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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

February 15, 2005

Mr. Michael J. Hoblock, Jr.
Chairman
Agriculture and New York State
Horse Breeding Development Fund
90 State Street - Room 805
Albany, NY 12207

Re: Internal Controls Over Financial Operations
Report 2004-S-56

Dear Mr. Hoblock:

Pursuant to Article X, Section 5 of the State Constitution and Section 2803 of the Public Authorities Law, we have audited the Agriculture and New York State Horse Breeding Development Fund's system of internal controls over its financial operations for the period April 1, 2001 through March 31, 2004.

A. Background

The Agriculture and New York State Horse Breeding Development Fund (Fund) was organized by law in 1965 as a public benefit corporation to promote the State's agriculture, horse breeding and equine research. The Fund's Board of Trustees includes the Chairman of the Racing and Wagering Board, the Commissioner of Agriculture and Markets and the Chairman and two members of the Harness Racing Commission. The Fund is administered by an Executive Director and one staff member.

The Fund finances purses for sire stakes races at the seven State harness tracks, the New York State Fair, and county and town fairs. The Fund also contributes to equine research through a grant to Cornell University, and it provides grants to county and town fairs for racetrack construction and repairs, as well as grants to local agricultural societies (4-H clubs) to develop standard-bred educational programs.

The Fund receives one percent of all pari-mutuel bets on live racing at the seven State harness tracks and one percent of all bets on in-State and out-of-State harness races made at the six regional off-track betting (OTB) corporations. Further, the Fund receives one-half of one percent of the bets on harness races simulcast at the harness tracks including the simulcast of in-State and out-of-State harness races, and one-half of one percent of the out-of-State thoroughbred races simulcast

at the New York State harness tracks. The Fund also collects breakage revenues (resulting from the downward rounding of winning payouts) from each regional OTB corporation. The Fund received \$4.7 million in handle revenue and \$1.9 million in breakage revenue for 2003. The Fund also receives nomination and sustaining fees, paid by the horse owners, to register and qualify New York State-bred horses for sire stake races at the State's harness tracks and local fairs. The Fund received about \$942,000 in such fees for 2003.

The Fund must distribute at least 75 percent of handle and breakage revenue to enrich racetrack purses for New York State-bred horses as required by the Racing, Pari-Mutuel Wagering and Breeding Law Section 332.1.f. An additional two percent of handle revenue is designated for equine research as well as four percent for administrative expenses. Fund trustees are also authorized to distribute the remaining 19 percent of the handle and breakage revenue, plus interest income and nomination and sustaining fees, to the above expenses as well as race purses, grants to local fairs, and grants to 4-H clubs.

B. Audit 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 control 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 audited the Fund's system of internal control over its basic financial operations for the period April 1, 2001 through March 31, 2004. The objectives of our performance audit were to assess the adequacy of the Fund's system of internal control over its basic financial operations and to express an opinion on the certifications based on our audit.

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 reasonable assurance that Fund employees follow established policies and procedures.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards. Such standards require that we plan and do our audit to adequately assess those procedures and operations included within the audit scope. Further, these standards require that we understand the Fund's internal control system and compliance with those laws, rules and regulations that are relevant to the Fund's procedures and operations that are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

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, several of which are performed by the Division of State Services. 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 management functions do not affect our ability to conduct independent audits of program performance.

C. Results of Audit

In our opinion, because of the effect of the material weaknesses described below, management's certification of compliance for the three years ended 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. Our audit identified material internal control weaknesses that were not identified in the certifications of compliance. These certifications do not list results of internal control assessments or planned internal control improvement, and they do not identify high risk areas and how the Fund plans to eliminate them. The certifications acknowledge that the Fund had very few staff but state that internal controls are continually reviewed. However, the Fund could not document how it reviews the effectiveness of its internal control system. Additionally, these certifications essentially state that the Fund has no internal control problems. The Fund's certification of compliance submitted to the Division of the Budget for the year ended March 31, 2004 was prepared during the early stages of our audit. After we shared some of our audit results with Fund management, this certification disclosed some procedural changes the Fund was making based on some of our early audit results.

Many of the areas we examined did not have written policies for employees to follow. There is no accountability over monies received and the Fund's cash handling responsibilities are not properly separated because the bookkeeper controls the entire process. This individual also controls all aspects of the disbursement cycle except for check signing. Also, the Fund relies on the harness tracks and regional OTB corporations to send the Fund the correct amount due and does not periodically validate that the amounts are correct. Although the Fund's annual management certification states that internal controls are reviewed constantly, the Fund's statements are very brief, do not recognize the internal control issues we identified, and do not adequately address how the Fund handles basic internal control issues. We believe these conditions represent material weaknesses in the Fund's system of internal control. A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material errors or irregularities will be prevented or detected on a timely basis.

In addition, we also noted the following instances in which the Fund could either improve its system of internal control, or strengthen the adherence to existing policies and procedures. Fund officials indicated that they are currently reviewing their overall operations and will seek to formalize, establish, improve or update policies and procedures over several areas. (A summary table addressing specific questions related to each of the Fund's basic financial operations is attached as Table I.)

1. The Fund does not have formal policies and procedures related to the following business functions: collecting and depositing cash, purchasing, recording time and attendance, making payroll changes, acquiring and disposing of equipment, or using the Internet.
2. The Fund's governing Board has not established corporate by-laws or a code of ethics for itself or its administrative staff and does not review and formally approve the Fund's investment policies or procurement policies annually as required by law.
3. The Fund's governing Board is responsible for ensuring that Fund monies are spent economically and efficiently. The Board approved the hiring of a lawyer. The individual hired does not submit time sheets or work at the Fund's offices. Instead he provides legal advice or services for the Fund as needed. Nevertheless this individual is paid as an employee, with related employee benefits including health insurance and membership in the New York State Retirement System. Accounting for this person as an employee with employee benefits is inappropriate as the individual gives the appearance of an independent contractor.

(Fund officials advised that they wrote to their parent organization, the NYS Racing and Wagering Board (NYSRWB) to request assistance in this matter. They were advised that NYSRWB is considering real-time pari-mutuel activity monitoring software. If fully implemented this system would verify harness track and OTB fund remittances. They also noted that each harness track and OTB does an annual financial audit showing all pari-mutuel revenues and statutory remittances including payments due the Fund. Those audits allow the Fund to keep a rough check on revenue due the Fund.)

4. Yonkers Raceway is often delinquent in remitting revenues to the Fund.
5. Cash handling responsibilities are not properly separated because the bookkeeper controls the entire process. This situation is exacerbated by the fact no one prepares an independent log of checks received and checks are not restrictively endorsed as soon as they are received. Controls would improve if, at a minimum, the Executive Director maintained a log of checks received, restrictively endorsed the checks and did the monthly bank reconciliations.
6. The Fund's investment guidelines require the Executive Director to make all investments, however, they were made by the Fund's bookkeeper. Also, there was no documentation indicating that competitive interest rates were sought before investments were made.
7. The Fund's checking account bank balances frequently exceeded Federal Deposit Insurance Coverage of \$100,000, but the excess was not collateralized.
8. The Fund has limited staffing and optimal separation of duties is not always possible but, at a minimum, the bank statements should be reconciled by someone other than the individual responsible for keeping the accounting records.
9. The Fund's employees charged leave time only if they were off for a full day. Employees calculate their leave accruals, which includes leave accrued, used and balances on hand at the end of each calendar year. We found that the Executive Director's leave accruals were

overstated by three vacation days and three sick days.

10. The Fund did not adhere to its procurement policies and procedures. It did not have a formal contract with the former executive director who had retired but continued to work as a consultant until his replacement was fully trained, or with a veterinarian who was paid a total of \$33,200 to draw and test samples taken from horses who participated in sire stakes races.

(In replying to our draft audit report, Fund officials explained why they did not enter into formal contracts for the consultant services and a veterinarian to draw blood samples. They also indicated that they will look into formal contracts if such services are needed in the future.)

11. The Fund did not maintain detailed equipment inventory records and inventory control numbers were not affixed to the equipment to help identify the equipment when physical inventories were taken.

12. By Law (Racing, Pari-Mutuel Wagering and Breeding Law, Section 332.1a), Fund administrative expenses are limited to four percent of revenues. For 2003, the Fund overspent its administrative budget by about \$191,000 or 49 percent although it became apparent during the calendar year that actual revenues would be less than expected.

(Fund officials replied to our draft report that they will seek a legal interpretation of the applicable statute regarding possible limits on expenditure of administrative monies.)

13. The Fund does not have a disaster recovery plan. Also, Fund employees were not required to use passwords to access software applications, and file server back up tapes were not stored off-site as a precaution against loss.

Recommendations

1. *Develop written policies and procedures for the Fund's various business processes.*

(Fund officials replied to the draft report that they are developing written collection procedures which will be presented for Board approval at its next meeting.)

2. *Improve internal controls over cash handling by maintaining a log of cash receipts received, restrictively endorsing checks as soon as they are received, separating the cash handling and recordkeeping, and bank reconciliation responsibilities.*

(Fund officials state that corrective actions were completed before the auditors finished the audit.)

3. *Periodically, verify that the funds transmitted by the harness tracks and the regional OTB corporations are correct.*

(Fund officials advised that they have requested assistance on this matter from its parent organization, the NYS Racing and Wagering Board.)

4. *Establish corporate by-laws and a code of ethics for Board members and staff.*

(Fund officials replied that by-laws and a formal code of ethics were adopted by the Board of Trustees at its meeting on July 1, 2004.)

5. *Examine its practice of including the Fund's attorney on the payroll because this individual's functions give the appearance of an independent contractor and not an employee of the Fund. In addition, determine what adjustments are needed for previously submitted New York State Retirement System reports.*

(Fund officials replied to our draft report that the Board of Trustees was informed of OSC's comments regarding the staff attorney and that this item has been placed on the agenda of the next Board meeting for discussion.)

6. *Take corrective action to have Yonkers Raceway remit the monies due the Fund timely.*

(Fund officials state that they notify the NYS Racing and Wagering Board after revenue is due over 60 days, which has generally been effective in collecting monies from Yonkers. Also, the Fund is developing a written collection procedure.)

7. *Require that the Board of Directors review the Fund's investment and procurement policies and procedures annually.*

8. *Adhere to the Fund's written policies which require that the Executive Director make all investments. Solicit competitive interest rates before investing funds.*

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

(In response to recommendations 7, 8 and 9, Fund officials state the Board will review and approve the Fund investment policy when it considers implementing OSC's Short Term Investment Program. Specifically related to recommendation 8, the Fund states that the current Executive Director always calls five different banks for a quote on current interest rates.)

10. *Implement detection controls for disbursement procedures by requiring that the Executive Director reconcile the bank statements to the accounting records monthly.*

(Fund officials indicate that new written procedures call for the Executive Director to reconcile the Fund bank accounts.)

11. *Require employees to note all leave or time-off on their time sheets. Exercise more care when calculating leave accruals and calculate the accruals bi-weekly.*

(The Fund agrees with the recommendation and has adopted a New York State Civil Service model Time and Attendance policy.)

12. *Enter into personal service contracts for all consulting services that spell out the expected terms and conditions.*

(The Fund agrees with the recommendation and will look to enter into a formal contract should consultants be needed in the future).

13. *Maintain detailed equipment inventory records. Affix control numbers to the equipment to help identify the equipment when physical inventories are taken.*

(Fund officials state this recommendation has been implemented.)

14. *Adjust planned or budgeted expenditures for the year as the amount of revenues collected becomes more apparent.*

(Fund officials replied to our draft report that they agreed with this recommendation but noted that management and Board of Trustees decisions on exactly how to spend the Fund's interest income is discretionary. However, in the future, if interest income is re-directed after formal budget approval, a budget amendment will be sought from the Board of Trustees.)

15. *Require that passwords be used to gain access to software applications.*

(Fund officials state that the extra level of security provided by password protection has been established as recommended.)

16. *Establish a disaster recovery plan. Store on site tapes in a fireproof box, and store backup tapes off-site.*

(Fund officials agreed and have implemented the recommendation.)

A draft copy of this report was provided to Agriculture and New York State Horse Breeding Development Fund officials for their review and comment. Their comments have been considered in preparing this final report, and are included as Appendix A. Fund officials stated that most of the recommendations have already been implemented or will soon be implemented by current Fund staff.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Chairman of the Agriculture and New York State Horse Breeding Development Fund shall report to the Governor, the State Comptroller, and 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 examination were Gerald Tysiak, Roger C. Mazula, Kenneth Ring, and Daniel Towle.

We wish to thank the management and staff of the Agriculture and New York State Horse Breeding Development Fund for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Carmen Maldonado
Audit Director

cc: Robert Barnes, Division of Budget

**AGRICULTURE AND NEW YORK STATE
HORSE BREEDING DEVELOPMENT 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 audit, 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.

	<p>Activities/Comments contain matters that should be of immediate concern to management.</p>		<p>Activities/Comments do not contain issues that require management’s immediate consideration.</p>
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	QUESTION	FUND ACTIVITIES	COMPTROLLER’S COMMENT
	A. Board Oversight & Governance		
	<p>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?</p>	<p>The Fund has five Board members: the Chairman of the Racing and Wagering Board and the Commissioner of Agriculture and Markets are ex officio members; the three other Board members are selected by the Governor with the advice and consent of the Senate. The Board meets quarterly.</p> <p>The Board should have by-laws. State law requires that the Board annually review and approve the Fund’s investment policies and procedures as well as the Fund’s procurement policies and procedures.</p> <p>The Board should have a formal ethics policy for its members and staff to follow. Ethics policies help ensure the independence of board members in the stewardship of public funds.</p>	<p>The Fund has not established corporate by-laws.</p> <p>One of the five board members missed half of the Board meetings during our audit period.</p> <p>There was no indication in the Board minutes that the Board reviewed and approved the Fund’s investment policies and procedures or the Fund’s procurement policies and procedures annually.</p> <p>The Fund has not established a code of ethics.</p>

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
	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 is responsible for ensuring that Fund monies are spent economically and efficiently.	The Board approved hiring a lawyer for \$15,000 a year; his benefits include health benefits and enrollment in the State retirement system. However, this individual is not actually a Fund employee but is actually an independent contractor. He does not submit time sheets or work at the Fund's offices, but provides legal advice or services to the Fund as needed. This individual should not be on the Fund's payroll.
B. 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 the following types of revenue: a share of the handle for the harness tracks and OTBs (\$4.7 million in 2003), breakage from the OTBs (\$1.9 million in 2003), nomination and sustaining fees from horsemen (\$942,000 in 2003), and investment income (\$66,000 in 2003). The Fund does not bill parties. It accepts and records revenue sent from the harness tracks and regional OTB corporations as well as nomination and sustaining fees from horsemen who register their horses with the Fund at the amount received.	The Fund maintains adequate records to account for handle revenue received, from the harness tracks and OTBs, for each track. It also maintains adequate records to account for breakage revenue. However, the Fund does not issue bills to the horsemen. It instead sends a general notice to the horsemen as a reminder that nomination and sustaining fees are due by a given date.
	Do the Fund's policies and procedures provide assurance that revenues are being collected timely?	The Fund does not have written collection procedures. The harness tracks and regional OTB corporations self-report how much they owe the Fund from the betting handle. Fund managers expect the harness tracks and regional OTB corporations to pay within 60 days after the end of each month. Fund managers notify the Racing and Wagering Board Chairman if payments are delinquent.	The Fund does not have written collection procedures. The Fund relies on the harness tracks and regional OTBs to send the correct amount of revenues and does not periodically validate the accuracy of such revenues. We reviewed Fund collections for the three-month period ending March 31, 2004 and found that Yonkers Raceway did not send revenues to the Fund timely. As of April 19, 2004, Yonkers Raceway owed the Fund handle revenues for the month ended January 31, 2004, or 19 days overdue at that time. Fund officials told us that Yonkers Raceway is often delinquent in remitting revenues to the Fund.

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
	<p>C. Cash & Investments:</p> <p>Do the Fund's policies and procedures provide assurance that cash and investments are properly safeguarded, accounted for, and deposited into the appropriate accounts?</p>	<p>The Fund receives checks from the harness tracks, OTB and horsemen. The Fund does not have written procedures for collecting and depositing cash.</p> <p>The Fund's bookkeeper opens the mail, records the checks received into the Fund's database, restrictively endorses the checks, deposits the checks and performs the monthly bank reconciliations.</p> <p>The Fund has established written investment policies and procedures. The guidelines require the Executive Director to make all investments.</p> <p>The Fund's Board is required by law to review and approve the investment policy and procedures annually.</p> <p>The Fund has one checking account and tries to keep the bank balance between \$50,000 and \$100,000. It invests excess funds in certificates of deposit with the same bank that handles the Fund's checking account. The checking account is protected up to \$100,000 with FDIC insurance. The certificates of deposit are collateralized; the collateral is held by a trust company related to the bank that has the Fund's certificates of deposit.</p>	<p>A record (log) of the checks received is not made promptly after the mail is received. It is important that the checks be listed or recorded as soon as received to ensure they are accounted for.</p> <p>The cash handling responsibilities are not properly separated because the bookkeeper controls the entire process. Since the Fund has only two employees, controls would improve if, at a minimum, the Executive Director maintained a log of the checks received, restrictively endorsed the checks, and performed the monthly bank reconciliations. This would provide more assurance that the bookkeeper accurately records and deposits the checks.</p> <p>The bookkeeper waits until after all payment information is entered into the Fund's accounting system before restrictively endorsing the checks. The checks should be restrictively endorsed as soon as they arrive.</p> <p>The Fund did not adhere to its investment procedures. All investments were made by the Fund's bookkeeper.</p> <p>The Board did not review the Fund's investment policy and procedures in 2003.</p> <p>During 2003, we found that the Fund's checking account balance frequently exceeded \$100,000 and was as high as \$985,010. The Fund did not obtain additional collateral coverage when the checking account balance exceeded the \$100,000 covered by FDIC insurance.</p> <p>The Fund does not document that it seeks competitive interest rates from other financial institutions and therefore may have lost the opportunity to earn a higher rate of return.</p>

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
	<p>Do the Fund's policies and procedures provide assurance that cash disbursements are properly authorized and recorded?</p>	<p>The Fund has written policies and procedures for disbursements. Generally, the bookkeeper initiates the disbursement process. Fund procedures require two authorization signatures for checks issued: including the signature of the Executive Director and the State Comptroller.</p> <p>The Executive Director requires that the bookkeeper furnish all of the supporting documentation for each transaction, which he reviews, before signing each check. The bookkeeper normally reconciles the bank account.</p>	<p>The Fund's disbursement policies and procedures do not address how accounting duties should be separated. They should. The Fund has only two employees. Given this situation, the Fund should implement detection controls and, at a minimum, have the bank account reconciled by the Executive Director.</p>
D. Payroll:			
	<p>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?</p>	<p>The Fund has written policies and procedures for employee leave.</p> <p>The two Fund employees prepare their time sheets bi-weekly. For each workday they note whether they were present or absent. The Executive Director signs the bookkeeper's time sheet. No one signs the Executive Director's time sheet.</p> <p>At the end of each calendar year, the employees calculate their leave accruals, including leave accrued, used, and the leave balances on hand.</p>	<p>The Fund's policies and procedures do not cover employee time and attendance.</p> <p>We examined the employee time sheets for the three-month period ended March 24, 2004. The time sheets were prepared and signed by the employees and the bookkeeper's timesheets were approved by the Executive Director. However, the employees did not keep track of time off if it is less than one day. They should.</p> <p>We calculated the employee leave accruals for 2003 and found that the Executive Director's leave accruals were not calculated correctly. He overstated accumulated annual leave three days and overstated accumulated sick leave three days. To provide more assurance that leave is calculated correctly, the employee should calculate their leave accruals bi-weekly, when the time sheets are prepared, instead of at the end of the calendar year.</p>

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
	<p>Do the Fund's policies and procedures provide assurance that payroll changes (e.g., additions, deletions, and overtime) are processed accurately and timely?</p>	<p>The current Executive Director started at the Fund in March 2003. The former Executive Director retired in December 2002, but agreed to stay on until a qualified replacement was found.</p> <p>Fund employees are not eligible for overtime.</p>	<p>The Fund does not have written policies and procedures for payroll changes. We reviewed the supporting documentation for these two payroll changes and found no exceptions.</p> <p>No overtime was paid for the six payroll periods we examined from December 27, 2003 to March 19, 2004.</p>
<p>E. Procurement & Contracting:</p>			
	<p>Do the Fund's policies and procedures provide assurance that purchases are authorized, received, and recorded properly?</p>	<p>The Fund does not have written purchasing policies and procedures. We were advised that the Fund's bookkeeper is responsible for ordering goods and services and reporting that they have been received. The bookkeeper prepares the check and furnishes the Executive Director with all supporting documentation. The Executive Director is supposed to review all of the supporting documentation before authorizing payment and signing the check.</p>	<p>The Fund should have written procurement policies for each individual's responsibility in the purchasing process. This includes who initiates, approves, orders, receives and records a purchase.</p> <p>All of the 10 purchasing transactions we examined were properly authorized and documented.</p>
	<p>Do the Fund's policies and procedures provide assurance that purchases are reasonable and necessary and made in an economical and efficient manner?</p>	<p>The Fund has policies and procedures for procurement contracts that were approved by the Board of Directors in 1992. The policies provide that the Executive Director can approve purchases for goods and services up to \$500 without obtaining price competition. At least three verbal price quotes are needed for purchases between \$500 and \$5,000; at least three written price quotes are needed for purchases between \$5,000 and \$15,000; sealed bids are needed for purchases between \$15,000 and \$24,999. There must be a written contract for purchases of goods or services that exceed \$5,000. The Board must approve all contracts exceeding \$25,000.</p>	<p>We identified three instances where the Fund did not adhere to its procurement guidelines. For 2003, the Fund paid a veterinarian a total of \$33,200 to draw blood samples from horses who participated in sire stake races and to test for illegal substances. The Fund did not solicit price competition for this service and there was no formal contract.</p> <p>Similarly, there was no contract for consultant services paid to the former executive director who had retired and agreed to continue as a consultant until his replacement, hired in March 2003, was fully trained. The Fund pays this individual one bi-weekly salary payment per quarter. As of April of 2004, he has received four such payments totaling \$13,500, without a formal contract to document the terms and conditions of this</p>

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
			<p>agreement.</p> <p>Fund guidelines allow waiver of price competition if State contracts are used. For 2004, the Fund selected its public accounting firm through a State contract. However, the Fund paid this same firm \$7,400 in 2003 for their services, and did not solicit competition or enter into a formal contract with this company.</p>
	F. Equipment & Asset Management:		
	<p>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?</p>	<p>Fund policy requires that the Executive Director approve all purchases, including equipment acquisitions up to \$25,000.</p> <p>The Fund maintains an inventory list of equipment items placed under inventory control which includes a brief description of the equipment items.</p> <p>Periodically, the Executive Director performed a physical inventory to determine that the equipment was on hand. Items that were on hand but not on the inventory listing were added to the listing.</p>	<p>The Fund does not have written policies and procedures for equipment acquisitions and dispositions.</p> <p>The Fund does not maintain detailed inventory records for equipment. When a new equipment item is purchased, the Fund does not record pertinent information such as the date the item was purchased, the cost, and the serial number.</p> <p>We judgmentally selected five equipment items to physically inventory. The items selected were located. However, inventory control numbers were not assigned and affixed to the equipment items to help the person performing the physical inventory to identify these items as belonging to the Fund.</p>
	<p>Do the Fund's policies and procedures provide assurance that equipment is secured properly and used as intended?</p>	<p>The Fund's staff monitors access to their office to prevent equipment theft or loss.</p> <p>Fund informal policy provides that the equipment be used only for business purposes.</p>	<p>The Fund does not have formal policies and procedures for equipment security or usage.</p> <p>Periodically, the staff accesses the Internet. The Fund has not established procedures restricting use of the Internet to business purposes.</p>
	G. Budgeting & Expenditure Control		
	<p>Do the Fund's policies and procedures provide assurance that the Fund's annual budget is prepared accurately and timely?</p>	<p>Budget estimates for revenues are based on prior year data. For example, the Fund keeps track of the daily handle it receives from each harness track. The average daily handle for the prior year is multiplied by the number of anticipated race days for the upcoming year.</p>	<p>We found that the Fund's budget for 2003 was prepared accurately and timely.</p>

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
		<p>The Fund also uses trend analyses to estimate revenues. There has been a decline in revenues in the harness racing industry. Consequently, the Fund lowers its estimates for handle to factor in this trend.</p> <p>Budgeted expenditures are based on the percentages specified in the law. For example, the law states that 75 percent of the handle revenue be used for sire stakes race purses; 19 percent is to be split among fairs and 4-H organizations; up to 4 percent can be used for Fund administration, and 2 percent is for equine research.</p>	
	<p>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?</p>	<p>Monthly, the Fund prepares financial statements to assess its financial position. Prior year's data is noted (in pencil) next to the current year revenue and expenditure data. A copy of the statement is furnished to the Board.</p> <p>The Law provides that administrative costs cannot exceed 4 percent of handle revenue. When the budget is established, the Fund establishes a record to note the total amount budgeted for each expenditure category and expenditures are noted on the record as the year progresses.</p> <p>For 2003, the estimated revenues for handle and breakage totaled \$6,695,290. Four percent of this amount (\$267,812) was allocated for administrative expenses. However, the total administrative budget that year was \$440,612 because a portion of the expense was to be paid from horsemen's fees (\$122,800) and one-third of total interest income (\$50,000).</p>	<p>While the Fund monitors actual and estimated expenditures monthly, it did not adjust or lower its spending as it became apparent that actual revenues for 2003 would be less than expected. For 2003, administrative expenditures totaled \$585,025. Thus, the Fund's budget exceeded the allowable amount. Further, the Fund's share of actual revenues from handle and breakage, horsemen fees and interest income totaled only \$394,028. The Fund overspent the amount allowed by \$190,997 (\$585,025 - \$394,028) or overspent by about 49 percent. The Fund used unspent moneys carried forward from prior years to cover the overspending.</p> <p>The Fund actually spent one-half of interest income on administration. The budget states that only one-third of interest income was to pay for administrative expenses.</p>
<p>H. Accounting and Information Systems</p>			
	<p>Do the Fund's accounting and information systems provide</p>	<p>The Fund recently purchased a computer software package to maintain its accounting records and</p>	<p>The Fund's accounting system produces timely and accurate monthly financial reports so that the Fund can monitor its</p>

	QUESTION	FUND ACTIVITIES	COMPTROLLER'S COMMENT
	<p>assurance that management has access to timely, accurate and relevant information?</p>	<p>produce financial reports. The Fund maintains a manual record backup system. The Fund operates on continuous cycle with similar deadlines every year.</p> <p>The Fund's internal control procedures describe what tasks need to be accomplished each month and the time or date the tasks need to be completed.</p>	<p>financial position. The system also keeps track of handle and breakage payments and payments from horsemen so that the Fund can quickly calculate the purse schedule for the upcoming racing season.</p>
	<p>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?</p>	<p>Employees are required to enter a password to access the computer server. The Fund has high speed cable access to the Internet with firewall protection against outside intrusion when accessing the Internet.</p> <p>The Fund's server produces daily backup tapes.</p>	<p>Once employees log into the server, they can access any program without needing another password. To provide an extra level of security, the Fund should require that passwords be established and used to gain access to the software applications.</p> <p>The Fund does not have a disaster recovery plan. The server backup tapes are stored on-site next to the Fund's server. The tapes should be stored off-site as a precaution against loss. Tapes on site should also be stored in a fireproof box away from the server.</p>



**STATE OF NEW YORK
RACING AND WAGERING BOARD**

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Michael J. Hoblock, Jr.

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November 15, 2004

Ms. Carmen Maldonado
Audit Director
Office of State Comptroller
110 State Street
Albany, N.Y. 12236

Re: Working Draft of Office of State Controller (OSC)
Audit of Internal Controls Over Financial Operations for
the Agriculture and New York State Horse Breeding
Development Fund - Report 2004-S-56

Dear Ms. Maldonado,

This letter responds to your working draft of the referenced audit of the Agriculture and New York State Horse Breeding Development Fund. (Fund). Our comments are keyed to the major areas listed as the "Comptroller's Comment," beginning on page 7 of the working draft report. We are pleased to report that most of the OSC recommendations have already been implemented or will soon be implemented by the current Fund staff.

A. Board Oversight and Governance:

"The fund has not established corporate by-laws." - At its meeting on July 1, 2004 the Board of Trustees adopted corporate by-laws. (Recommendation # 1)

"One of the five board members missed half of the Board meetings during our audit period." - The Board member that missed these meetings had family emergencies that coincided with a number of Fund Board meetings. To minimize the impact of these absences, the Executive Director of the Fund was in frequent communication with this Trustee, sending him all notes, minutes, agendas and relevant data to keep him continuously updated on Fund business and afford the opportunity for his valuable input and counsel. This Board member has attended every board meeting held since the fieldwork for the audit was completed and continues to be very responsible and attentive to his duties.

"The Fund has not established a code of ethics." "...no indication that the Board reviewed and approved of the Fund's investment policies and procedures.." - A formal code of ethics and an updated version of the Fund's investment policies and procedures was adopted by the Board of Trustees at its meeting on July 1, 2004 at Goshen, N.Y. (Recommendations 1, 4 & 7)

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“The Board approved hiring a lawyer for \$15,000 a year...” The Fund Board of Trustees has been informed of OSC comments regarding our staff attorney. This issue will be placed on the agenda of the next Board meeting for discussion. (Recommendation 5)

B. Revenue and Collections:

“The Fund maintains adequate records..” - No response.

“The Fund does not have written collection procedures.” - The Fund agrees with this OSC recommendation and is developing a written collection procedure that will be presented for Board approval at its next meeting. (Recommendations 3 and 1)

“The Fund relies on harness tracks and regional OTBs to send correct amount of revenues...” - The Fund has explored possible methods to verify that it is receiving legally correct revenues from harness tracks and regional OTB corporations. We have written to our parent organization, the NYS Racing and Wagering Board (NYSRWB), to request its assistance in this matter. NYSRWB advises that it is considering real-time pari-mutuel activity monitoring software. If fully implemented this system would verify harness track and OTB fund remittances. It should be noted that each harness track and OTB does an annual financial audit showing all pari-mutuel revenues and statutory remittances including payments due the Fund. This allows us to keep a rough check on revenue due the Fund. (Recommendation 1, 3 & 6)

“Fund officials told us that Yonkers Raceway is often delinquent in remitting revenues to the Fund.” - The Fund’s practice has been to call Yonkers Raceway for revenue that has been due for 30 days or more and to notify the Chairman of the New York State Racing and Wagering Board after revenue is due over 60 days. This has been generally effective in collecting monies from Yonkers. As noted above, the Fund is developing a written collection procedure that will be presented to the Fund Board at its next meeting. (Recommendations 1, 3 & 6)

C. Cash and Investments:

“A record of checks received is not made promptly after the mail is received.” “The cash handling responsibilities are not properly separated because the bookkeeper controls the entire process.” “The bookkeeper waits until after all payment information is entered into the Fund’s accounting system before restrictively endorsing the checks.”

Corrective action to OSC comments and recommendations on this issue were completed before the auditors finished their audit. Currently, when the Fund receives checks in the mail, the Executive Director opens the mail and immediately records the checks in a log and restrictively endorses them. The checks are then passed to the Fund bookkeeper who then fills out bank deposit tickets and deposits the checks in the bank. Deposit tickets are then returned to the Executive Director, who verifies that each check originally logged into the system, has, indeed, been deposited in the Fund’s account. When the monthly bank statement arrives, it is opened and reconciled by the Executive Director. (Recommendations 1, 2 & 10)

“The Fund did not adhere to its investment procedures. All investments were made by the Fund’s bookkeeper.” - The current Fund Executive Director always calls five different banks to get a quote on current interest rates being paid on Certificates of Deposit. Once the Executive Director decides which quote is best, he then directs the Fund bookkeeper to call the high bidding bank to invest the Fund’s money. (Recommendation 8)

“The Fund did not review the Fund’s investment policy and procedures in 2003.” – The Board will review and approve the FUND investment policy when it considers implementing OSC’s Short Term Investment Program (STIP) as detailed below. Regarding the comments in the working draft report, the balance of the Fund’s

checking account has exceeded the FDIC insured level of \$100,000. For example on August 29, 2003 the Fund had a \$3,752,500 certificate of deposit mature with the proceeds deposited directly into the Fund's checking account. This was done to cover outstanding purse checks. Two days later the account balance was down to \$899,000, but the Fund had outstanding checks in the amount of \$706,778.59 against the \$899,000. During the months of July, August and September the Fund disburses approximately \$6,000,000 and it has been a challenge to prevent the checking balance from occasionally exceeding \$100,000 for a day or two.

Both the pursuit of competitive interest rates and the issue of the Fund's checking account having an excessive balance for even a few days will be remedied by the Fund's transition into the OSC Short Term Investment Program (STIP). Under STIP, OSC will daily sweep all funds over a pre-determined level in the Fund's checking account and invest the money according to OSC guidelines. STIP would seem to be the perfect solution to any further cash and investment problems. (Recommendation 7, 8 & 9).

"Fund's disbursement policies and procedures do not address how accounting duties should be separated. ...at a minimum, have the bank account reconciled by the Executive Director." - The new written procedure calls for the Executive Director to reconcile the Fund bank account. (Recommendation 10 & 1)

D. Payroll:

"The Fund's policies and procedures do not cover employee time and attendance." - The Fund agrees with the OSC recommendations regarding payroll changes and adopted a New York State civil service model Time and Attendance policy at its July 1, 2004 Board of Trustees meeting. Written policies and procedures will also be developed for payroll changes. In fact, a payroll change planned for 2005 has already been submitted to and approved by the Fund's Board of Trustees. With the assistance of the OSC auditors, the Fund has corrected the bookkeeping error on the Director's time sheet noted in the report and has implemented the OSC recommendation to calculate leave accruals bi-weekly, when time sheets are prepared. In fairness, it would seem worth mentioning (as one of the auditors pointed out) that the bookkeeping error notwithstanding, the review of the timesheets resulted in Fund employees gaining leave hours. (Recommendation 11 & 1)

E. Procurement and Contracting

"The Fund should have written procurement policies for each individual's responsibility in the [purchasing process...]" " - The Comptroller comments that the Fund did not adhere to its procurement guidelines in choosing a veterinarian to draw blood samples to test for illegal substances. For the 2004 season the current Director searched in the local phone book and on-line and contacted all the laboratory-sampling firms available for quotes. Three of the firms said they dealt only in testing human substances, one said it would be interested in 2005 but could not possibly be ready to accommodate the Fund's business for 2004. The Fund also checked with the testing laboratory at Cornell University under the leadership of Dr. George Maylin. To have Cornell do the Fund's blood work for 2004 would have cost approximately \$150,000. As the Comptroller notes, the \$33,200 that the Fund did pay was slightly over our procurement guidelines but it was absolutely the least expensive rate for this service available anywhere in the State of New York and represents a saving of \$116,800 for the Fund. In the future the current Director intends to carefully follow the Fund's procurement guidelines. (Recommendations 7 & 12, p. 5 & 6.)

The former executive director retired and agreed to continue as a consultant to train his replacement who entered on duty in March of 2003. The Chairman of the Fund's Board of Trustees approved this arrangement. The combined compensation to the new director and his predecessor for the first year was less than the former director's annual salary. The Fund agrees with OSC's recommendation and will look to enter into a formal contract should consultants be needed in the future. (Recommendation 12).

In future years the Fund will continue the practice established in 2004 of using public accounting firms that offer services through State Contract. Competitive bids will be sought and documented and a formal

contract will be used to engage the selected firm. (Recommendation 12).

F. Equipment & Asset Management – The text below responds to various comments.

Before the OSC auditors left Fund offices all OSC recommendations regarding equipment inventory were implemented and we have since affixed a unique tag to each piece of equipment. Although the Fund did not previously label every piece of equipment with a tag, this did not seem necessary for an office with so little equipment concentrated in three rooms in one location. The serial numbers have always been listed on our equipment inventory, which in our opinion obviated the need for individual tags. The Fund also has established a set of written policies and procedures for equipment acquisitions and dispositions. (Recommendation 13 and 1).

The Fund has added a section to its internal control manual establishing procedures for restricting use of the Internet to business purposes. (Recommendation 15 &1).

G. Budgeting & Expenditure Control

“The Fund’s budget exceeded the allowable amount.” - It seems to us that the former Fund Executive Director protected the integrity of the Fund by aggressively conserving the Fund’s administrative revenue, saving scarce administrative dollars for the “rainy days” that are now upon us in a declining industry. The Fund will seek a legal interpretation of the applicable statute regarding possible limits on expenditure of administrative monies.

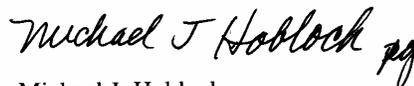
“The Fund actually spent one-half of interest income on administration. The budgets states that only one-third of interest was to pay for administrative purposes.” - The Fund agrees with OSC Recommendation 14 but notes that the management and Board of Trustees decision on exactly how to spend the Fund’s interest income is discretionary. In the future, if interest revenue is again re-directed after formal budget approval, a budget amendment will be sought from the Board of Trustees to better document the decision making process. (Recommendation 14)

H. Accounting & Information Systems

“Once employees log into the server, they can access any program without needing another password. To provide an extra level of security, the Fund should require that passwords be established and used to gain access to the software applications.” - The extra level of security provided by password protection has been established as recommended by OSC. (Recommendation 15).

“The Fund does not have a disaster recovery plan.” - Server backup tapes are now being stored off-site as recommended and on-site tapes are stored in a fireproof box. (Recommendation 16)

Sincerely,



Michael J. Hoblock
Chairman
Agricultural and New York State
Horse Breeding Development Fund

cc: Peter Goold
Robert Barnes