

**A Special Performance Audit**

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# **State Racing Fund**

**As Administered by the Department of Agriculture**

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**COMMONWEALTH OF PENNSYLVANIA  
Department of the Auditor General  
Bureau of Special Performance Audits**

**EUGENE A. DEPASQUALE, AUDITOR GENERAL**



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**EUGENE A. DePASQUALE**  
AUDITOR GENERAL

June 17, 2014

The Honorable Tom Corbett  
Governor  
Commonwealth of Pennsylvania  
Harrisburg, PA 17120

Dear Governor Corbett:

This report contains the results of the Department of the Auditor General's performance audit of the State Racing Fund, as administered by the Department of Agriculture (Agriculture), for the period July 1, 2009, through June 30, 2013. This audit was conducted under the authority of Sections 402 and 403 of The Fiscal Code and in accordance with generally accepted government auditing standards as issued by the Comptroller General of the United States. 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.

Our objectives included determining if all applicable revenues were received and deposited into the State Racing Fund and if expenditures were appropriate and spent in accordance with applicable laws and regulations. Our audit also included an analysis of the legislatively-mandated transfers of gaming revenues from the Pennsylvania Race Horse Development Fund (PRHDF), as well as the impact those transfers had on the PRHDF and the horse racing industry.

We found that wagering taxes, the primary source of revenues into the State Racing Fund, decreased from \$14.7 million to \$11.1 million (a 24 percent decline) from fiscal years 2009-10 to 2012-13. We also found that the Race Horse Industry Reform Act (Act), which provides for the revenues into the State Racing Fund, has not been amended since it was enacted in 1981, and it did not contain provisions that would allow for inflation growth. As a result, we believe urgent legislative action is needed to bring the Act into the 21<sup>st</sup> century by modifying current State Racing Fund revenue sources, as well as adding new revenue streams.

We also found that Agriculture overcharged the State Racing Fund for personnel costs. While the Act contains a provision that allows Agriculture to charge the State Racing Fund for administrative services that it provides to the horse and harness racing commissions (commissions), we found that Agriculture essentially used the State Racing Fund as a revenue source to pay for personnel costs. Specifically, we found that Agriculture charged the State Racing Fund more than \$5 million in personnel costs over the four year audit period that it could not document as being directly related to commission activities.

Since fiscal year 2008-09, Agriculture's general government operations (GGO) appropriation has been cut by nearly \$4 million. During those same years, Agriculture charged the State Racing Fund for "shared services" by using a cost allocation formula, but then adjusted that calculation by the amount needed "to balance the department's general fund budget." In addition to the shared services cost allocation, Agriculture charged the State Racing Fund directly for personnel costs in amounts that were determined, in part, by the "budgetary circumstances in any particular fiscal year." We believe that balancing Agriculture's budget with State Racing Fund monies is not an allowable use of the fund.

With regard to the PRHDF, we found that over \$212 million has been diverted from the fund since 2010 when the General Assembly began to redirect monies from that fund to fill gaps in the state's budget. As a result, the amount of money available for the PRHDF's original purpose—to stimulate the viability and quality of horse racing in Pennsylvania—has been significantly reduced. This reduction has caused a decline in purses and breeders' awards, which could impact the number of horse owners, trainers, and breeders coming to the state, as well as discourage attendance at races.

The decreasing revenues of the State Racing Fund, coupled with the redirection of monies from the PHRDF, raises serious concerns about the future of the very segment of the commonwealth's economy that these two funds aimed to secure—the horse racing industry itself.

We make five recommendations to address the declining revenues into the State Racing Fund and Agriculture's practice of overcharging the fund. Our expectation is that this report will be used as part of the current budget discussions so that the declining revenues of the State Racing Fund will be addressed. We will follow up with Agriculture at the appropriate time to determine whether, and to what extent, it has implemented our recommendations.

Finally, we would like to thank Agriculture officials for the cooperation extended to us throughout the audit.

Sincerely,



Eugene A. DePasquale  
Auditor General

cc: The Honorable George Greig, Secretary, Department of Agriculture



## State Racing Fund

<b>Table of Contents</b>	<b>Executive Summary</b>	ii
	<b>Introduction and Background</b>	1
	<b>Finding One</b> – The State Racing Fund is in jeopardy, and urgent changes are needed, both by Agriculture and the General Assembly, to ensure the future viability of the fund.	9
	<b>Recommendations</b>	13
	<b>Finding Two</b> – Agriculture overcharged the State Racing Fund for personnel costs.	18
	<b>Recommendations</b>	27
	<b>Observation</b> – Monies from the Pennsylvania Race Horse Development Fund are being diverted to fill state budgetary shortfalls resulting in declining revenues available to support the horse racing industry.	32
	<b>Appendix A</b> – Objectives, Scope, and Methodology	40
	<b>Appendix B</b> – Total Expenses paid out of the State Racing Fund, by expense item, fiscal years 2009-10 through 2012-13	44
	<b>Appendix C</b> – Agriculture salaries charged directly to the State Racing Fund, fiscal years 2009-10 through 2012-13.	47
<b>Response from Department of Agriculture</b>	48	
<b>Audit Report Distribution List</b>	55	

## EXECUTIVE SUMMARY

### State Racing Fund in Jeopardy

The State Racing Fund (Fund), which is administered by the Department of Agriculture (Agriculture), was established to provide funding for the regulation of horse and harness racing activities. Due to declining wagering tax revenues and Agriculture's practice of overcharging the Fund for personnel costs, the ability of the State Racing Fund to pay for the expenses related to the regulation of the horse racing industry is in jeopardy.

#### Stop gap funding actions were necessary to address the declining wagering tax revenues.

The primary revenue source for the Fund is wagering taxes.<sup>1</sup> Due to increased competition from other gaming activities, wagering tax revenues decreased from \$14.7 million in fiscal year 2009-10 to \$11.1 million in fiscal year 2012-13, a 24 percent decline. The largest expense of the Fund is personnel costs, accounting for up to 72 percent of total State Racing Fund expenses during the audit period.

As discussed in Finding One, declining revenues forced Agriculture to implement several stopgap measures in both fiscal years 2012-13 and 2013-14 to ensure the Fund was solvent for each of those fiscal years. Many of these stopgap actions, which included borrowing from the commonwealth's General Fund, delaying payment to contractors, and transferring costs to other agencies, were temporary and cannot be continued on an annual basis. In fact, the Fund was in such dire financial condition in 2013-14 that the legislature recently acted to allow transfers totaling \$4.2 million from another commonwealth special fund, the Pennsylvania Race Horse Development Fund (PRHDF), to ensure there were sufficient monies to cover the expenses of the horse and harness racing commissions (commissions) through the end of the fiscal year.

The Race Horse Industry Reform Act (Act) established, and set limits for, the revenues that can be deposited into the State Racing Fund. However, the Act has not been amended since it was enacted in 1981, and it did not contain provisions to allow for inflation growth. For example, licensing fees could not be raised to keep pace with the increased costs of regulating the industry. Therefore, we made a recommendation that the General Assembly should amend the Act to change current revenue streams and add new revenue sources for the Fund.

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<sup>1</sup> Wagering taxes comprised approximately 80 percent of total revenues into the State Racing Fund during most of our audit period.

**At the same time that revenues were declining, Agriculture overcharged the State Racing Fund for personnel costs.**

The Act allows Agriculture to charge the State Racing Fund for administrative services it provides to the commissions. We found that Agriculture charged the State Racing Fund for these administrative services in two ways. First, Agriculture charged the Fund for “shared services”<sup>2</sup> by using a cost allocation formula. Second, Agriculture charged the Fund directly for additional personnel costs, but it did not have any documentation to support to what extent these employees conducted racing commission-related work. The amount of personnel costs billed directly to the State Racing Fund depended “upon budgetary circumstances in any particular fiscal year.”

Specifically, we found that from fiscal year 2009-10 to fiscal year 2012-13, Agriculture charged the State Racing Fund \$6,065,000 in “shared services” costs using the cost allocation method. Agriculture charged an additional \$5,171,432 for personnel costs using the direct billing method.

In both cases, Agriculture overcharged the State Racing Fund. We found that Agriculture did not charge the State Racing Fund for the actual amount calculated using the “shared services” formula. In fact, in fiscal year 2011-12 Agriculture overcharged the Fund \$332,836, and in fiscal year 2012-13 Agriculture overcharged the Fund by \$383,699. According to Agriculture officials, these “additional administrative service charges were made in order to balance [the] department’s general fund budget.”

With regard to the direct billing of Agriculture’s personnel costs, Agriculture could not provide documentation to support the actual time each of these employees spent on racing commission-related work. As a result, there is no assurance that the salary amounts charged to the State Racing Fund were appropriate. Further, because these employees worked in numerous Agriculture program areas throughout the year, Agriculture should have included them in the “shared services” allocation, rather than as a direct billing. By direct billing the State Racing Fund for these personnel costs, Agriculture was able to charge up to 100 percent of an employee’s salary to the Fund, a much larger percentage than would have been charged using the shared services formula. (See Finding Two for additional information on these overcharges.)

In order to address Agriculture’s overcharges to the State Racing Fund, we made four recommendations; including the implementation of a time tracking system for its employees to document the actual amount of time spend on racing commission-related work.

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<sup>2</sup> “Shared Services” are personnel and operational costs for employees from Agriculture’s centralized organizations who provided administrative services to the horse and harness racing commissions.

**\$212 million of gaming revenues redirected from the Pennsylvania Race Horse Development Fund (PRHDF) since 2010.**

The PRHDF, created in 2004 with the enactment of the Pennsylvania Race Horse Development and Gaming Act, was set up to revitalize the horse racing industry by using slots gaming revenues to increase track purses, provide funding for health and pension benefits for horsemen, and provide a revenue source for three restricted accounts: Breeding Fund, Sire Stakes Fund, and Standardbred Breeders Development Fund. The three restricted funds provide monetary awards to breeders and owners and support races that feature horses sired by a Pennsylvania stallion, among other uses.

Since 2010, the General Assembly has redirected over \$212 million from the PRHDF, primarily to the General Fund, to fill gaps in the state's budget. (See the Observation beginning on page 32 for additional detail.) In addition to the redirections of these specifically designated funds, slots gaming revenues have become stagnant in recent years. The declining revenues, coupled with the redirection of funds, have a direct impact on the Pennsylvania horse racing industry by reducing the amount of money available for purses, breeders' awards, and health and pension benefits for horsemen. The ripple effect of these declines include, but are not limited to, fewer breeders coming to the state, smaller track purses, and lower racetrack attendance. Collectively, these effects can then cause an adverse impact on the businesses that support the horse racing industry and the local economies.

The General Assembly must decide if stimulating the viability and quality of horse racing in Pennsylvania should still be the primary use of the PRHDF. If the original intent of the PRHDF remains the same, then the General Assembly should stop transferring monies away from the horse racing industry and find another means to address the state's budgetary gaps.

**State Racing Fund**

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**Introduction  
and  
Background**

Pennsylvania's horse racing industry is governed by the Race Horse Industry Reform Act (Act),<sup>3</sup> which was enacted in 1981. The Act also created the State Racing Fund,<sup>4</sup> which supports the racing industry. The Department of the Auditor General conducted a performance audit of the State Racing Fund to determine the viability of the fund to support the racing industry.

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**Pennsylvania Horse Racing**

Horse (thoroughbred<sup>5</sup>) and harness (standardbred<sup>6</sup>) racing are an integral part of the agricultural industry in the commonwealth. Pennsylvania has six racing facilities, three horse racing tracks and three harness racing tracks. These six tracks are located at casinos<sup>7</sup> throughout the state.

The three thoroughbred tracks are as follows:

- Parx Racing in Bensalem
- Hollywood Casino at Penn National in Grantville
- Presque Isle Downs in Erie

The three harness tracks are as follows:

- Harrah's Philadelphia Racetrack in Chester
- Meadows Racetrack in Meadow Lands
- Pocono Downs Racetrack in Wilkes Barre

In addition to the three harness tracks, the commonwealth also hosts harness racing at 16 annual agricultural county fairs.

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<sup>3</sup> 4 P.S. § 325.101 *et seq.* (Act 135 of 1981, as amended). Act 135 repealed the Pennsylvania Harness Racing Law (Act 728 of 1959) and the Pennsylvania Thoroughbred Horse Racing Law (Act 331 of 1967), but the commissions were reestablished as agencies under the "Sunset Act." *See also* 58 Pa. Code Part IV (relating to Horse Racing Commission) and Part V (relating to Harness Racing Commission) and 7 Pa. Code §§ 133.1 to 133.7 (relating to the Statement of Policy on "New or Amended Pari-mutuel License Applications").

<sup>4</sup> 4 P.S. § 325.222.

<sup>5</sup> The form of racing in which each horse is mounted by a jockey.

<sup>6</sup> The form of racing in which each horse has the ability to race in harness at a trot or pace instead of under saddle at a gallop.

<sup>7</sup> Category 1 gaming licensees are also known as "racinos" since they house both a casino and a racetrack.

**State Racing Fund**

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**The Commissions**

The state's racing industry is regulated by the Pennsylvania State Horse Racing Commission and the Pennsylvania State Harness Racing Commission, collectively referred to as the commissions.

The mission of the commissions is "to direct, regulate, secure, and promote the horse racing and breeding industry in the commonwealth."

The Horse Racing Commission has general jurisdiction over all pari-mutuel thoroughbred horse racing activities in the commonwealth, as well as the corporations engaged in such activities. The Horse Racing Commission participates in all regional regulatory activities offering reciprocity to all racing jurisdictions.

The Harness Racing Commission has general jurisdiction over all pari-mutuel and county fair harness racing activities in the commonwealth, as well as the corporations engaged in such activities. The Harness Racing Commission has jurisdiction over the administration of all standardbred horse racing conducted by a county agricultural society or an independent agricultural society as provided under the Pennsylvania Agricultural Fair Act.

Each commission consists of three members who are appointed by the Governor, by and with the advice and consent of the Senate. Each commissioner holds office for a term of three years and until a successor is qualified. The Secretary of Agriculture, or his designee, is a nonvoting ex-officio member of each of the commissions. Each commission meets at least once a month, and both commissions have their own executive secretary.

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**Department of Agriculture**

The commissions are departmental administrative commissions<sup>8</sup> within the Pennsylvania Department of

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<sup>8</sup> The Administrative Code provides that departmental administrative boards, commissions, and other like entities are to be independent of department agency heads yet subject and responsible to departments regarding the expenditure of money. 71 P.S. § 183.

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## State Racing Fund

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Agriculture. According to the department's organization chart dated November 20, 2013, the commissions are under the jurisdiction of the deputy secretary for animal agriculture. All employees of the commissions are employees of Agriculture.

Agriculture provides administrative support to the commissions, including fiscal operations. Approval and authorization of expenditures are provided by Agriculture utilizing the same internal processes in place for all Agriculture operations. In addition, the Secretary of Agriculture hires (and has the ability to dismiss) the commissions' executive secretaries.<sup>9</sup>

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## State Racing Fund Revenues

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The Act established six primary revenue sources for the State Racing Fund. The following sections describe each of these sources in detail.

### 1. Wagering Taxes

Each racetrack is required to pay a tax on the total amount wagered each racing day. The tax amount is different for "straight pari-mutuel" wagers and for "exotic" wagers.

Pari-mutuel betting is a system of playing against other bettors. The money from all bettors is pooled. If you win your bet, you get part of the pool. Since 1986, the wagering tax for "straight pari-mutuel" bets has been 1.5 percent when at least 100 days of racing have been conducted.<sup>10</sup>

A wagering tax of 1.0 percent is imposed on the total amount wagered from "exotic" betting. Exotic betting offers a chance to turn a small wager into a larger payout and includes the following:

- Exacta. You win if you select the 1<sup>st</sup> and 2<sup>nd</sup> place horses in a race in the "exact" order.

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<sup>9</sup> However, pursuant to the Act, each commission, and not Agriculture, is charged with hiring and dismissing its "executive secretary, deputies, secretaries, officers and representatives as it may deem necessary, who shall serve during its pleasure." 4 P.S. § 325.201(d).

<sup>10</sup> If a track has less than 100 racing days in a year, the wagering tax is 2.0 percent. Newly licensed tracks pay a wagering tax of 1.0 percent the first four years of operation.

## State Racing Fund

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- Quinella. You win if you select the first two finishers of a race in any order.
- Trifecta. You win if you select the 1<sup>st</sup>, 2<sup>nd</sup>, and 3<sup>rd</sup> place horses in a race in the correct order of finish.
- Daily Double. You win if you pick the winner of two consecutive races before the running of the first race in the sequence of races.

### 2. Breakage

Breakage is the downward rounding of odds before making winning payoffs. The Act requires the three thoroughbred tracks to pay 25 percent of their breakage into the State Racing Fund, but the Act does not require the three harness tracks to pay any percentage of their breakage into the fund.

All tracks in the United States currently use dime breakage which means that the odds on a horse are always rounded down to the nearest tenth. For example, if the odds on a specific horse were 6.73 to 1, the odds would be rounded down to 6.7 to 1 before calculating the winning payoffs.

Winning payoffs are also rounded down. For example, a payoff of \$3.43 would be rounded down to \$3.40 and the remaining three cents is considered the “breakage,” which is then taxed at 25 percent.

### 3. Admissions Taxes

The Act states that each track must pay a five percent tax on the total admission fees collected each race day. However, the six racetracks do not charge any admissions fees. Therefore, in lieu of the strict computation set forth in the Act, the Department of Revenue collects a three cent “tax” for each person admitted to a race event. For example, if 1,000 people attended a race event at one of the tracks on a particular day, then that track would owe \$30 to the State Racing Fund in admissions taxes.

### 4. Uncashed Tickets

Each winning ticket must be presented to the racetrack for payment before April 1 of the year following the ticket’s purchase. After April 1, the racetracks must forward all

**State Racing Fund**

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uncashed tickets to the Department of Revenue for credit to the State Racing Fund.

**5. Licensing Fees**

All persons participating in thoroughbred and harness horse race meetings must be licensed by the pertinent commission. Licensees include trainers, jockeys, drivers, and horse owners, as well as other persons and vendors working at or employed at the racetracks. Licenses must be renewed every three years.

Each commission sets the fee rates for the applicable occupational licenses. According to the Act, no license fee is allowed to exceed \$100.

The thoroughbred racing occupational license fees have not changed since 2009, and range from \$15 to \$75, with most licenses costing \$30. In addition to the thoroughbred occupational licenses, each thoroughbred race horse owner must pay an annual fee of \$15 to register his/her colors to be worn by jockeys during each race.

The harness racing occupational fees were increased July 1, 2013. Prior to that increase, fees ranged from \$15 to \$75, with most licenses costing \$60. With the 2013 license fee change, the Harness Racing Commission removed all “combination” licensee categories. For example, in the past, a person who wanted an owner-trainer license paid only one fee of \$60 but got two licenses. With the new license fee schedule, that same person now pays \$100 for an owner’s license and another \$100 for a trainer’s license.

**6. Miscellaneous Revenues**

The primary miscellaneous revenue credited to the State Racing Fund is the fund’s interest earnings. To a much smaller and more infrequent extent, the State Racing Fund is also credited with any penalties paid by the racetracks for late submission of taxes to the Department of Revenue.

In fiscal year 2012-13, the State Racing Fund received a loan from the General Fund for \$300,000.<sup>11</sup> That loan was recorded under “miscellaneous revenues.”

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<sup>11</sup> This loan was paid back in fiscal year 2013-14.

### State Racing Fund

The following table shows the State Racing Fund revenues for fiscal years 2009-10 through 2012-13. As shown in the table, revenues are on the decline largely due to increased competition from Internet wagering and gaming at the casinos, which is drawing bettors away from the tracks. (The effect of the declining revenues is discussed in more detail in Finding One.)

<b>State Racing Fund Revenues</b>				
Revenue Category	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Wagering Taxes	\$14,655,171	\$12,417,261	\$12,513,992	\$11,073,072
Uncashed Tickets	2,277,175	2,004,972	1,901,810	1,722,087
License Fees	644,504	656,983	619,330	615,469
Breakage	527,623	420,622	403,867	354,485
Admissions Taxes	50,829	47,318	46,027	39,865
Miscellaneous Revenues	<u>185,672</u>	<u>2,908,184</u> <sup>a/</sup>	<u>455,583</u>	<u>638,547</u> <sup>b/</sup>
<b>Total Revenues</b> <sup>c/</sup>	<b>\$18,340,974</b>	<b>\$18,455,340</b>	<b>\$15,940,609</b>	<b>\$14,443,525</b>

<sup>a/</sup> A one-time sum of nearly \$2.3 million was received from the Pennsylvania Treasury Department in interest on securities because Treasury changed its investment strategy, which caused a previous unrealized gain to become realized income. Other special funds besides the State Racing Fund received similar payments.

<sup>b/</sup> Includes the \$300,000 loan from the commonwealth General Fund.

<sup>c/</sup> The Act provides for transfers of wagering taxes to the Pennsylvania Breeding Fund and the Pennsylvania Sire Stakes Fund after costs to administer duties under the act are paid. (See 4 P.S. § 325.222 (b)(5)(i)-(ii)). Wagering taxes on this table include the amounts that were transferred to these two funds, which were: FY 2009-10, \$2,058,353 (Breeding); FY 2010-11, \$1,855,761 (Breeding) and \$693,622 (Sire Stakes); FY 2011-12, \$32,960 (Breeding) and \$14,126 (Sire Stakes); and FY 2012-13, \$30,968 (Breeding) and \$13,272 (Sire Stakes).

**Source:** Developed by the Department of the Auditor General from information obtained from Agriculture. (See Appendix A for more information.)

**State Racing Fund**

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**State Racing Fund Expenditures**

The State Racing Fund is used to pay the following expenses:

- Horse and Harness Racing Commissions
  - Salaries, wages, and benefits of commission employees
  - Operating costs of the commissions
  - Personnel and operational costs of Agriculture staff that provide administrative services to the commissions
- Department of Revenue
  - Salaries and benefits for one employee responsible for collecting racing taxes
  - Operating costs for collecting racing taxes
- Equine Laboratories
  - Salaries and benefits of staff
  - Operating costs of the equine laboratories
- PA Fair<sup>12</sup>
  - Salaries and benefits of employees responsible for fair administration
  - Operating costs for fair administration

The following table shows the expenses paid from the State Racing Fund for fiscal years 2009-10 through 2012-13. As shown on this table, the commissions' expenses comprise the largest portion of State Racing Fund expenses, ranging from 79 to 82 percent of funding each year. This table also shows that 63 to 72 percent of the total State Racing Fund expenses each year were related to personnel costs.

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<sup>12</sup> Because certain agricultural fairs conduct harness racing, the State Harness Racing Commission has authority over the racing at those fairs. Specifically, the Race Horse Industry Reform Act, 4 P.S. § 325.202(c) states that the State Harness Racing Commission shall have jurisdiction over and shall promulgate regulations as necessary for the proper administration of all racing conducted by a county agricultural society or an independent Agriculture society as provided for under the Pennsylvania Agricultural Fair Act. Historically, the commonwealth had a special fund called the PA Fair Fund. This special fund was discontinued in 1986, and replaced with a separate executive authorization in the State Racing Fund.

## State Racing Fund

State Racing Fund Expenses								
Organizations	FY 2009-10		FY 2010-11		FY 2011-12		FY 2012-13	
	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
Racing Commission	\$12,919,636	78.7%	\$12,878,428	79.6%	\$12,885,737	79.2%	\$11,894,270	81.7%
Equine Laboratories	3,023,567	18.4%	2,840,255	17.6%	2,940,467	18.1%	2,431,359	16.7%
PA Fair Administration	233,749	1.4%	244,896	1.5%	225,274	1.4%	227,976	1.6%
Department of Revenue	232,924	1.4%	216,777	1.3%	208,187	1.3%	0	0%
<b>Total expenses</b>	\$16,409,875	100%	\$16,180,356	100%	\$16,259,665	100%	\$14,553,606	100%
Expenses of all organizations combined:								
Personnel costs	\$10,317,645	62.9%	\$10,292,001	63.6%	\$10,325,355	63.5%	\$10,497,988	72.1%
Operating costs	4,312,230	26.3%	4,033,355	24.9%	4,204,311	25.9%	2,605,618 <sup>2/</sup>	17.9%
Payments to agencies <sup>1/</sup>	1,780,000	10.8%	1,855,000	11.5%	1,730,000	10.6%	1,450,000	10.0%
<b>Total expenses</b>	\$16,409,875	100%	\$16,180,356	100%	\$16,259,665	100%	\$14,553,606	100%
<p>Note: Totals may not add due to rounding.</p> <p><sup>1/</sup> Reflects payments to the Department of Agriculture for “shared services” and \$250,000 to the Department of Community and Economic Development in each year from FY 2009-10 through FY 2011-12 for a racing promotional program.</p> <p><sup>2/</sup> Operating costs decreased in FY 2012-13 because Agriculture took deliberate emergency actions to reduce expenses since revenues were declining. These emergency actions are discussed in detail in Finding One.</p> <p><b>Source:</b> Developed by Department of the Auditor General staff from information obtained from Agriculture. (See Appendix A for more information.)</p>								

See Appendix B for a schedule of State Racing Fund expenses, by category, for each of the four fiscal years.

**State Racing Fund**

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**Finding One**

**The State Racing Fund is in jeopardy, and urgent changes are needed, both by Agriculture and the General Assembly, to ensure the future viability of the fund.**

In fiscal year 2012-13, wagering tax revenues declined significantly over prior year levels (as shown in the table in the *Introduction and Background* section). As a result, total revenues into the State Racing Fund were not adequate to pay the same level of expenses that were paid from the fund in prior years. Consequently, in both fiscal years 2012-13 and 2013-14, Agriculture had to implement several stopgap measures to ensure the fund was solvent for each of those fiscal years. Many of these actions were temporary and cannot be continued on an annual basis.

Even with the stopgap measures Agriculture implemented, the State Racing Fund was in serious jeopardy of running out of funds before the end of the 2013-14 fiscal year. The General Assembly provided an alternative source of funding to shore up the State Racing Fund for that year. The legislature enacted legislation that permitted transfers totaling \$4.2 million from the Pennsylvania Race Horse Development Fund (PRHDF) to the State Racing Fund.<sup>13</sup> This was a one-time transfer of funds; therefore, Agriculture, the commissions, and the General Assembly, have to work together to find a permanent funding solution for the State Racing Fund.

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**The State Racing Fund's declining revenues resulted in Agriculture taking numerous stopgap actions.**

With decreasing wagering tax revenues in fiscal years 2012-13 and 2013-14, Agriculture implemented stopgap measures, including borrowing from the commonwealth's General Fund, to ensure it had sufficient funds to pay the commission's operational expenses through the end of each year. In addition

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<sup>13</sup> Act 30 of 2014, effective April 10, 2014, amended The Fiscal Code to provide that \$300,000 shall be transferred each week, for a total of 14 weeks, from the Pennsylvania Race Horse Development Fund to the State Racing Fund for a total amount of \$4.2 million. See 72 P.S. § 1723-A.1(2).

## State Racing Fund

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to the amount borrowed from the General Fund, certain costs were deferred, transferred to other funds, and even to other state agencies, for payment during those fiscal years.

Even with the stopgap measures taken by Agriculture, as previously mentioned, in fiscal year 2013-14 the State Racing Fund still needed the \$4.2 million transfer from the PRHDF to remain solvent. (The impact to the horse racing industry overall due to the redirections of monies from the PRHDF is discussed in the *Observation* beginning on page 32.)

However, the continuation of such measures is not sustainable because these measures are merely a “shell game” to an issue that needs much more attention. Decreasing revenues coupled with increasing expenses lead to questions about the ability of the commissions to effectively regulate the horse racing industry without sufficient funds. The decreasing revenues also raise serious concerns about the future of the very segment of the commonwealth’s economy that the Act aimed to secure—the horse racing industry itself.

The narrative that follows details the actions taken by Agriculture each year to cover expenses.

### **Fiscal Year 2012-13**

In addition to borrowing \$300,000 from the state’s General Fund,<sup>14</sup> nearly \$2.2 million in expenses were transferred, deferred, or reduced as follows:

- Transferred \$655,967 in costs to Agriculture’s general government operations (GGO) appropriation.
  - \$305,456 in personnel costs for four Agriculture positions that had historically been paid out of the State Racing Fund (see Finding Two for more details).
  - \$215,897 for some equine laboratory supplies.
  - \$134,614 for a portion of specialized services.<sup>15</sup>

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<sup>14</sup> This amount was paid back in full from the State Racing Fund to the General Fund in FY 2013-14.

<sup>15</sup> These specialized services included commonwealth agency-provided services, such as Comptroller Operations, Department of General Services, and the Pennsylvania State Police (fingerprinting as part of licensee background checks).

**State Racing Fund**

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- Transferred \$155,024 in personnel costs for two racing commission positions to be paid out of the Pennsylvania Sire Stakes Fund.<sup>16</sup>
- Transferred the Department of Revenue's collection costs, which amounted to over \$200,000, to the Department of Revenue.
- Deferred a \$615,000 payment to the contractor responsible for the equine testing program.<sup>17</sup>
- Cancelled the advertising contract promoting horse racing in the commonwealth, which cost over \$400,000 annually.
- Reduced an IT vendor contract payment by \$161,249 by using one employee instead of two.

**Fiscal Year 2013-14**

- Borrowed money from the Pennsylvania Breeding Fund, the Pennsylvania Sire Stakes Fund, and the Pennsylvania Standardbred Breeders Development Fund in anticipation of legislation enacted providing a \$4.2 million transfer from the Pennsylvania Race Horse Development Fund. (According to Agriculture officials, these funds were repaid once the transfer was made.)
- Transferred the personnel costs of four Agriculture employees that were historically paid out of the State Racing Fund back to Agriculture's GGO appropriation. (Agriculture did not pick up lab supplies and specialized services costs as it did in fiscal year 2012-13.)
- The Department of Revenue continued to pay for its operating costs related to the collection of racing taxes.

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<sup>16</sup> According to Agriculture officials, these two positions support Sire Stakes Fund-related activities 100 percent of their time. The Pennsylvania Sire Stakes Fund ultimately receives its revenues from slots gaming, and depending upon availability, it also receives revenue from wagering taxes. (See *Observation* beginning on page 32 of this report for more information on this fund and slots gaming revenues.)

<sup>17</sup> The contractor agreed to this arrangement, with the understanding that the difference would be paid in fiscal year 2013-14.

**State Racing Fund**

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- The Pennsylvania Sire Stakes Fund continued to pay the personnel costs for two racing commission employees.

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**Urgent actions by both the General Assembly and Agriculture are needed to address revenue shortfalls in the State Racing Fund.**

As discussed in the *Introduction and Background* section of this report, the Race Horse Industry Reform Act (Act) established, and set limits for, the revenues that can be deposited into the State Racing Fund. The Act has not been amended since it was enacted in 1981, and it did not contain provisions that would allow for inflation growth. For example, the Act established a maximum occupational license fee of \$100; therefore, licensing fees could not be raised to keep pace with the increased costs of regulating the industry.

In addition, new revenue sources have not been introduced to offset the negative impact to the horse racing industry due to significant changes to gaming. For example, with increased competition from casinos, which were authorized in 2004 in Pennsylvania, as well as Internet gaming activities, live betting at the tracks has declined. New revenue sources could include harness breakage or adding additional “vendor” licensing fees for parties who have a connection to wagering.

Urgent legislative action is needed to bring the Race Horse Industry Reform Act into the 21<sup>st</sup> century by modifying its current revenue sources, as well as adding new revenue streams.

Moving beyond legislative changes needed to increase revenues, we found that during the course of our audit period, Agriculture charged millions of dollars of personnel expenses to the State Racing Fund that were not directly related to commission activities. As discussed in Finding Two, Agriculture’s GGO appropriation was reduced by nearly \$4 million from fiscal year 2008-09 through fiscal year 2013-14. Agriculture officials stated that the amount of Agriculture personnel costs charged to the State Racing Fund “depends upon budgetary circumstances in any particular fiscal year.”

## **State Racing Fund**

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While the Act allows Agriculture to charge the State Racing Fund for administrative services it provides to the commissions, the fund was never intended to be a source of revenues to make up for reductions in Agriculture's GGO appropriation.

Agriculture and the General Assembly need to address the State Racing Fund's revenue shortfalls as discussed above. Until they do so, the ability of the State Racing Fund to pay expenses for the regulation of the horse racing industry will be in jeopardy, and the commissions' ability to carry out all required regulatory functions could be at risk.

Further, the law<sup>18</sup> requires that a portion of any remaining monies in the State Racing Fund, after administrative and operating costs are paid, are to be transferred to the Sire Stakes Fund and the Breeding Fund. Every time Agriculture uses the State Racing Fund to pay other unrelated expenses, these two restricted accounts—and the horse racing-related activities they support—are impacted by not receiving the additional funds.

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## **Recommendations**

1. The General Assembly should amend and update the Race Horse Industry Reform Act to make changes to the revenue sources that support the State Racing Fund. The General Assembly should consider removing the cap on occupational license fees, as well as adding any other funding options that Agriculture and the commissions may develop.
2. The Department of Agriculture should not use the State Racing Fund monies to make up for GGO appropriation reductions. Agriculture should find other revenue sources to cover its expenses and/or take actions to reduce its expenses.

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<sup>18</sup> See 4 P.S. § 325.222(b)(5)(i)-(ii).

**State Racing Fund****Department of the Auditor General's Evaluation of Agriculture's Response:**

*Following is the Department of the Auditor General's evaluation of significant points from Agriculture's response to Finding One. Agriculture's response to the report appears in full beginning on page 48.*

In its response, Agriculture disagreed with our conclusion that decreasing wagering taxes led to the stopgap measures that were implemented beginning in 2012-13. Instead, Agriculture officials pointed to a workload increase in excess of 50 percent since 2006 without a corresponding increase in funding as the principle reason that the stopgap measures were needed.

*Agriculture is correct in stating that two new fully licensed and operational racetracks opened since 2006, but the additional administrative expenses related to the opening of those two tracks were primarily incurred in the years preceding our audit period. The personnel expenses of the commissions actually remained relatively steady throughout the audit period. But what did change notably during the audit period were the revenues generated from the pari-mutuel wagering taxes. Wagering tax revenues into the State Racing Fund decreased 24 percent from \$14.7 million in fiscal year 2009-10 to \$11.1 million in fiscal year 2012-13.*

*Agriculture itself was so concerned about the declining revenues into the State Racing Fund that the Secretary of Agriculture wrote in an October 2, 2013, memo to the commissions that the Racing Fund is facing a projected deficit of \$5 million this fiscal year [2013-14], and that Agriculture "currently projects that funding may not be available to pay staff or operational expenses after December 31, 2013." To close the projected deficit, the General Assembly passed Act 30 of 2014 to provide \$4.2 million to the State Racing Fund from the Pennsylvania Race Horse Development Fund (PRHDF).<sup>19</sup>*

*Without a change to the revenue streams into the State Racing Fund, the future viability of the fund to support the regulation and oversight of the horse racing industry remains in jeopardy.*

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<sup>19</sup> The *Observation* section of this report discusses the negative impact to the horse racing industry each time the PRHDF is used to fill commonwealth budgetary holes, including this transfer.

## State Racing Fund

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In its response to Finding One, Agriculture took issue with certain statements we made in the report. Agriculture believes that we took the following quote out of context: “Agriculture officials stated that the amount of Agriculture personnel costs charged to the State Racing Fund ‘depends upon budgetary circumstances in any particular fiscal year.’”

*We disagree that this quote from Agriculture officials was in any manner taken out of context. As we discuss in more detail in Finding Two, we found that Agriculture used two methods to charge the State Racing Fund for administrative costs. It was difficult to understand why Agriculture used both a cost allocation formula method and a direct billing method, especially when Agriculture could not provide documentation to support that the direct billings were for work related to the commissions.*

*The most notable example of the misuse of the fund was identified when we found that the full salary for the Special Agriculture Advisor to the Governor was charged to the State Racing Fund in fiscal year 2012-13. In the previous year, the advisor’s salary was shared between the State Racing Fund and Agriculture’s GGO appropriation. It was in response to our inquiries about how Agriculture decided what portion of an employee’s salary to charge to the State Racing Fund that Agriculture provided the quote: “it depends upon budgetary circumstances in any particular fiscal year.”*

*There is only one conclusion to be drawn from this statement—the amount of Agriculture personnel costs charged to the State Racing Fund depends on budgetary circumstances in any given year. When we considered the content of the entire discussion, Agriculture’s statement was not in any manner taken out of context. To the contrary, our use of Agriculture’s relevant statement was valid and reasonable. Therefore, we declined Agriculture’s request to delete it.*

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Agriculture also took issue with another statement in Finding One with regard to the use of the State Racing Fund for expenses not directly related to the work of the commissions. Agriculture indicated that the statement in the report, “that Agriculture uses the State Racing Fund as a source of revenues to make up for reductions in Agriculture’s GGO

**State Racing Fund**

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appropriation,” is not supported by any evidence. Agriculture asked us to correct this statement, but we declined because we disagree with Agriculture’s assertion regarding a lack of evidence.

*During the audit, in accordance with generally accepted government auditing standards, we obtained sufficient and appropriate evidence to support our conclusions. Specifically, we reviewed budget documents and accounting records, interviewed Agriculture officials and staff, and obtained written responses from Agriculture officials to specific questions about its charges to the State Racing Fund. The evidence in support of our conclusion is as follows:*

- 1) Agriculture’s GGO appropriation was reduced by nearly \$4 million since fiscal year 2008-09.*
- 2) When we questioned Agriculture officials about the methodology used for direct billings to the State Racing Fund, Agriculture officials stated that the amount charged depends on budgetary circumstances.*
- 3) Agriculture charged over \$1 million each year in personnel costs to the State Racing Fund but could not document that those costs related to racing commission work.*

*Collectively, these facts support our conclusion that Agriculture uses the State Racing Fund for expenses not directly related to the work of the commissions. Furthermore, in its written response to this report, Agriculture admits that, in order to avoid any annual lapse of monies to the General Fund, it is in the best interest of the Department to achieve as close to a \$0 balance in the fund as possible each year. Therefore, it is more than reasonable to conclude that Agriculture chose to use the State Racing Fund as a source of revenues to pay personnel costs of Agriculture employees rather than allow any funds to lapse back to the General Fund.*

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Agriculture did not respond to Recommendation #1 because it stated the recommendation was not applicable to the Department.

## State Racing Fund

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*While the recommendation is directed toward the General Assembly, it is our hope that Agriculture and the commissions will take the initiative of working with key members of the General Assembly in developing amendments to the Act that will provide for additional revenue sources needed for the continued viability of the State Racing Fund.*

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Agriculture does not agree with Recommendation #2.

*In its response, Agriculture points out that the total amount charged to the State Racing Fund declined over the audit period. But what Agriculture fails to mention is that the primary reason for the decrease was the fact that the fund did not have the revenues to support all those charges. In all likelihood, if wagering tax revenues had not declined over the four year audit period as it did, we believe the amount Agriculture charged to the State Racing Fund would not have decreased.*

## State Racing Fund

**Finding Two****Agriculture overcharged the State Racing Fund for personnel costs.**

During our four year audit period, Agriculture charged the State Racing Fund more than \$11 million. Some of these costs were approved under the Act and legitimate charges for services provided to the commissions by Agriculture employees. However, we found that Agriculture charged more than \$5 million in personnel costs to the State Racing Fund that it could not document as being directly related to commission activities.

Agriculture charged the State Racing Fund two different ways. First, it charged for “shared services,” which was for the services provided to the racing commissions by Agriculture employees. Second, it charged the State Racing Fund directly for the personnel costs of several Agriculture employees, most of whom provided limited services to the commissions (often referred to as “direct billing”).

Agriculture employees’ direct personnel costs, as well as the “shared services” costs paid out of the State Racing Fund comprised about 18 percent of the total expenses paid out of the State Racing Fund each fiscal year, as shown on the table that follows.

Item	Agriculture’s costs charged to the State Racing Fund			
	Fiscal Year			
	2009-10	2010-11	2011-12	2012-13
Agriculture “direct billing” costs	\$ 1,333,694	\$ 1,276,193	\$ 1,322,826	\$ 1,238,719
Agriculture “shared services” costs	<u>1,530,000</u>	<u>1,605,000</u>	<u>1,480,000</u>	<u>1,450,000</u>
Total Agriculture costs	\$ 2,863,694	\$ 2,881,193	\$ 2,802,826	\$ 2,688,719
Total State Racing Fund expenses	\$16,409,875	\$16,180,356	\$16,259,665	\$14,553,606
Agriculture costs as a percentage of total State Racing Fund expenses	17.5%	17.8%	17.2%	18.5% <sup>a/</sup>
<sup>a/</sup> The increase in this percentage in FY 2012-13 was due to a decrease in total State Racing Fund expenses because many expenses were transferred to other funds. (See Finding One for more information on these transfers.) <b>Source:</b> Developed by the Department of the Auditor General from information obtained from Agriculture. (See Appendix A for more information.)				

**State Racing Fund**

The Race Horse Industry Reform Act (Act) states that the commissions shall distribute monies from the State Racing Fund, and that one use of the fund is for “the expenses of the Secretary and the Department of Agriculture incurred in administering their duties under this act.”<sup>20</sup>

The Act states that the State Racing Fund can be used for “the expenses of the Secretary and the Department of Agriculture incurred in administering their duties under the act.” However, it is our position that based on language in the Act, it is reasonable to expect that Agriculture would only charge expenses to the fund that were directly related to racing commission work.

**Agriculture charged the State Racing Fund over \$6 million in four years for administrative “shared services.”**

Agriculture charged the State Racing Fund for the administrative services (Agriculture also refers to these as “shared services”)<sup>21</sup> provided to the commissions by Agriculture’s centralized service organizations.

Agriculture charged the State Racing Fund the following amounts for “shared services” during fiscal years 2009-10 through 2012-13.<sup>22</sup>

FY 2009-10	\$1,530,000
FY 2010-11	\$1,605,000
FY 2011-12	\$1,480,000
FY 2012-13	\$1,450,000
<b>Total</b>	<b>\$6,065,000</b>

These charges were for services provided to the racing commissions, the equine laboratories, and fair administration

<sup>20</sup> The Race Horse Industry Reform Act, 4 P.S. § 325.222(b)(3).

<sup>21</sup> Agriculture charges other restricted funds/restricted accounts whose enabling legislation authorizes Agriculture costs to be paid out of the fund/account for administrative services. These other funds/accounts include: Farm Show operations, dog law enforcement, farm operations, pesticide regulatory account, agronomic regulatory account, and the animal health diagnostic commission.

<sup>22</sup> This billing includes Agriculture “shared services” provided to the racing commissions, the equine lab, and fair administration.

**State Racing Fund**

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(we refer to this group as “racing commission-related work”) from the centralized service organizations listed below.

- 1) Office of the Secretary
- 2) Press Office
- 3) Policy Office
- 4) Legislative Office
- 5) Legal Office
- 6) Executive Deputy Secretary
- 7) Human Resources
- 8) Administrative Services
- 9) Regional Offices
- 10) Office of Information Technology
- 11) Deputy Secretary for Animal Agriculture
- 12) Deputy Secretary for Consumer Protection, Regulatory Affairs, and Dairy Industry Relations
- 13) Deputy Secretary for Marketing and Agriculture Development

Agriculture does not use time sheets to record the amount of time administrative staff actually spends on racing commission-related work. Instead, Agriculture uses a cost share allocation formula to calculate the amount of “shared services” it charges to the State Racing Fund, as well as to the other restricted funds/accounts within its control.

When we asked Agriculture officials why they used a formula instead of time sheets, they provided the following response:

The Department does not require time sheets for offices that provide shared services. A time-sheet based approach is not a practical or a cost efficient methodology for cost distribution. Shared service offices provide service and support to multiple program areas on a daily, hourly, and minute-by-minute basis. Due to this multi-program involvement, paper time tracking and attributing portions of that time to specific coding would require significant additional administrative overhead, leading to substantially more costly, and an inefficient, provision of shared services and simply increase shared

**State Racing Fund**

services billing to the Racing Fund and other funds.

Even though Agriculture officials stated that they use a cost share allocation formula to determine the amount of “shared services” to charge to the State Racing Fund and other funds/accounts, we found that Agriculture did not charge the State Racing Fund the actual amount determined by the formula as the following table shows.

<b>State Racing Fund charges for Agriculture “shared services”</b>			
<b>Fiscal year</b>	<b>Formula amount</b>	<b>Actual charges</b>	<b>Difference (under billed) / over billed</b>
2009-10	\$1,683,187	\$1,530,000	(\$153,187)
2010-11	\$1,870,220	\$1,605,000	(\$265,220)
2011-12	\$1,147,164	\$1,480,000	<b>\$332,836</b>
2012-13	\$1,066,301	\$1,450,000	<b>\$383,699</b> <sup>a/</sup>
<sup>a/</sup> Agriculture stated that this overcharge was offset by the fact that Agriculture paid nearly \$656,000 of the State Racing Fund’s expenses in that year. (See Finding One for more information on this transfer.) <b>Source:</b> Developed by the Department of the Auditor General from information obtained from Agriculture. (See Appendix A for more information.)			

As this table shows, Agriculture did not charge the State Racing Fund for the full formula amount in fiscal years 2009-10 and 2010-11. However, Agriculture more than made up for that under billing in the next two years when it charged the State Racing Fund \$716,535 more than the formula amount for these “shared services.”

In explaining these overcharges, Agriculture officials stated that in fiscal year 2011-12 “these additional charges were made to balance [the] department’s general fund budget which provides considerable resources and services to the State Racing Commission.” Agriculture made a similar statement related to the fiscal year 2012-13 overcharge: “additional administrative service charges were made in order to balance [the] department’s general fund budget.”

## State Racing Fund

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For the current fiscal year of 2013-14, Agriculture officials stated that the actual charges to the State Racing Fund would exceed the formula calculation by \$156,671 in order “to balance [the] department’s general fund budget which provides considerable resources and services to State Racing Commission.”

Despite having a formula to calculate “shared services” costs, Agriculture did not follow the formula. Instead, each year Agriculture looked at its overall funding status, and when needed, used the State Racing Fund to balance the department’s budget.<sup>23</sup> In other words, if Agriculture did not need money for its budget in any given year, it undercharged the fund. But if Agriculture needed money to balance its own budget in any particular year, it overcharged the State Racing Fund for “shared services.”

While the Act provides that the State Racing Fund can be used for “the expenses of the Secretary and the Department of Agriculture incurred in administering their duties under this act,” balancing Agriculture’s overall budget by overcharging the State Racing Fund is not an allowable use of the fund, and it is our position that it is an abuse of Agriculture’s authority.

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### **Agriculture charged the State Racing Fund nearly \$5.2 million over four years for additional Agriculture personnel costs that it could not document were directly related to services provided to the commissions.**

As previously stated, Agriculture charged the State Racing Fund for “shared services” for its administrative staff who conducted racing commission-related work. While allocating costs for shared services is reasonable, we found that Agriculture also charged the State Racing Fund for “direct” additional personnel costs for its own employees, yet Agriculture did not have time sheets or other documents to

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<sup>23</sup> The State Racing Fund is a “lapsing” fund, which means that any fund balance that is remaining after all expenses are paid (including transfers to the Sire Stakes Fund and the Breeding Fund) would be transferred to the General Fund. (See 4 P.S. § 325.222(b)(6). However, during our audit period, no monies lapsed back to the General Fund. Instead, Agriculture used any available balance in the fund to “balance [the] department’s general fund budget.”

**State Racing Fund**

support the extent to which these employees conducted racing commission-related work.

Agriculture paid the personnel costs for 16 to 19 Agriculture positions out of the State Racing Fund during fiscal years 2009-10 through 2012-13.<sup>24</sup> As the table below shows, these costs amounted to approximately 12 percent of all personnel costs paid out of the State Racing Fund each year. (See Appendix C for the salary amounts charged to the State Racing Fund for each position during each of these four fiscal years.)

<b>Fiscal Year</b>	<b>Salaries and benefits of Agriculture employees directly billed to State Racing Fund <sup>1/</sup></b>	<b>Total personnel costs paid from the State Racing Fund</b>	<b>Agriculture employees' salaries and benefits as a % of total State Racing Fund personnel costs</b>
2009-10	\$ 1,333,694	\$ 10,317,645	12.9%
2010-11	1,276,193	10,292,001	12.4%
2011-12	1,322,826	10,325,355	12.8%
2012-13	1,238,719 <sup>2/</sup>	10,497,988	11.8%
<b>Totals</b>	<b>\$ 5,171,432</b>	<b>\$ 41,432,989</b>	<b>12.5%</b>

<sup>1/</sup> Includes positions charged to the racing commissions, the equine laboratory, and fair administration. Benefits ranged from 42.1 percent to 54.2 percent of salaries over the four years.  
<sup>2/</sup> Agriculture transferred \$305,456 of this amount back to its GGO appropriation. (See Finding One for more information.)  
**Source:** Developed by the Department of the Auditor General from information obtained from Agriculture. (See Appendix A for more information.)

Agriculture employees whose salaries and benefits were paid directly out of the State Racing Fund came primarily from the same centralized service organizations that are captured under “shared services.”

For example, the operational and personnel costs of the department’s legal office are included in the “shared services” allocation. However, we found that Agriculture also billed the State Racing Fund directly for up to five legal positions during our audit period. According to Agriculture officials, one Agriculture attorney worked full-time for the racing

<sup>24</sup> According to Agriculture, not all positions were fully funded from the State Racing Fund during each of the four fiscal years, and some positions could have been filled by more than one employee because of changes in employment.

**State Racing Fund**

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commissions for all four fiscal years, and another attorney worked full time for the racing commissions in fiscal year 2009-10.<sup>25</sup>

Agriculture officials stated that besides these two individuals, none of the other legal positions, as well as any of the other employees whose salaries were charged to the State Racing Fund conducted racing commission-related work on a full-time basis.

Because Agriculture employees working in these areas did not complete timesheets, Agriculture could not provide documentation to support the actual time each of these Agriculture employees spent on racing commission-related work. In fact, Agriculture officials said that “it is extremely rare that employees who provide shared services work solely for any one, or even two, program areas. It is more likely that these employees worked for anywhere up to 8 to 10 program areas, at least throughout a fiscal year.” Accordingly, since these are shared services costs, then we question why Agriculture chose to charge the State Racing Fund directly for these costs instead of including them in the “shared services” cost allocation.

Agriculture officials stated that the percentage of each employee’s salary that was charged to the State Racing Fund “depends upon budgetary circumstances in any particular fiscal year.” In some cases, 100 percent of the salary could have been charged to the State Racing Fund.

We are at a loss to understand why Agriculture believes that it is an acceptable business practice to not require employees to keep track of their time, especially since it is a regulatory agency administering multiple special and restricted funds. Given the digital age, we question why Agriculture cannot find a cost-effective electronic time tracking system like many of the other agencies within the executive branch.

Without any documents to show hours actually devoted to racing commission-related work, there is no assurance that the salary amounts charged to the State Racing Fund—even if not the full salaries—were the appropriate amounts.

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<sup>25</sup> Job description provided by agriculture for an attorney position stated that the primary responsibility was work for the Horse and Harness Racing Commissions.

## State Racing Fund

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One Agriculture position that was charged to the State Racing Fund—special agriculture advisor to the governor—was especially concerning. This person was hired in May 2011, and Agriculture charged the State Racing Fund:

- \$18,790 in salary expense in fiscal year 2010-11.
- \$57,905, partial salary,<sup>26</sup> in fiscal year 2011-12.
- \$101,264, the full salary, in fiscal year 2012-13.

When we asked Agriculture officials why this position’s full salary was charged to the State Racing Fund in fiscal year 2012-13, they stated that “Special Agriculture Advisor to the Governor” is a working title for the “PA Fair Fund Administrator,” and that during that year this person had “devoted all of his time to Fair Fund administration.”

However, the position description provided to us by Agriculture did not support this assertion, and instead stated that the position purpose was to do “staff and advisory work in support of Governor Corbett and the Secretary of Agriculture.” While the job description stated that the person in this position would attend fairs, that duty was only one of many duties.

Further, the position description on Agriculture’s website states that this person is “the ambassador for Governor Corbett on issues facing rural communities, the agriculture industry and state/federal agriculture partnerships.” While the website posting stated that this individual was the administrator of the Fair Fund, the website also stated that this person works on special projects assigned by the governor and the secretary of agriculture.

After we brought these discrepancies to Agriculture’s attention, Agriculture officials revised their prior statement and confirmed that the special agriculture advisor to the governor did not work exclusively for the Fair Fund even though his full salary was charged to the State Racing Fund in fiscal year 2012-13.

As was the case in fiscal year 2011-12, we believe that only a portion of this employee’s 2012-13 salary should have been

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<sup>26</sup> Agriculture’s budget picked up the remainder of his salary, \$42,182, during fiscal year 2011-12.

## State Racing Fund

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charged to the State Racing Fund with the remaining portion charged to Agriculture's GGO appropriation—or even to the governor's budget.

However, with regard to Agriculture's GGO appropriation, Agriculture officials stated that, from fiscal year 2008-09 through fiscal year 2013-14, Agriculture "suffered a complement reduction" of 80 positions "due to the inadequacy of GGO appropriations." In fact, they stated that over the same time period, Agriculture "suffered the loss of \$3,960,000" in its funding obtained from the General Fund.

During the same time period that Agriculture's GGO appropriation was cut, Agriculture charged \$5.2 million to the State Racing Fund in personnel costs but could not document that these costs were for commission-related work. Charging these personnel costs to the State Racing Fund is especially significant when you consider the fact that during the same time period, Agriculture already charged the State Racing Fund more than \$6 million for administrative costs using the "shared services" formula.

We believe that Agriculture over charged the State Racing Fund when it billed the fund for \$5.2 million in salaries and benefits costs for several Agriculture positions. Because Agriculture officials explained that persons in these positions "worked for anywhere up to 8 to 10 program areas, at least throughout a fiscal year," these positions should have been included as part of the "shared services" allocation, or there should have been time sheets maintained to allocate the expenses appropriately.

When Agriculture directly billed the State Racing Fund for its personnel expenses, Agriculture was able to charge up to 100 percent of an employee's salary to the fund. If those persons were included in the "shared services" calculation, a much smaller percentage of their salaries would have been charged to the State Racing Fund.<sup>27</sup>

As was the case with the "shared services" charges, the amount of personnel expenses directly billed to the State Racing Fund is determined by Agriculture's own budgetary circumstances.

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<sup>27</sup> The State Racing Fund was charged approximately 21 percent of Agriculture's total "shared services" allocation costs each year.

## State Racing Fund

We reiterate that balancing Agriculture's overall budget with State Racing Fund monies is not an allowable use of the fund and that it is an abuse of Agriculture's authority.

## Recommendations

3. Agriculture should discontinue its practice of balancing its general fund budget by charging the State Racing Fund for additional expenses not directly related to carrying out the administrative duties of the commissions.
4. Agriculture should also cease its practice of directly billing the State Racing Fund for staff personnel costs until it develops and implements a system for its employees to document the actual amount of time spent on racing commission-related work. Agriculture should then use that documentation to calculate the appropriate amount to charge the State Racing Fund.
5. When Agriculture uses the cost-sharing allocation formula to charge the State Racing Fund for shared administrative services, it should ensure the actual amount determined by the formula is charged to the State Racing Fund.

### Department of the Auditor General's Evaluation of Agriculture's Response:

*Following is the Department of the Auditor General's evaluation of significant points from Agriculture's response to Finding Two.<sup>28</sup> Agriculture's response to the report appears in full beginning on page 48.*

In its response, Agriculture stated that we "erroneously" claimed that it overcharged the State Racing Fund \$716,535 for shared services administrative billing. Instead, Agriculture claims the fund was undercharged a cumulative \$357,872 because it applied the \$656,000 in expenses paid by

<sup>28</sup> In its response to Finding Two, Agriculture again took issue with a similar statement we made in Finding One about Agriculture's personnel costs charged to the fund being dependent on budgetary circumstances, claiming that the statement was taken out of context. The statement made in Finding Two reads as follows: "Agriculture officials stated that the percentage of each employee's salary that was charged to the State Racing Fund 'depends upon budgetary circumstances in any particular fiscal year.'" We direct readers to our discussion in the evaluation to Finding One about the similar statement pertaining to personnel charges being dependent on the budget (page 15), but again note that Agriculture's arguments are invalid and therefore, we again declined Agriculture's request to delete the statement.

**State Racing Fund**

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Agriculture's GGO appropriation in fiscal year 2012-13 against the "shared services" amount paid that year.

*We disagree with Agriculture's assertions in this regard. The chart on page 21 presents the amount calculated by the cost allocation formula and the amount actually charged. As the chart shows, and we state in the narrative that follows the chart, Agriculture undercharged the fund in the first two years but then overcharged in the next two years. The point of the chart was not to show a cumulative effect but rather to demonstrate that despite having a formula for calculating shared services costs, the total amount Agriculture ultimately charged to the State Racing Fund depended on the budgetary circumstances that year.*

*Agriculture asserts that the net cumulative effect of the over/under charges is an undercharge of \$357,872 after factoring in the credit of \$656,000 in expenses charged back to Agriculture's GGO appropriation in 2012-13. However, we disagree that the \$656,000 in expenses paid from Agriculture's GGO appropriation can offset the shared services costs.*

*In fiscal year 2012-13, Agriculture charged the State Racing Fund \$1.45 million in shared services, even though the cost allocation formula amount was only \$1.07 million. It was only at year end when Agriculture realized that the State Racing Fund revenues were insufficient to support expenses that Agriculture began its "shell game" of shifting expenses to other funds and/or other agencies. Further, included in that \$656,000 was over \$300,000 in Agriculture's personnel expenses that should have been paid from Agriculture's GGO appropriation in the first place.*

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In its response, Agriculture indicated that our statement that Agriculture paid the personnel costs for "16 to 19" Agriculture positions out of the State Racing Fund is misleading and an incomplete statement of fact. Instead, Agriculture believes the full-time employee equivalency of 7.5 positions, which is a much smaller number, should have been reported.

*Agriculture's use of full-time equivalency is an attempt to minimize the number of employees whose personnel costs were directly charged to the State Racing Fund. Appendix C clearly*

**State Racing Fund**

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*lists each of those positions. We were careful to note that these positions could have been filled by more than one person during the fiscal year and that it was possible that the full salary was not charged to the State Racing Fund. However, it was also possible that the full salary was charged to the fund.*

*As Agriculture officials stated to us during the audit, the amount of personnel costs charged to the State Racing Fund depended upon budgetary circumstances. Further, Agriculture could not provide documentation to support the actual time each of these Agriculture employees spent on racing commission-related work. Without such documentation, there is no assurance that the salary amounts charged to the State Racing Fund—even if not the full salaries—were the appropriate amounts.*

*We chose to present the full number of positions whose personnel costs were charged to the State Racing Fund to ensure full transparency about the positions and their related expenses. Agriculture's attempt to minimize this number by using a full-time equivalency is a blatant affront to such transparency.*

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In its response, Agriculture disagreed with our recommendation to use an electronic time tracking system for the direct billing of salaries to the State Racing Fund. Agriculture stated that paying a software designer to build such a system to interface with the Commonwealth accounting systems is not cost effective for the small number of employees involved.

*We have two issues with Agriculture's statements. First, an electronic time tracking system would be instrumental in supporting charges that are directly billed to the State Racing Fund. We agree that time tracking for all personnel in centralized service organizations is not cost efficient, therefore, a "shared services" formula to allocate those costs is appropriate. However, when Agriculture chooses to directly bill other personnel costs to the State Racing Fund then it must ensure that those charges are supported by sufficient documentation to prove the work performed was specifically related to the commissions.*

## State Racing Fund

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*Second, we never suggested that Agriculture had to pay a software designer to build such an electronic system. Rather, numerous, simple to use, time tracking systems are readily available in the marketplace at low prices, or an electronic system could be internally developed using software programs that are already available to Agriculture. If Agriculture cannot develop its own internal tracking system, it could seek the assistance of the Governor's Office of Administration which has experienced and knowledgeable information system personnel at its disposal. Since time tracking would be required for "as few as 7 employees," an internally developed system should suffice.*

*Agriculture's dismissal of our recommendation to employ a time tracking system is concerning and leads us to believe that Agriculture does not want to utilize sound business practices to verify accurate accounting for the personnel costs it charges to the fund and in turn to be transparent and accountable for those charges.*

*As we stated in our report, Agriculture directly billed over \$1 million each year to the State Racing Fund for employees that, according to Agriculture, "could work on anywhere from 8 to 10 program areas." Tracking time for those employees is imperative so that the State Racing Fund is charged only for work related to the racing commissions and not for work related to other Agriculture programs.*

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In response to Recommendations #3 and #4, Agriculture stated that it is consulting with the Governor's Office of the Budget to address various issues, including direct billing of complement positions and shared service administrative billing.

*We are pleased that Agriculture is working with the Governor's Office of the Budget on these issues. As we stated in our report, the Act allows for Agriculture's administrative expenses related to racing commission duties to be charged to the State Racing Fund, but we found that Agriculture was overcharging the fund. Agriculture must not use the State Racing Fund to pay Agriculture personnel costs that are not directly related to the racing commission activities.*

**State Racing Fund**

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*As we state in the report, every time Agriculture uses the fund to pay for unrelated expenses, the Sire Stakes Fund and the Breeding Fund, as well as the horse racing-related activities they support, are adversely impacted by not receiving additional funds.*

**State Racing Fund**

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**Observation****Monies from the Pennsylvania Race Horse Development Fund are being diverted to fill state budgetary shortfalls resulting in declining revenues available to support the horse racing industry.**

The Pennsylvania Race Horse Development Fund (PRHDF) is a special fund that was created in 2004 with the enactment of the Pennsylvania Race Horse Development and Gaming Act<sup>29</sup> (Gaming Act). The Gaming Act allowed slots gaming in Pennsylvania and provided that licensed gaming facilities would pay 12 percent of their total gross terminal revenues from slot machines into the PRHDF.<sup>30</sup>

The purpose of the PRHDF is to stimulate the viability and quality of horse racing in Pennsylvania by providing money for track purses, health and pension benefits for horsemen, and breeders' awards, among other purposes. However, as early as 2010, the General Assembly began to redirect monies from the PRHDF to the General Fund to fill gaps in the state's budget. Over \$212 million has been diverted from the PRHDF since 2010, and with revenue shortfalls anticipated by the end of the current fiscal year, the likelihood is high that PRHDF redirections will continue.

As a result, the amount of money available for the PRHDF's original purpose—to stimulate the viability and quality of racing in Pennsylvania—has been reduced by more than \$212 million. These reductions have caused a decline in purses and breeders' awards which can then impact the number of horse owners, trainers, and breeders coming to the state, as well as discourage attendance at horse races.

The table on the following page shows the amount of PRHDF monies that have been disbursed each year from 2006 through 2013, including the amounts that have been redirected to fill budgetary gaps.

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<sup>29</sup> 4 Pa.C.S. § 1101 *et seq.* This fund does not receive any revenues from table games.

<sup>30</sup> A complex funding formula is used to calculate the amount of revenue each licensed gaming entity deposits into the PRHDF based on gross terminal revenues, with a cap of 12 percent for each entity's contribution. Because slots gaming revenues have declined with the introduction of table games and competition from casinos in neighboring states, the contributions into the fund are at about 11 percent.

**State Racing Fund**

Distributions from the Pennsylvania Race Horse Development Fund (calendar year basis)								
Item	2006	2007	2008	2009	2010	2011	2012	2013
<b>Amount to distribute</b>	<b>\$3,788,151</b>	<b>\$124,683,705</b>	<b>\$193,867,891</b>	<b>\$235,707,247</b>	<b>\$271,006,216</b>	<b>\$276,974,931</b>	<b>\$273,713,913</b>	<b>\$254,371,772</b>
<b>Distributions from the Pennsylvania Race Horse Development Fund were made to the following areas and in the following amounts:</b>								
<b>Original uses of the PRHDF:</b>								
Purses	\$3,030,521	\$99,746,964	\$155,094,312	\$188,565,797	\$158,138,844	\$182,100,518	\$177,702,123	\$166,991,842
Health/pension benefits	151,526	4,987,348	7,754,716	9,428,290	12,173,561	11,368,571	11,440,000	11,249,787
Breeding Fund	190,328	8,399,133	14,681,313	18,235,972	16,319,709	18,717,448	18,224,235	17,252,484
Sire Stakes Fund	207,888	5,775,130	8,168,775	9,738,594	7,654,030	8,851,328	8,658,095	8,072,942
Standardbred Breeders Development Fund	207,888	5,775,130	8,168,775	9,738,594	7,654,030	8,851,328	8,658,095	8,072,942
<b>Redirections of PRHDF monies to fill budgetary gaps:</b>								
General Fund	<b>Redirections begin in 2010</b> →				69,066,042	47,085,738	46,531,365	22,572,775
Farm Products Show Fund	<b>Another redirection begins in 2012</b> →						2,500,000	2,500,000
For agriculture programs	<b>And another redirection begins in 2013</b> →							17,659,000
Note: Not reflected on this table is the \$4.2 million transfer to the State Racing Fund which occurred from April to June 2014. This \$4.2 million brings the total redirections to \$212 million.								
<b>Source:</b> Developed by the Department of the Auditor General from information obtained from the Pennsylvania Department of Revenue. (See Appendix A for more information.)								

Note: The pages that follow provide more details on the legislative changes mandating the redirections of PRHDF monies.

## State Racing Fund

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While the focus of our audit was the State Racing Fund, we present information in this section on the PRHDF because it also supports the horse racing industry, and in the current fiscal year (2013-14) it provided funding to the State Racing Fund.

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### Original uses of the PRHDF

When the Gaming Act was enacted in 2004, it originally mandated that the PRHDF would be distributed to the six casinos that operate a racetrack (referred to as Category 1 licensees)<sup>31</sup> in the following manner:

- 80% -- To increase purses paid at the six racetracks
- 4% -- To fund the health and pension benefits for the members of the horsemen's organizations representing the owners and trainers affiliated with six racetracks
- 16% -- To three restricted accounts for various racing purposes, discussed below.

The 16 percent to the three restricted accounts is distributed as follows:

For the three racetracks that are thoroughbred tracks (Penn National, Presque Isle Downs, and Parx Racing), the full 16 percent is deposited in the Pennsylvania Breeding Fund.

**Pennsylvania Breeding Fund** – this fund is used to enhance the breeding industry of Pennsylvania thoroughbreds by offering monetary awards to breeders, stallion owners, and owners of Pennsylvania bred horses. It is also used to fund purses at thoroughbred races and for the administration and development costs of breeding incurred by the Pennsylvania Horse Breeders' Association.

For the three racetracks that are harness tracks (Harrah's, Pocono Downs, and Meadows), the distribution is split equally between the Pennsylvania Sire Stakes Fund and the

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<sup>31</sup> The Gaming Act allows for three categories of casinos to be licensed: Category 1 is a facility that offers both gaming and horse or harness racing; Category 2 is a stand-alone casino; and Category 3 is a resort that offers a gaming facility on the resort's premises. The Gaming Act allows for seven Category 1 licensees, but at the time of our audit, only six licensees were operating both a casino and a racetrack.

**State Racing Fund**

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Pennsylvania Standardbred Breeders Development (8 percent to each).

**Sire Stakes Fund** – this fund is used to promote Pennsylvania agriculture by providing funding for a series of races that feature the top horses sired by a registered Pennsylvania stallion.

**Standardbred Breeders Development Fund** – this fund is used to benefit the breeders of trotters and pacers racing in the commonwealth by providing awards to the owners of stallions and broodmares residing in Pennsylvania.

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**Redirections of monies from  
the PRHDF began in 2010**

The General Assembly began to use the PRHDF to support the state's General Fund budgetary gaps in 2010.

The Gaming Act was amended in 2010<sup>32</sup> to allow table games at the state's casinos. While the PRHDF does not receive any revenues from table games, the 2010 Gaming Act amendments changed the distributions from the PRHDF for the period January 1, 2010, through June 30, 2013.

Specifically, the amendments required an annual cash transfer from the PRHDF to the state's General Fund, and this transfer was required to be made before distributing monies to the Category 1 licensees for the original purposes of the fund.

Then in fiscal year 2012-13, the General Assembly included a provision in the General Appropriations Act<sup>33</sup> that required an additional cash transfer out of the PRHDF. For just fiscal year 2012-13, in addition to a transfer of PRHDF monies to the General Fund, another \$5 million was transferred to the Farm Products Show Fund, which is a fund administered by the Department of Agriculture.<sup>34</sup>

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<sup>32</sup> Act 1 of 2010, often referred to as "SB 711," was enacted on January 7, 2010. *See also* 4 Pa.C.S. § 13A02 *et seq.*

<sup>33</sup> Act 9A of 2012.

<sup>34</sup> *See* 72 P.S. §§ 1720-G and 1721-G.

## State Racing Fund

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In fiscal year 2013-14 the General Assembly made a significant change to the PRHDF. Act 71 of 2013, which was the 2013-14 budget implementation act, repealed the sections of the Gaming Act relating to the PRHDF and re-enacted them under the Fiscal Code.<sup>35</sup>

The significance of this change is that with the repeal of the PRHDF sections in the Gaming Act, the General Assembly has to define the distributions out of the PRHDF with each year's annual budget implementation act. As a result, the General Assembly can now define the distributions out of the PRHDF in any manner it sees fit, and it can make those distributions without the label of "redirections" because there is no longer a mandate in the Gaming Act stating that the PRHDF must be used in a particular manner.

While the General Assembly left a portion of the PRHDF to be used for the original horse racing-related purposes with each redirection since 2010, there is no guarantee that this practice will continue. Alternatively, it is possible that the General Assembly will continue to allow the PRHDF to be used for the original horse racing purposes, but the amount could be much smaller than in prior years.

Because the General Assembly must state in the annual budget implementation act how distributions will be made from the PRHDF, the fiscal year 2013-14 act contained a provision in case the General Assembly did not outline the uses of the PRHDF. Act 71 of 2013 stated that the original allocations out of the PRHDF will return (80 percent to purses; 4 percent for health and pension benefits; 16 percent for three restricted revenue accounts), if the Fiscal Code sections related to the PRHDF are not amended each year.

The table that follows summarizes how the PRHDF was used to cover the state's budgetary shortfalls beginning January 1, 2010.

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<sup>35</sup> See 72 P.S. § 1723-A.1.

**State Racing Fund**

<b>Uses of the PRHDF beginning January 1, 2010</b>	
<b>Time Period</b>	<b>Distribution Order—Redirections Occur First</b>
January 1, 2010 to June 30, 2010	<ul style="list-style-type: none"> <li>➤ <b>34% of PRHDF revenues to the General Fund</b> Then remainder used for original purposes <sup>1/</sup></li> </ul>
FY 2010-11	<ul style="list-style-type: none"> <li>➤ <b>17% of PRHDF revenues to the General Fund</b> Then remainder used for original purposes</li> </ul>
FY 2011-12	<ul style="list-style-type: none"> <li>➤ <b>17% of PRHDF revenues to the General Fund</b> Then remainder used for original purposes</li> </ul>
FY 2012-13	<ul style="list-style-type: none"> <li>➤ <b>17% of PRHDF revenues to the General Fund</b></li> <li>➤ <b>\$5 million to the Farm Products Show Fund</b> Then remainder used for original purposes</li> </ul>
FY 2013-14	<ul style="list-style-type: none"> <li>➤ <b>\$17.7 million for agriculture programs</b> <sup>2/</sup></li> <li>➤ <b>\$4.2 million to the State Racing Fund</b> <sup>3/</sup> Then remainder used for original purposes</li> </ul>
FY 2014-15 and future years	<ul style="list-style-type: none"> <li>➤ Unknown?</li> <li>➤ The state must decide if it will continue to use the PRHDF to plug the state’s budget holes</li> </ul>

<sup>1/</sup> Original purposes include distributions to each of the Category 1 licensees for purses, health and pension benefits for horsemen, and to the three restricted accounts for racing related purposes.  
<sup>2/</sup> \$17,659,000 to be used as follows: \$4 million to the Farm Products Show Fund; \$3 million to PA Fairs; \$5.4 million to the Animal Health Commission; and \$5.3 million to the PA veterinary laboratory.  
<sup>3/</sup> While a redirection from the original uses of the PRHDF, this redirection at least supported the horse racing industry.  
**Source:** Developed by Department of the Auditor General staff.

**State Racing Fund**

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**Legislative mandated redirections out of the Pennsylvania Race Horse Development Fund decreased the amount of funding available to support the horse and harness racing industries.**

Since January 1, 2010, at least \$212 million of PHRDF monies were distributed to fill the state's budget holes. As a result, this \$212 million was not available for horse racing purses, breeders' awards, and health and pension benefits for horsemen as the Gaming Act originally intended.

For example, before any redirections begin, there was \$189 million available from the PRHDF to fund purses at the six racetracks. By 2013, the amount available for purses was down to \$167 million, a 12 percent decrease.

The legislative impetus behind the PRHDF was to revitalize the horse racing industry, and providing larger purses and breeders' awards was a primary component of that revitalization. Therefore, the ongoing decrease in purses, as well as breeders' awards, can adversely impact the horse racing industry.

For example, horse owners, trainers, and breeders from other states may no longer come to Pennsylvania because purses and prizes are not large enough to make investing in Pennsylvania worthwhile. Further, existing owners and breeders may be discouraged from maintaining their investments in the industry. These declines can then adversely impact the small businesses that support these owners and breeders, such as hotels and restaurants.

Other potential negative impacts could include the reduction in the number of people employed by the racetracks, which would result in a decline in the amount of state and local income taxes collected. Further, the wagering public can lose interest in betting at Pennsylvania races if famous and/or well-bred horses are not running in Pennsylvania races.

In addition to the redirections out of the PRHDF, the fund has also been adversely impacted by the stagnation of slots gaming revenues from the state's casinos. Slots gaming revenues into the PRHDF exceeded the \$200 million mark in 2009. For the next three years revenues from slots gaming continued to

**State Racing Fund**

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increase and reached a high of \$273 million in 2012. But with the increase in Internet wagering, as well as the increased competition from casinos in neighboring states, slots gaming revenues in Pennsylvania have begun to decline. In fact, in 2013, revenues were down to \$254 million and are expected to remain stagnant for several years.

In recent years, the amount of funding available to support the horse racing industry has been negatively impacted in two ways—diversion of revenues from the PRHDF *and* declining slots gaming revenues. Moving forward, the General Assembly must decide if the PRHDF will be used only for its original purpose of stimulating the viability and quality of the horse racing industry in Pennsylvania, or if monies from the fund will continue to be used to plug the state's budgetary gaps each year.

**State Racing Fund**

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**Appendix A****Objectives,  
Scope, and  
Methodology**

The Department of the Auditor General conducted this performance audit in order to provide an independent assessment of the State Racing Fund as administered by the Pennsylvania State Horse and State Harness Racing Commissions (commissions) within the Pennsylvania Department of Agriculture (Agriculture).<sup>36</sup>

We conducted this 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.

**Objectives**

Our primary objective was to review the revenues and expenses of the State Racing Fund. Our objective focused on determining if all applicable revenues were received and deposited into the State Racing Fund and if all expenditures from the State Racing Fund were appropriate and spent in accordance with applicable laws and regulations.

Our audit also included an assessment of the fiscal impact of legislatively mandated changes to the revenue streams into the State Racing Fund, including the restricted revenue accounts within the fund.

**A note about our audit objective.**

We identified Agriculture and the commissions as our auditee and opened this audit to review the State Racing Fund as administered by the commissions. During the course of our audit we learned that the Pennsylvania Department of Revenue (Revenue) is responsible for collecting and depositing revenues into the State Racing Fund. We met with Revenue officials and obtained an understanding of their processes for collecting State Racing Fund revenues. Revenue officials conduct annual

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<sup>36</sup> While the Horse Racing and Harness Racing Commissions are responsible for disbursements out of the State Racing Fund, the commissions are departmental administrative commissions within Agriculture, and the employees of the commissions are employees of Agriculture. As a result we report on Agriculture, in conjunction with the commissions, in this report, where applicable.

**State Racing Fund**

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audits of each of the six racetracks to ensure each racetrack deposits appropriate and accurate revenues into the State Racing Fund. As a result, we refined the portion of our objective related to the State Racing Fund's revenues. Therefore, we conducted limited procedures to determine if all applicable revenues were received and deposited into the State Racing Fund.

**Scope**

This audit report presents information for the period of July 1, 2009, through June 30, 2013, unless otherwise indicated.

The commissions' management, in conjunction with Agriculture's management, is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that they are in compliance with applicable laws, regulations, contracts, grant agreements, and administrative policies and procedures. In conducting our audit, we obtained an understanding of Agriculture's and the commissions' internal controls, including any information systems controls, as they relate to those requirements and that we considered to be significant within the context of our audit objectives. For those internal controls that we determined to be significant within the context of our audit objectives, we also assessed the effectiveness of the design and implementation of those controls, as described in the *Methodology* section that follows. Any deficiencies in internal control that were identified during the conduct of our audit and determined to be significant within the context of our audit objectives are included in this report.

**Methodology**

To address our audit objectives, we performed the following procedures:

- Reviewed the Race Horse Industry Reform Act and identified the applicable sections of the law outlining revenue sources and allowable expenditures related to the State Racing Fund.
- Interviewed Agriculture officials, Horse and Harness Racing Commission officials, and Department of Revenue

### State Racing Fund

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officials to obtain an understanding of the revenues and expenses of the State Racing Fund, as well as to obtain pertinent documentation on the fund from these officials.

- Obtained and reviewed a listing of all revenue sources and amounts deposited into the State Racing Fund from July 1, 2009, through December 31, 2013.
- Obtained and reviewed a listing of all occupational license fees for horse and harness racing that were in effect during our audit period, as well as reviewed the policies and procedures the commissions follow to ensure that all pertinent parties obtain an occupational license and pay the required fee.
- Obtained and reviewed internal audit reports of audits conducted by Department of Revenue staff on each of the six racetracks to ensure applicable taxes and other revenues were collected and deposited into the State Racing Fund.
- Obtained expenditure reports from the commonwealth's SAP accounting system listing expenses paid out of the State Racing Fund from July 1, 2009, through December 31, 2013. It was outside the scope of this engagement to audit the SAP system; however, we performed limited test work to assess the accuracy and completeness of those reports. Data presented in our findings is based on these SAP reports.
- Conducted a detailed analysis of all expense items paid out of the State Racing Fund to determine appropriateness of the expenditures. We did not conduct testwork related to these expenses (i.e., review all supporting documentation for each expense item).
- Obtained and reviewed data related to all salaries and wages paid out of the State Racing Fund during each year of our audit period. These salaries and wages for employees who worked for Agriculture, Revenue, the racing commissions, the equine laboratories, and for fair administration.
- Reviewed job descriptions for positions whose salaries and/or wages were paid out of the State Racing Fund to

**State Racing Fund**

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analyze the extent to which these positions provided racing commission-related work.

- Compared salaries and wages paid to a select group of commission and Agriculture employees to the salaries and wages listed on the Office of Administration's website to determine if amounts paid were in line with commonwealth standards.
- Analyzed the "shared services" worksheets and obtained an understanding of Agriculture's cost-sharing allocation formula for charging administrative services to the State Racing Fund to determine if these charges were appropriate.

With regard to our Observation related to the Pennsylvania Race Horse Development Fund, we performed the following procedures:

- Reviewed pertinent sections of the 2004 Pennsylvania Race Horse Development and Gaming Act, as well as the 2010 amendments to that act.
- Obtained and reviewed relevant sections of the annual General Appropriations Act, as well as pertinent annual amendments to The Fiscal Code.
- Reviewed the Pennsylvania Horse and Harness Racing Commissions' annual reports, as well as the Pennsylvania Gaming Control Board's *Racetrack/Casino Benchmark Report* for each year of the audit period.
- Obtained and analyzed a schedule from the Pennsylvania Department of Revenue showing all revenues in, and all disbursements from, the Pennsylvania Race Horse Development Fund for calendar years 2006 through 2013.

## State Racing Fund

**Appendix B**

**Total Expenses paid out of the State Racing  
Fund, by expense item,  
Fiscal years 2009-10 through 2012-13**

Expense Item <sup>a/</sup>	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
<b>Personnel Costs:</b>				
Salaries-Reg. Hours	\$ 2,466,367	\$ 2,423,830	\$ 2,151,206	\$ 1,964,624
Salaries-Shift Differential	209	298	15	0
Salaries-Higher Class Pay	1,390	196	1,696	(55)
Gen. Pay Inc.-Cash Pymt	12,609	13,967	0	11,317
Repay Salary Overpay	(621)	(1,027)	19	300
Wages-Reg. Hours	4,577,705	4,548,244	4,652,381	4,708,170
Wages-Shift Differential	28,330	23,930	26,281	25,464
Wages-Higher Class Pay	3,775	2,144	1,060	2,752
Overtime	59,131	63,352	71,124	54,280
Hosp. Ins.-SS	841,692	700,447	817,697	901,225
Soc. Security Cont.-SS	430,125	428,613	417,497	412,857
Medicare-SS	101,819	100,617	98,162	97,007
Ret. Cont.-SS	220,593	282,138	482,815	661,105
State Workmen's Ins.	137,111	121,657	161,944	165,299
Emp. Group Life Ins.-SS	11,995	11,966	12,465	11,819
Health Benefits-SS	1,060,227	1,232,251	1,127,221	1,129,586
Unemp. Comp.-SS	262,509	215,197	198,749	215,178
Leave Payout Assessment	96,906	97,152	74,022	82,060
Leave Payout	775	0	0	0
Rewards/Bonuses	5,000	27,000	31,000	55,000
Allowances	0	28	0	0
<b>Total Personnel Costs</b>	<b>\$10,317,645</b>	<b>\$10,292,001</b>	<b>\$10,325,355</b>	<b>\$10,497,988</b>
<b>Operating Costs:</b>				
Travel	\$ 48,659	\$ 53,472	\$ 44,822	\$ 42,637
Training	1,094	2,224	0	2,136
Telecomm.-Recurring	65,639	55,718	42,417	55,496
Telephone/Equipment	0	148	0	0
Telecom Security Services	0	0	386	471
Telecom Voice	0	0	3,351	59
Telecom Data	0	0	0	146
Telecomm-Non-Recur.	910	50	0	0
Telecom Data Service	0	0	10,893	0

## State Racing Fund

Expense Items <sup>a/</sup>	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Radio-Proc. <\$5K	1,477	1,104	0	288
IT Contract App. Dev.	0	0	535,014	279,144
IT Contract App. Maint. Supp.	0	0	0	94,621
Legal Services/Fees	11,079	38,178	73,776	41,326
Specialized Services	1,053,619	274,361	279,718	108,036
Other Specialized Services	575,218	1,238,625	1,343,006	857,250
Prof Svcs.-Not Specified	7,006	0	3,300	336
Advertising	411,002	426,346	429,420	802
Med/Mental/Dental Svc	900	677	600	0
Cont. EDP Svc.-Vend. Prov.	738,589	489,094	474	0
Hardware Network Maint.	0	0	0	284
Hardware Periph. Maint.	0	0	29	25
Cont. Maint. Svc.-EDP	356	6,171	0	0
Cont. Maint -Non-EDP	268,687	200,013	290,940	145,072
Cont. Repairs-EDP	3,677	8,582	0	0
Cont. Repairs-Non-EDP	0	0	0	6,069
Cont. Repairs-Motor Equip.	0	0	0	303
Real Estate	266,475	266,475	266,475	266,475
Vehicles	18,456	17,592	13,256	8,432
Office Equipment	18,113	16,544	13,166	12,165
Other Rentals/Leases	6,732	926	97	78
Office Supplies	48,666	35,279	47,942	32,230
Publications	79	0	1,220	0
Housekeeping Supplies	283	0	214	0
Educational Supplies	0	0	0	17
Miscellaneous	15,088	19,001	7,791	8,709
Medical Supplies	534	36,173	30,858	0
Laboratory Supplies	552,797	470,495	317,477	256,494
Drugs	0	4,607	3,416	0
Software License-Non Rec	0	0	0	2,064
Other Computer Equip.	15,999	2,844	0	0
Hardware Network	0	0	373	0
Hardware Peripheral	0	0	1,291	0
Hardware Desktop	0	0	55,214	28,620
Furniture/Fixtures	843	1,437	21,680	1,682
Other Equipment	504	1,177	2,122	170
Materials and Supplies	213	0	0	0
Fuels	5,513	5,204	5,815	4,650
Motorized Equipment	820	1,851	839	1,494

## State Racing Fund

Expense Items <sup>a/</sup>	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Miscellaneous Equipment	5,641	109,660	182,160	182,200
Printed Forms	4,650	0	0	0
Postage	19,553	26,470	17,907	202
Freight	47,562	71,744	72,062	54,336
Printing	8,795	20,565	8,756	12,675
Subscriptions	5,927	3,558	4,624	2,574
Membership Dues	35,228	37,127	1,218	68,645
Purchasing Card Purchases	0	5,564	1,844	0
Conference Expense	2,127	948	400	13,710
Wearing Apparel	8,280	868	1,136	517
Insur/Sur/Fid Bonds	1,987	2,435	1,940	1,886
Lab-Mat Test Vouchers	0	70,504	57,756	0
Attorney Gen Invest	450	0	0	0
Other Oper. Expenses	8,393	9,545	7,118	11,093
Refunds	24,612	0	0	0
<b>Total Operating Costs</b>	<b>\$ 4,312,230</b>	<b>\$ 4,033,355</b>	<b>\$ 4,204,311</b>	<b>\$ 2,605,618</b>
<b>Department of Agriculture administrative services charges:</b>				
Interfund Reimbursements <sup>b/</sup>	<b>\$ 1,780,000</b>	<b>\$ 1,855,000</b>	<b>\$ 1,730,000</b>	<b>\$ 1,450,000</b>
<b>Total expenses</b>	<b>\$16,409,875</b>	<b>\$16,180,356</b>	<b>\$16,259,665</b>	<b>\$14,553,606</b>

Note: Columns may not add due to rounding.

<sup>a/</sup> Includes expenses for Horse and Harness Racing Commissions, Department of Agriculture, Department of Revenue, Equine Toxicology Laboratory, and Fair Fund.

<sup>b/</sup> Reflects payments to the Department of Agriculture for "shared services" and \$250,000 to the Department of Community and Economic Development in each year from FY 2009-10 through FY 2011-12 for a racing promotional program.

**Source:** Department of Agriculture. (See Appendix A for more information.)

## State Racing Fund

**Appendix C****Agriculture salaries charged directly to  
the State Racing Fund,  
Fiscal years 2009-10 through 2012-13**

<b>Agriculture salaries charged directly to the State Racing Fund <sup>1/</sup></b>				
<b>Job position <sup>2/</sup></b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>
Veterinary Lab Diagnostician	\$ 82,552	\$ 81,870	\$ 82,078	\$ 83,046
Secretary's Office – Ex. Sec.	0	12,515	42,394	44,787
Press Office-Info Specialist	52,324	50,538	48,331	48,906
Attorney 4	105,901	106,691	106,958	108,225
Attorney 4	89,455	52,864	82,370	0
Attorney 3	0	0	14,378	75,928
Paralegal	43,682	45,981	46,944	41,730
Legal Assistant 1	27,428	30,765	31,398	19,440
HR Analyst	54,634	55,043	55,182	34,164
HR Analyst	68,101	68,613	68,787	69,870
HR Assistant	0	0	0	8,086
Budget Analyst	46,843	47,194	60,738	35,884
Purchasing Agent	46,676	49,161	50,194	45,666
IT Generalist 1/Network Specialist	43,682	45,981	46,941	51,484
Dep. Sec. – Executive Secretary	31,751	18,594	0	0
Chief Agriculture Marketing Div.	45,048	47,194	21,934	0
Commodity Prom. Div-AO	31,927	0	0	0
Commodity Prom. Div-Admin Asst	4,784	0	0	0
Commodity Prom. Div-Clerk	29,507	35,452	11,227	0
Telecomm. Specialist	44,807	46,144	46,941	29,064
Economic Devel. Analyst	44,641	47,008	14,896	0
Economic Devel. Div. AO	44,817	29,557	0	0
Special Agriculture Advisor to the Governor	0	18,790	57,905	101,264
Administration-Clerk	0	0	0	5,883
<b>Total</b>	<b>\$ 938,560</b>	<b>\$ 889,953</b>	<b>\$ 889,894</b>	<b>\$ 803,424<sup>3/</sup></b>

Note: Totals may not add due to rounding.

<sup>1/</sup> Numbers presented are for salaries only and do not include benefits. According to Agriculture officials, other funding sources of Agriculture could have been used to pay additional salary amounts for these positions.

<sup>2/</sup> These positions could have been filled by more than one employee in any given fiscal year because of changes in employment.

<sup>3/</sup> Agriculture transferred \$305,456 in salaries and benefits back to its own budget in fiscal year 2012-13. (See Finding One for more information.)

**Source:** Developed by Department of the Auditor General from information obtained from Agriculture. (See Appendix A for more information.)

**State Racing Fund**

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**Response from  
Department of  
Agriculture**

The Department of Agriculture's full response to this audit report is reproduced on the following pages. A summary of significant points from Agriculture's response, and our evaluation of those points, can be found after the recommendations section of each finding contained in this audit report.

State Racing Fund

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COMMONWEALTH OF PENNSYLVANIA  
DEPARTMENT OF AGRICULTURE

June 10, 2014

The Honorable Eugene A. DePasquale  
Department of the Auditor General  
229 Finance Building  
Harrisburg PA 17120-0018

Re: Response to Special Performance Audit  
State Racing Fund - June 2014

Dear Auditor General DePasquale:

**A. Introduction**

This office is in receipt of the draft findings and recommendations (consisting of 40 pages) pertaining to your office's special performance audit of the State Racing Fund.

We appreciate the important role the Auditor General's office plays in ensuring that state government works efficiently in the interest of all Pennsylvanians. Thank you for your commitment to assuring taxpayers an open, honest and effective commonwealth.

We acknowledge the efforts your office has devoted to this matter and it has been a pleasure working with your employees since the entrance conference on December 18, 2013.

The response to an Auditor General's special performance audit report by an agency under the Governor's jurisdiction is governed by Management Directive 325.10 Amended.<sup>1</sup> Accordingly, the following is offered in response.

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<sup>1</sup>Pursuant to MD 325.10, agencies are to apply the following minimum criteria to audit report findings and recommendations in determining and evaluating the merit, acceptance, and application of such findings and recommendations to agency operations:

- **Accuracy and Completeness.** Ensure that findings, conclusions, and related recommendations are based on complete, accurate, and factual data disclosed during the audit process. The audit report review process shall determine that broad conclusions and related recommendations are not based on isolated instances or events that may not be representative of the whole.
- **Bias.** Determine that findings, conclusions, and related recommendations are indicative of objective, fair, and independent reporting, and that personal or organizational bias on the part of the auditor or audit organization does not exist.
- **Corrective Action.** Ensure that corrective action for a particular condition has not already been taken before the issuance and receipt of the audit report. Audit report responses should clearly disclose any strengthening, correcting, or other actions taken subsequent to the audit, but prior to the issuance and receipt of the related audit report.
- **Cost Effectiveness.** Ensure that the implementation of recommended actions will be cost effective in relation to benefits received and/or the reduction in exposure to potential adverse risks.

## State Racing Fund

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### B. Response to Finding No. 1

The Department does not disagree with the basic premise set forth in Finding No. 1.<sup>2</sup>

#### 1. **Agriculture does not concur with Finding No. 1 in so far as it does not articulate the primary reason for the present circumstances.**

For decades, the Department has managed the Racing Fund throughout each fiscal year so as to achieve a year-end result as consistent with the dictates of 4 P.S. § 325.222(b) as possible. The Racing Fund is a lapsing fund. It is in the best interests of the Department and the horse and harness racing industry to achieve as close to a \$0 balance in the fund as possible at each fiscal year-end. This avoids any annual lapse of funds to the General Fund pursuant to 4 P.S. § 325.222(b)(6).

However, achieving that result was made increasingly more difficult, and presently not capable of being achieved, by the advent of gaming in Pennsylvania. The reason this is no longer achievable is not the incremental decline of pari-mutuel wagering tax revenues as mentioned in Finding No. 1.

The reason why stopgap measures were needed in fiscal year 2012-2013 and Act 30 of 2014 was needed in fiscal year 2013-2014 is that **the regulatory obligations of the Department of Agriculture in fulfilling its duties under the Racing Act increased well in excess of 50% with the advent of slots and table games in Pennsylvania.**

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- **Legality.** Determine that findings, conclusions, and related recommendations conform to applicable state and federal laws, regulations, and other compliance factors. However, when audit disclosures support the need for new or revised legislation, regulations, or other compliance elements, such action shall be pursued and plans referenced in the audit report response process.
  - **Perspective.** Determine that findings, conclusions, and related recommendations took into consideration any commonwealth or agency broad range policies, goals, or objectives relevant to particular organizations, programs, activities, or functions.
  - **Relevancy.** Ensure that findings, conclusions, and related recommendations are formulated from objective, factual, and actual evidence that is directly applicable to individual situations.
  - **Timeliness.** Ensure that findings, conclusions, and related recommendations contained in audit reports are directly relevant to current conditions and have not become outdated or inapplicable as a result of the passage of time between the conduct of an audit and the issuance of the audit report.

<sup>2</sup> The Department does, however, take issue with some statements made in Finding No. 1. On page 13, it states that "Agriculture officials stated that the amount of Agriculture personnel costs charged to the State Racing Fund 'depends upon budgetary circumstances in any particular fiscal year.'" No such statement was ever made by any employee(s) of the Department of Agriculture to any employee(s) of the Department of Auditor General at any time during the course of the audit. The actual statement made was in a May 1, 2014 written response to a question about whether the manner of handling the salary of one particular Racing Fund complement position could be replicated for others. The response was that it would depend upon budgetary circumstances in any particular fiscal year. The quote is taken completely out of context and an intentional attempt is made to confer upon that statement a broad and incriminating meaning which it clearly did not have. When asked to limit the quote to its actual context, the Department of Auditor General refused.

In addition, as addressed more fully in response to Recommendation 2 of Finding No. 1, the implication on page 13 that the Department utilizes the Racing Fund as "a source of revenues to make up for reductions in Agriculture's GGO appropriation," is not supported by any evidence produced in this audit. When asked to correct this statement, the Department of Auditor General also refused.

## State Racing Fund

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While the Gaming Act brought a virtual fountain of tax revenue to many stakeholders, the Department of Agriculture received nothing except three additional racetracks to license, staff and regulate. **The Department received absolutely no increase in funding with which to accomplish the >50% increase in its regulatory obligations.**

The number of licensed racetracks prior to the advent of gaming in Pennsylvania was four. Two fully licensed and operational tracks have opened since 2006, increasing the total to six (a 50% increase). An additional seventh track is also fully licensed but has yet to gain a gaming license or build its physical facility. Nevertheless, that seventh track license has caused the Department to spend tens of thousands of man-hours in a licensing process that has been litigated multiple times, among multiple competing applicants, during years of protracted administrative hearings and court proceedings. Litigation over that track license continues to this very day. In addition to the Departmental administrative and executive staff time and resources this has consumed, the legal work has all been handled in-house by attorneys in the Department's Office of Chief Counsel. The licensing and litigation over the non-operational seventh track license has lasted more than a decade and continues to cause significant expenditures of licensing, administrative and legal staff time on a regular and recurrent basis.

Therefore, the increased workload of the Department is well in excess of a 50% increase – with \$0 in increased funding with which to handle that workload. In fact, **due to the decrease in pari-mutuel wagering since the advent of gaming, there has been a decrease in funding over that same period of time.**

The increase in regulatory responsibility of the Department is the principle reason for the "shortfalls" referenced in Finding No. 1.

### **C. Response to Recommendations on Finding No. 1**

1. *Not applicable to the Department.*

2. *"The Department of Agriculture should not use the State Racing Fund monies to make up for GGO appropriation reductions."*

The Department does not use State Racing Fund monies to "make up for GGO appropriation reductions" and there was no evidence produced in this audit to support that conclusion in this recommendation. The opposite has in fact been the case. For example, Appendix C to the report shows that direct billing of complement positions has decreased over the audit period at issue by over \$130,000. At the present time, there are only seven shared services complement positions direct billed to the Racing Fund. Moreover, shared services administrative billing has decreased by \$80,000 over the audit period. The evidence is directly contrary to the claim being made in this recommendation.

### **D. Response to Finding No. 2**

1. **Agriculture does not concur with Finding No. 2 in so far as it erroneously claims that Agriculture "overcharged" the State Racing Fund \$716,535 for shared services administrative billing.**

The report claims on pages 17-18 that Agriculture overcharged the Racing Fund according to Agriculture's formula-based approach to shared services administrative billing. This formula was explained at length during the course of the audit and the Department stands by its methodology. It is correct that there has been deviation, both down and up, from the formula-derived amount during the audit period. In 2009-2010 and 2010-2011, the

## State Racing Fund

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charges were less. In 2010-2011 and 2012-2013, the charges were more. However the 2012-2013 charge was subsequently adjusted that fiscal year by credit payments made from the Department's GGO funds on behalf of the Racing Fund.

The report adopts an aggregated number of \$6,065,000 in the table appearing on page 15 to state the total amount of shared services administrative billing over the four-year audit period. However, the report neglects to adopt the same aggregated approach and does not consider the entirety of the numbers when arriving at the conclusion that an "overcharge" occurred.

On page 17, the report claims that Agriculture overcharged the Racing Fund more than \$716,535 for shared services administrative billing over a selected two year period, as shown in the table on page 17. However, the data in that very table shows that **over the entire four-year audit period, the Racing Fund was actually "undercharged" a cumulative total of \$357,872.** This results when, instead of cherry-picking two select fiscal years, the aggregate is considered (as it is when the Department approaches managing the Racing Fund).

This undercharge is evident when the proper credit is applied for: (a) the \$656,000 in Racing Fund bills paid out of the Department's GGO in 2012-2013 (as recounted in footnote a of the table on page 17); and (b) the undercharges for shared services administrative billing in audit years 2009-2010 and 2010-2011.

While the report states that "Agriculture more than made up for the under billing in the next two years," it fails to acknowledge the additional direct GGO payment of Racing Fund bills. If the table on page 17 was complete and contained a "Total," as the table on page 15 contains, it would reveal that the aggregate shared services administrative billing resulted in an undercharge of \$357,872.

**2. Agriculture does not concur with Finding No. 2 in so far as it contains misleading and incomplete statements of fact and again concludes that the Racing Fund was "overcharged" in direct billing of complement positions.**

The report is misleading, primarily caused by incomplete statements of fact.<sup>3</sup>

While the report at page 19 reports "16 to 19" as a cumulative number of complement positions direct billed to the Racing Fund during the entire audit period, that figure includes duplicate entries for: (a) persons who filled more than one position during the audit period; and (b) complement positions which had more than one occupant during the audit period. Moreover, that figure includes positions that were not billed for an entire fiscal year. For example, in 2012-2013, while the number of Racing Fund direct-billed complement positions, however briefly or incrementally, was 13, the full-time employee equivalency was

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<sup>3</sup> In addition to incomplete facts, the Department does take issue with another attempt in Finding No. 2 to take the identical quote which is the subject of footnote 2 herein completely out of context and attribute to it a broad and incriminating meaning which it clearly did not have. On page 20 the report states that "Agriculture officials stated that the percentage of each employee's salary that was charged to the State Racing Fund 'depends upon budgetary circumstances in any particular fiscal year.'" As previously recounted in footnote 2, no such thing was ever said. When the Department of Auditor General was asked to revise this error, it again refused. We are at a loss to understand why the Department of Auditor General believes this is an acceptable practice.

## State Racing Fund

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7.5, a reduced impact of over 40%. The "gross" number of positions recited in the report is substantially misleading.

Additionally, while the report recites "up to five legal positions" direct billed during the audit period and notes that only two attorneys were devoted to racing on a full-time basis, it neglects to mention the multiple other attorneys, paralegal and legal assistant position which devoted substantially all of their time, at various intervals, to racing.

The report also references "a cost-effective electronic time tracking system like many of the other agencies within the executive branch." The Department is unaware of any Commonwealth executive branch agency utilizing an off-the-shelf time tracking software package as referenced. Paying a software designer/contractor to build such an electronic time tracking system to interface with Commonwealth accounting systems is not cost effective for the small number of employees (presently a total of 7) involved. The Department already addressed the present available system, as recited on page 16 of the report.

Lastly, the report at page 22-23 criticizes the methodology of the Department in charging a shared services administrative billing as well as direct billing of complement positions. The Department stands by its methodology in that the administrative billing for shared services is determined by a formula which excludes personnel costs for complement positions that are directly funded by the Racing Fund. Total costs for these positions are calculated and applied as a credit in the administrative billing calculation and prevents duplicative treatment.

### **E. Response to Recommendations on Finding No. 2**

**3.** *Agriculture should discontinue its practice of balancing its general fund budget by charging the State Racing Fund for additional expenses not directly related to carrying out the administrative duties of the commissions.*

The Department does not charge the State Racing Fund expenses simply to balance its general fund budget. Although this characterization is denied in its entirety, some of the contributory factors that lead to this recommendation will be addressed as follows. The Department has been, and will continue to be, in consultation with the Governor's Office of the Budget on a comprehensive plan to address issues concerning the agency complement report, special fund direct billing of complement positions and shared service administrative billing. Presently, there are 7 complement positions direct billed to the Racing Fund.

**4.** *Agriculture should cease its practice of directly billing the State Racing Fund for staff personnel costs until it develops and implements a system for its employees to document the actual amount of time spent on racing commission-related work. Agriculture should then use that documentation to calculate the appropriate amount to charge the State Racing Fund.*

As stated in response to the previous recommendation, the Department has been, and will continue to be, in consultation with the Governor's Office of the Budget on a comprehensive plan to address issues concerning the agency complement report, special fund direct billing of complement positions and shared service administrative billing. Presently, there are 7 complement positions direct billed to the Racing Fund.

**State Racing Fund**

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**5.** *When Agriculture uses the cost-sharing allocation formula to charge the State Racing Fund for shared administrative services, it should ensure the actual amount determined by the formula is charged to the State Racing Fund.*

This will be implemented by charging the actual amount reflected in the formula. This has been done in the fiscal year 2014-2015 Governor's Proposed Budget.

**F. Observation - Pages 24 through conclusion** - This portion of the report is not directed to the Department of Agriculture and is not responded to herein.

Thank you for the opportunity to respond to the draft report.

Sincerely,



George D. Greig  
Secretary

**State Racing Fund**

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House Agriculture and Rural Affairs  
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Pennsylvania House of Representatives

**State Racing Fund**

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Mr. Alan Novak  
Chairman  
PA State Horse Racing Commission

Mr. Walter Remmert  
Acting Executive Secretary  
PA State Horse Racing Commission

Mr. George Crawford  
Executive Secretary  
PA State Harness Racing Commission

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