

Audit Report

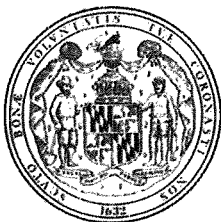
**Maryland Thoroughbred and Harness
Horse Racing Tracks**

August 2012



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

August 23, 2012

Karl S. Aro
Executive Director

Bruce A. Myers, CPA
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

As required by the Business Regulation Article, Section 11-313 of the Annotated Code of Maryland, we have audited the licensees for the following racetracks for the period beginning July 1, 2009 and ending June 30, 2011:


- Laurel Park
- Pimlico Race Course
- Timonium Race Course
- Rosecroft Raceway
- Ocean Downs Racetrack

The purpose of this audit was to assess whether the entities licensed by the Department of Labor, Licensing and Regulation - Maryland Racing Commission had complied with certain State laws, rules, and regulations.

Our audit disclosed that the licensees tested properly reported the forms of ownership in accordance with State law. In addition, based on our review of work performed by other auditors, no deficiencies were disclosed regarding the various systems used by the licensees to distribute wagering revenues, including taxes due to the State. Nevertheless, our audit disclosed that the audited financial statements for certain racetracks had not been obtained as required by State law. In addition, two racetracks had not entered into written agreements with trainers and breeders regarding the distribution of certain revenue.

The Commission's response to this audit is included as an appendix to this report and represents the consolidated views of both the Commission and the licensees. We wish to acknowledge the cooperation extended to us by the Commission and the licensees during our audit.

Respectfully submitted,


Thomas J. Barnickel III, CPA
Acting Legislative Auditor

Background Information

Racetracks

The thoroughbred and harness racing tracks are licensed by the State of Maryland to conduct live racing and accept wagering on simulcast racing from other facilities throughout the United States. Details of live race days and wagering at the racetracks for calendar year 2010 are provided in the following table:

Calendar Year 2010 Racetrack Activity			
Type of Racing	Racetrack	Live Race Days	Pari-mutuel Wagering
Thoroughbred	Laurel Park	119	\$125,286,760
	Pimlico Race Course	20	\$63,646,054
	Timonium Race Course	7	\$1,694,243
Harness	Rosecroft Raceway	0	\$11,184,716
	Ocean Downs Racetrack	4	\$11,568,851
	Total	150	\$213,380,624

Source: Maryland Racing Commission records (unaudited)

Status of Licensees

There were two transfers of ownership, affecting three racetracks, since our preceding audit report dated September 2, 2010. Both license transfers were approved by the Maryland Racing Commission. A recent financial statement audit for another licensee raised substantial doubt as to its ability to continue as a going concern.

- Maryland Racing, Incorporated (MRI), through the Maryland Jockey Club, owns Laurel Park and Pimlico Race Course. Ownership of MRI was transferred from its co-owners, MI Developments, Incorporated, and Penn National Gaming, Incorporated, to the Stronach Trust on July 1, 2011.
- A new parent company of Rosecroft Raceway, Penn National Gaming, Incorporated, reopened the racetrack to live racing on October 21, 2011. The racetrack had been closed since July 2010 due to bankruptcy under a different licensee (Cloverleaf Enterprises, Incorporated).
- In its fiscal year 2011 audited financial statement report, which was submitted subsequent to the completion of our audit fieldwork, the Ocean Downs Racetrack independent auditor commented that recurring losses from

operations and cash flow deficiencies raised substantial doubt as to its ability to continue as a going concern.

Automated Online Wagering Systems

Wagers at racetracks, both in Maryland and throughout the United States, are recorded electronically by use of various automated systems. In Maryland, racetracks generally use one system to transmit wagering transactions and compute the payoff of winning bets, and another system to compute deductions, such as for purses, State taxes, and simulcast signal fees.

Status of Finding From Preceding Audit Report

Our audit included a review to determine the status of the finding contained in our preceding audit report dated September 2, 2010. We determined that the finding was not satisfactorily addressed and is repeated in this report.

Scope, Objectives, and Methodology

Scope

We have audited the licensees for the following racetracks for the period beginning July 1, 2009 and ending June 30, 2011:

- Laurel Park
- Pimlico Race Course
- Timonium Race Course
- Rosecroft Raceway
- Ocean Downs Racetrack

These racetracks are licensed by the Maryland Racing Commission (the Commission) to conduct live thoroughbred and harness racing in Maryland, and to accept wagering on simulcast racing from other facilities throughout the United States.

The purpose of this audit was to determine the licensees' compliance with certain State laws, rules, and regulations. We also determined the status of the finding included in our preceding audit report. The Business Regulation Article, Section 11-313 of the Annotated Code of Maryland requires the Office of Legislative Audits to audit the licensees of thoroughbred and harness racing tracks at least once every two years in accordance with the provisions of the State Government Article, Sections 2-1217 through 2-1227, of the Annotated Code of Maryland.

Our audit was performed in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Objectives

The three objectives of our audit were to determine whether

1. licensees disclosed all forms of ownership, as defined by the Annotated Code of Maryland, to the Commission;
2. various systems used by licensees to distribute wagering revenues, including taxes due the State, generated reliable financial information; and

3. licensees complied with certain requirements of State law (such as having an annual audit performed of the financial statements for each racetrack, and properly using revenue from video lottery proceeds), as well as with licensing requirements of the Commission contained in the Code of Maryland Regulations.

Methodology

To accomplish our objectives, we interviewed various individuals employed by the licensees. In addition, we reviewed applicable State laws, as well as records maintained by the Commission. Furthermore, independent auditors for Laurel Park, Pimlico Race Course, Rosecroft Raceway, and Ocean Downs Racetrack performed certain agreed-upon procedures to provide assurances regarding the accuracy of wagering revenues collected and the related distributions during the audit period.¹ The related reports disclosed no material deficiencies. We have relied on the work of the independent auditors to provide audit coverage of wagering revenues collected and related distributions. Therefore, our audit procedures in these areas were generally limited to obtaining a sufficient basis for that reliance.

The financial statements of each licensee are to be audited annually by independent auditors for the purpose of expressing opinions on the fair presentation of the licensees' financial statements. We reviewed the available financial statements and the related independent auditors' reports for 2009 and 2010 (most of which are on a calendar year basis) to ensure the audits had been completed as required by State law and to determine if any other conditions existed that would impact our audit objectives. In each report issued,² the auditors stated that the licensees' financial statements presented fairly, in all material respects, their respective financial positions, results of operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

¹ Due to the limited number of racing days (seven) at Timonium Race Course, and because the Maryland Jockey Club (which operates Laurel Park and Pimlico Race Course) provided the pari-mutuel staff and expertise during those seven days of racing, agreed-upon procedures were not conducted for Timonium Race Course. For similar reasons, we also excluded such procedures from our scope. Nevertheless, an independent accounting firm, under contract to the Maryland Racing Commission, monitors the wagering and payments at each of the five tracks whenever racing is conducted.

² Three of the five licensees had not obtained required audited financial statements (see Finding 1).

Our fieldwork was completed during the period from October 2011 to February 2012. A copy of this draft report was provided to each licensee and to the Commission. The Commission's response to our findings and recommendations is included as an appendix to this report and represents the consolidated views of the Commission and the licensees. Separate written responses to this report were not requested from the licensees. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the Commission regarding the results of our review of its response.

Conclusions

We concluded that, for the licensees tested, all forms of ownership were properly reported to the Maryland Racing Commission as required by law. In addition, based on our review of the work performed by other auditors, no material deficiencies were disclosed regarding the various systems used by the licensees to distribute wagering revenues, including taxes due to the State from wagering. However, we noted that certain racetracks had not obtained audited financial statements, as required by State law. We also noted that a written agreement regarding the allocation of certain revenue at two racetracks had not been executed.

Findings and Recommendations

Financial Statements

Finding 1

Audited financial statements had not been completed as required by State law.

Analysis

Three of the five licensees had not obtained audited financial statements, as required by State law, due to certain financial issues associated with the licensees. Specifically, as of June 4, 2012, one licensee (Rosecroft) had not obtained audited financial statements for two fiscal years, covering the period from January 1, 2009 through December 31, 2010. In addition, two licensees (Laurel and Pimlico) had not obtained audited financial statements for the period from January 1, 2009 through April 30, 2010. We were advised that the financial statements were not audited during these periods due to the bankruptcy status of the entities that previously owned controlling interests in the racetracks.

In our preceding audit report, the financial statements for two of these licensees (Laurel and Pimlico) for fiscal year 2008 (January 1, 2008 through December 31, 2008) were not issued. These financial statements also remain outstanding. Because of the changes in ownership, Maryland Racing Commission management advised us that it believes it is unlikely to receive these outstanding financial statements.

The Business Regulation Article, Title 11-313 (b) of the Annotated Code of Maryland requires licensees to submit audited financial statements within 90 days of the end of the fiscal year.

Recommendation 1

We recommend that the Commission work with the licensees to ensure that audited financial statements are completed in accordance with the requirements of State law (repeat).

Finding 2

Two racetracks had not entered into formal agreements concerning the allocation of simulcast funds used for purses.

Analysis

Two thoroughbred racetracks (Laurel and Pimlico) had not entered into formal agreements with the organizations that represent trainers and breeders concerning how to allocate the revenue received from simulcast races at Maryland racetracks. Instead, we were advised that only an oral agreement to allocate the funds is in place.

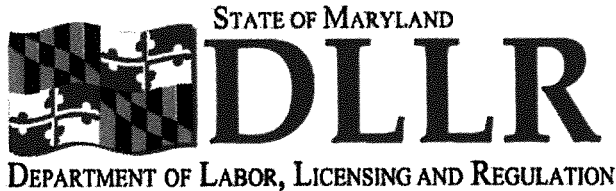
According to licensee records, simulcast revenue for the two racetracks totaled \$15.3 million during calendar year 2010.

State law requires that revenue from simulcast races in this state shall be allocated to the licensee, purse, and applicable bred fund according to the agreement made by the licensee, licensed owners and trainers, and breeders.

Recommendation 2

We recommend that the racetracks execute written agreements with organizations that represent trainers and breeders as to how to allocate the revenue from simulcast races.

APPENDIX



MARYLAND RACING COMMISSION
300 East Towsontown Blvd.
Towson, MD 21286

August 20, 2012

Mr. Thomas J. Barnickel III
Acting Legislative Auditor
Office of Legislative Audits
301 West Preston Street
Room 1202
Baltimore, Maryland 21201

Dear Mr. Barnickel:

This is to advise you that the Commission concurs with the finding and recommendations cited in your audit of the Maryland thoroughbred and harness horse racing tracks covering the period beginning July 1, 2009 and ending June 30, 2011. I have circulated the draft of your recommendations and findings to the track licensees. They have all responded with nothing to add.

Finding 1 - The Commission will continue to work with the track licensees to ensure the annual audited financial statements are completed and received in accordance with the Business Regulation Article as they were for calendar year 2011.

Finding 2 - The Commission will work with the thoroughbred track licensees, horseman groups and the breeders to reduce to writing the ongoing verbal agreement regarding the distribution of wagering revenue. The Commission anticipates that the current ongoing discussions will be finalized no later than December 31, 2012 at which time a written agreement is expected.

If you have any questions or comments please do not hesitate to contact me at any time.

Very truly yours,

A handwritten signature in black ink, appearing to read "J. Michael Hopkins".

J. Michael Hopkins
Executive Director

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