Thomas P. DiNapoli
COMPTROLLER

OFFICE OF THE
NEW YORK STATE COMPTROLLER

DIVISION OF STATE
GOVERNMENT ACCOUNTABILITY

INDUSTRIAL EXHIBIT AUTHORITY

CONTROLS OVER TRADE AGREEMENTS

Report 2008-S-91

AUDIT OBJECTIVES

The objectives of our audit were to determine whether the Industrial Exhibit Authority (Authority) received fair value in the form of goods and services in exchange for the services and opportunities that it provided in the course of trade agreements for the 2007 New York State Fair (Fair) and to ensure that the goods and services received by the Authority, as a result of these trade agreements, were utilized for reasonable and necessary business purposes.

AUDIT RESULTS - SUMMARY

We reviewed the trade agreements in place for the 2007 Fair and identified several opportunities for the Authority to improve its controls over and monitoring of these contracts. In particular, Authority officials did not properly assess the value of either the goods and services obtained from trade vendors, or the services and sponsorship opportunities provided by the Authority. We found no consistency from one agreement to the next in how Authority staff established these values and, as a result, there is limited assurance that the values of the goods and services exchanged were either equitable or accurate. In several instances, there was also little or no evidence that the goods and services were actually received from the vendors, were truly necessary to the Fair's operations, and/or were used for legitimate business purposes.

We reviewed each of the 31 trade agreements in effect at the beginning of the 2007 Fair; 18 of which were new agreements put in place for the 2007 Fair, while the other 13 were continuations of agreements negotiated in previous years. In total, the Authority valued the goods and services it was to receive under these agreements at more than $1.2 million. We were not able to independently assess the reasonableness of about $458,000 in value that management placed on 12 of the 31 agreements, because of a lack of available historical information on the cost of similar services at the time of the 2007 Fair. We could establish the fair market value of the goods received for the other 19 agreements. We found for five of these agreements, worth over $126,500, that these values were overstated by about $55,000, with individual variances ranging from $2,600 to over $24,000. In addition, for nine agreements totaling almost $137,000, the Authority could not provide supporting documentation to show that the goods and services it traded for were actually received, and/or that they were needed by the Authority and used for business purposes.

We also found the Authority does not have a method for consistently valuing its part of these barter agreements; particularly the advertising and sponsorship opportunities it provides to vendors as part of the trade agreements. Authority officials stated that many of these items were simply thrown in to close the deal with individual vendors with little or no consideration of their value. As a result, although the Sales Manager was required to review all trade agreements and the Business Manager was to provide final approval, we found management actually paid little attention to the total value provided to individual vendors or whether some vendors appeared to be getting a much better deal than others for no apparent reason. This lack of oversight significantly increases the risk of abuse in these arrangements. We analyzed the values placed on similar opportunities and services provided to different vendors and identified variances which individually approached $100,000.

We identified two issues which we believe to be root causes for much of the problems we observed. First, the two Authority sales

associates who negotiated most of the trade agreements lack formal education, training or experience in marketing or sales which could assist them to appropriately negotiate these kinds of agreements on behalf of the Authority. In addition, the Authority's sales commission policies provide these staff - and the Sales Manager who oversees them - with commissions and bonuses based on the difference between the value of services and opportunities that the Authority provides to the vendors and the value of goods and services it receives in return. Consequently, these individuals have a financial incentive to undervalue the Authority's portion of a trade agreement and overvalue the vendor's part.

A new Fair Director was appointed early in 2007 and since that time, the administration has reviewed the existing policies and made several changes to strengthen controls over trade agreements. However, the commission structure described above remains in place and certain goods and services provided by the Authority in the trade agreements still have no value assigned to them.

Our audit report contains six recommendations to improve controls over trade agreements. Authority officials agreed with our recommendations and stated that the current administration is committed to implementing them.

This report, dated January 16, 2009, is available on our website at: http://www.osc.state.ny.us. Add or update your mailing list address by contacting us at: (518) 474-3271 or
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

BACKGROUND

The Industrial Exhibit Authority (Authority) was created to provide a means for obtaining the bond financing necessary to construct buildings on the Fairgrounds in Syracuse. This funding was used to build five structures on 375 acres, four of which still exist. The Fairgrounds has eight primary facilities, temporary RV parking sites, as well as parking and shuttle services for 23,000 vehicles. The Fairgrounds hosts events, performances and expositions throughout the year, including the New York State Fair (Fair), which the Authority hosts in conjunction with the Department of Agriculture and Markets. More than two million people attend these events each year, including 936,000 who attended the 2007 Fair between August 23 and September 3, 2007.

In addition to collecting revenues from admissions to the Fair and events, the Authority generates revenues by soliciting corporate sponsorships. Sponsors purchase space to display their products and/or advertisements during the Fair. In most cases these items are purchased for cash, however, the Authority also enters into trade agreements with some vendors in which the vendor trades goods or services (or a combination of goods, services, and cash) for sponsorship. Authority officials stated these agreements are used primarily to obtain goods and services it needs without paying cash.

The Authority's sales department comprises a Sales Manager and two assistants. In addition, the Authority contracts with two private consultants for additional sales work. In fiscal year 2007, the Authority's sales department reported total sales of $3,143,000 of which $1,092,000 were from trade agreements.

AUDIT FINDINGS AND RECOMMENDATIONS

Controls Over the Value of Goods and Services Exchanged

Valuation of Goods Received

Trade agreements can be mutually beneficial to the sponsor and the Authority. However, as with any contractual agreement, controls need to be established to ensure that each party receives fair value for the goods and services exchanged and, in accordance with the Public Authority and State Finance Laws, that the agreement is in the best interest of the Authority. We identified opportunities for the Authority to improve its control and oversight of trade agreements.

We reviewed the 31 trade agreements that were active as of the start of the 2007 Fair on August 23, 2007. The Authority valued the goods and services received under these agreements at $1,237,636. We were able to independently assess the value that management placed on all or most of the goods and services that the Authority received for 19 of these agreements, which totaled $724,131. To accomplish this, we reviewed available documentation, spoke with vendors, and obtained comparable cost information from other sources. For 5 of these 19 agreements valued at over $126,500, we found that the goods and services received were overvalued by about $55,000, with individual variances ranging from almost $2,600 to over $24,000.

In one case, the Authority valued furniture it received at the manufacturer's suggested retail price of over $65,000. When we contacted furniture company officials, we found the furniture is normally sold to the public at their "showroom price," which is usually discounted by at least 38 percent. We therefore determined that the Authority overvalued the furniture items in this trade by about $24,760. In another case, the Authority valued a block of hotel rooms received in a trade agreement at over $22,000. However, we confirmed that these same rooms would have otherwise been available to the Authority at the State government rate for only $10,000, $12,000 less than the value in the agreement. In a third case, the Authority valued the cost of certain equipment rentals in an agreement at $17,200. We called a local competitor and determined the cost to rent the same equipment at that time would have been $7,800; $9,400 less than the value in the agreement.

Prior to 2008, the Authority's policies and procedures did not require competition for trade agreements and we found no evidence that indicated Authority staff used any competitive practices in negotiating or valuing these contracts. Furthermore, we found no evidence that management, at any level, took measures to verify that the value of the goods and services received were of fair and competitive value. As a result, in each of these cases, the Authority ended up trading more than the fair market value of the goods and services it actually received. If fair value was received, the Authority could have either traded less to these vendors or possibly received either additional goods and services or revenue from them.

We were not able to verify the value of 12 agreements totaling $457,934 for various reasons, including cases where the nature of the goods and/or services provided was unique to the Authority or where there was a lack of available historical information on the cost of similar services at the time of the 2007 Fair. It is therefore critical that management ensure that these contracts are properly valued at the time the agreements are negotiated.

As of April 2008, Authority officials had updated the policies and procedures to require staff to obtain three quotes from competitive vendors. Also, the updated procedures state that the Department of Transportation equipment rental pricing can be used as a value guide when determining the value of equipment rentals obtained through trade agreements. Another way officials could ensure that contracts are properly valued is to compare the costs of similar goods and services available on Statewide contracts through the Office of General Services.

Valuation of Sponsorships and Services Provided by the Authority

The Authority also needs to have proper controls in place to ensure that the goods and services it provides to vendors as part of the trade agreements are valued fairly and consistently. We found that the Authority's policies provided little guidance to the staff in this area and the Authority's sales associates do not appear to have the requisite knowledge or experience to accomplish this task on their own. Furthermore, we found the Authority's sales commission policies actually provide an incentive for sales staff to undervalue the goods and services provided by the Authority. Finally, while the Sales Manager and Business Manager were required to monitor this process, we found no evidence that they provided this oversight.

The Authority provides vendors with a range of advertising options, as well as space to promote their products, as the Authority's part of the trade agreements. For the 2007 Fair, advertising options included items such as: signage; the sponsorship of a building, location, specific show, or performers; public announcements; commercials; and admission and concert tickets. While the Authority has established procedures for determining the value of space that it provides in the trade agreements, officials stated that the advertising options have no real value and were often simply added into trade agreements as an incentive to get sponsors to sign. As a result, we found there is currently no consistent policy, procedure, or methodology in place to define how the sales department should value the sponsorships and advertising provided to vendors as part of these trade agreements.

We calculated the value of the sponsorships and advertising provided by the Authority in the 31 trade agreements and compared them with the values evident in 30 paid sponsorship agreements. To accomplish this, we subtracted the known value of the space included in each agreement and assigned the balance of the total value to the sponsorships and/or advertising. Since there are varying types of advertising and sponsorships provided in each agreement, we separated this component of each of the 61 agreements into eight comparable categories.

We recognize that no two deals are exactly the same and as a result, there will always be some variation between the final agreements reached between parties. Since the Authority has no established policies for assessing the value of the advertising it provides to sponsors, we could not conclusively determine whether each agreement was properly valued. However, our analysis does clearly indicate that the Authority provided different vendors with similar goods and services at vastly different costs. In fact, we identified individual contract value variances that exceeded $15,000 in six of the eight component categories we analyzed.

For example, we found a vendor traded almost $11,000 worth of goods for one advertising sign, while another vendor traded over $46,000 in goods for two similar signs in the same general area of the Fairgrounds. In

other cases, vendors traded varying amounts of goods to sponsor similar venues. One vendor traded almost $78,000 in goods and services for the sponsorship of a specific show for the entire Fair, while another vendor traded goods and services valued at only about $39,000 for the sponsorship of a similar show.

Officials stated that these items were often thrown in to close the deal with a specific vendor with little or no consideration of value. However, we found many cases where other vendors actually paid the Authority for similar advertising and sponsorship opportunities. As a result, we found significant differences in the value of some of the sponsorship agreements that were paid for by vendors when compared to those arranged through trade agreements. For example, one vendor paid the Authority almost $110,000 for the exclusive rights to sell its product at the Fair, while another vendor was granted similar rights through a trade agreement in return for goods and services valued at only $13,000. In other cases, vendors paid as much as $41,000, and in some cases almost $24,000 more than trade vendors, for sponsorships that were similar to those provided to vendors in trade agreements.

The Authority's sales department employs only three people, a Sales Manager and two sales assistants. We found that 83 percent of the paid sponsorship agreements, and 55 percent of the trade agreements, were negotiated by the two sales assistants. We reviewed these individuals' backgrounds and found neither had any formal education in marketing, sales or a related field, nor any prior marketing or sales experience outside of the Authority. We therefore question whether these individuals have the requisite knowledge, skills, and abilities to perform their functions. The Business Manager, who was responsible for reviewing and approving the trade and sponsorship agreements, also had no previous sales experience. The sales team's lack of qualifications, abilities and overall sales experience may have been, and may still be, contributing to the inconsistencies in the valuation of the goods and services provided by the Authority as its part of the trade agreements.

The Authority pays commissions and bonuses to its sales associates, and bonuses to its Sales Manager, based on the net value of the trade agreements they negotiate. This means that the value of the services that the Authority provides (such as advertising, space and sponsorships) is subtracted from the value of the goods and services provided by the vendor to arrive at a net figure on which to compute percentage-based commissions and bonuses. As a result, if the sales associates overvalue the vendors' portion, and undervalue the Authority's part of these agreements, they will earn higher commissions and bonuses. The Sales Manager, who is also paid certain bonuses based upon reaching various sales levels, can also benefit from this scenario. The two sales associates each receive an annual base salary of over $31,000. One of the associates received over $111,000 in commissions and bonuses during the two years ended March 31, 2008, while the other received over $61,000. The Sales Manager, who was hired prior to the 2007 Fair, received $50,000 in bonuses during the 2007-08 fiscal year in addition to a $40,000 base salary.

Authority officials indicated that the Sales Manager is responsible for approving and monitoring all sponsorship agreements negotiated by sales staff. However, we found no indication that he performed this function. Also, the prior Business Manager, who was also responsible for verifying that agreements were legitimate, had established no procedures to monitor negotiated trade agreements. The limited monitoring and

weak control activities contributed to a weak control environment and a breakdown in the contracting processes. Authority officials stated they have instituted new policies to help alleviate these conditions. For example, the Fair Director now must review and approve all agreements. In addition, the Authority no longer provides free admissions and concert tickets as part of the packages they offer to contractors when negotiating trade agreements. However, the commission structure remains in place and certain goods and services provided by the Authority in the trade agreements still have no value assigned to them.

Recommendations

1. Use competitive processes to establish the value of goods and services received pursuant to trade agreements.

2. Establish a consistent methodology for determining the fair value of sponsorships and advertising exchanged in trade agreements.

3. Monitor future trade agreements to ensure the goods and services exchanged are valued fairly and consistently.

4. Implement staff training and hiring practices that will ensure sales department staff possess the skills, knowledge and experience needed to meet the Authority's goals and objectives.

5. Establish commission policies for trade agreements that do not encourage staff to inflate the cost of goods and services received in trade agreements or undervalue the cost of those given.

Controls Over the Receipt and Use of Goods and Services

The Authority needs to have controls in place that ensure the goods and services obtained through trade agreements are necessary for the operation of the Fair, are actually received, and are used for legitimate business purposes. Officials indicated that, when these agreements were negotiated in years prior to 2008, the Authority had no formal procedures which established the criteria for entering into trade agreements. In addition, the prior administration did not have an inventory control system in place for these goods. As a result, we found little documentation that all of these goods and services were received or that they had actually been used by the Authority.

We reviewed the 31 trade agreements for which the Authority received goods and services valued at $1,237,636 and identified discrepancies in nine agreements totaling $136,737. In four of these agreements, valued at $95,812, officials were unable to provide us with documentation to support the receipt of goods and services. This included $60,000 of building materials from one vendor and $25,000 worth of advertising from another vendor. For the other five agreements, which totaled $40,925, the documentation provided little assurance the goods and services traded for were necessary and/or used for business purposes. In three of these five cases, the Authority could not document how the goods and services received were used for legitimate business purposes or if they were received at all. These five agreements include:

- Hotel Rooms - The Authority had a trade agreement with a hotel in which the Authority was to receive 70 rooms valued at $11,786. Authority officials

could not explain or provide documentation to us to indicate how these rooms were used in 2006. We question whether these rooms were used at all or whether they were used for legitimate business purposes.

- Cell Phones - The Authority had trade agreements with two different cell phone providers; one company that provided free use of eight phones valued at $11,000 and another company for six phones valued at over $14,000. Neither the Authority nor the companies could provide us with records of use for these phones. As a result, we could not determine whether they were used primarily for business-related activities, as required by the Authority, or if they were used at all. In addition, we found two of the eight phones from the first company were missing their SIM cards when they were returned at the end of the agreement in May 2008. These cards contain the service, numbers, and memory for the phones. If a person had removed and transferred one of these cards to a different phone, they could have received free cell phone use as part of this agreement. Authority officials could not locate these cards.

- Newspaper Articles - The Authority has a long standing trade agreement with a local newspaper for a "free" 400-word article quarterly. According to newspaper officials, the Authority never utilized this opportunity during the period April 1, 2006 through June 30, 2008, because it did not submit any articles for publication. The newspaper officials estimated the value of these unused articles to be $3,466; 15 percent of the estimated $23,100 value of the agreement.

- Cable TV Service - The Authority had a trade agreement for cable service at the Fairgrounds that included service for three cable boxes. Authority officials could not locate one of the boxes or explain its business use to us. The cable company determined that the box was not currently active on the Fairgrounds and discontinued service to the box. It is possible that the box had been removed from the Fairgrounds and was used by someone to receive free cable service. The cable company has since given the Authority a new box to replace the missing one.

In total, the documentation provided to us by Authority officials provided us with limited assurance that the Authority actually received over $95,000 worth of goods and services that it traded for, or that an additional $41,000 worth of goods and services it received through trade agreements was necessary or used for business purposes. As a result, it is possible the Authority could have obtained other necessary goods and services, or received commensurate cash value, for sponsorship items that it traded to vendors in these agreements. Further, some of the goods and services may have been diverted for personal use and, thus, not used for legitimate Authority business.

The Fair Director, who began working at the Authority in early 2007, has hired a new management team for the Fair. Officials indicate they are finalizing a comprehensive inventory control system, which now requires all goods to be delivered to a central warehouse where they are inventoried. Additionally, the Fair Director now requires department heads to explain the need for

certain goods and services and must approve the request before the sales department begins negotiating a trade agreement. As a result, officials believe the Authority will only negotiate trade agreements for items it needs.

Recommendation

6. Ensure that goods and services acquired through trade agreements are necessary for Authority operations, and are actually received and used for legitimate business purposes.

AUDIT SCOPE AND METHODOLOGY

We audited the Authority's records regarding the 31 trade agreements which were active as of August 23, 2007. We reviewed all available documentation received from Authority officials and contacted vendors to receive additional support. We also reviewed 30 additional sponsorship agreements (cash contracts) active as of the same date. To accomplish our audit objectives, we reviewed State laws and regulations regarding procurement. We reviewed the Authority's policies and procedures regarding procurement, including control activities to help identify, prevent or reduce the risk of fraudulent activity. In addition, we interviewed Authority officials and staff regarding those policies and procedures in place for processing and submitting agreements for approval by the Comptroller.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

AUTHORITY

The audit was done according to the State Comptroller's authority set forth in Article V, Section 1 of the State Constitution, Article II, Section 8 of the State Finance Law, and Article 8, Section 1656 of the Public Authorities Law.

REPORTING REQUIREMENTS

A draft copy of this report was provided to the Authority officials for their review and comment. We considered their comments in preparing this final audit report, and they are included as Appendix A.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Chairman of the Industrial Exhibit Authority shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal

committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

CONTRIBUTORS TO THE REPORT

Major contributors to this report include Frank Houston, John Buyce, Greg Petschke, Heather Pratt, W Sage Hopmeier, and Andre Spar.

APPENDIX A - AUDITEE RESPONSE

STATE OF NEW YORK
DEPARTMENT OF AGRICULTURE AND MARKETS
10B Airline Drive, Albany, New York 12235
1-800-554-4501
www.agmkt.state.ny.us

Office of the Commissioner

December 17, 2008

Mr. John Buyce, Audit Manager
Office of the State Comptroller
Division of State Government Accountability
110 State Street – 11th Floor
Albany, New York 12236

Dear Mr. Buyce:

I have reviewed the audit report issued by the Comptroller's Office regarding the Industrial Exhibit Authority's Controls over Trade Agreements (2008-S-91). We welcome your agency's independent review and acknowledge that within every organization, there are opportunities to implement additional controls or enhance those currently in place. The report acknowledges that the current administration has implemented several changes to strengthen controls over trade agreements. However, there is much more work to be done and the current administration is committed to implementing the recommendations contained in the report to further improve controls over trade agreements.

Please contact Ms. Tracy Robbins, the Department's Director of Internal Audit, if you have any questions regarding the enclosed response or require any additional information or documentation. Ms. Robbins can be reached at (518)485-7728.

Sincerely,

Patrick Hooker

Patrick Hooker
Commissioner