive Director's entertainment expenses was inadequate – only the name of the couple and the dollar amount. There were no invoices, such as restaurant bills, etc. and no mention of the business nature of the expense. The Fund's Chairman authorized reimbursement to the former Executive Director, he could not explain the business nature of the expenses. He told us he assumed the people entertained were associated with racing. Notwithstanding, the Fund essentially has one customer – NYRA. Therefore, we question why there was any need for entertaining expenses.
		Petty cash reimbursements (disbursements) totaled $24,619 for our review period, a monthly average of $1,448. We judgmentally selected four petty cash fund disbursements made during January of 2003 for review. The disbursements totaled $1,337, an average of $334 per payment.	Except for minor differences, there was adequate supporting documentation such as receipts or invoices for the expenses paid. However, the supporting documentation was not date stamped and marked paid by the Fund. Good internal control procedures require that the receipts and invoices be date stamped and marked paid to prevent their reuse. Also, for the four payments we examined, most of the expenses were for food, such as deli sandwiches and coffee for lunch and breaks for the Fund's office staff.
		The Fund paid $3,483 for car transportation services, during the 14-month period ending May 4, 2004. The Fund was not able to furnish documentation for 5 payments totaling $1,029.	The car transportation service invoices listed the dates and names of the individuals who were transported. We question the propriety of some of the car payments as noted below: - The Fund paid $962 for a total of 17 trips made by three non-Fund personnel. - The Fund paid $252 for three trips made by the Fund's outside counsel.

TABLE I (Cont'd)

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
			According to his contract, he is entitled to be reimbursed for reasonable expenses incurred. However, no travel statements were submitted to explain the purpose or nature of these trips. - The Fund paid $1,221 for 12 trips made by the Fund's Administrative Director generally to LaGuardia Airport. We were advised that the purpose of these trips was to transport documents to the Chairman while he was at his Florida residence. However, no travel statements were submitted. Further, since the Fund frequently mails packages to the Chairman when he resides in Florida, we question why the documents were not mailed or sent by an overnight parcel carrier instead of driving to the airport.
		Payments for office supplies totaled $5,364 for our 17-month review period, a monthly average of $316.	We questioned office supply expenses totaling $1,805 or about 34 percent of the total payments made for office supplies. - Payments for green stock paper totaled $655. At the Fund's storeroom/copier room, there was an open package of this green stock paper and next to the package was a pile of printed green stock sheets with an advertisement of a bed and breakfast inn that is owned by the Fund's Chairman. - Payments for gold stock paper totaled $438. At the Fund there was one printed gold sheet which was a menu for a Mexican restaurant in upper Manhattan. We were advised that the restaurant is also owned by the Fund's Chairman. - Payments totaling $195 were made for aspirin and coffee creamer purchases. These items should not be purchased by the Fund.
		The Fund paid shipping costs to Federal Express totaling $15,127 for our 17-month review period, a monthly average of $890.	We question the appropriateness of some of the Federal Express shipping costs: - $510 for 18 packages mailed by either the former Executive Director, the Administrative Director, or the Chairman to gift shops that the former Executive Director's wife was

TABLE I (Cont'd)

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
			associated with. -$617 for 9 packages mailed by the Fund's Administrative Director to her husband. -$365 for 18 packages mailed by individuals who are not Fund employees, including one person who, according to a website address, is associated with the Fund Chairman's bed and breakfast business. - $447 for 20 packages mailed to Colorado and Florida banks and accounting or bookkeeping services firms in Florida. - $349 for 16 packages that also appeared to be unrelated to Fund business such as packages mailed to a hair salon, a traffic violations bureau, a watch repair company, and the repair department of a manufacturer of cigarette lighters.
Payroll:			
	Do the Fund's policies and procedures provide assurance that employee time and attendance records are accurate and that leave time is accounted for and recorded properly?	The Fund has written policies for accruing vacation, sick and personal leave but not for time and attendance. The Fund had two employees, but the Executive Director resigned in October 2003 and has not been replaced.	The Fund's current employee does not prepare time sheets to document the time worked and any leave taken. She calculated leave accruals and leave taken at the end of the year, noting the leave and accruals on a summary record. The record did not indicate the specific dates when vacation and sick leave was taken. The Fund should establish policies and procedures for attendance.
	Do the Fund's policies and procedures provide assurance that payroll changes (e.g., additions, deletions, and overtime) are processed accurately and timely?	The Fund's former Executive Director resigned in October 2003. This was the only addition/deletion to the payroll during our review period. Fund employees are not eligible for overtime.	The Fund does not have written policies and procedures for payroll changes. We reviewed the supporting documentation for the one payroll deletion and found no exceptions. No overtime was paid during our review period.

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Procurement & Contracting:			
	Do the Fund's policies and procedures provide assurance that purchases are authorized, received, and recorded properly?	The Fund has established procurement guidelines for contracts of $5,000 or more. Fund internal control procedures require the Board Chairman to sign/approve all checks of $2,000 or less, but require that checks exceeding $2,000 be co-signed by the Vice Chairman (who is also the Chairman of the Racing and Wagering Board).	The Fund does not have written procedures for routine purchases. We judgmentally selected 10 purchases for review. No exceptions were noted. The checks were properly signed, there were supporting invoices, and the expenditures were properly recorded in the cash disbursement journal. During our 17-month review period, the Fund made 159 payments to its attorney totaling more than $285,000, each of which was below the $2,000 threshold that requires a co-signature on the check from the Fund's Vice Chairman. We found that between two and four checks were written on the same day to the attorney on 66 different occasions, thus circumventing the requirement that the Vice Chairman co-sign checks exceeding $2,000.
	Do the Fund's policies and procedures provide assurance that purchases are reasonable and necessary and made in an economical and efficient manner?	Bi-weekly, the Executive Director submitted travel statements for reimbursement. The Chairman did not submit such statements to account for his travel. Oil company credit cards were issued to the Chairman and Executive Director. One card was used exclusively by the Chairman. We were advised that the other card was shared between the Chairman and the former Executive Director. However, when we asked the Chairman questions about specific charges, he was not sure whether the charges were incurred by him or the other persons sharing the card.	We found the Chairman used the credit card, but did not submit travel statements to account for his travel. Exceptions were noted with the shared credit card. The records indicated that payments for fuel charges totaled $8,689 during our review period. If these charges were incurred by the Chairman, he should have submitted travel statements to account for his travel and to show that the travel was Fund related. If these charges were incurred by the Executive Director, the Fund should not have paid the fuel charges because he was already paid for gas in the mileage rate listed on his travel voucher. The shared credit card also included "non-fuel" purchases totaling $2,558. There was no detailed documentation on file to indicate the nature of these charges. The Fund should not have paid these charges without obtaining travel expense statements with supporting documentation to explain what these charges were for. We noted that, with the exception of an $8 charge, the non-fuel charges stopped after September 15, 2003. The Fund does not, but should have, written travel policies and procedures to ensure that only expenses directly related to

TABLE I (Cont'd)

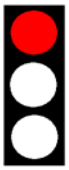
		The procurement guidelines require that the Fund enter into a written agreement for goods or services when expenditures are estimated to exceed $5,000.	travel for the Fund are reimbursed. The Fund shares office space with the New York State Thoroughbred Breeding and Development Fund. TBDF pays the rent to the realtor in the first instance and then obtains reimbursement from the Fund. Quarterly, the Fund pays TBDF $7,500 for its share of the rent. The Fund does not, but should have a contract with TBDF for this agreement. The Fund paid its attorney $150 per hour (at an average of 25 hours weekly) for more than $200,000 in 2003. The Board approved this contract in 1990 for the period December 5, 1990 through December 4, 1991. There is no renewal clause in the contract and no new contract for legal services by the outside attorney had been presented to the Board for approval during our review period. There is similarly no valid contract between the Fund and its accountant ($24,000 per year).
Equipment & Asset Management:			
	Do the Fund's policies and procedures provide assurance that equipment acquisitions and dispositions are authorized and recorded properly, and that a comprehensive inventory of equipment is maintained?	The Fund has office equipment on hand with an acquisition value of about $51,000. It has not established an equipment inventory control system. Also, the Fund does not have policies and procedures in place to provide assurance that equipment acquisitions and dispositions are properly authorized and recorded.	The Fund should maintain detailed inventory records, tag equipment for identification purposes, and conduct annual physical inventories. The Fund should establish written policies and procedures for equipment acquisitions and dispositions. Such policies provide more assurance that transactions are properly authorized and recorded.
	Do the Fund's policies and procedures provide assurance that equipment is secured properly and used as intended?	The office equipment is properly secured. The front door of the office is locked after business hours.	We observed that the Fund's Administrative Director frequently uses the Fund's offices, including its telephone, to conduct personal business for the Chairman. Fund equipment and employees should not be used to conduct business not related to the Fund.

TABLE I (Cont'd)

Budgeting & Expenditure Control:			
	Do the Fund's policies and procedures provide assurance that the Fund's annual budget is prepared accurately and timely?	The Fund has no budget policies and procedures.	The Fund does not prepare an annual budget. We were advised that the reason for not preparing a budget is that it is too difficult to predict the amount NYRA will repay for the upcoming year.
	Do the Fund's policies and procedures provide assurance that actual operating results are monitored against budgeted estimates and that appropriate revisions to current and future budgets are made as warranted by these operating results?	Since the Fund does not prepare a budget, it does not compare budget and actual expenditures and make appropriate revisions.	The Fund should prepare a budget to more effectively monitor and control actual revenues and expenditures. As a minimum, the budget helps to monitor and control administrative costs.
Accounting and Information Systems:			
	Do the Fund's accounting and information systems provide assurance that management has access to timely, accurate and relevant information?	The Fund's Administrative Director maintains manual accounting records and information systems. An outside consultant (accountant) reviews the journal entries, reconciles the bank statements, prepares the general ledger entries and prepares the necessary reports.	The Fund's accounting and information systems provide assurance that management has timely, accurate and relevant information.
	Do the Fund's policies and procedures provide assurance that the accounting and information systems are secure and that the information is recoverable in case of system failure?	The Fund's accounting information reports are kept manually and stored at the Administrative Director's desk. The Fund's independent accountant uses a computer to prepare general journal and ledger entries, and this information is stored off-site.	Manual accounting and information systems leave the Fund vulnerable in case of a catastrophe. The Fund should consider establishing a computerized accounting and information system which includes storing back-up files off-site.