

**Pennsylvania Harness Horsemen's
Association**

Financial Statements and Supplementary
Information

Years Ended December 31, 2016 and 2015 with
Independent Auditor's Report

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PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

YEARS ENDED DECEMBER 31, 2016 AND 2015

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Independent Auditor's Report

Board of Directors and Secretary Albright, Pennsylvania Office of the Budget
Pennsylvania Harness Horsemen's Association

Report on the Financial Statements

We have audited the accompanying financial statements of the Pennsylvania Harness Horsemen's Association (Association) (a nonprofit organization), which comprise the statements of financial position as of December 31, 2016 and 2015, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Association as of December 31, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying statement of cash receipts and cash disbursements and changes in escrow balances is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 31, 2017, on our consideration of the Association's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Association's internal control over financial reporting and compliance.

Maher Duessel

Harrisburg, Pennsylvania
May 31, 2017

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2016 AND 2015

	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 241,015	\$ 270,740
Accounts receivable	29,329	11,751
Prepaid expenses	192,465	208,075
Total current assets	462,809	490,566
Fixed assets:		
Property, plant, and equipment, at cost	130,458	114,436
Less: accumulated depreciation	(104,726)	(98,870)
Net fixed assets	25,732	15,566
Other assets:		
Restricted cash and cash equivalents	15,139,367	22,352,024
Restricted investments	25,075,292	22,416,406
Total other assets	40,214,659	44,768,430
Intangible assets:		
Naming rights, net of accumulated amortization of \$400,000 in 2016 and \$300,000 in 2015	300,000	400,000
Total Assets	\$ 41,003,200	\$ 45,674,562
Liabilities and Net Assets		
Liabilities:		
Current Liabilities:		
Accounts payable	\$ 275,406	\$ 270,555
Accrued employer retirement plan contribution	48,000	31,037
Accrued severance	77,442	-
Total current liabilities	400,848	301,592
Noncurrent Liabilities:		
Long-term liabilities	200,000	300,000
Escrow funds and deferred revenue:		
Purses - racing revenue	8,741,606	8,062,352
Purses - slot revenue	5,541,265	13,620,831
Health and pension - slot revenue	25,931,188	23,084,648
Total escrow funds and deferred revenue	40,214,059	44,767,831
Total non-current liabilities	40,414,059	45,067,831
Total liabilities	40,814,907	45,369,423
Net Assets:		
Unrestricted	188,293	305,139
Total Liabilities and Net Assets	\$ 41,003,200	\$ 45,674,562

The accompanying notes are an integral part of these financial statements.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Revenues:		
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Race track revenues:		
Downs Racing	\$ 1,613,106	\$ 2,100,000
Harrah's Chester	1,200,000	1,200,000
Membership dues	27,200	27,090
Race Horse Development Fund	1,173,790	1,284,667
Member benefit reimbursements	540,023	595,211
Special events	22,000	25,000
Corporate sponsorships	-	24,000
Interest income	148	139
Miscellaneous income	112	2,293
	4,576,379	5,258,400
Expenses:		
<hr/>		
Salaries	478,477	463,382
Payroll taxes	37,969	36,339
Employee benefits	128,618	69,359
General insurance	210,493	237,215
Member benefits	1,795,500	1,878,019
Chaplaincy program	12,600	12,600
Advertising, newsletter, and public relations	1,036,314	829,601
Promotion expenses - television	-	87,826
Meeting expense and travel	48,412	64,605
National dues	12,300	12,000
Office expense	26,449	21,226
Telephone	8,488	7,930
Legal and accounting	224,651	117,237
Legislative fees	175,611	141,076
Donation and gifts	132,164	284,109
Special events	32,147	33,970
Fair maintenance and purses	179,226	741,750
Depreciation	5,856	4,965
Amortization	100,000	100,000
Miscellaneous expense	47,950	11,266
	4,693,225	5,154,475
Change in Net Assets	(116,846)	103,925
Net Assets:		
<hr/>		
Beginning of year	305,139	201,214
End of year	\$ 188,293	\$ 305,139

The accompanying notes are an integral part of these financial statements.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Reconciliation of Change in Net Assets to Net Cash and Cash Equivalents Provided by Operating Activities:		
Change in net assets	\$ (116,846)	\$ 103,925
Adjustments to reconcile change in in assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	105,856	104,965
Effects of changes in operating assets and liabilities:		
Accounts receivable	(17,578)	31,292
Prepaid expenses	15,610	(28,329)
Accounts payable	4,851	25,242
Payroll taxes and deductions	-	(4,878)
Accrued employer retirement plan contribution	16,963	(4,963)
Accrued severance benefits	77,442	-
Net cash and cash equivalents provided by operating activities	86,298	227,254
Cash Flows From Investing Activities:		
Payments for purchase of furniture and equipment	(16,023)	(3,880)
Purchase of naming rights	(100,000)	(100,000)
Net cash and cash equivalents used in investing activities	(116,023)	(103,880)
Net Increase (Decrease) in Cash and Cash Equivalents	(29,725)	123,374
Cash and Cash Equivalents:		
Beginning of year	270,740	147,366
End of year	\$ 241,015	\$ 270,740

The accompanying notes are an integral part of these financial statements.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Pennsylvania Harness Horsemen's Association (Association) is a membership organization which promotes the welfare and development of harness racing in Pennsylvania. The primary sources are from two harness race tracks in Pennsylvania.

Basis of Presentation

The financial statements of the Association are prepared on the accrual basis of accounting. Under this method, revenues are recognized when earned rather than received, and expenses are recognized when incurred rather than when the obligation is paid. In accordance with FASB ASC 958, *Not-for-Profit Entities*, the Association is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The Association does not have any temporarily restricted or permanently restricted net assets at December 31, 2016 and 2015.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent gains and losses. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Association considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. The restricted cash accounts are not included in cash balances for the purpose of the statement of cash flows as they are not available for normal operations of the Association.

Restricted Cash and Cash Equivalents and Investments

Certain cash, cash equivalents, and investments are restricted as to use by Pennsylvania law. These funds are held in separate accounts.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Accounts Receivable

Accounts receivable consists of member health benefit reimbursements. The Association uses the direct write-off method for bad debts, the results of which are not materially different from those under the allowance method.

Fair Value of Investments

The carrying value of cash and cash equivalents, accounts receivable, and accounts payable approximates fair value due to the short maturity of these instruments. Investments are stated at fair value. Gains or losses on sales of investments and any unrealized gains or losses are reflected as components of the escrow funds – health and pension and racing revenue liability accounts.

Furniture and Equipment

Furniture and equipment is stated at cost. Depreciation is calculated using the straight-line method over the estimated lives of depreciable assets which range from two to ten years based on management's estimate of the useful lives.

Additions, major replacements, and betterments which are individually in excess of \$1,000, and have a life in excess of one year, are capitalized. Maintenance and repairs are charged to expense as incurred.

Long-Lived Assets

Long-lived assets, such as property and equipment, are evaluated for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through the estimated undiscounted future cash flows from the use of these assets. When any such impairment exists, the related assets will be reduced to fair value. No impairment losses have been recorded through December 31, 2016.

Intangible Assets

The intangible asset represents the naming rights to an arena located in Wilkes-Barre, Pennsylvania and is amortized over the life of the agreement.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Functional Allocation of Expenses

The costs of providing the Association's various programs and activities are presented on a functional basis in Note 8 to the financial statements. Accordingly, certain costs have been allocated based on management estimates of the time spent and materials used among the programs and supporting services benefited.

Income Taxes

The Association is a non-profit organization which is exempt from federal income taxes under Section 501(c)(5) of the Internal Revenue Code. FASB ASC 740-10, *Accounting for Uncertainty in Income Taxes*, requires an assessment of the Association's exposure to income taxes at the entity level as a result of uncertain tax positions taken in current and previously filed tax returns. Examples of tax positions taken at the entity level include the continuing validity of its 501(c)(5) status, potential unrelated business activities, and other tax positions that could result in income taxes to the Association upon examinations by taxing authorities. The Association's management is not aware of any activities that would jeopardize its tax-exempt status or would be subject to unrelated business or excise tax.

The Association files Form 990 - Return of Organization Exempt from Income Tax, on an annual basis.

Reclassifications

Certain amounts in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year financial statements.

Subsequent Events

Subsequent events have been evaluated through the Independent Auditor's Report date, which is the date the financial statements were available to be issued.

Pending Standards Update

ASU 2015-07, *"Fair Value Measurement (Topic 820): Disclosures for Investments in Certain entities that Calculate Net Asset Value Per Share (or its Equivalent)"*, is effective for the Association's financial statements for the year ending December 31, 2017. This amendment removes the requirement to categorize investments within the fair value hierarchy for all for which fair value is measured using the net asset value per share as the practical expedient.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

ASU 2014-09, "*Revenue from Contracts with Customers*," is effective for the Association's financial statements for the year ending December 31, 2019 (as amended by ASU 2015-14). This amendment provides guidance for revenue recognition related to contracts with transfer of promised goods or services to customers and related disclosures.

ASU 2016-02, "*Leases (Topic 842)*," effective for the Association's financial statements for the year ending December 31, 2020. This amendment will require lessees to recognize assets and liabilities on the statement of financial position for the rights and obligations created by all leases with terms of more than twelve months. Disclosures also will be required by lessees to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

ASU No. 2016-14, "*Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities*," is effective for the Association's financial statements for the year ending December 31, 2018. This amendment aims to improve how a nonprofit organization classifies its net assets and provides information in its financial statements and notes about its financial performance, cash flow, and liquidity. The ASU changes the net asset classifications, requires presentation of expenses both by nature and function, requires investment return reported net of investment expenses, requires placed-in-service approach for gifts of/for long-lived assets, and provides enhanced disclosures for: governing body restrictions; composition of net assets with donor restrictions; qualitative and quantitative information on liquidity; methods to allocate costs among program and support functions; and underwater donor-restricted endowment funds.

Management has not yet determined the impact of these amendments on the Association's financial statements.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

ESCROW FUNDS, DEFERRED REVENUE, AND RESTRICTED CASH/INVESTMENTS

Pennsylvania law requires certain portions of revenue from slot machines at Pennsylvania racetracks to be used for horse racing purses and pension and health benefits for horse men and women. The Association acts as fiduciary in the collection and disbursement of these funds, which are required to be maintained in separate accounts. The detail of transactions in these accounts for 2016 and 2015 is as follows:

	Purses	Benefits
Escrow balance, January 1, 2015	\$ 7,162,220	\$ 21,842,415
Gaming Funds - Chester Downs and Marina, LLC	31,046,769	1,814,881
Gaming Funds - Downs Racing, LP	30,805,239	1,765,385
Unrealized/realized losses on investments	-	(1,776,068)
Investment income (net of fees)	57,417	1,002,826
	61,909,425	2,807,024
Purse payments - Chester Downs and Marina, LLC - purse account	(27,619,565)	-
Purse payments - Downs Racing, LP - purse account	(27,831,250)	-
Health insurance payments	-	(1,299,305)
Retirement distributions	-	(265,486)
	(55,450,815)	(1,564,791)
Escrow balance, December 31, 2015	13,620,830	23,084,648
Gaming Funds - Chester Downs and Marina, LLC	21,657,320	1,630,948
Gaming Funds - Downs Racing, LP	22,771,337	1,755,165
Unrealized/realized gains on investments	-	614,875
Investment income (net of fees)	31,404	903,139
	44,460,061	4,904,127
Purse payments - Chester Downs and Marina, LLC - purse account	(26,302,326)	-
Purse payments - Downs Racing, LP - purse account	(26,237,300)	-
Health insurance payments	-	(1,167,397)
Retirement distributions	-	(890,190)
	(52,539,626)	(2,057,587)
Escrow balance, December 31, 2016	\$ 5,541,265	\$ 25,931,188

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	Purses	Benefits
December 31, 2016		
Composition of ending balance:		
Cash and cash equivalents	\$ 5,541,665	\$ 2,925,939
Investments	-	23,005,449
	5,541,665	25,931,388
Opening cash due the Association	(400)	(200)
Ending cash and cash equivalents and investments	\$ 5,541,265	\$ 25,931,188
December 31, 2015		
Composition of ending balance:		
Cash and cash equivalents	\$ 13,621,230	\$ 2,701,932
Investments	-	20,382,916
	13,621,230	23,084,848
Opening cash due the Association	(400)	(200)
Ending cash and cash equivalents and investments	\$ 13,620,830	\$ 23,084,648

The restricted cash accounts each include deposits made by the Association to open the accounts.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Pursuant to an agreement with Chester Downs and Marina, LLC dated January 1, 2011, certain racing revenues are to be paid to the Association. The Association is required to maintain these funds in a separate account. These funds are to be used to finance the Association's operating expenses, marketing and promotional costs, or fund purses at the Chester racetrack. Revenue is recognized when cash is moved from restricted to unrestricted in order to cover Association expenses. The detail of the transactions for 2016 and 2015 is as follows:

	<u>Racing Revenues</u>
Deferred revenue balance, January 1, 2016	\$ 8,062,352
Transfers from Chester Downs and Marina, LLC - racing income	1,828,857
Investment income (net of fees)	<u>50,653</u>
	<u>1,879,510</u>
Racetrack (pari-mutuel) revenues paid to the Association	(1,200,000)
Bank charges	<u>(256)</u>
	<u>(1,200,256)</u>
Deferred revenue balance, December 31, 2016	<u>\$ 8,741,606</u>
Compositions of ending balance:	
Cash and cash equivalents	\$ 6,671,763
Investments	<u>2,069,843</u>
Ending cash and cash equivalents and investments	<u>\$ 8,741,606</u>

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	Racing Revenues
Deferred revenue balance, January 1, 2015	\$ 7,603,336
Transfers from Chester Downs and Marina, LLC - racing income	1,876,193
Investment income (net of fees)	28,816
	1,905,009
Racetrack purse pay-outs	(245,650)
Racetrack (pari-mutuel) revenues paid to the Association	(1,200,000)
Bank charges	(343)
	(1,445,993)
Deferred revenue balance, December 31, 2015	\$ 8,062,352
Compositions of ending balance:	
Cash and cash equivalents	\$ 6,028,862
Investments	2,033,490
Ending cash and cash equivalents and investments	\$ 8,062,352

Summary of all escrow accounts:

	Purses - Slot Revenue	Benefits - Slot Revenue	Racing Revenue	Total
December 31, 2016				
Cash and cash equivalents	\$ 5,541,265	\$ 2,925,739	\$ 6,671,763	\$ 15,138,767
Investments	-	23,005,449	2,069,843	25,075,292
Escrow and deferred revenue balance, December 31, 2016	\$ 5,541,265	\$ 25,931,188	\$ 8,741,606	\$ 40,214,059

**PENNSYLVANIA HARNESS
HORSEMEN'S ASSOCIATION**

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	<u>Purses - Slot Revenue</u>	<u>Benefits - Slot Revenue</u>	<u>Racing Revenue</u>	<u>Total</u>
December 31, 2015				
Cash and cash equivalents	\$ 13,620,830	\$ 2,701,732	\$ 6,028,862	\$ 22,351,424
Investments	-	20,382,916	2,033,490	22,416,406
	<hr/>	<hr/>	<hr/>	<hr/>
Escrow and deferred revenue balance, December 31, 2015	<u>\$ 13,620,830</u>	<u>\$ 23,084,648</u>	<u>\$ 8,062,352</u>	<u>\$ 44,767,830</u>

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Investments are stated at fair value. Fair value and unrealized appreciation (depreciation) at December 31, 2016 and 2015 are summarized as follows:

	2016			Fair Value
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Mutual funds:				
Fixed income - domestic	\$ 6,227,887	\$ -	\$ (373,461)	\$ 5,854,426
Fixed income - other	595,200	-	(10,290)	584,910
Equity - domestic	582,766	11,853	(30,270)	564,349
Equity - international	510,101	-	(48,849)	461,252
Money market	631,568	-	-	631,568
Total mutual funds	<u>8,547,522</u>	<u>11,853</u>	<u>(462,870)</u>	<u>8,096,505</u>
Exchange traded funds:				
Fixed income - domestic	2,905,535	477	(60,093)	2,845,919
Fixed income - U.S. government	731,019	2,657	(9,291)	724,385
Fixed income - other	224,228	1,500	-	225,728
Equity - domestic	779,574	25,394	-	804,968
Equity - international	660,166	1,007	(26,358)	634,815
Commodity	54,325	-	(3,357)	50,968
Total exchange traded funds	<u>5,354,847</u>	<u>31,035</u>	<u>(99,099)</u>	<u>5,286,783</u>
Corporate bonds:				
Domestic	3,931,814	3,820	(122,916)	3,812,718
International	627,608	527	(16,691)	611,444
Total corporate bonds	<u>4,559,422</u>	<u>4,347</u>	<u>(139,607)</u>	<u>4,424,162</u>
U.S. government agency bond	<u>196,544</u>	<u>-</u>	<u>(846)</u>	<u>195,698</u>
Fixed index annuity	<u>2,000,000</u>	<u>-</u>	<u>-</u>	<u>2,000,000</u>
Other investments:				
FS Corporation II	1,391,737	-	(140,143)	1,251,594
FS Energy and Power Fund	1,534,018	-	(418,130)	1,115,888
FS Global Credit Opportunities Fund	1,472,955	-	(195,329)	1,277,626
NorthStar Real Estate Income II	1,420,350	-	(80,121)	1,340,229
Dividend Capital Diversified Property Fund	115,000	-	(28,193)	86,807
Total other investments	<u>5,934,060</u>	<u>-</u>	<u>(861,916)</u>	<u>5,072,144</u>
Total investments	<u>\$ 26,592,395</u>	<u>\$ 47,235</u>	<u>\$ (1,564,338)</u>	<u>\$ 25,075,292</u>

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2015			Fair Value
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Mutual funds:				
Fixed income - domestic	\$ 6,073,843	\$ -	\$ (568,393)	\$ 5,505,450
Fixed income - international	1,108,281	-	(126,503)	981,778
Fixed income - other	567,907	-	(49,224)	518,683
Equity - domestic	569,530	8,269	(42,973)	534,826
Equity - international	503,663	-	(70,857)	432,806
Money market	445,594	-	-	445,594
Total mutual funds	<u>9,268,818</u>	<u>8,269</u>	<u>(857,950)</u>	<u>8,419,137</u>
Exchange traded funds:				
Fixed income - domestic	3,339,486	-	(91,458)	3,248,028
Fixed income - U.S. government	740,439	-	(3,843)	736,596
Equity - domestic	696,134	25,363	-	721,497
Equity - international	450,230	-	(31,845)	418,385
Total exchange traded funds	<u>5,226,289</u>	<u>25,363</u>	<u>(127,146)</u>	<u>5,124,506</u>
Corporate bonds:				
Domestic	3,895,818	3,707	(109,351)	3,790,174
International	684,729	886	(14,165)	671,450
Total corporate bonds	<u>4,580,547</u>	<u>4,593</u>	<u>(123,516)</u>	<u>4,461,624</u>
U.S. government agency bond	<u>222,550</u>	<u>-</u>	<u>(22,176)</u>	<u>200,374</u>
Other investments:				
FS Corporation II	1,289,369	-	(198,764)	1,090,605
FS Energy and Power Fund	1,431,946	-	(540,001)	891,945
FS Global Credit Opportunities Fund	1,342,455	-	(338,691)	1,003,764
NorthStar Real Estate Income II	1,322,939	-	(183,989)	1,138,950
Dividend Capital Diversified Property Fund	115,000	-	(29,499)	85,501
Total other investments	<u>5,501,709</u>	<u>-</u>	<u>(1,290,944)</u>	<u>4,210,765</u>
Total investments	<u>\$ 24,799,913</u>	<u>\$ 38,225</u>	<u>\$ (2,421,732)</u>	<u>\$ 22,416,406</u>

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Investment income (restricted) is excluded from the statements of activities and consists of:

	<u>2016</u>	<u>2015</u>
Interest and dividends	\$1,038,148	\$1,137,844
Investment fees	<u>(73,872)</u>	<u>(70,303)</u>
	<u>\$ 964,276</u>	<u>\$1,067,541</u>

3. FAIR VALUE MEASUREMENTS

The fair value measurement framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Association has the ability to access.

Level 2 – Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in inactive markets.
- Inputs other than quoted prices that are observable for the assets or liabilities.
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

ASC 820-10 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring the most observable inputs be used when available. This hierarchy consists of three broad levels: Level 1 inputs consist of unadjusted quoted prices in active markets for identical assets or liabilities and have the highest priority. Level 1 assets may include securities that are traded in an active exchange market, or actively traded over-the-counter markets. Level 2 valuation is based on directly or indirectly observable inputs other than quoted prices for identical assets. Level 3 assets may include financial instruments whose value is determined using pricing models with internally developed assumptions, discounted cash flows methodologies, or similar techniques.

The Association uses the following valuation techniques to measure fair value of assets on a recurring basis. There have been no changes in the methodologies used at December 31, 2016 and 2015.

Mutual Funds and Exchange Traded Funds: Fair value of mutual funds and exchange traded funds are based on quoted market prices for identical securities. These investments are classified within Level 1 of the valuation hierarchy.

Money Market Mutual Funds: Money market mutual funds are valued at a stable \$1.00 net assets value which is the value at which the fund is traded and approximates fair value based on the fair value of the underlying investment. Such securities are classified within Level 1 of the valuation hierarchy.

Government Agency Bonds: Certain government agency bonds are valued at the closing price reported in the active market in which the bond is traded. These investments are classified within Level 1 of the valuation hierarchy.

Corporate Bonds: Certain corporate bonds are valued at the closing price reported in the active market in which the bond is traded. Other corporate bonds are valued based on yields currently available on comparable securities of issues with similar credit ratings. When quoted prices are not available for identical or similar bonds, the bond is valued using a discounted cash flow approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks. These investments are classified within Level 2 of the valuation hierarchy.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Fixed Index Annuity: The annuity is valued at the initial premium plus or minus any transfers, surrenders, or interest credited. Interest earned is based on changes in an underlying market index, calculated using an annual point-to-point margin method. Interest credited will not be less than zero. Inputs used by the Association include surrender charge and interest rate based on an index as calculated by the insurance company. This annuity is recorded at its cash surrender value at year-end and is classified within Level 3 of the valuation hierarchy.

FS Investment Corporation II: The underlying investments consist principally of debt securities, including senior secured loans, second lien secured loans, and, to a lesser extent, subordinated loans. The net asset value of the investment portfolio is determined quarterly using a combination of quoted market prices and estimations based on relevant inputs such as indicative dealer quotes, values of like securities, and valuations prepared by third-party valuation services. This investment is classified within Level 3 of the valuation hierarchy.

FS Energy and Power Fund: The underlying investments consist primarily of income-oriented securities of privately-held and power related energy companies. The fund is an externally managed, non-diversified, closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended. The fund's investment policy is to invest at least 80% of total assets in securities of Energy companies defined as those companies that engage in the exploration, development, production, gathering, transportation, processing, storage, refining, distribution, mining, generation, or marketing of natural gas, crude oil, refined products, or coal. The investment objectives are to generate current income and long-term capital appreciation. The company determines the net asset value of its investment portfolio each quarter. Securities that are publicly-traded are valued at the reported closing price on the valuation date. Securities that are not publicly-traded are valued at fair value as determined in good faith by the company's board of trustees with portfolio company valuations which are based on relevant inputs, including, but not limited to, indicative dealer quotes, values of like securities, recent portfolio company financial statements and forecasts, and valuations prepared by third-party valuation services. This investment is classified within Level 3 of the valuation hierarchy.

FS Global Credit Opportunities Fund: The underlying investments consist principally of secured and unsecured floating and fixed rate loans, and to a lesser extent, senior secured bonds and other credit instruments. The net asset value of the investment portfolio is determined quarterly using a combination of quoted market prices and estimations based on relevant inputs such as indicative dealer quotes, values of like securities, and valuations prepared by third-party valuation services. This investment is classified within Level 3 of the valuation hierarchy.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Real Estate Investment Trusts (Dividend Capital Diversified Property Fund and NorthStar Real Estate Income II, Inc.): These non-traded real estate investment trusts are valued at an estimated amount based on overall economic and real estate market conditions of the underlying commercial properties. These investments are classified within Level 3 of the valuation hierarchy.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Association believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

The following table sets forth by level, within the fair value hierarchy, the Association's assets at fair value on a recurring basis as of December 31, 2016:

	Level 1	Level 2	Level 3	Total
Mutual funds:				
Fixed income - domestic	\$ 5,854,426	\$ -	\$ -	\$ 5,854,426
Fixed income - other	584,910	-	-	584,910
Equity - domestic	564,349	-	-	564,349
Equity - international	461,252	-	-	461,252
Money market	631,568	-	-	631,568
Total mutual funds	<u>8,096,505</u>	<u>-</u>	<u>-</u>	<u>8,096,505</u>
Exchange traded funds:				
Fixed income - domestic	2,845,919	-	-	2,845,919
Fixed income - U.S. government	724,385	-	-	724,385
Fixed income - other	225,728	-	-	225,728
Equity - domestic	804,968	-	-	804,968
Equity - international	634,815	-	-	634,815
Commodity	50,968	-	-	50,968
Total exchange traded funds	<u>5,286,783</u>	<u>-</u>	<u>-</u>	<u>5,286,783</u>
Corporate bonds:				
Domestic	-	3,812,718	-	3,812,718
International	-	611,444	-	611,444
Total corporate bonds	<u>-</u>	<u>4,424,162</u>	<u>-</u>	<u>4,424,162</u>
U.S. government agency bond	<u>195,698</u>	<u>-</u>	<u>-</u>	<u>195,698</u>
Fixed index annuity	<u>-</u>	<u>-</u>	<u>2,000,000</u>	<u>2,000,000</u>
Other investments:				
FS Coporation II	-	-	1,251,594	1,251,594
FS Energy and Power Fund	-	-	1,115,888	1,115,888
FS Global Credit Opportunities Fund	-	-	1,277,626	1,277,626
Northstar Real Estate Income II	-	-	1,340,229	1,340,229
Dividend Capital Diversified Property Fund	<u>-</u>	<u>-</u>	<u>86,807</u>	<u>86,807</u>
Total other investments	<u>-</u>	<u>-</u>	<u>5,072,144</u>	<u>5,072,144</u>
Total	<u><u>\$ 13,578,986</u></u>	<u><u>\$ 4,424,162</u></u>	<u><u>\$ 7,072,144</u></u>	<u><u>\$ 25,075,292</u></u>

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

The following table sets forth by level, within the fair value hierarchy, the Association's assets at fair value on a recurring basis as of December 31, 2015:

	Level 1	Level 2	Level 3	Total
Mutual funds:				
Fixed income - domestic	\$ 5,505,450	\$ -	\$ -	\$ 5,505,450
Fixed income - international	981,778	-	-	981,778
Fixed income - other	518,683	-	-	518,683
Equity - domestic	534,826	-	-	534,826
Equity - international	432,806	-	-	432,806
Money market	445,594	-	-	445,594
Total mutual funds	<u>8,419,137</u>	<u>-</u>	<u>-</u>	<u>8,419,137</u>
Exchange traded funds:				
Fixed income - domestic	3,248,028	-	-	3,248,028
Fixed income - U.S. government	736,596	-	-	736,596
Equity - domestic	721,497	-	-	721,497
Equity - international	418,385	-	-	418,385
Total exchange traded funds	<u>5,124,506</u>	<u>-</u>	<u>-</u>	<u>5,124,506</u>
Corporate bonds:				
Domestic	-	3,790,174	-	3,790,174
International	-	671,450	-	671,450
Total corporate bonds	<u>-</u>	<u>4,461,624</u>	<u>-</u>	<u>4,461,624</u>
U.S. government agency bond	<u>200,374</u>	<u>-</u>	<u>-</u>	<u>200,374</u>
Other investments:				
FS Coporation II	-	-	1,090,605	1,090,605
FS Energy and Power Fund	-	-	891,945	891,945
FS Global Credit Opportunities Fund	-	-	1,003,764	1,003,764
Northstar Real Estate Income II	-	-	1,138,950	1,138,950
Dividend Capital Diversified Property Fund	<u>-</u>	<u>-</u>	<u>85,501</u>	<u>85,501</u>
Total other investments	<u>-</u>	<u>-</u>	<u>4,210,765</u>	<u>4,210,765</u>
Total	<u>\$ 13,744,017</u>	<u>\$ 4,461,624</u>	<u>\$ 4,210,765</u>	<u>\$ 22,416,406</u>

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

Level 3 Information

The following table sets forth additional disclosures for the measurements of investments in certain entities that calculate net asset value per share (or its equivalent) at December 31, 2016:

Investment Type	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Other investments:				
FS Investment Corporation II	\$ 1,251,594	\$ -	3 months	30 days
FS Energy and Power Fund	1,115,888	-	3 months	30 days
FS Global Credit Opportunities Fund	1,277,626	-	3 months	30 days
Northstar Real Estate Income II	1,340,229	-	3 months	15 days

Northstar Real Estate Income II does not allow redemptions if 5% of its investment portfolio has already been redeemed during the calendar year.

Level 3 Gains and Losses

The following table sets forth a summary of changes in the fair value of the Association's Level 3 assets for the years ended December 31, 2016 and 2015:

Balance, January 1, 2015	\$ 3,180,964
Net depreciation	(470,199)
Purchases	1,500,000
	4,210,765
Balance, December 31, 2015	4,210,765
Net appreciation	861,379
Purchases	2,000,000
	7,072,144
Balance, December 31, 2016	\$ 7,072,144

Gains and losses (realized and unrealized) included in changes in value for the period above are reflected as a component of the escrow funds – health and pension liability account. There were no transfers in or out of Level 3 in 2016 and 2015.

**PENNSYLVANIA HARNESS
HORSEMEN'S ASSOCIATION**

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

4. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	<u>2016</u>	<u>2015</u>
Member benefit reimbursements	<u>\$ 29,329</u>	<u>\$ 11,751</u>

5. ACCRUED SEVERANCE

During the year ended December 31, 2016, an employee of the Association was no longer able continue their employment due to unforeseen circumstances. The Board of Directors authorized a severance package, which allowed this individual to continue to receive their bi-weekly salary through April 2017 and health insurance benefits through January 2022. The total estimated liability for these benefits totaled \$77,442 at December 31, 2016.

6. NAMING RIGHTS

The Association recognized an intangible asset in the amount of \$700,000 for the benefits derived from an agreement related to naming rights entered into with Downs Racing, LP (Downs Racing). Downs Racing owns and operates a gaming and entertainment facility and harness racing track with pari-mutuel wagering in Wilkes-Barre, Pennsylvania known as Mohegan Sun Pocono Downs. Downs Racing entered into an agreement with the Luzerne County Convention Center Authority for the naming rights to the arena located in Wilkes-Barre. The arena is known as the Mohegan Sun Arena at Casey Plaza through January 2020. In consideration of the mutual benefits that the Association and its members and employees will receive relating to the naming rights granted to Downs Racing, the Association has contracted to contribute to Downs Racing \$100,000 annually during the term of Downs Racing's naming rights agreement. The Association will amortize the intangible asset, naming rights, ratably over the term of the agreement with Downs Racing. The Association recognized \$100,000 of amortization expense related to naming rights during 2016 and 2015. The Association will recognize \$100,000 of amortization expense annually through 2019.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

7. RACE TRACK REVENUES

The Association holds a contract with a harness race track in Pennsylvania, Downs Racing, which expires December 31, 2017. Under the terms of this contract, the Association will receive \$1,200,000 annually. In addition, the Association can request additional payments exceeding \$100,000 if deemed necessary. These amounts may be used toward Association operating expenses, dues to any national organization, group health insurance for drivers, trainers, and grooms, accident and disability insurance for trainers and drivers, and marketing and promotional items.

In addition, the Association holds a contract with Chester Downs and Marina, LLC that expires February 28, 2017. Under this contract, a percentage of wagering handle shall be paid to the Association to be used toward Association operating expenses, dues to any national horsemen's organizations, group health insurance, marketing and promotional costs to fund purses as determined by the Association in consultation with Chester Downs, or administrative costs.

8. SPECIAL EVENTS

The following is a schedule of income and direct expenses from the Association's special events for the years ended December 31:

	<u>2016</u>	<u>2015</u>
Golf outing:		
Revenue	\$ 22,000	\$ 25,000
Direct expenses	<u>32,147</u>	<u>33,970</u>
Net loss	<u>\$ (10,147)</u>	<u>\$ (8,970)</u>

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

9. FUNCTIONAL CLASSIFICATIONS OF EXPENSES

Expenses by function for the years ended December 31 are as follows:

	<u>2016</u>	<u>2015</u>
Program services:		
Health program	\$ 70,282	\$ 126,217
Pension program	31,961	70,202
Member benefits	2,445,983	2,579,391
Racetrack relations	78,220	45,665
Industry promotion	1,523,436	1,661,476
Regulatory matters	336,468	222,940
Supporting services:		
Management and general	<u>206,875</u>	<u>448,584</u>
Total	<u>\$4,693,225</u>	<u>\$5,154,475</u>

10. 401(K) PLAN

The Association established a deferred salary arrangement under I.R.C. Section 401(k). The Plan covers substantially all its eligible employees. The Association's matching contribution is discretionary and is equal to a uniform percentage as determined by the Employer of each participant's elective deferral. The Association may also make a discretionary nonelective contribution. The Association's discretionary contribution for 2016 and 2015 totaled \$48,000 and \$31,037, respectively.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

11. LONG-TERM PAYABLE

The Association entered into a naming rights agreement February 1, 2010 with Downs Racing, to become a party to naming the arena located in Wilkes-Barre, Pennsylvania. The Association contributes \$100,000 per year for the life of the agreement. In 2016 and 2015, the Association paid \$100,000. Future payments will be:

2017	\$	100,000
2018		100,000
2019		100,000
Total	\$	<u>300,000</u>

12. CONCENTRATIONS OF CREDIT RISK

The Association maintains several cash balances (restricted and unrestricted) at financial institutions located in Pennsylvania. Accounts in these financial institutions are secured by Federal Deposit Insurance Corporation (FDIC) up to specified limits. In the normal course of business, the Association may have deposits that exceed the insured limit which management considers to be a normal business risk. At December 31, 2016 and 2015, the Association had bank deposits of \$15,598,040 and \$22,635,774, respectively.

For the years ended December 31, 2016 and 2015, revenue includes \$2,813,106 and \$3,300,000, respectively, arising from race track revenues received from two race tracks. The loss of these revenue sources could have a material effect on the Association.

Supplementary Information

**PENNSYLVANIA HARNESS
HORSEMEN'S ASSOCIATION**

**STATEMENT OF CASH RECEIPTS AND CASH DISBURSEMENTS
AND CHANGES IN ESCROW BALANCES**

PERIOD JANUARY 1, 2016 THROUGH DECEMBER 31, 2016

	<u>Purses</u>	<u>Benefits</u>	<u>Total</u>
Cash Receipts:			
Gaming funds - Chester Downs and Marina, LLC	\$ 21,657,320	\$ 1,630,948	\$ 23,288,268
Gaming funds - Downs Racing LP	22,771,337	1,755,165	24,526,502
Interest and investment income, net of fees	31,404	903,139	934,543
Total cash receipts	<u>44,460,061</u>	<u>4,289,252</u>	<u>48,749,313</u>
Cash Disbursements:			
Purse payments - Chester Downs and Marina, LLC	26,302,326	-	26,302,326
Purse payments - Downs Racing, LP	26,237,300	-	26,237,300
Health insurance payments	-	1,167,397	1,167,397
Retirement distributions	-	890,190	890,190
Total cash disbursements	<u>52,539,626</u>	<u>2,057,587</u>	<u>54,597,213</u>
Other:			
Net unrealized and realized gains on restricted investments	<u>-</u>	<u>614,875</u>	<u>614,875</u>
Changes in Escrow Balances	(8,079,565)	2,846,540	(5,233,025)
Escrow balance at January 1, 2016	<u>13,620,830</u>	<u>23,084,648</u>	<u>36,705,478</u>
Escrow balance at December 31, 2016	<u>\$ 5,541,265</u>	<u>\$ 25,931,188</u>	<u>\$ 31,472,453</u>

See accompanying notes to statement of cash receipts and cash disbursements and changes in escrow balances.

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

NOTES TO STATEMENT OF CASH RECEIPTS AND CASH DISBURSEMENTS AND CHANGES IN ESCROW BALANCES

PERIOD JANUARY 1, 2016 THROUGH DECEMBER 31, 2016

1. BASIS OF PRESENTATION

The accompanying statement of cash receipts and cash disbursements and changes in escrow balances includes the Pennsylvania Race Horse Development Fund activity of the Pennsylvania Harness Horsemen's Association (Association) and is presented on the cash basis of accounting. The information in this statement is presented in accordance with Chapter 436a of the Pennsylvania Horse Development and Gaming Act, and fiscal code (72 P.S. § 1701-O). Therefore, some amounts presented in this statement may differ from amounts presented in, or used in, the preparation of the basic financial statements.

2. FLOW OF THE PENNSYLVANIA HORSE FUNDS

The Pennsylvania Department of Revenue transfers Pennsylvania Racehorse Development Funds to the casinos on a weekly basis designating amounts for purses and health and retirement benefits. The casinos then transfer these funds to the Association to separate accounts established by the casinos, by purpose.

Management of the Association determines the portion of the Race Horse Development Funds to transfer to the casinos for purse purposes based on an estimate provided by the casinos. The frequency of purse payments to the casinos is dependent on the established racing schedules. The Association maintains schedules detailing all purse fund payments. The purse payments are reconciled to the actual purses paid by the casinos. Health disbursements are made directly to the carriers based on invoiced amounts. There were no administrative expenses charged for those funds in 2016.

**Pennsylvania Harness Horsemen's
Association**

Independent Auditor's Report in
Accordance with *Government Auditing
Standards*

Year Ended December 31, 2016

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors and Secretary Albright, Pennsylvania Office of the Budget
Pennsylvania Harness Horsemen's Association

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Pennsylvania Harness Horsemen's Association (Association) (a nonprofit organization), which comprise the statement of financial position as of December 31, 2016, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 31, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Association's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses as item 2016-001 that we consider to be a significant deficiency.

Board of Directors and Secretary Albright, Pennsylvania Office of the Budget
Pennsylvania Harness Horsemen's Association
Independent Auditor's Report on Internal Control over
Financial Reporting and on Compliance and Other Matters

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Association's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts including Chapter 436a of the Pennsylvania Race Horse Development and Gaming Act and Fiscal Code (72 P.S. § 1701-O). However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Response to Findings

The Association's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Association's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Association's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Maher Duessel

Harrisburg, Pennsylvania
May 31, 2017

PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION

SCHEDULE OF FINDINGS AND RESPONSES

YEAR ENDED DECEMBER 31, 2016

Significant Deficiency

Finding 2016-001: Segregation of Duties

Condition: The Chief Financial Officer (CFO) directly receives investment statements, has the ability to request wire transfers, and records all investment transactions in the general ledger.

Criteria: The Internal Control Integrated Framework (COSO report) requires adequate internal controls including proper segregation of duties to ensure that transactions are properly recorded and reduce the risk that errors will be undetected.

Cause: The Pennsylvania Harness Horsemen's Association (Association) did not have policies and procedures in place throughout the fiscal year to ensure that all investment transactions were properly authorized, recorded, and reviewed.

Effect: Inadequate controls could result in material misstatements in financial records, whether due to fraud or error, that may not be prevented, or detected and corrected on a timely basis. This is especially important given that these funds are held to fund benefits for horsemen and women.

Recommendation: We recommend that the Executive Director or a member of the Board of Directors directly receive and review investment statements prior to providing these statements to the CFO for reconciliation. The individual reviewing the statements should initial the statements to denote the review. In addition, wire transfers initiated by the CFO should require a separate approval by the Executive Director or a member of the Board of Directors to provide for proper segregation of duties.

Management's Response: Association management will initiate the following processes starting in the fiscal year 2017.

On a quarterly basis, the CFO will reconcile the investment accounts in QuickBooks to the quarterly investment statements received. The Executive Director will verify that the changes to the investment values are posted to QuickBooks by initialing the reconciliations prepared by the CFO.

A dual authorization procedure will be set up with the investment advisory firm to ensure that any changes, such as wire transfers, require dual approval by the Executive Director and the CFO. Changes to the investment activities will be approved and recorded in the Health and Pension committee meetings.