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SPECIAL REPORT

THE USE OF STATE DIRECTED FUNDS BY THE HORSEMEN'S BENEVOLENT AND PROTECTIVE ASSOCIATIONS

AUDIT OVERVIEW

The Charles Town and Mountaineer Horsemen's Benevolent and Protective Associations Are Using State Directed Funds to Assist in Paying for General Operating Costs and Expenses Such as Lobbying, Although the Funds Were Directed by Statute for Administering the Medical Trusts of Backstretch Personnel



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EXECUTIVE SUMMARY

This Special Report on the use of state directed funds by the Horsemen's Benevolent and Protective Associations (HBPA) is authorized by West Virginia Code §4-2-5 and examines the statutory language directing funds to the HBPA's associated with the State's two thoroughbred racetracks. West Virginia Code §19-23-9(b)(1) allows for up to two percent of purses paid at Mountaineer Park Racetrack and Charles Town Races to be disbursed to the local HBPA for its medical trusts for backstretch personnel and administrative fees. This report contains the following issue.

Report Highlights:

The Charles Town and Mountaineer Horsemen's Benevolent and Protective Associations Are Using State Directed Funds to Assist in Paying for General Operating Costs and Expenses Such as Lobbying, Although the Funds Were Directed by Statute for Administering the Medical Trusts of Backstretch Personnel.

- For the years examined, 2007-2009, Charles Town HBPA allocated 75 percent (\$1.79 million) of the funds received from purses to its administrative account and the remaining 25 percent (\$595,224) to the medical trust, while Mountaineer allocated 25 percent (\$437,457) to its administrative account and 75 percent (\$1.3 million) to the medical trust.
- The Legislative Auditor is concerned that state directed funds intended to benefit the backstretch personnel are also being used for lobbying, legislative travel and other expenses clearly outside legislative intent.
- It is clear that both HBPA's rely on state directed funds to not only carry out functions related to the medical trust, but also to operate in general. During the time period examined, it is also important to note that for both associations, revenue from other sources has decreased steadily and at a significant amount. With the yearly decrease in revenue from other sources, the statutorily directed funds from purses are representing a larger percentage of total revenue for the administrative accounts of the HBPA's.
- The disparity between the amount of purse revenue allocated to each HBPA's respective administrative and medical trust accounts is a product of the ambiguity of the term "administrative fees" in the enabling statute. If the term "administrative fees" was well defined in this instance

it would provide clarity as to whether the funds were being expended appropriately.

- The Legislative Auditor is of the opinion that the Legislature or the West Virginia Racing Commission consider; (1) defining “administrative fees,” (2) establishing a maximum percentage of funds that can be used for administrative fees, (3) increasing oversight, (4) requiring that state directed funds be kept in a separate account and (5) requiring the HBPA's to submit annual independent audits to the Racing Commission.

Recommendations

1) *The Legislative Auditor recommends that the Legislature or the West Virginia Racing Commission consider defining administrative fees for the purpose of this section.*

2) *The Legislative Auditor recommends that any definition of administrative fees explicitly state that fees can not include lobbying expenses, lobbying travel expenses, charitable donations, and other expenses that are clearly outside administering the medical trust funds for backstretch personnel.*

3) *The Legislative Auditor recommends that the Legislature consider establishing a maximum percentage of funds directed by §19-23-9(b)(1) that can be used for administrative fees.*

4) *The Legislative Auditor recommends that the Legislature consider requiring the West Virginia Racing Commission to increase its oversight function for the state directed funds provided to the HBPA's from racetrack purses.*

5) *The Legislative Auditor recommends that the Charles Town and the Mountaineer Horsemen Benevolent Protective Associations be required to separate revenue received from the racetracks for the medical trusts from other sources of revenue.*

6) *The Legislative Auditor recommends that the Charles Town and the Mountaineer Horsemen Benevolent Protective Associations be required to submit annual, independent audits of the expenditure of funds received from the racetracks for the medical trusts for backstretch personnel.*

ISSUE 1

The Charles Town and Mountaineer Horsemen’s Benevolent and Protective Associations Are Using State Directed Funds to Assist in Paying for General Operating Costs and Expenses Such as Lobbying, Although the Funds Were Directed by Statute for Administering the Medical Trusts of Backstretch Personnel.

Issue Summary

West Virginia Code authorizes the operators of the State’s two thoroughbred racetracks to pay a specific amount of purses to the local affiliates of the national Horsemen’s Benevolent and Protective Association (HBPA). Funds are to be used for the respective medical trusts for track backstretch personnel, and administrative fees. The Charles Town HBPA allocates 75 percent of the purse funds to its administrative fund and 25 percent to its medical trust. Conversely, Mountaineer HBPA allocates 25 percent to its administrative account and 75 percent to its medical trust. Statute does not define administrative fees, thus there are no criteria stating how much funds should be expended for the administrative expenses of the HBPA’s. Analysis shows that both HBPA’s are using the racetrack purse funds for administrative purposes outside of administering the medical trusts. For the Mountaineer HBPA, an annual average of 51 percent of its administrative funds are from the racetrack purses, and for the Charles Town HBPA, an annual average of 90 percent of its administrative funds are from racetrack purses. Thus, state directed racetrack purse revenue, especially in the case of the Charles Town HBPA, clearly assist the HBPA’s in not only administering the medical trusts, but assist in funding other HBPA activities such as lobbying. As a result, that the Legislative Auditor is of the opinion that the Legislature or the West Virginia Racing Commission consider (1) defining “administrative fees,” (2) establishing a maximum percentage of funds that can be used for administrative fees, (3) increasing oversight, (4) requiring that state directed funds be kept in a separate account and (5) requiring the HBPA’s to submit annual independent audits to the Racing Commission.

Two Percent of Thoroughbred Horse Racing Purses Are Paid to Two Local Horsemen's Benevolent and Protective Associations by Mountaineer Park and Charles Town Races

West Virginia Code §19-23-9(b)(1) authorizes the operators of the State's two thoroughbred racetracks to pay up to two percent of purses to the local affiliates of the national Horsemen's Benevolent and Protective Association (HBPA). Specifically, WVC states that:

*Each thoroughbred racetrack licensee is authorized to enter into an agreement with its local Horsemen's Benevolent and Protective Association under which an agreed upon percentage of up to two percent of purses actually paid during the preceding month may be paid to the local Horsemen's Benevolent and Protective Association from the special fund required by this section for their **respective medical trusts for backstretch personnel and administrative fees.** (emphasis added)*

HBPA's both promote the industry of horseracing and engage in political advocacy. This is evident by the fact that both Mountaineer and Charles Town HBPA's have incurred a total of \$159,109 in lobbying expenses.

Thoroughbred racing is conducted at Mountaineer Park Racetrack, located in Chester, WV, and Charles Town Races, located in Charles Town, WV. Each of these racetracks have entered into an agreement with an HBPA affiliate established specifically to represent the horsemen of Mountaineer Park and Charles Town Races. The Mountaineer and Charles Town HBPA's are 2 of 31 affiliates of the National HBPA.

State Directed Dollars are Intended to Benefit the Medical Trusts of Backstretch Personnel Working at Mountaineer Park and Charles Town Races

The HBPA's are private, non-profit entities that represent owners and trainers of horses. The HBPA's negotiate collectively on behalf of their members with racetracks regarding issues like working conditions, scheduling, and safety issues. Also, HBPA's both promote the industry of horseracing and engage in political advocacy. This is evident by the fact that both Mountaineer and Charles Town HBPA's have incurred a total of \$159,109 in lobbying expenses for the years examined. The form of assistance to backstretch personnel referred to in statute is the operation of a medical trust. Backstretch personnel include individuals

at racetracks such as exercise riders, trainers, grooms, stable forepersons, etc. Backstretch personnel are not employees of the tracks, but work for owners of the horses that race at the track. The HBPA's use this trust to help defray the cost of medical related expenses incurred by backstretch personnel. Based on the applications, these benefit trusts are intended to be utilized in conjunction with a primary insurer, whether that be an insurance company or Medicare. Through conversations with backstretch personnel, the Legislative Auditor determined that this program does represent the only form of health coverage for some members. The respective medical trusts cover, to a certain limit for each, medical, dental, vision, audiology, chiropractic, and prescriptions. In order to be eligible, the HBPA's require that the backstretch employee be stabled at the track for an initial period of time, and then at least 75 percent of the member's starts must be at his or her respective racetrack.

Through conversations with backstretch personnel, the Legislative Auditor determined that this program does represent the only form of health coverage for some members.

Charles Town Allocates 75 Percent of the Funds Received from Purses to Its Administrative Account and the Remaining 25 Percent to the Medical Trust, While Mountaineer Allocates 25 Percent to Its Administrative Account and 75 Percent to the Medical Trust

West Virginia Code allows each racetrack to provide up to two percent of purses paid to its local HBPA, and in both instances, the entire two percent is distributed. What varies, however, is the manner in which each HBPA allocates those dollars between its administrative account and the medical trust account. Mountaineer and Charles Town HBPA's operate separate accounts and employ separate staff for these two functions. The Legislative Auditor analyzed two independent accountants' reports on applying Agreed-upon Procedures conducted for the West Virginia Lottery Commission. These reports were conducted by Suttle and Stalnaker for 2007-2009 and the financial statements for the HBPA's were included as attachments to the reports.

Charles Town Races and the Charles Town HBPA have a fund distribution arrangement where 1.5 percent of the 2 percent total is deposited into the Charles Town HBPA's administrative fund and the remaining 0.5 percent into the medical trust.

Charles Town Races and the Charles Town HBPA have a fund distribution arrangement where 1.5 percent of the 2 percent total is deposited into the Charles Town HBPA's administrative fund and the remaining 0.5 percent into the medical trust. These payments are to be made at the end of each month based on the actual racetrack purses paid. Table 1 shows how the Charles Town HBPA allocated its two percent of purse payments between the medical trust and administrative account.

Table 1 Charles Town HBPA Allocation of Racetrack Purses 2007-2009								
	2007		2008		2009		Total	
Medical Trust	\$182,849	25%	\$205,685	25%	\$206,690	25%	\$595,224	25%
Administrative	548,547	75%	617,053	75%	620,072	75%	1,785,672	75%
Total Allocation	\$731,396		\$822,738		\$826,762		\$2,380,896	

Source: Suttle & Stalnaker Independent Accountants' Report on Applying Agreed Upon Procedures, Performed for WV Lottery Commission

As shown, for the three year period, a total of \$1.79 million has been deposited into the administrative account, averaging \$595,224 per year. For the same time frame, the average yearly contribution to the medical trust account was \$198,408 and totaled \$595,224.

Mountaineer Park and its HBPA have an opposite fund distribution relationship when compared to Charles Town Races and the Charles Town HBPA. In Mountaineer's case, 0.5 percent of the total 2 percent distributed by the racetrack to the HBPA is allocated to the administrative fund. The remaining 1.5 percent is deposited into the medical trust. Table 2 illustrates the contrast in Mountaineer's allocation of purse payments as compared to the Charlestown HBPA.

In Mountaineer's case, 0.5 percent of the total 2 percent distributed by the racetrack to the HBPA is allocated to the administrative fund. The remaining 1.5 percent is deposited into the medical trust.

Table 2 Mountaineer Park HBPA Allocation of Racetrack Purses Years 2007-2009								
	2007		2008		2009		Total	
Medical Trust	\$432,225	75%	\$455,604	75%	\$424,542	75%	\$1,312,371	75%
Administrative	144,075	25%	151,868	25%	141,514	25%	437,457	25%
Total Allocation	\$576,300		\$607,472		\$566,056		\$1,749,828	

Source: Suttle & Stalnaker Independent Accountants' Report on Applying Agreed Upon Procedures, Performed for WV Lottery Commission

As shown, for the three year period a total of over \$1.3 million has been deposited into the medical trust. For the same time frame, the average yearly contribution to the administrative account was \$145,819 and totaled \$437,457.

The Legislative Auditor examined HBPA financial statements included with the independent accountants' report to determine the extent to which the state directed funds provided by the racetracks are funding the administrative accounts of the HBPA's. Using the numbers provided in tables 1 and 2, the purse contribution allocated to the administrative funds by the racetracks was compared to the stated total income on the financial statements. Table 3 shows that in both cases, a significant portion of the administrative accounts for the HBPA's are funded by state directed dollars. For the Mountaineer HBPA, an annual average of 51 percent of its administrative funds are from the racetrack purses, and for the Charles Town HBPA, an annual average of 90 percent of its administrative funds are from racetrack purses. Thus, state directed racetrack purse revenue, especially in the case of the Charles Town HBPA, clearly assists the HBPA's in operating.

For the Mountaineer HBPA, an annual average of 51 percent of its administrative funds are from the racetrack purses, and for the Charles Town HBPA, an annual average of 90 percent of its administrative funds are from racetrack purses.

Table 3
Sources of Revenue For HBPA Administrative Accounts
(2007 – 2009)

	<u>Mountaineer - HBPA Admin.</u>				<u>Charlestown - HBPA Admin.</u>			
	Purses \$	Other \$	Total \$	% Purse	Purses \$	Other \$	Total \$	% Purse
2007	144,075	238,339	382,414	38%	548,547	80,288	628,835	87%
2008	151,868	138,142	290,010	52%	617,053	75,268	692,321	89%
2009	141,514	46,758	188,272	75%	620,072	40,757	660,829	94%
Total	437,457	423,238	860,695	51%	1,785,672	196,313	1,981,985	90%

Source: Suttle & Stalnaker Independent Accountants' Report on Applying Agreed Upon Procedures, Performed for WV Lottery Commission

Given this disparity in administrative funding, it is apparent that any amount of funds received from thoroughbred purses can be used for administrative expenses so long as the racetrack and the HBPA come to a formal agreement. **Based on the statutory language there is no limit to the amount of funds the HBPA's may allocate to administration.** Due to the fact that the HBPA's perform functions other than administering their respective medical trusts, and that the trust accounts normally incur some amount of administrative costs themselves, **it is the Legislative Auditor's opinion that funding the administrative accounts of the HBPA's at this level may not be the intent of the Legislature.** It is, however, important to note that according to the HBPA's, qualified members have not been denied payment for medical services due to insufficient funds in either of the HBPA's medical trusts.

Based on the statutory language there is no limit to the amount of funds the HBPA's may allocate to administration.

The Legislative Auditor Is Concerned That State Directed Funds Intended to Benefit the Backstretch Personnel Are Also Being Used for Lobbying, Legislative Travel and Other Expenses Clearly Outside Legislative Intent

The state directed funds received from the racetracks make up a substantial percentage of the HBPA's revenue. In the case of Charles Town, this percentage ranges from 87 to 94 percent, while Mountaineer's administrative account ranges from 38 to 75 percent. In an effort to determine how these funds were being spent, the Legislative Auditor analyzed the HBPA's financial statements and general ledgers that were provided to the West Virginia Lottery Commission as part of the two Independent Accountant's Reports.

State directed funds are not kept separate from other revenue received by the HBPA's. Given that administrative account revenue is not segregated from purse revenue, the Legislative Auditor utilized a comparison of revenue from other sources to specific expenditures that clearly do not fit the definition of administrative fees, as it relates to the operation of a medical trust for backstretch personnel. The HBPA's other income generally comes in the form of interest on various bank accounts or CDs, reimbursements, and a few other sources. **The line items the Legislative Auditor identified as clearly being outside of the Legislature's intent were lobbying, lobbying travel, charities/donations, race track chaplaincy, and advertising/public relations.**

These five categories were chosen based on their relationship, or lack thereof, to the benefit of backstretch personnel through the operation of a medical trust. In the cases of lobbying and lobbying travel, it is reasonable to conclude that the Legislature would not intend for state directed dollars to be spent for these purposes. Charities, while a benevolent cause, are included in this analysis as well because the donations do not directly benefit the backstretch personnel through the operation of a medical trust. Donations in this category were made to organizations/causes such as cystic fibrosis, free clinics, 4-H, Special Olympics, Boys and Girls Club, fire and police organizations, American Cancer Society, etc. Similarly, the Racetrack Chaplaincy category is most likely a worthy cause and does benefit the backstretch personnel through "providing with excellence for the spiritual, emotional, physical and social/educational needs of horse racing vast workforce." But given that it is a program all its own, it relates neither to the operation of a medical trust for backstretch personnel or administrative fees incurred therein.

The line items the Legislative Auditor identified as clearly being outside of the Legislature's intent were lobbying, legislative travel, charities/donations, race track chaplaincy, and advertising/public relations.

These five categories were chosen based on their relationship, or lack thereof, to the benefit of backstretch personnel through the operation of a medical trust. In the cases of lobbying and lobbying travel, it is reasonable to conclude that the Legislature would not intend for state directed dollars to be spent for these purposes.

Advertising and public relations were also identified in this list due to the fact that such expenditures do not expressly benefit the backstretch.

Once the Legislative Auditor established that these expense categories are clearly outside the scope of administering a medical trust for backstretch personnel, HBPA revenue from other sources was then examined. **Essentially, if the dollar amount of expenditures in these categories meets or exceeds the total revenue from other sources, then state directed funds are by default being used for purposes clearly outside of the Legislature's intent.** A detailed discussion of expenditures unrelated to the administration of the medical trusts follows for both HBPA's.

Charles Town HBPA

As stated previously, the Charles Town HBPA allocates 75 percent of its purse revenue to its administrative account. The calculated revenue from other sources on the Independent Auditor's Report for 2007-2009 was \$80,288, \$75,268, and \$40,757 respectively. In all three years, the expenditure categories identified by the Legislative Auditor as clearly outside funding and administering medical trusts exceeded these other revenue sources. Thus, not only does the statutorily directed purse revenue cover all other operating expenses of the Charles Town HBPA but also a significant amount of the expenditures the Legislative Auditor identified as clearly outside the Legislature's intent. As shown in Table 4, the three year total for the identified expense categories was \$363,741. Compared to the total revenue from sources other than state directed funds, the Legislative Auditor finds that statutorily directed funds in the amount of \$167,428 paid for expenses unrelated to administering medical trust funds. **State directed dollars paid for expenses such as lobbying, lobbying travel, and charitable donations.**

Essentially, if the dollar amount of expenditures in these categories meets or exceeds the total revenue from other sources, then state directed funds are by default being used for purposes clearly outside of the Legislature's intent.

In all three years, the expenditure categories identified by the Legislative Auditor as clearly outside funding and administering medical trusts exceeded these other revenue sources.

Table 4
Selected Charles Town HBPA Administrative Expenses
(2007-2009)

	2007	2008	2009	Total
Lobbying	\$33,000	\$33,500	\$0	\$66,500
Lobbying Travel	15,452	1,975	7,826	25,253
Charities	38,500	31,000	20,650	90,150
Chaplaincy	31,500	46,500	30,000	108,000
Advertising/PR	52,593	1,197	20,048	73,838
Total Selected Expenses	\$171,045	\$114,172	\$78,524	\$363,741
Revenue from Other Sources	\$80,288	\$75,268	\$40,757	\$196,313
Selected Expenses paid by state directed funds	\$90,757	\$38,904	\$37,767	\$167,428

Source: Suttle & Stalnaker Independent Accountants' Report on Applying Agreed Upon Procedures, Performed for WV Lottery Commission

In addition to state directed funds paying for lobbying and related travel, the Charles Town HBPA is using state directed funds as a source of revenue to pay for its operating costs, such as rent, salaries, supplies and utilities. In order to illustrate the extent to which the purse revenue authorized by the Legislature is funding the overall operation of the Charles Town HBPA, Table 5 shows selected other expenditures that were **fully funded** by state directed dollars for a three year total of \$1,371,346.

In addition to state directed funds paying for lobbying and related travel, the Charles Town HBPA is using state directed funds as a source of revenue to pay for its operating costs, such as rent, salaries, supplies and utilities.

Table 5
Charles Town HBPA Operating Expenses
(2007-2009)

	2007	2008	2009	Total
Salaries	\$127,755	\$217,282	\$223,351	\$568,388
Rent	13,500	41,500	42,000	97,000
Electric	3,584	3,605	5,083	12,272
Business Supplies	3,011	932	4,532	8,475
Land/Cell Phone	4,819	4,091	3,994	12,904
Membership dues	30,575	33,553	46,391	110,519
Legal Fees	97,692	71,560	280,151	449,403
Accounting Fees	4,775	14,725	24,837	44,337
BOD Travel	32,606	20,091	15,351	68,048
Total	\$318,317	\$407,339	\$645,690	\$1,371,346

Source: Suttle & Stalnaker Independent Accountants' Report on Applying Agreed Upon Procedures

Mountaineer HBPA

As shown in Table 6, the Mountaineer HBPA has higher lobbying expenses but overall lower expenditures in the identified categories. Additionally, it has higher revenue from other sources than the Charles Town HBPA. The calculated revenue from other sources was \$238,339, \$138,142, and \$46,758 for 2007-2009 respectively. The identified expenditure categories only exceeded revenue from other sources in 2009 by \$5,846.

The Mountaineer HBPA has higher lobbying expenses but overall lower expenditures in the identified categories.

Table 6 Selected Mountaineer HBPA Administrative Expenses (2007–2009)				
	2007	2008	2009	Total
Lobbying	\$33,000	\$33,500	\$26,109	\$92,609
Lobbying Travel	8,524	939	1,092	10,555
Charities	9,735	1,779	5,403	16,917
Chaplaincy	20,000	20,000	20,000	60,000
Advertising/PR	1,352	0	0	1,352
Total Selected Expenses	\$72,611	\$56,218	\$52,604	\$181,433
Revenue from Other Sources	\$238,339	\$138,142	\$46,758	\$423,239
Selected Expenses paid by state directed funds	0	0	\$5,846	\$5,846

Source: Suttle & Stalnaker Independent Accountants' Report on Applying Agreed Upon Procedures, Performed for WV Lottery Commission

Mountaineer HBPA's operating expenses shown in Table 7 total \$505,484 from 2007 - 2009. Although to a lesser extent, Mountaineer HBPA also relies on state directed dollars to fund general operating expenses that may be outside the intent of the Legislature. Table 7 shows Mountaineer HBPA operating expenses, some of which were partially funded by state dollars. State directed dollars paid up to \$106,295 and \$197,322 of Mountaineer HBPA's general operating expenses in 2008 and 2009 respectively.

Although to a lesser extent, Mountaineer HBPA also relies on state directed dollars to fund general operating expenses that may be outside the intent of the Legislature.

Table 7
Mountaineer HBPA Operating Expenses
(2007-2009)

	2007	2008	2009	Total
Payroll Expense	\$21,517	\$82,843	\$73,692	\$178,052
Office Help	36,565	25,394	21,473	83,432
Office Supplies	4,649	11,267	3,440	19,356
Internet	6,161	1,734	1,108	9,003
Telephone	2,810	2,384	1,993	7,187
Dues/Subscriptions	18,350	20,514	21,115	59,979
Legal Fees	15,341	19,853	31,787	66,981
Accounting Fees	5,575	3,000	0	8,575
Travel and Entertainment	24,067	21,230	27,622	68,379
Total Operating Expenses	\$119,943	\$188,219	\$197,322	\$505,484
Remaining revenue from other sources *	\$165,728	\$81,924	0	\$247,652
Operating expenses paid by state directed funds	0	\$106,295	\$197,322	\$299,077

* = Revenue from other sources, less total selected expenses from Table 6.
Source: Suttle & Stalnaker Independent Accountants' Report on Applying Agreed Upon Procedures, Performed for WV Lottery Commission

It is clear that both HBPA's rely on state directed funds to not only carry out functions related to the medical trust, but also to operate in general. During the time period examined, it is also important to note that for both associations, revenue from other sources has decreased steadily and at a significant amount. With the yearly decrease in revenue from other sources, the statutorily directed funds from purses are representing a larger and larger percentage of total revenue for the administrative accounts of the HBPA's. Given this relationship, the HBPA's, although to different degrees, are relying heavily on state directed dollars to pay for the day to day operations of the associations regardless of whether expenditures benefit the backstretch personnel.

It is clear that both HBPA's rely on state directed funds to not only carry out functions related to the medical trust, but also to operate in general.

The Legislative Auditor Is Concerned That the Ambiguity of Enabling Statute Results in Practices That Are Not Concurrent With the Legislature’s Intent

The section of West Virginia Code that enables the previously discussed funding arrangement between the State’s two thoroughbred racetracks and their local HBPA’s creates the opportunity for practices that may not represent the intention of the Legislature. Apart from specifying the maximum percentage of purses available and identifying the parties involved, statute provides little guidance. Currently, the only restrictions placed on these funds are that they be used for the HBPA’s “...respective medical trusts for backstretch personnel and administrative fees.” The Legislative Auditor is concerned with the following issues:

- nowhere is it stipulated at what ratio the funds are to be distributed between the administrative fees and the medical trusts for backstretch personnel;
- the term “administrative fees” itself is not defined; and
- a previous incident with the Charles Town HBPA shows that the racetrack purse funds have been misused in the past.

The lack of guidance regarding how the funds received from thoroughbred racing purses are to be distributed creates the opportunity for what appears to be an amount allocated to the administrative accounts in excess of what the Legislature intended, especially in the case of the Charles Town HBPA. Mountaineer Park Racetrack allocates 75 percent of the funds it receives to its medical trust account for the benefit of the members of the Association. At the same time, Charles Town Races only allocates 25 percent of the money it receives from purses to its medical trust account. Although there is a large disparity between these amounts, nothing in the enabling statute precludes it. **The Legislative Auditor is of the opinion that it may not be the intent of the Legislature for such a large portion of these funds to be expended on “administrative fees.”** The Director of the West Virginia Lottery Commission is of a similar opinion. He stated that administrative fees to him mean:

...the payment by HBPA of fees that HBPA may incur from trustees and fund managers retained by HBPA to perform fiduciary tasks connected with managing the medical trust fund.

Currently, the only restrictions placed on these funds are that they be used for the HBPA’s “...respective medical trusts for backstretch personnel and administrative fees.”

The Legislative Auditor is of the opinion that it may not be the intent of the Legislature for such a large portion of these funds to be expended on “administrative fees.”

Furthermore, he states:

What I have learned is the HBPA's have apparently interpreted "and administrative fees" to mean a minimal source of minimal funding medical trust administration plus a significant source of money to pay the general costs of operating HBPA that has no relation to the medical trusts for backstretch personnel.

In an April 28, 2010 inquiry placed to the Racing Commission, the Legislative Auditor requested the Commission's position and insight as to what the term "administrative fees" means as used in WVC §19-23-9(b)(1). The Commission authorized the Attorney General's Office to respond on its behalf. The response points out that the language in question was passed by the Legislature in 2004 and has not been changed or modified since that time. Also, the Racing Commission had not:

...affirmatively interpreted this statutory language; has never issued any policy or interpretive guidance to the local HBPA's or racetracks; and, has never taken any action to enforce or administer this statutory provision.

The Attorney General's response goes on to state that the term itself as used in this section is ambiguous, no legislative history or other materials could be found to determine legislative intent, and that the term is not defined in statute. **Even though West Virginia Code does not specifically state how the funds are to be distributed, if the term "administrative fees" was well defined in this instance it would provide clarity as to whether the funds were being expended appropriately.**

Finally, in a 2004 audit report conducted for the Charles Town HBPA, instances of fund misuse by the Charles Town HBPA's personnel were outlined. The report provides a detailed description of fund misuse such as purchasing equipment for personal use, unapproved personal loans, unapproved cash withdrawals, paying personal credit card bills, and unapproved retirement, bonus, and vacation pay. This past situation illustrates how funds distributed with little or no guidance can be expended in a manner that would not reflect the intention of the Legislature. Thus, better oversight of the fund expenditures is necessary.

The Attorney General's response goes on to state that the term itself as used in this section is ambiguous, no legislative history or other materials could be found to determine legislative intent, and that the term is not defined in statute.

Even though West Virginia Code does not specifically state how the funds are to be distributed, if the term "administrative fees" was well defined in this instance it would provide clarity as to whether the funds were being expended appropriately.

The West Virginia Lottery Commission Finds That Racetrack Purses Transferred to the Local HBPA's Are State Funds

The Legislative Auditor questioned the Racing Secretary of the West Virginia Racing Commission and the Director of the West Virginia Lottery Commission as to whether funds that are statutorily authorized to be transferred by the racetracks to the HBPA's retain its status as "state funds" after being transferred. The Racing Secretary responded that the Racing Commission:

...has not taken any action on this matter.

The Director of the West Virginia Lottery Commission stated that it is his opinion that these funds are state funds, and open to review by the West Virginia Lottery Commission. The Director cited West Virginia Code §29-22-29 as criteria in support of his opinion, which states:

(a) Moneys transferred by the commission under provisions of this article and articles twenty-two-a, twenty-two-b, twenty-two-c and twenty-five of this chapter to nongovernmental recipients, are state moneys and have been state moneys in prior fiscal periods.

(b) All nongovernmental entities that have received state moneys as described in subsection (a) of this section are subject to audit by the commission. An audit provided for by this section may be conducted by employees or agents of the commission. An audit provided for by this section may also be conducted by the Legislative Auditor.

Additionally, he goes on to state that:

...it is (his) opinion the 2% money retains its distinction as "state funds", and that HBPA administration of that money is reviewable by the State Lottery Commission....

Given this statement, and given the concerns identified with the manner the HBPA's are expending funds, the Legislative Auditor finds that legislative intent needs to be clarified and oversight of the funds needs to be increased. Recommendations on how to make these improvements is discussed in the following section.

The Director of the West Virginia Lottery Commission stated that it is his opinion that these funds are state funds, and open to review by the West Virginia Lottery Commission.

Given this statement, and given the concerns identified with the manner the HBPA's are expending funds, the Legislative Auditor finds that legislative intent needs to be clarified and oversight of the funds needs to be increased.

The Legislative Auditor Has Developed Possible Solutions to Ensure That the HBPA's Are Expending State Directed Funds as Intended by the Legislature

In order to ensure that these funds distributed at the direction of West Virginia Code are being allocated and spent in the manner in which they were intended, the intent of the Legislature needs to be clarified. Currently, it is uncertain whether the intent of this section is to strictly fund the medical trusts and any administrative fees incurred in the operation of said trusts or whether the Legislature intended on funding the trusts as well as administrative expenses incurred from operating the HBPA's themselves. **From analyzing the financial statements of the HBPA's, it is clear that both are using the state directed funds to operate activities unrelated to the medical trust, thus the state directed funds may be what enables the organizations to be solvent.** The Executive Director of Mountaineer Park HBPA stated in a message to the Legislative Auditor's Office that without the one half percent funding from purses, the Association would be defunct.

Currently, it is uncertain whether the intent of this section is to strictly fund the medical trusts and any administrative fees incurred in the operation of said trusts or whether the Legislature intended on funding the trusts as well as administrative expenses incurred from operating the HBPA's themselves.

For example, using Chapters 436a and 436b of the Pennsylvania Code as criteria, statute requires the Pennsylvania Gaming Control Board to establish guidelines to ensure funds are used properly. It goes on to require that: funds not be used to benefit organization officials personally, funds are kept apart from revenue acquired from other sources, a limit be established regarding the maximum percentage that can be used to administer the program, and includes an audit function. Excerpts from applicable sections are as follows:

58 Pa. Code § 436a.4

*(b) Funds allocated to horsemen's organizations for benevolent programs **are not to be used for the personal benefit** of any officer, director, representative or fiduciary of a horsemen's organization except to the extent that the officer, director, representative or fiduciary of the horsemen's organization is a participant in the benevolent programs on the same basis as other eligible program participants.*

58 Pa. Code § 436b.3

*(b) Registered horsemen's organizations shall ensure that funds received from the Fund are used to benefit all horsemen and are **kept apart from funds acquired from other sources.** Funds that are allocated to horsemen's organizations for benevolent programs are not to be used for the personal benefit of any officer, director, representative or fiduciary of the horsemen's organization.*

58 Pa. Code § 436b.1

*(3) Ensure that **no more than 15%** of funds available annually for benevolent programs, including pension, health and insurance plans, are used to administer the programs.*

*(4) Ensure that the horsemen's organizations that receive funds from the Fund **file an annual audit** prepared by a certified public accountant. (See 4 Pa.C.S. §1406(e).) (emphasis added).*

Pennsylvania statute establishes that no more than 15 percent of state directed funds can be used to administer the benevolent programs.

Using the Pennsylvania code as an example of best practices, the Legislative Auditor provides the following solutions.

Provide Guidance on the Percentage of Purse Funds to be Used for Administrative Fees

Pennsylvania statute establishes that no more than 15 percent of state directed funds can be used to administer the benevolent programs. The Legislative Auditor recommends that the West Virginia Legislature consider establishing in statute the maximum percentage that can be used by the local HBPA's in order to administer the medical trusts.

Define "Administrative Fees"

Another solution is to define the term "administrative fees." This can either be done by the Legislature in statute or by the Racing Commission to do so in its rules. At the conclusion of the response to the Legislative Auditor's inquiry, the Attorney General's Office suggests that:

...the Racing Commission may exercise its right to issue an interpretive rule or other appropriate formal policy guidance to the HBPA's and the racetracks on this matter.

The Director of the Lottery Commission and legal counsel from Legislative Services both agree that the Racing Commission could adopt an interpretative rule defining administrative fees. Legislative Services legal counsel cited West Virginia Code §19-23-6 as clearly giving the Racing Commission authority to promulgate reasonable rules, and specifically stated that:

With this authority I believe the Racing Commission could propose for promulgation a legislative rule defining "administrative fees" or adopt an interpretive rule defining "administrative fees." I believe the Racing Commission could establish a maximum percentage of the subject funds that could be used for administrative fees, however, it would have to be established through the legislative rule-making process.

The West Virginia Racing Commission was given an opportunity to provide an opinion on this subject, and stated that it:

...has not taken any action on this matter.

The Legislative Auditor also recommends that any definition of administrative fees explicitly state that fees are not to be used for lobbying, lobbying travel, and charitable donations which are clearly outside the intention of funding and administering a medical trust fund.

Increased oversight of funds by the West Virginia Racing Commission

Increased oversight of the purse money transferred to the HBPA's could assist in ensuring that funds are being spent as intended by the Legislature. Legal counsel from Legislative Services stated that the West Virginia Racing Commission has the authority to increase oversight of the funds. In his opinion, legal counsel stated that within the powers and authority of the Racing Commission, West Virginia Code §19-23-6 (16) authorizes it to take action to effectuate the provisions of Chapter 19, which is the article including the authority for the racetracks to transfer funds to the HBPA's. He further states that:

The Director of the Lottery Commission and legal counsel from Legislative Services both agree that the Racing Commission could adopt an interpretive rule defining administrative fees.

Increased oversight of the purse money transferred to the HBPA's could assist in ensuring that funds are being spent as intended by the Legislature. Legal counsel from Legislative Services stated that the West Virginia Racing Commission has the authority to increase oversight of the funds.

With this authority the Racing Commission could increase its oversight of the state directed funds provided to the HBPA's from racetrack purses. Rules would not be necessary of it to increase its oversight. It could however, provide through the use of legislative or procedural rules, specific procedures outlining how it is going to provide the increased oversight.

Increased oversight should include requiring the HBPA's to keep state directed funds separate from other sources of revenue. This would improve the ability for the State to determine where state directed dollars are being spent. Additionally, increased oversight should include requiring the HBPA's to submit annual reports of expended funds received from the racetracks. The requirement to submit annual reports could be similar to West Virginia Code §12-4-14, which requires grantees of state funds to file an annual report prepared by a certified public accountant to test whether state grants were spent as intended.

Conclusion

The Charles Town and Mountaineer HBPA's have different practices regarding the allocation of funds received from purses at their respective racetracks. Although the percentages of funds distributed between the administrative and medical trust accounts vary widely, West Virginia Code does not provide any guidance as to what the Legislature intended the proper ratio to be. It is the Legislative Auditor's duty to inform the Legislature of this fact and that a portion of these funds are being expended for administrative purposes unrelated to the medical trusts. The Legislature may decide that this arrangement is perfectly acceptable, but the statute, as written does not expressly define the intent of the Legislature. An example for clarifying what constitutes an acceptable funding relationship between the racetracks and the HBPA's does exist in the state of Pennsylvania. The selected Pennsylvania Code shows more specific guidance which would leave little or no ambiguity as to the intent of the Legislature. Therefore, the Legislature and the Racing Commission should consider taking all necessary corrective actions to ensure that state funds directed to the HBPA's are being spent in a manner consistent with the intent of WVC §19-23-9(b)(1), both now and in the future.

Additionally, increased oversight should include requiring the HBPA's to submit annual reports of expended funds received from the racetracks. The requirement to submit annual reports could be similar to West Virginia Code §12-4-14, which requires grantees of state funds to file an annual report prepared by a certified public accountant to test whether state grants were spent as intended.

Recommendations

- 1) *The Legislative Auditor recommends that the Legislature or the West Virginia Racing Commission consider defining administrative fees for the purpose of this section.*
- 2) *The Legislative Auditor recommends that any definition of administrative fees explicitly state that fees can not include lobbying expenses, lobbying travel expenses, charitable donations, and other expenses that are clearly outside administering the medical trust funds for backstretch personnel.*
- 3) *The Legislative Auditor recommends that the Legislature consider establishing a maximum percentage of funds directed by §19-23-9(b)(1) that can be used for administrative fees.*
- 4) *The Legislative Auditor recommends that the Legislature consider requiring the West Virginia Racing Commission to increase its oversight function for the state directed funds provided to the HBPA's from racetrack purses.*
- 5) *The Legislative Auditor recommends that the Charles Town and the Mountaineer Horsemen Benevolent Protective Associations be required to separate revenue received from the racetracks for the medical trusts from other sources of revenue.*
- 6) *The Legislative Auditor recommends that the Charles Town and the Mountaineer Horsemen Benevolent Protective Associations be required to submit annual, independent audits of the expenditure of funds received from the racetracks for the medical trusts for backstretch personnel.*

Appendix A: Transmittal Letter

WEST VIRGINIA LEGISLATURE *Performance Evaluation and Research Division*

Building 1, Room W-314
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John Sylvia
Director

June 23, 2011

Charles O. Lorensen, Cabinet Secretary
Department of Revenue
State Capitol Complex
Building 1, W-300
Charleston, WV 25305

Dear Secretary Lorensen:

This is to transmit a draft copy of the Special Report on the use of state directed funds by the Horsemen's Benevolent and Protective Associations. This report is scheduled to be presented during the July 11-13, 2011 interim meeting of the Joint Committee on Government Operations and the Joint Committee on Government Organization. We will inform you of the exact time and location once the information becomes available. It is expected that a representative from the West Virginia Lottery Commission and the West Virginia Racing Commission be present at the meeting to orally respond to the report and answer any questions the committees may have.

If you would like to schedule an exit conference to discuss any concerns you may have with the report, please notify us by June 29, 2011. We need your written response by noon on June 30, 2011, in order for it to be included in the final report. If your agency intends to distribute additional material to committee members at the meeting, please contact the House Government Organization staff at 340-3192 by Thursday, July 7, 2011 to make arrangements.

We request that your personnel not disclose the report to anyone not affiliated with your agency. Thank you for your cooperation.

Sincerely,

Handwritten signature of John Sylvia in cursive.
John Sylvia

c: John C. Musgrave, Director
West Virginia Lottery Commission

Jon Amores, Racing Secretary
West Virginia Racing Commission

Joint Committee on Government and Finance

Appendix B: Objective, Scope and Methodology

This Special Report on the use of state directed funds by the Horsemen's Benevolent and Protective Associations (HBPA) is authorized by West Virginia Code §4-2-5.

Objective

The objective of this report was to illustrate how the ambiguity of the term "administrative fees" in West Virginia Code §19-23-9(b)(1), which allows for up to two percent of purses paid at the state's two thoroughbred racetracks to be distributed to the local HBPA's for backstretch personnel medical trust funds, has produced practices that the Legislature may not have intended. This review outlines the allocation of state directed funds and presents the Legislature with options to clarify its intent.

Scope

This report utilized two Suttle and Stalnaker reports analyzing the 2007 – 2009 general ledgers for the Mountaineer and Charles Town HBPA's. The Legislative Auditor also interviewed various backstretch personnel at each thoroughbred racetrack for insight into their current health insurance status.

Methodology

The West Virginia Lottery Commission engaged Suttle and Stalnaker to assist with the collection and interpretation of Mountaineer and Charles Town HBPA's' accounting records. These reports and attached documents included the financial statements and general ledgers for each association. The Legislative Auditor utilized these documents to determine how the HBPA's were allocating the funds statutorily directed to them. Financial statements and general ledgers provided the information necessary to construct tables showing how the HBPA's used the available funds on an annual basis. Pennsylvania Code was used as criteria to show how this funding relationship between state directed funds and HBPA's can be expressly guided. Opinions from Legislative Services' legal counsel, the Attorney General's Office, the West Virginia Lottery Commission, and the Racing Commission were also utilized. Additionally, interviews occurred with backstretch personnel at Mountaineer Racetrack and Charles Town Racetrack.

Appendix C: Agency Responses

Jon Amores
Racing Secretary

106 Dee Drive, Suite 2
Charleston, WV 25311



Sherry J. Dorsey
Racing Specialist

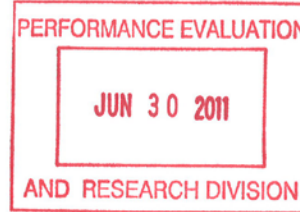
Phone (304) 558-2150
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STATE OF WEST VIRGINIA
DEPARTMENT OF REVENUE
WEST VIRGINIA RACING COMMISSION

Earl Ray Tomblin
Governor

June 30, 2011

John Sylvia, Director
West Virginia Legislature
Performance Evaluation and Research Division
Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston WV 25305



Dear Mr. Sylvia,

The West Virginia Racing Commission appreciates the efforts of the Legislative Auditor in the investigation and preparation of its report and recognizes the concerns raised regarding administrative fees.

At the time the response from the Racing Commission's counsel was provided, the Racing Commission was in the midst of drafting a complete rewrite of its wagering, thoroughbred, greyhound, and procedural rules, as well as a number of pieces of legislation to be introduced in the upcoming 2011 Regular Session. It was also aware that the issue of administrative fees was being reviewed by the Legislative Auditor. Under those circumstances, it was thought best to defer action until the benefit of any investigation by the Legislative Auditor could be incorporated into the Racing Commission's actions.

The Racing Commission is certainly willing to support the recommendations of the auditor as set forth in the report. We look forward to working with the Legislature, the HBPA's, and any other stakeholders to make sure that the concerns raised by the Legislative Auditor are addressed in an appropriate manner.

Sincerely,

A handwritten signature in black ink, appearing to read "Jon Amores".

Jon Amores, Executive Director

Web site: www.wvracingcommission.com



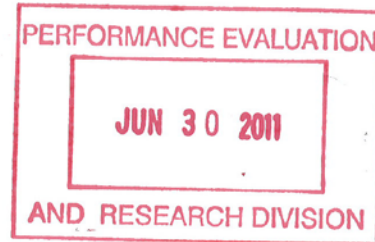
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Earl Ray Tomblin
Governor

John C. Musgrave
Director

June 30, 2011



John Sylvia, Director
Performance Evaluation and Research Division
Office of the Legislative Auditor
Building 1, Room W-314
Charleston, West Virginia 25305

**Subject: REVIEW OF THE REPORT CONCERNING 2% DISTRIBUTIONS FOR
BACKSTRETCH EMPLOYEE HEALTH PROGRAMS**

Dear Director Sylvia:

It was our privilege to read your draft report concerning the use of statutorily authorized funds by the HBPA organizations associated with Charles Town Races and Mountaineer Park, and to attend your wrap-up meeting with Secretary Lorensen and Director Amores on June 29, 2011.

The West Virginia Lottery has no objections to the draft report as written. We believe it fairly represents the subject matter being studied by PERD.

Sincerely,

John C. Musgrave
Director

c: Secretary Lorensen
Director Amores



WEST VIRGINIA LEGISLATIVE AUDITOR

PERFORMANCE EVALUATION & RESEARCH DIVISION

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