# Pennsylvania Thoroughbred Horsemen's Association, Inc.

## Combined Financial Statements and Supplementary Information

Year Ended December 31, 2016 with
Independent Auditor's Report

MaherDuessel

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# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

YEAR ENDED DECEMBER 31, 2016

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## Independent Auditor's Report

Board of Directors and Secretary Albright, Pennsylvania Office of the Budget
Pennsylvania Thoroughbred Horsemen's Association, Inc.

**Report on the Financial Statements**

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

***Management's Responsibility for the Combined Financial Statements***

Management is responsible for the preparation and fair presentation of these combined 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 combined financial statements based on our audit. We did not audit the financial statements of the Pennsylvania Race Horse Development Fund Division of the Pennsylvania Thoroughbred Horsemen's Association, Inc. (PRDF), which statements reflect total assets and total liabilities of $5,853,066, as of December 31, 2016. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Race Horse Development Funds, is based solely on the report of the other auditors. We conducted our audit 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 audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined financial statements.

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

***Basis for Qualified Opinion***

As explained in Note 1 to the combined financial statements, the activities of the Pennsylvania Thoroughbred Horsemen's Political Action Committee are not included in the combined financial statements of the Association. Accounting principles generally accepted in the United States of America require an organization to consolidate the activities of another entity when the organization has an economic interest in and control of the other entity. The effects on the combined financial statements of the failure to consolidate have not been determined.

***Qualified Opinion***

In our opinion, based on our audit and the report of the other auditors, and except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Association as of December 31, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Matters***

*Auditor's Updated Opinion on 2015 Combined Financial Statements*

In our report dated October 18, 2016, we expressed an opinion that the 2015 combined financial statements presented fairly, in all material respects, the combined financial position of the Association as of December 31, 2015, and the changes in its combined net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. As described in the Basis for Qualified Opinion paragraph, we became aware that the Pennsylvania Thoroughbred Horsemen's Political Action Committee was not included in the 2015 combined financial statements of the Association as required by accounting principles generally accepted in the United States of America. Accordingly, our present opinion on the 2015 combined financial statements, as presented herein, is different from that expressed in our previous report.

*Supplementary Information*

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The accompanying supplementary information on pages 17-23 is presented for purposes of additional analysis and is not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined 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 combined 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 January 23, 2018, 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
January 23, 2018

# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

## COMBINED STATEMENT OF FINANCIAL POSITION

DECEMBER 31, 2016

| | | |
|---|---|---|
| **Assets** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ | 187,031 |
| Accounts receivable | | 31,199 |
| Other receivable | | 171,883 |
| Inventory | | 203,111 |
| Prepaid expenses | | 31,659 |
| Total current assets | | 624,883 |
| Investments | | 478,336 |
| Restricted Pennsylvania Racehorse Development Fund assets: | | |
| Restricted cash | | 2,214,407 |
| Restricted investments | | 980,729 |
| Statutory funds receivable | | 2,634,561 |
| Prepaid expenses | | 23,369 |
| Total restricted Pennsylvania Racehorse Development Fund assets | | 5,853,066 |
| Equipment and Furnishings | | |
| Cemetery lots | | 2,410 |
| Vehicles | | 107,964 |
| Storage trailers and related equipment | | 71,075 |
| Office equipment and furniture | | 130,070 |
| Less: accumulated depreciation | | (266,849) |
| Net equipment and furnishings | | 44,670 |
| **Total Assets** | $ | 7,000,955 |
| **Liabilities and Net Assets** | | |
| Liabilities: | | |
| Current Liabilities: | | |
| Accounts payable | $ | 244,395 |
| Customer deposits | | 11,107 |
| Due to Philadelphia Park | | 273,752 |
| Accrued payroll | | 10,690 |
| Other accrued expenses | | 3,500 |
| Total current liabilities | | 543,444 |
| Pennsylvania Race Horse Development Fund liabilities: | | |
| Accounts payable | | 32,937 |
| Accrued purse payouts | | 5,248,343 |
| Accrued employee and trainers pension funds | | 421,034 |
| Other accrued expenses | | 150,752 |
| Total Pennsylvania Race Horse Development Fund liabilities | | 5,853,066 |
| Total liabilities | | 6,396,510 |
| Net Assets: | | |
| Unrestricted | | 604,445 |
| **Total Liabilities and Net Assets** | $ | 7,000,955 |

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

# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

## COMBINED STATEMENT OF ACTIVITIES

YEAR ENDED DECEMBER 31, 2016

| | |
|---|---|
| **Unrestricted Revenues and Support:** | |
| Shares of wagering - per Live Racing Agreement | $ 1,399,833 |
| Contributions | 443,670 |
| Fundraising, net of direct expenses | 39,460 |
| Sale of merchandise | 2,904,041 |
| Interest on Horsemen's funds - Philadelphia Park | 14,051 |
| Broadcasting income | 23,800 |
| Miscellaneous income | 4,522 |
| Interest income | 17,354 |
| Realized and unrealized gain on investments | 4,985 |
| Total unrestricted revenues and support | 4,851,716 |
| **Expenses:** | |
| Program services: | |
| Horsemen's Advocacy Program | 1,870,676 |
| Horse Supplies Program | 2,902,864 |
| Backstretch Social Programs | 56,937 |
| Backstretch Healthcare Programs, Non-PRDF Funded | 818 |
| Thoroughbred Horse Retirement Program | 399,334 |
| Total program services | 5,230,629 |
| Management and general | 142,913 |
| Total expenses | 5,373,542 |
| **Change in Net Assets** | (521,826) |
| **Net Assets:** | |
| Beginning of year | 1,126,271 |
| End of year | $ 604,445 |

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

# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

## COMBINED STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2016

| | |
|---|---|
| **Cash Flows From Operating Activities:** | |
| Change in net assets | $ (521,826) |
| Adjustments to reconcile change in assets to net cash used in operating activities: | |
| Depreciation and amortization | 14,727 |
| Realized and unrealized gain on investments | (4,985) |
| Effects of changes in operating assets and liabilities: | |
| Accounts receivable | (14,180) |
| Other receivables | (83,403) |
| Inventory | (27,112) |
| Prepaid expenses | (24,622) |
| Accounts payable | 117,328 |
| Due to Philadelphia Park | 91,332 |
| Customer deposits | (2,616) |
| Accrued payroll | 2,874 |
| Other accrued expenses | 17,704 |
| Net cash used in operating activities | (434,779) |
| **Cash Flows From Investing Activities:** | |
| Purchase of fixed assets | (8,185) |
| Proceeds from the sale of investments | 254,422 |
| Purchase of investments | (266,451) |
| Net cash used in investing activities | (20,214) |
| **Net Decrease in Cash and Cash Equivalents** | (454,993) |
| **Cash and Cash Equivalents:** | |
| Beginning of year | 642,024 |
| End of year | $ 187,031 |
| **Supplemental Cash Flow Disclosures:** | |
| Cash paid for taxes | $ 2,240 |

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

## 1. Summary of Significant Accounting Policies

Organization

The combined financial statements include the following entities: Pennsylvania Thoroughbred Horsemen's Association, Inc. (PTHA), Horsemen's Purchasing Association, Inc. (HPA), Turning for Home, Inc. (TFH), and the Pennsylvania Race Horse Development Fund (PRDF Division). For the purposes of these combined financial statements, the combined entities of PTHA, HPA, TFH, and PRDF will be referred to as the Association.

PTHA represents the common business interests of horse owners, their employees, and independent contractors (collectively referred to as Members) with management of Bensalem Racing Association, the owner of Parx Racing, and Keystone Turf Clubs, Inc. PTHA works to protect and provide for Parx Racing horsemen through the guarantee of live racing, increased purses, and healthcare for its families. It also promotes thoroughbred racing and improvements in the thoroughbred racing industry in the Commonwealth of Pennsylvania. PTHA, located in Bucks County, provides administrative and management services, strategic and financial planning, asset management, and budgeting services to the related entities – HPA, and TFH. Each of the entities is related to PTHA as a result of their common management and common Board of Directors.

HPA sells horse related goods and supplies to the members of PTHA.

TFH is a retirement program for the thoroughbred horses that can no longer race due to injury or lack of ability. TFH provides humane and dignified retirement for horses stabled at Philadelphia Park.

The PRDF Division of the PTHA was formed in December 2006 pursuant to Sections 1405 and 1406 of the Pennsylvania Consolidated Statutes Title 4 Amusements (Statute). Section 1405 of the Statute provides for the establishment of a Pennsylvania Race Horse Development Fund within the State Treasury and requires that each active and operating licensed gaming entity shall pay a daily assessment to the Pennsylvania Race Horse Development Fund. In accordance with Section 1406 of the Statute, the State Treasury shall make distributions from the Pennsylvania Race Horse Development Fund to each active and operating Category 1 licensee conducting live racing in the matter outlined in Section 1406 of the Statute. It is the responsibility of the PTHA-PRDF Division to distribute the funds received from Philadelphia Park Racetrack's Horsemen's Association (PTHA) in accordance with the Statute. The PRDF Division serves as the custodian of funds to be used by the beneficiary of the funds received under Sections 1405 and 1406 of the Statute.

On December 10, 2014, the Board of Directors (Board) of the Association approved the dissolution of the Pennsylvania Thoroughbred Horsemen's Association Benefit Trust (PTHA-BT). On April 29, 2015, the Pennsylvania Gaming Control Board voted to approve the Board's plan to fund backstretch benefits using a portion of the PRDF allocation. Beginning in 2016, backstretch benefits expenses are presented in the statement of cash receipts and cash disbursements and changes in cash balance – Pennsylvania Racehorse Development Funds.

The Association allows individual members to contribute to the Pennsylvania Thoroughbred Horsemen's Political Action Committee (PAC). These activities are not included in the financial statements of the Association. The PAC does not issue a separate financial statement.

Combination Policy

The combined financial statements include the accounts of PTHA, HPA, PRDF, and TFH. Intercompany transactions and balances have been eliminated in combination.

Basis of Accounting

The accompanying combined financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, except for the matter described in the Organization paragraph related to the exclusion of the PAC activity.

Use of Estimates

The preparation of combined 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 and liabilities and disclosures of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Combined Financial Statement Presentation

The Association reports information regarding their financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

*Unrestricted net assets* – Unrestricted net assets are the net assets that are neither permanently restricted nor temporarily restricted by donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Board or otherwise limited by contractual arrangements with outside parties. Unrestricted net assets are composed of the following:

- General – Represents resources available for support of operations.
- Fixed assets – Represents resources designated for fixed asset acquisitions and net assets expended for fixed assets.
- Board-designated – The Board has designated certain amounts, within which the balance of net assets together with accumulated earnings thereon is to be spent only for purposes approved by the Board.

*Temporarily restricted net assets* – Temporarily restricted net assets result from contributions whose use is limited by donor-imposed stipulations that either expire by the passage of time or can be fulfilled and removed by actions of the Board pursuant to those stipulations. Net assets may be temporarily restricted for various purposes, such as use in future periods or use for specified purposes. As of December 31, 2016, the Association had no temporarily restricted net assets.

*Permanently restricted net assets* – Permanently restricted net assets result from contributions whose use is limited by donor-imposed stipulations that neither expire by the passage of time nor can be fulfilled or otherwise removed by the Board's actions. As of December 31, 2016, the Association had no permanently restricted net assets.

## Contributions

Contributions are recorded as unrestricted, temporarily restricted, or permanently restricted support depending upon the existence and/or nature of any donor restriction.

## Contributed Services and Facilities

A number of unpaid volunteers, which include the Directors of the Association, have made significant contributions of their time toward developing and achieving the Association's goals and objectives. Contributions of donated services that create or enhance nonfinancial assets, or that require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation, are recorded at their fair values in the period received. During the year ended December 31, 2016, there were no donated services that met the reporting requirements.

Under terms of the Racing Agreement, the entities making up the combined group are permitted to use office space and the tack shop office located in the administrative building of Parx Racing. This includes the use of all common utilities.

Cash and Cash Equivalents

For purposes of the combined statement of cash flows, the Association considers all unrestricted highly-liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

The Association maintains cash accounts at various financial institutions. Balances on deposit are insured by the Federal Deposit Insurance Corporation (FDIC) up to specified limits. Balances in excess of FDIC limits are uninsured.

Restricted cash represents statutory funds held under the Pennsylvania Race Horse Development Fund and are restricted by statute as to their use.

Accounts Receivable and Reserve for Uncollectible Receivables

Accounts receivable is stated at the amount management expects to collect from outstanding balances. The Association uses the allowance method for potential uncollectible amounts. A reserve was established totaling $10,000 for potential uncollectible amounts for the sale of horse supplies and equipment. The amount written off in 2016 as bad debt expense totaled $7,100.

Investments

***Fair Value Measurements***

The Association records its investments based on fair value. The use of observable inputs are maximized and the use of unobservable inputs are minimized by using observable inputs when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the transparency of inputs as follows:

Level 1 — Quoted prices are available in active markets for identical assets or liabilities as of the report date. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

Level 2 — Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the report date. The nature of these securities includes investments for which quoted prices are available, but traded less frequently, and investments that are fair valued using other securities, the parameters of which can be directly observed.

Level 3 — Securities that have little to no pricing observability as of the report date. These securities are measured using management's best estimate of fair value, where the inputs into the determination of fair value are not observable and require significant management judgment or estimation.

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes "observable" requires significant judgment by the Association. The Association considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the Association's perceived risk of that instrument.

***Valuation of Investments***

Investments whose values are based on quoted market prices in active markets, and are therefore classified within Level 1, include money market funds, exchange-traded funds, and mutual funds.

Investments in marketable securities with readily determinable fair values are recorded at the fair values in the combined statement of financial position. Realized and unrealized gains and losses are included in the change in net assets in the accompanying combined statement of activities and changes in net assets for investments held by PTHA. Realized and unrealized gains and losses for PRDF are included in the statement of cash receipts and cash disbursements and changes in cash balances.

Inventory

Horse supplies are valued at the lower of cost or market. Cost is computed using the average cost method. Inventory is valued at $203,111 for the year ended December 31, 2016.

Equipment and Furnishings

Equipment and furnishings are stated at cost if purchased and at estimated fair market value at date of donation, if donated. Depreciation is calculated using the straight-line and declining balance methods over the estimated useful lives of the respective assets. Expenditures for repairs and maintenance are charged against operations as incurred; expenditures for renewals and betterments are capitalized in accordance with the Association's capitalization policies. A summary of the estimated useful lives is as follows:

| | |
|---|---|
| Vehicles | 5 to 7 years |
| Storage trailers and related equipment | 7 years |
| Office equipment and furniture | 3 to 10 years |

Functional Expense Allocation Method

Functional expenses are allocated based on: (1) actual direct time spent and cost incurred by program and supporting service; (2) direct costs associated with each program or supporting service; and (3) division of common area costs among program and supporting services according to utilization of a common distribution base.

Income Taxes

PTHA, HPA, and TFH were organized under the Pennsylvania Nonprofit Corporation Law of 1972 and, as such, are exempt from state income taxes. PTHA and TFH have been granted tax-exempt status by the Internal Revenue Service under Section 501(c)(6) and Section 501(c)(3), respectively, of the Internal Revenue Code. HPA is subject to income tax for federal purposes only. All tax forms are filed on an annual basis.

In accordance with accounting principles generally accepted in the United States of America, the Association accounts for uncertain tax positions, if any, as required. Using that guidance, management has determined that there are no uncertain tax positions that qualify for either recognition or disclosure in the combined financial statements.

Pending Standards Update

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),"* is 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.

Subsequent Events

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

## 2. PROGRAM SERVICES

Services are provided through the following programs:

Horsemen's Advocacy Program – represents the common business interests between horsemen (horse owners, trainers, their employees, and independent contractors) who race at Parx Racing and management of Parx Racing (Bensalem Racing Association, Inc. and Keystone Turk Club, Inc.). The program also promotes thoroughbred racing and improvements in the thoroughbred racing industry in the Commonwealth of Pennsylvania.

Horse Supplies Program – purchases and sells feed, bedding, and other equine related commodities and services to members of PTHA.

Backstretch Social Program – provides social programs for members and the employees of PTHA.

Backstretch Healthcare Program – provides welfare benefits for members and the employees of PTHA.

Thoroughbred Horse Retirement Program – provides care for thoroughbred horses that can no longer race, due to injury or lack of ability. The program provides a humane and dignified retirement for thoroughbred horses through rehabilitation, including veterinary care and surgery, and adoption to approved homes.

## 3. RESTRICTED PENNSYLVANIA RACE HORSE DEVELOPMENT FUND ACTIVITY

The PRDF Division of the PTHA distributes the funds received by Parx Racetrack's Horsemen's Association in accordance with Sections 1405 and 1406 of the Pennsylvania Consolidated Statutes Title 4 Amusements (Statute) and the PA Fiscal Code, an act of 1929, as amended.

The funds received are required to be disbursed for purses, an Act 71 mandated annual contribution to the jockey association at Parx Racing, and pension and health benefits for the members. An allowance for reasonable administrative expenses is permitted.

Statutory funds receivable consist of Pennsylvania Race Horse Development Fund allocations for daily assessments that are due to the PTHA – PRDF Division. Payments of the assessment are statutorily required and are expected to be collected in full. At December 31, 2016, the statutory funds receivable was $2,634,561. This balance represents the gross terminal revenue allocation (GTR) due from the Pennsylvania Race Horse Development Fund for PTHA – PRDF Division's share of GTR generated at Category I, Category II, and Category III casinos throughout Pennsylvania. Approximately 29 percent of total revenues and support for the year ended December 31, 2016 is from this allocation.

Below is a summary of the activity for the year ended December 31, 2016:

| | |
|---|---|
| Pennsylvania Race Horse Development Funds (PRDF) held, January 1, 2016 | $ - |
| Plus funds and earnings received: | |
| Purse payments | 43,170,953 |
| Contractual arrangement | 1,329,731 |
| Health and life insurance benefits | 3,358,985 |
| Promotional payback reduction | (2,523,268) |
| Interest income | 19,086 |
| Unrealized gain on investments | 103,468 |
| Realized loss on investments | (56,865) |
| Dividend income | 18,474 |
| | 45,420,564 |
| Less funds allocated for legislated purposes: | |
| Purse payments | 40,857,151 |
| Contractual payments | 1,257,916 |
| Health and life insurance benefits | 2,455,387 |
| Pension expenses incurred | 422,824 |
| Administrative expenses | 177,286 |
| Jockey Association | 250,000 |
| | 45,420,564 |
| Increase in PRDF funds held, December 31, 2016 | - |
| Total PRDF funds held, December 31, 2016 | $ - |

| | |
|---|---|
| Related assets: | |
| Restricted cash | $ 2,214,407 |
| Statutory funds receivable | 2,634,561 |
| Restricted investments | 980,729 |
| Prepaid expenses | 23,369 |
| Less other related liabilities: | |
| Accounts payable | 32,937 |
| Accrued employee and trainers pension fund | 421,034 |
| Accrued purse payments | 5,248,343 |
| Other accrued expenses | 150,752 |
| Total PRDF funds held, December 31, 2016 | $ - |

## 4. INVESTMENTS AND FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

The following tables summarize the valuation of the Association's assets subject to measurements at fair value as of December 31, 2016:

| | Level | Fair Value | Cost |
|---|---|---|---|
| Money market funds | 1 | $ 146,320 | $ 146,320 |
| Mutual funds: | | | |
| U.S. equity | 1 | 352,178 | 321,076 |
| International equity | 1 | 248,504 | 274,841 |
| Fixed income | 1 | 149,231 | 151,728 |
| Other | 1 | 191,579 | 186,320 |
| Exhange-traded funds: | | | |
| U.S. equity | 1 | 272,631 | 248,317 |
| International equity | 1 | 98,622 | 103,865 |
| Total investments | | 1,459,065 | $ 1,432,467 |
| Restricted PRDF investments | | (980,729) | |
| Total unrestricted investments | | $ 478,336 | |

Investment income activity is as follows at December 31, 2016:

| | PRDF Investments | Unrestricted Investments | Total Investments |
|---|---|---|---|
| Interest and dividend income | $ 18,474 | $ 16,704 | $ 35,178 |
| Realized gain (loss) | (56,865) | (11,825) | (68,690) |
| Unrealized gain (loss) | 103,468 | 16,810 | 120,278 |
| Total investment income (loss) | $ 65,077 | $ 21,689 | $ 86,766 |

## 5. Live Racing Agreement

PTHA entered into a live racing agreement with Keystone Turf Club, Inc. and Bensalem Racing Association, Inc. (operating as Parx Racing) effective September 4, 2004. The agreement is set to expire on December 31, 2018. As outlined in the agreement, purse monies shall be allocated as follows:

- Ninety percent (90%) of purses shall be allocated to overnights.
- Seven percent (7%) of purses shall be applied to stake races.
- Three percent (3%) of purses shall be paid to PTHA to support member activity.

## 6. Related Party Transactions

The President of the Association is a partner in a law firm representing PTHA; however, this individual has no voting rights and abstains from all discussions regarding legal fees paid to the firm. Legal expenses incurred by PTHA for the year ended December 31, 2016 were $151,154 and were entirely related to the law firm in which the President is a partner. The entire amount is included in professional fees as paid from Association funds.

During the year, TFH received a $50,000 contribution from PTHA. Also during the year, HPA paid $14,000 to PTHA for advertising. These transactions were eliminated in the combined financial statements.

## 7. Benefit Plans

Act 71 Pennsylvania Gaming Law mandates that a portion of the slot revenue be utilized for pension benefits. As a result, on December 2, 2009, the Board of Directors of PTHA approved two pension plans for the benefit of the trainers and the employees of PTHA. The Pennsylvania Thoroughbred Horsemen's Association Trainers' Retirement Plan and the Pennsylvania Thoroughbred Horsemen's Association Employees' Retirement Plan were approved by the Pennsylvania Gaming Control Board and adopted by the Association on March 1, 2010.

Trainer's Retirement Plan

Effective December 1, 2011, the Board of Directors of PTHA approved to amend the eligibility requirements of the Plan as follows:

Trainers will be eligible to participate in the defined contribution non-qualified pension plan if they meet one of the following criteria: has twenty starts during the calendar year or the prior calendar year, provided that 65 percent of such trainer's total annual starts for that year are at Parx Racing; has 100 starts during the calendar year or the prior calendar year; or has a full barn at Parx Racing. In the event that one of the three criteria are met, the PRDF will contribute an approved dollar amount per start into each participant's account. The Plan has a five-year vesting schedule and distributions would be made upon the participant obtaining the age of 65, becoming disabled, or death.

Effective February 13, 2016, the eligibility requirement of twenty starts was reduced to fifteen starts during the calendar year or the prior calendar year. All other eligibility requirements remained the same.

The Association accrued the funding of the Plan for 2016 for trainers that met the criteria stated above for the year ended December 31, 2016, and contributions were made as follows: trainers aged 55 and over received $40 per eligible start; and trainers under age 55 received $30 per eligible start. Total contributions made to the Plan from the PRDF on behalf of eligible participants were $328,360 for the year ended December 31, 2016.

Employees' Retirement Plan

Eligible employees of the Association may participate in an ERISA, nondiscrimination qualified 401(k) plan. To be eligible to participate, an employee must have one year of service with the Association and attained the age of 21. Under the Plan, the PRDF may contribute a discretionary non-elective contribution. Total contributions made to the Plan for employees from the PRDF for the year ended December 31, 2016 were $94,464.

Total contributions to pension plans from PRDF for the year ended December 31, 2016 were $422,824.

## 8. COMMITMENTS AND CONTINGENCIES

The Association has contracted with a vendor through June 2017 to remove manure and wood shavings waste from the Philadelphia Park facility. The contract expense was $263,850 for the year ended December 31, 2016. Future minimum non-cancelable contract payments are $123,500 through June 2017.

## 9. PROMOTIONAL ITEMS - PRDF

On March 27, 2015, the Department of Revenue issued Gaming Tax Bulletin 2015-01. This bulletin clarified the policy concerning the deductibility of promotional items for purposes of calculating GTR as a result of the Pennsylvania's Supreme Court's April 28, 2014 decision to allow all casinos to receive tax credits for promotional giveaways. These items include vehicles, concert tickets, sporting event tickets, and gift cards.

Consequently, the issuance of this bulletin affected the results of the PRDF division as of January 1, 2014. The monies associated with this bulletin were reimbursed starting in 2015. Slot machine gaming revenue allocation has decreased in total by $1,150,706 for the year ended December 31, 2016.

## 10. CONCENTRATION

For the year ended December 31, 2016, revenue includes $1,399,833 arising from race track revenue received from the Live Racing Agreement. The loss of this revenue source could have a material effect on the Association.

# Supplementary Information

# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

## COMBINING STATEMENT OF FINANCIAL POSITION

DECEMBER 31, 2016

| Assets | PTHA | HPA | TFH | PRDF | Eliminations | Combined Total |
|---|---|---|---|---|---|---|
| Current Assets: | | | | | | |
| Cash and cash equivalents | $ 134,355 | $ 52,059 | $ 617 | $ - | $ - | $ 187,031 |
| Accounts receivable | 15,520 | 15,679 | - | - | - | 31,199 |
| Other receivable | 97,843 | - | 74,040 | - | - | 171,883 |
| Intercompany receivables | 249,686 | - | - | 12,033 | (261,719) | - |
| Inventory | - | 203,111 | - | - | - | 203,111 |
| Prepaid expenses | 22,558 | 1,574 | - | 7,527 | - | 31,659 |
| Total current assets | 519,962 | 272,423 | 74,657 | 19,560 | (261,719) | 624,883 |
| Investments | 478,336 | - | - | - | - | 478,336 |
| Restricted Pennsylvania Racehorse Development Fund assets: | | | | | | |
| Restricted cash | - | - | - | 2,214,407 | - | 2,214,407 |
| Restricted investments | - | - | - | 980,729 | - | 980,729 |
| Statutory funds receivable | - | - | - | 2,634,561 | - | 2,634,561 |
| Prepaid expenses | - | - | - | 23,369 | - | 23,369 |
| Total restricted Pennsylvania Racehorse Development Fund assets | - | - | - | 5,853,066 | - | 5,853,066 |
| Equipment and Furnishings | | | | | | |
| Cemetery lots | 2,410 | - | - | - | - | 2,410 |
| Vehicles | 107,964 | - | - | - | - | 107,964 |
| Storage trailers and related equipment | - | 71,075 | - | - | - | 71,075 |
| Office equipment and furniture | 107,153 | 22,917 | - | - | - | 130,070 |
| Less: accumulated depreciation | (190,367) | (76,482) | - | - | - | (266,849) |
| Net equipment and furnishings | 27,160 | 17,510 | - | - | - | 44,670 |
| **Total Assets** | $ 1,025,458 | $ 289,933 | $ 74,657 | $ 5,872,626 | $ (261,719) | $ 7,000,955 |

(Continued)

# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

## COMBINING STATEMENT OF FINANCIAL POSITION

DECEMBER 31, 2016
(Continued)

| **Liabilities and Net Assets** | PTHA | HPA | TFH | PRDF | Eliminations | Combined Total |
|---|---|---|---|---|---|---|
| Liabilities: | | | | | | |
| Current liabilities: | | | | | | |
| Accounts payable | $ 190,465 | $ 42,651 | $ 11,279 | $ - | $ - | $ 244,395 |
| Customer deposits | - | 11,107 | - | - | - | 11,107 |
| Due to Philadelphia Park | 277,529 | (3,777) | - | - | - | 273,752 |
| Intercompany payables | 9,888 | 225,588 | 6,683 | 19,560 | (261,719) | - |
| Accrued payroll | 7,022 | 3,668 | - | - | - | 10,690 |
| Other accrued expenses | - | 3,500 | - | - | - | 3,500 |
| Total current liabilities | 484,904 | 282,737 | 17,962 | 19,560 | (261,719) | 543,444 |
| Pennsylvania Race Horse Development Fund liabilities: | | | | | | |
| Accounts payable | - | - | - | 32,937 | - | 32,937 |
| Accrued purse payouts | - | - | - | 5,248,343 | - | 5,248,343 |
| Accrued employee and trainers pension funds | - | - | - | 421,034 | - | 421,034 |
| Other accrued expenses | - | - | - | 150,752 | - | 150,752 |
| Total Pennsylvania Race Horse Development Fund liabilities | - | - | - | 5,853,066 | - | 5,853,066 |
| Total liabilities | 484,904 | 282,737 | 17,962 | 5,872,626 | (261,719) | 6,396,510 |
| Net Assets | | | | | | |
| Unrestricted | 540,554 | 7,196 | 56,695 | - | - | 604,445 |
| **Total Liabilities and Net Assets** | $ 1,025,458 | $ 289,933 | $ 74,657 | $ 5,872,626 | $ (261,719) | $ 7,000,955 |

(Concluded)

# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

## COMBINING STATEMENT OF ACTIVITIES

YEAR ENDED DECEMBER 31, 2016

| | PTHA | HPA | TFH | Eliminations | Combined Total |
|---|---|---|---|---|---|
| **Unrestricted Revenues and Support:** | | | | | |
| Shares of wagering - per Live Racing Agreement | $ 1,399,833 | $ - | $ - | $ - | $ 1,399,833 |
| Contributions | 180,892 | - | 312,778 | (50,000) | 443,670 |
| Fundraising, net of direct expenses | - | - | 39,460 | - | 39,460 |
| Sale of merchandise | - | 2,904,041 | - | - | 2,904,041 |
| Interest on Horsemen's funds - Philadelphia Park | 14,051 | - | - | - | 14,051 |
| Broadcasting income | 37,800 | - | - | (14,000) | 23,800 |
| Miscellaneous income | 4,370 | 127 | 25 | - | 4,522 |
| Interest income | 17,121 | 105 | 128 | - | 17,354 |
| Realized and unrealized gain on investments | 4,985 | - | - | - | 4,985 |
| Total unrestricted revenues and support | 1,659,052 | 2,904,273 | 352,391 | (64,000) | 4,851,716 |
| **Expenses:** | | | | | |
| Program services: | | | | | |
| Horsemen's Advocacy Program | 1,920,676 | - | - | (50,000) | 1,870,676 |
| Horse Supplies Program | 25,348 | 2,891,516 | - | (14,000) | 2,902,864 |
| Backstretch Social Programs | 56,937 | - | - | - | 56,937 |
| Backstretch Healthcare Programs | 818 | - | - | - | 818 |
| Thoroughbred Horse Retirement Program | - | - | 399,334 | - | 399,334 |
| Total program services | 2,003,779 | 2,891,516 | 399,334 | (64,000) | 5,230,629 |
| Management and general | 89,103 | 30,869 | 22,941 | - | 142,913 |
| Total expenses | 2,092,882 | 2,922,385 | 422,275 | (64,000) | 5,373,542 |
| **Change in Net Assets** | (433,830) | (18,112) | (69,884) | - | (521,826) |
| **Net Assets:** | | | | | |
| Beginning of year | 974,384 | 25,308 | 126,579 | - | 1,126,271 |
| End of year | $ 540,554 | $ 7,196 | $ 56,695 | $ - | $ 604,445 |

# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

## COMBINING STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2016

| | PTHA | HPA | TFH | PRDF | Eliminations | Combined Total |
|---|---|---|---|---|---|---|
| **Cash Flows From Operating Activities:** | | | | | | |
| Change in net assets | $ (433,830) | $ (18,112) | $ (69,884) | $ - | $ - | $ (521,826) |
| Adjustments to reconcile change in assets to net cash used in operating activities: | | | | | | |
| Depreciation and amortization | 13,837 | 890 | - | - | - | 14,727 |
| Realized and unrealized gain on investments | (4,985) | - | - | - | - | (4,985) |
| Forgiveness of intercompany borrowing | 50,000 | - | (50,000) | - | - | - |
| Effects of changes in operating assets and liabilities: | | | | | | |
| Accounts receivable | (8,967) | (5,213) | - | - | - | (14,180) |
| Other receivables | (20,233) | - | (63,170) | - | - | (83,403) |
| Intercompany receivables | 81,793 | - | - | (7,490) | (74,303) | - |
| Inventory | - | (27,112) | - | - | - | (27,112) |
| Prepaid expenses | (10,978) | (1,574) | - | (12,070) | - | (24,622) |
| Accounts payable | 120,902 | 992 | (4,566) | - | - | 117,328 |
| Due to Philadelphia Park | 95,109 | (3,777) | - | - | - | 91,332 |
| Intercompany payables | 6,045 | (86,228) | 4,024 | 1,856 | 74,303 | - |
| Customer deposits | - | (2,616) | - | - | - | (2,616) |
| Accrued payroll | 1,440 | 1,434 | - | - | - | 2,874 |
| Other accrued expenses | - | - | - | 17,704 | - | 17,704 |
| Net cash used in operating activities | (109,867) | (141,316) | (183,596) | - | - | (434,779) |
| **Cash Flows From Investing Activities:** | | | | | | |
| Purchase of fixed assets | (8,185) | - | - | - | - | (8,185) |
| Proceeds from the sale of investments | 254,422 | - | - | - | - | 254,422 |
| Purchase of investments | (266,451) | - | - | - | - | (266,451) |
| Net cash used in investing activities | (20,214) | - | - | - | - | (20,214) |
| **Net Decrease in Cash and Cash Equivalents** | (130,081) | (141,316) | (183,596) | - | - | (454,993) |
| **Cash and Cash Equivalents:** | | | | | | |
| Beginning of year | 264,436 | 193,375 | 184,213 | - | - | 642,024 |
| End of year | $ 134,355 | $ 52,059 | $ 617 | $ - | $ - | $ 187,031 |

# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

## STATEMENT OF CASH RECEIPTS AND CASH DISBURSEMENTS AND CHANGES IN CASH BALANCES - PENNSYLVANIA RACEHORSE DEVELOPMENT FUNDS

PERIOD JANUARY 1, 2016 THROUGH DECEMBER 31, 2016

| | Purses | Contractual Agreement | Benefits | Total |
|---|---|---|---|---|
| Cash receipts: | | | | |
| Gaming funds - cash receipts | $ 43,170,953 | $ 1,329,731 | $ 3,358,985 | $ 47,859,669 |
| Promotional payback reduction | (2,322,003) | (71,815) | (129,450) | (2,523,268) |
| Interest earned | 9,299 | - | 9,787 | 19,086 |
| Total cash receipts | 40,858,249 | 1,257,916 | 3,239,322 | 45,355,487 |
| Other revenue (loss): | | | | |
| Unrealized gain on investments | - | - | 103,468 | 103,468 |
| Realized loss on investments | - | - | (56,865) | (56,865) |
| Dividends | - | - | 18,474 | 18,474 |
| Total other revenue (loss) | - | - | 65,077 | 65,077 |
| Cash disbursements: | | | | |
| Purse payments - Parx | (40,857,151) | - | - | (40,857,151) |
| Contractual disbursements | - | (1,257,916) | - | (1,257,916) |
| Health and welfare benefit disbursements | - | - | (3,128,211) | (3,128,211) |
| Administrative disbursements | - | - | (177,286) | (177,286) |
| Total cash disbursements | (40,857,151) | (1,257,916) | (3,305,497) | (45,420,564) |
| Changes in escrow balances | 1,098 | - | (1,098) | - |
| Escrow balance at January 1, 2016 | (2,064,939) | - | 2,064,939 | - |
| Escrow balance at December 31, 2016 | $ (2,063,841) | $ - | $ 2,063,841 | $ - |
| Reconciliation to Audited Financial Statements | | | | |
| Gaming funds - as reported above | $ 43,170,953 | $ 1,329,731 | $ 3,358,985 | $ 47,859,669 |
| Gaming funds, as reported in Note 3 to the audited financial statements | $ 43,170,953 | $ 1,329,731 | $ 3,358,985 | $ 47,859,669 |
| Purse payments - as reported above | $ (40,857,151) | $ (1,257,916) | $ - | $ (42,115,067) |
| Purse payments, as reported in Note 3 to the audited financial statements | $ (40,857,151) | $ (1,257,916) | $ - | $ (42,115,067) |
| Health and welfare benefit payments - as reported above | $ - | $ - | $ (3,305,497) | $ (3,305,497) |
| Health and welfare benefit payments - as reported in Note 3 to the audited financial statements | $ - | $ - | $ (3,305,497) | $ (3,305,497) |

See accompanying notes to the statement of cash receipts and cash disbursments and changes in cash balances.

# PENNSYLVANIA THOROUGHBRED HORSEMEN'S ASSOCIATION, INC.

## SCHEDULE OF ADMINISTRATIVE EXPENSES

DECEMBER 31, 2016

| | Date | Amount | Description |
|---|---|---|---|
| PTHA, Inc. | 12/31/2016 | $ 19,560 | Accounting fees |
| Monthly accrual | 1/4/2016 | 1,667 | Audit fee accrual |
| Monthly accrual | 2/4/2016 | 1,667 | Audit fee accrual |
| Monthly accrual | 3/4/2016 | 1,666 | Audit fee accrual |
| Monthly accrual | 4/4/2016 | 1,667 | Audit fee accrual |
| Monthly accrual | 5/4/2016 | 1,667 | Audit fee accrual |
| Monthly accrual | 6/4/2016 | 1,666 | Audit fee accrual |
| Herbein + Company, Inc. | 6/30/2016 | 1,770 | Audit fee accrual |
| Monthly accrual | 7/4/2016 | 1,667 | Audit fee accrual |
| Monthly accrual | 8/4/2016 | 1,667 | Audit fee accrual |
| Monthly accrual | 9/4/2016 | 1,666 | Audit fee accrual |
| Monthly accrual | 10/4/2016 | 1,667 | Audit fee accrual |
| Monthly accrual | 11/4/2016 | 1,667 | Audit fee accrual |
| Monthly accrual | 12/4/2016 | 1,666 | Audit fee accrual |
| Herbein + Company, Inc. | 12/27/2016 | 3,569 | Audit fee accrual |
| Bank service charges | Total for 2016 | 660 | Bank service charges |
| Investment service charges | 10/1/2016 | 7,544 | Advisory fees - Morgan Stanley |
| Herbein audit adjustments | 12/31/2016 | 2,652 | Advisory fees - Morgan Stanley |
| Simon, Edward G. | 2/22/2016 | 5,750 | Consultant |
| Simon, Edward G. | 3/1/2016 | 2,875 | Consultant |
| Simon, Edward G. | 3/31/2016 | 4,625 | Consultant |
| Simon, Edward G. | 4/30/2016 | 4,750 | Consultant |
| Simon, Edward G. | 6/1/2016 | 4,000 | Consultant |
| Simon, Edward G. | 6/30/2016 | 5,000 | Consultant |
| Simon, Edward G. | 8/5/2016 | 5,500 | Consultant |
| Simon, Edward G. | 9/1/2016 | 5,250 | Consultant |
| Simon, Edward G. | 9/30/2016 | 4,750 | Consultant |
| Simon, Edward G. | 11/14/2016 | 4,125 | Consultant |
| Simon, Edward G. | 12/3/2016 | 4,875 | Consultant |
| Simon, Edward G. | 12/31/2016 | 5,625 | Consultant |
| Correct misposting of interest income | 1/1/2016 | (40) | Misc expenses |
| Foster, William B. (SE Benevolence) | 1/26/2016 | 3,000 | Misc expenses |
| Herbein audit adjustments | 12/31/2016 | 25,446 | Misc expenses |
| 1st quarter accrual | 3/31/2016 | 8,500 | State audit fee accrual |
| 2nd quarter accrual | 6/6/2016 | 8,500 | State audit fee accrual |
| Adjust accrual | 12/31/2016 | 19,000 | State audit fee accrual |
| Administrative expenses at December 31, 2016 | | $ 177,286 | |

## 1. Basis of Presentation

The accompanying statement of cash receipts and cash disbursements and changes in cash balances includes the Pennsylvania Race Horse Development Fund activity of the Pennsylvania Thoroughbred Horsemen's Association (Association) and is presented on the cash basis of accounting. The information in this schedule 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 schedule 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. Approximately two weeks after the Casino has received the Pennsylvania Racehorse Development Funds, amounts are wired to the Association into their Pennsylvania Racehorse Development Fund Division.

The Funds are wired into a clearing account at the Association. From this account, management of the Association transmits the Pennsylvania Racehorse Development Funds into four (4) separate accounts:

- Purses – Overnight
- Purses – Stakes
- Contractual Agreement
- Health and Benefit

A statistician contracted by the Association sends an email to the Association staff indicating the amounts of funds to transfer to Parx Racing each week for the various purses paid. The Association also receives an email from the racetrack officials stating how much money is needed each week for purses. The Association compares the two before the monies are sent. Health and welfare disbursements are made directly by the Association based on the invoices received.

Management of the Association determines the portion of the Race Horse Development Funds to transfer to Parx Racing for purse purposes based on the estimate provided by Parx Racing. The frequency of purse payments is dependent upon the established racing schedules. The Association maintains schedules detailing all purse fund payments. The purse payments are reconciled to the actual purses paid by Parx Racing by both Parx Racing and the Association's consultants. Health disbursements are made directly to the carriers based on invoiced amounts.

# Pennsylvania Thoroughbred Horsemen’s Association, Inc.

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

Year Ended December 31, 2016

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Certified Public Accountants

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# 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 Thoroughbred Horsemen's Association, Inc.

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 combined financial statements (financial statements) of the Pennsylvania Thoroughbred Horsemen's Association, Inc. (Association), which comprise the combined statement of financial position as of December 31, 2016, and the related combined statements of activities and cash flows for the year then ended, and the related notes to the combined financial statements, and have issued our report thereon dated January 23, 2018. Our report includes reference to another report on the Association's financial statements. The financial statements of the Pennsylvania Race Horse Development Fund Division of the Pennsylvania Thoroughbred Horsemen's Association, Inc. (PRDF) funds were not audited in accordance with *Government Auditing Standards.*

## 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses as items 2016-001, 2016-002, and 2016-003 that we consider to be material weaknesses.

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. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses as items 2016-004 and 2016-005 that we consider to be significant deficiencies.

**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*.

**The Association's Response to Findings**

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

**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 organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Maher Duessel*

Harrisburg, Pennsylvania
January 23, 2018

***Material Weaknesses***

**Finding 2016-001: Lack of Support for Cash Disbursements**

*Condition:* During testing, we noted that the Pennsylvania Thoroughbred Horsemen's Association, Inc. (Association) could not provide support documentation for all transactions charged to three company credit cards. Missing receipts totaled approximately $11,800. These expenses were recorded as Association activity and not Pennsylvania Race Horse Development Fund (PRDF) activity.

Additionally, we could not determine the business purposes of other charges including hotel spa services, non-itemized meal receipts over $100, and travel expenses of spouses.

*Criteria:* Organizations should maintain support for all transactions recorded in the accounting records. Only necessary and reasonable business-related expenses should be charged.

*Cause:* The Association does not have policies and procedures in place that require the submission of support documentation prior to payment of credit cards. Propriety of credit card charges is not reviewed.

*Effect:* Certain amounts paid by the Association are unsubstantiated and may not be business-related.

*Recommendation:* We recommend that the Association obtain support documentation for all credit card transactions prior to payment, and that documentation be maintained for all cash disbursements. We also recommend that the Association develop a formalized credit card policy.

*Management's Response:* Management acknowledges that it could not produce documentation for credit card receipts totaling $11,800. In the scope of the Association's total expenses, this does not appear to be a material deficiency. In any event, the Association has already implemented controls to ensure that all credit card charges are properly documented.

Management disagrees with this Finding with respect to MD's note that it could not determine the business purpose of certain charges related to hotels, meals and other related expenses, including for spouses. It is the Association's understanding that these charges all relate to attendance by Association representatives at conferences and similar industry events which include social functions attended by many other horsemen's association members with spouses. Accordingly, the Association maintains a policy which allows spouses to travel with

Association representatives for approved Association business, including attendance at functions at which spouses/significant others are invited and regularly attend, and provides for reimbursement of related expenses.

*Auditor's Response:* The Internal Revenue Service (IRS) defines taxable benefits at Regulation 1.132-5(t)(1). These regulations define when spousal travel should be treated as income based on whether it is a bonafide business purpose. Based on the response above, the amounts paid for spousal travel were taxable. Documentation supporting that these amounts were handled properly by PTHA was requested, but not supplied.

**Finding 2016-002: Segregation of Duties**

*Condition:* The Program Administrator of Turning for Home, Inc. (TFH) receives, deposits, and records in the general ledger all cash receipts received on behalf of TFH.

The Controller receives all bank statements directly, prepares all bank reconciliations, and is an authorized check signer. No review of bank reconciliations is conducted.

*Criteria:* The Internal Control Integrated Framework (COSO report) describes that adequate segregation of duties is necessary to ensure that transactions are properly recorded and reduce the risk that errors will be undetected.

*Cause:* The Association did not have policies and procedures in place to ensure that TFH cash receipts were properly recorded, and that bank reconciliations were properly and accurately prepared.

*Effect:* This 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.

*Recommendation:* We recommend that an employee other than the Program Director of TFH maintain a listing of all cash receipts received on behalf of TFH prior to their deposit in the bank and posting in the general ledger. This listing should then be reconciled to the general ledger on a monthly basis by the individual preparing the listing.

Additionally, we recommend that bank statements be received directly by the Executive Director, and that these statements be reviewed prior to providing the statements to the Controller for reconciliation. Upon completion of the bank reconciliation, we recommend that it be reviewed by a knowledgeable member of the Association's Board of Directors (Board).

*Management's Response:* Management disagrees with MD's comment as to the handling of Turning for Home's cash receipts by the Program Administrator. As a result of a 2015 audit finding, the Association implemented additional internal controls.

As to bank reconciliations, the Association has hired an assistant to the Controller starting in July 2017. The Assistant now performs all bank reconditions. Once completed, the reconciliations are given to the Controller for approval. All approved bank reconciliations are initialed by both the preparer and the Controller.

*Auditor's Response:* We have reviewed management's response above and note that the prior year audit Finding 2015-002: Segregation of Duties, was not issued until October 18, 2016. As a result, additional internal controls related to TFH were not implemented for at least 10 months of the year ended December 31, 2016.

**Finding 2016-003: Political Action Committee Activity**

*Condition:* The activities of the Pennsylvania Thoroughbred Horsemen's Association Political Action Committee (PAC) are not included in the combined financial statements of the Association.

Individual contributions are transferred to a separate cash account prior to spending. This activity and the corresponding cash account is not included on the Association's financial statements.

We also became aware during current year audit procedures, that a separate PAC trial balance was available for the prior year.

*Criteria:* Accounting principles generally accepted in the United States of America (GAAP) require a non-profit organization to combine the activities of another entity when the non-profit organization has an economic interest in and control of the other entity.
*Cause:* The Association was not aware of GAAP reporting requirements surrounding PACs.

*Effect:* The Association's combined financial statements are understated, as they do not include the activity and accounts of the PAC. This resulted in the qualification of opinion.

*Recommendation:* We recommend that the Association combine and include the activities of the PAC in the financial statements of the Association.

*Management's Response:* PTHA objects to Finding No. 2016-003, in which MD states that PTHA failed to include the activities of PTHA's Political Action Committee (PAC) in PTHA's consolidated financial statements.

We have reviewed the AICPA guidance document supplied by MD as the basis for this Finding, 3.69 Technical Questions and Answers, Section 6140.10 addressing "Consolidation of Political Action Committee." This guidance states that consolidation of PAC activities is required where "the PAC holds significant resources that must be used for the purposes of the membership entity." (Emphasis added).

This standard – one of materiality – plainly is not met here. The PAC does not hold "significant resources." In 2016, PAC receipts were $43,040 and PAC expenditures were $68,500. The PAC balance as of December 31, 2016, was $55,180. By any objective standard, whether viewed on its own or in the context of a balance sheet showing total assets of approximately $7 million, the PAC's activity is neither significant nor material.

This is conclusively demonstrated by the fact that neither MD nor any prior auditor made any findings in this regard, despite comparable (and even greater) PAC activity and resources in the past. For example, in 2015, PAC receipts were substantially greater ($104,250) and expenses were comparable ($59,500). The PAC balance as of December 31, 2015, was $80,214.11 – almost 50% greater than the balance as of December 31, 2016. MD made no finding with respect to consolidation of PAC activity.

Likewise, in 2014, PAC receipts ($132,286) and expenses ($119,150) were both far greater than 2016; the PAC balance as of December 31, 2014 was $27,954.11. The prior auditor, CliftonLarsonAllen (CLA), made no finding.

PTHA requests that that this Finding be removed for these reasons. To the extent MD insists on including this Finding, PTHA requests that MD explain the standard under which this Finding can be reconciled with the lack of any such finding in prior years. We also expect that, if MD insists on including this Finding, you will contact Mr. Colucci to discuss how this information is presented in the financial statements.

*Auditor's Response:* The AICPA guidance, 3.69 Technical Questions and Answers, Section 6140.10 addressing "Consolidation of Political Action Committee," states that consolidation of PAC activities is required where "the PAC holds significant resources that must be used for the purposes of the membership entity."

During the current year audit, previously undisclosed PAC transactions were provided for both the year ended December 31, 2016 and 2015. This PAC activity meets the definition in Section 6141.10 above. The transactions are not included in the Association's accounting records and were not made available during the 2015 audit. As noted in the Auditor's Updated Opinion on 2015 Combined Financial Statements, included in the Independent Auditor's Report, the prior year audit opinion was modified based upon the newly disclosed information. This activity is considered material to the 2015 and 2016 financial statements and the 2016 Independent Auditor's Report was also modified.

***Significant Deficiencies***

**Finding 2016-004: Comingling of Pennsylvania Race Horse Development Funds**

*Condition:* The Association allocates 3% of purse monies of the PRDF under the terms of the Live Racing Agreement to the Association for general uses (known as contractual agreement funds). Those disbursements are for purposes other than purses and are maintained in the Association's general checking account. This is inconsistent with current code, which requires this type of activity to be kept separate.

*Criteria:* Per PA Code 436.a.5, fiduciaries shall ensure that the funds received for the benefit of the horsemen are distributed pursuant to the act. Per 4 PA.C.S.A. §1406(a)(2.1)(iii), eighty-three and one-third percent of the money to be distributed under this clause shall be deposited on a weekly basis into a separate, interest-bearing purse account to be established by and for the benefit of the horsemen. The earned interest on the account shall be credited to the purse account. Licensees shall combine these funds with revenues from existing purse agreements to fund purses for live races consistent with those agreements with the advice and consent of the horsemen.

*Cause:* The Association has entered into a Live Racing Agreement that is not in compliance with PRDF disbursement and distribution requirements.

*Effect:* Noncompliance with PRDF distribution regulations.

*Recommendation:* We recommend that management amend the Live Racing Agreement to ensure compliance with state requirements.

*Management's Response:* PTHA strongly objects to Finding 2016-004. This is the same objection we expressed in connection with your audit report for the year ending December 31, 2015, as well as with respect to audit reports issued by prior auditors as directed by the Department of Agriculture or Office of the Budget pursuant to the Fiscal Code.

MD states that the PTHA is not in compliance with PRDF "disbursement and distribution regulations" because 3% of purse monies are allocated to fund PTHA pursuant to PTHA's

Live Racing Agreement with the operator. Specifically, MD concludes that PTHA "entered into a Live Racing Agreement that is not in compliance" with those regulations and recommends that the Live Racing Agreement be amended to ensure compliance.

PTHA strongly disagrees with this entirely legal conclusion, which MD continues to assert, just as its predecessors did year-after-year, without any justification.

In fact, Act 71 reflects a legislative endorsement of the horsemen's collective, voluntary, and private decision to fund their designated statutory representative through a percentage of the purses they win – a decision which has been negotiated with and agreed to by the licensees, as embodied in the Live Racing Agreements. This is precisely why Act 71 states that "Licensees shall combine these [PRDF] funds with revenues from existing purse agreements to fund purses for live races consistent with those agreements with the advice and consent of the horsemen." 4 PA.C.S.A. § 1406(a)(1)(i). There is no contrary authority in Act 71 or the applicable regulations, and MD does not provide any. MD's recommendation that PTHA amend the Live Racing Agreement reflects a fundamental lack of understanding of both Act 71 and the nature of the Live Racing Agreement itself, which is an agreement between PTHA and the operator.

Again, this is not the first time this issue has been addressed in the context of a Fiscal Code audit. This same issue was first vetted and resolved in the context of the PRDF audit conducted pursuant to the Fiscal Code for the year ending December 31, 2010, under the auspices of the Department of Agriculture. Specifically responding after the Fiscal Code auditors raised this same issue (and addressing the details of PTHA's Live Racing Agreement), we noted: "[T]he 3% of PRDF-originated purse revenues, which PTHA's members voluntarily agree to use to fund the operations of the organization, are akin to membership dues, and not distributions to PTHA from PRDF." The Department of Agriculture and the auditors agreed that there is no violation of Act 71 – there was no reference to this whatsoever in the Fiscal Code audit report for the year ended December 31, 2010.

Subsequent auditors (McKonly &Asbury) nonetheless raised the same issue during the Fiscal Code audit for the year ended December 31, 2011, and refused to delete their finding of a violation in response to PTHA's objection. When pressed during the exit interview, McKonly & Asbury agreed that this was a legal judgment, that there is conflicting authority on which PTHA relies and, worse, that they only included this "Finding" based on an instruction by counsel for the Office of the Budget.

CLA raised this same issue for three years without addressing the substance of PTHA's objection, and now MD has done the same thing.

It is telling that there has been no claim or other action taken against PTHA based on this purported violation of Act 71, even though it has been alleged in multiple statutory audit reports that are prepared and distributed pursuant to the Fiscal Code. This Finding should be removed from the report. If MD refuses to remove this Finding, we request that MD provide legal authority for the statement that PTHA is in violation of the law and, if this Finding has been included at the instruction of the Office of the Budget, that MD should so state. The Fiscal Code requires that the Office of the Budget engage independent accountants to perform these audits. If any aspect of MD's report reflects a determination or instruction by the Office of the Budget, it is critical that this is plainly disclosed.

**Finding 2016-005: Permitting of Officers**

*Condition:* Three of the members of the Association's Board are not registered with the Pennsylvania Gaming Control Board (PGCB). Of the three, one member has not completed the application and the other two are pending approval.

*Criteria:* Chapter 436a, Section 436a.3, requires that all representatives be permitted with the PGCB.

*Cause:* The Association does not have an established control to ensure compliance with Section 436a.3, permitting requirements of the PGCB.

*Effect:* The Association is not in compliance with 436a.3.

*Recommendation:* We recommend that management develop procedures and controls to ensure all members of the Board have appropriate permits with the PGCB.

*Management's Response:* Management understands that the statute requires every officer, director or representative who is authorized to act on behalf of the Association to be permitted by PGCB, and acknowledges the importance of prompt compliance.

The Condition states that "three of the members of the Association's Board are not registered with the Pennsylvania Gaming Control Board. Of the three, one member has not completed the application and the other two are pending approval." As an initial point, we believe it important to clarify this. Two of these individuals were asked by PGCB for additional information or clarification of the information previously submitted. One of those two had their license renewed in October, 2017, and one has been asked to contact the PGBC for further clarifications. The third person has apparently moved out of the country and is difficult to contact.

The Association has existing procedures in place to ensure compliance. All Board candidates are given a "Director Candidate Affidavit" form for their completion. The form requires their signature and informs the candidate of PGCB licensing requirements, including future renewals. When PGCB notifies the Association that a Board member is coming up for renewal, the Association's Secretary promptly notifies the individual, provides information on how to complete the process on PGCB's website and offers the Association's assistance as necessary. Once the Board member notifies the Association's Secretary that the application has been completed, the Association remits the required fee to PGCB.

In light of this Finding, the Association will further strengthen these procedures. A form similar to the current "Director Candidate Affidavit" will be given to all individuals subject to PGCB licensing. The Association will also make clear that any individual's failure to sign the Affidavit form will result in ineligibility to represent the Association (or stand for election in the case of a Board candidate). The Board will also consider additional disciplinary actions in cases as appropriate where an individual fails or refuses to comply on a timely basis.