

AGENCY: New Mexico State Racing Commission (NMRC)

DATE: July 28, 2016

PURPOSE OF HEARING: The State of Horseracing in New Mexico

WITNESSES:

Ray Willis, State Racing Commission Board Chair, Ismael "Izzy" Trejo, State Racing Commission Executive Director, Ralph Vincent, New Mexico Horse Breeders Association President, Shaun Hubbard, Ruidoso Downs President, Joe Dee Brooks, New Mexico Horsemen's Association Board Member, Susan Vescovo, New Mexico Horsemen's Association Board Member, William Bunce, New Mexico Livestock Board Executive Director

PREPARED BY:

Sunny Liu, LFC Analyst, and Bryce Smith, LFC Research Assistant

EXPECTED OUTCOME: Informational

BACKGROUND INFORMATION

The Horse Racing Act (HRA), enacted in 1933, allows horse racing and pari-mutuel wagering in New Mexico. The New Mexico State Racing Commission (NMRC) oversees compliance with the HRA through licensing and enforcement activities.

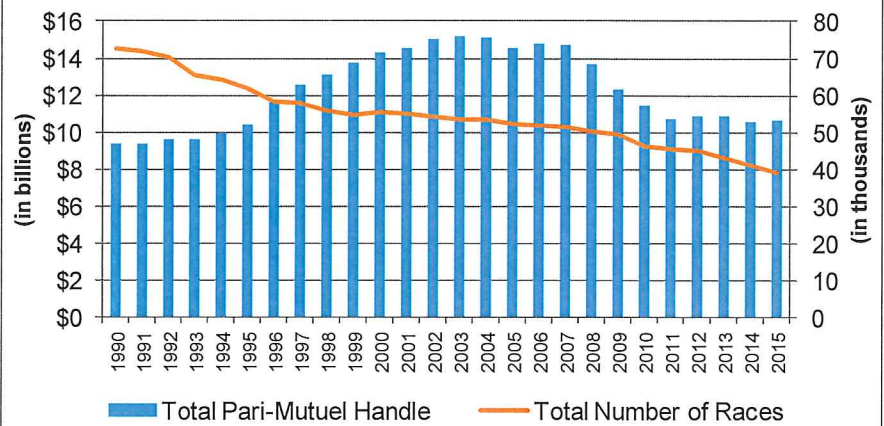
Horseracing Industry

In line with a long-term decline, the U.S. horseracing industry has performed poorly over the past 10 years. Industry demand has increasingly been eroded as other leisure and gambling activities compete with horse race tracks for customers. A 2016 Harris poll found horseracing ranked 13th among popular American sports with only 1 percent of Americans listing it as their favorite. In 1985, horseracing was ranked 8th with 4 percent of people calling it their favorite. The Jockey Club, horseracing's breed registry, conducted a study in 2011 and found horseracing bettor and fan-count on the decline. Money wagered on horseracing peaked in 2003, at \$15.2 billion but fell to \$10.6 billion in 2015. Money wagers at racetracks rose 1.2 percent in 2015 from the year before and 2016 has seen a 4.4 percent year-over-year growth so far; however, it is unclear how much of the success is attributable to casino facilities offered at these venues.

Horse Racing Integrity

The existence of 38 racing jurisdictions in the U.S. has created inconsistencies around enforcement of horse doping. In 2015, U.S. Representatives Andy Barr and Paul Tonko introduced the Thoroughbred Horseracing Integrity Act, which would grant authority for rule making, testing, and enforcement of drug and medication use in thoroughbred horseracing to the United States Anti-Doping Agency (USADA). Under the proposed legislation, USADA would create the Thoroughbred Horseracing Anti-Doping Authority—funded by the industry—to run a nationwide anti-doping program that would go into effect beginning January 1, 2017.

U.S. Horseracing 1990-2015

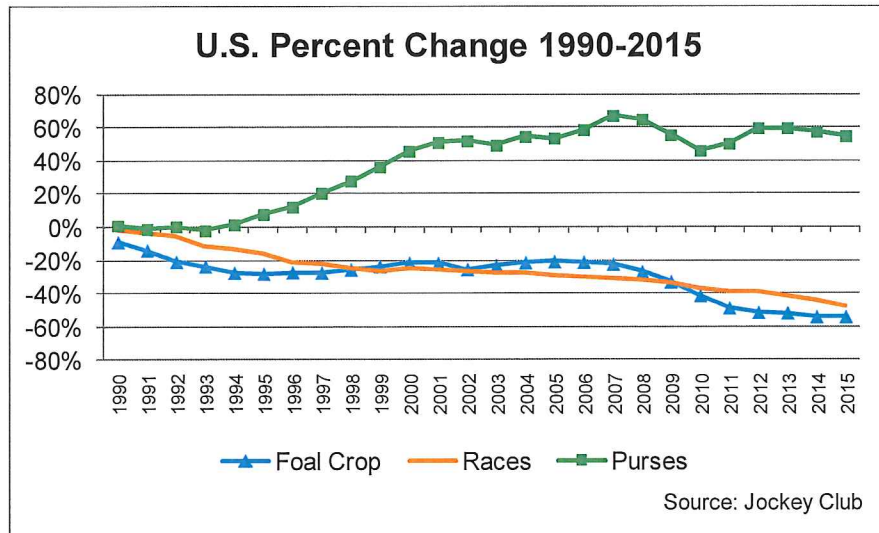


Source: Jockey Club

A recent study by the Rockefeller Institute found expansion of gambling nationwide has led to market saturation and cannibalization, as new gambling operations compete for the same consumers. The expansion of lotteries and casinos has contributed to declines in revenues from pari-mutuel betting with many racetracks converting into racinos—a hybrid of a casino and a racetrack. Rhode Island was the first state to legalize racino operations in 1992, followed by 11 other states between 1994 and 2007. Two more states legalized and opened racinos after 2008. Between 2008

and 2015, inflation-adjusted pari-mutuel gambling revenue fell 44.5 percent while racino gambling revenue grew by 18.6 percent. Combined revenue collections from racino operations and pari-mutuel wagering, 12.5 percent of total gambling in the U.S., increased by 2.7 percent in FY14 and 4.2 percent in FY15.

In 2011, the Jockey Club projected thoroughbred racing was losing fans at a rate of about 4 percent a year. From 2001 to 2011, purses (awards to highest finishers) remained relatively flat, handle (wagers on an event) decreased by 37 percent, attendance decreased by 30 percent, and starts per horse and race days were both down 14 percent. In contrast, premier events in racing still remained popular: Kentucky Derby attendance increased by 8 percent from 2000, television ratings for the Breeders' Cup were up 6 percent from 2006, and Grade I and Grade II handle per races increased 23 percent per race from 2001. The Jockey Club's analysis included a forecast for 2021 showing a 25 percent decline in total handle, 9 percent to 18 percent decrease in foal crop, 27 percent drop in the number of viable tracks, 25 percent fall in state revenues, and 50 percent loss in revenue for the average horse owner.



Several racetracks have experienced increases in total handle after decreasing the number of race days. In 2010, New Jersey's Monmouth Park Racetrack cut summer race days by 47 percent, resulting in a 26 percent increase in average field size (horses per race), a 117 percent increase in total handle and a 58 percent increase in revenue. According to a Jockey Club model based on data from over 600 thousand races over 11 years, cutting 10 percent of race days could save racetracks about \$36.2 million nationally each year. As attendance for the industry shifts to higher quality races, decreasing annual losses by consolidating unpopular races and race days could benefit racetracks and patrons.

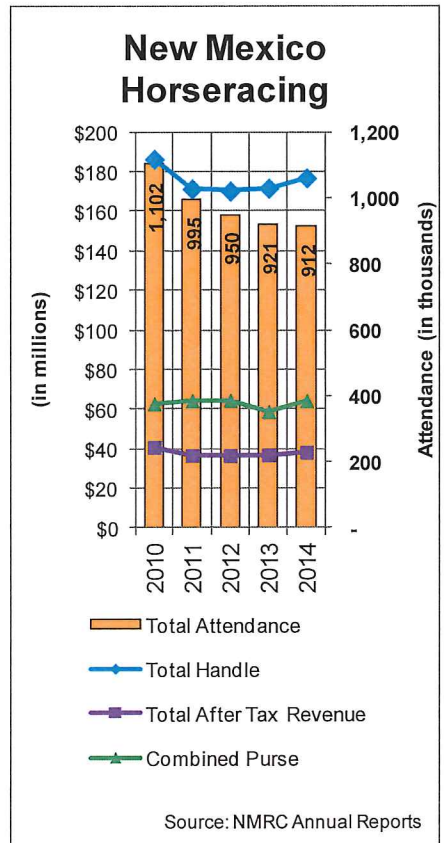
New Mexico Horseracing Industry

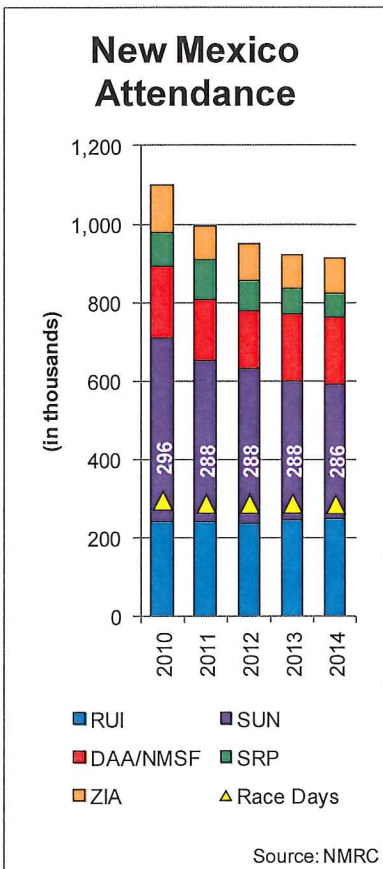
A 2012 New Mexico State University (NMSU) study found approximately 14.6 thousand total horses comprised the horseracing industry in New Mexico and more than 11 thousand people were licensed by NMRC to participate in the industry in 2006. Initial expenditures associated with ownership, breeding, and training of horses for racing was estimated at

Daily Fantasy Sports

Daily fantasy sports (DFS) are paid competitions where players compete against others by building a team of professional athletes from a particular league or competition. They must remain under a salary cap and earn winnings based on actual statistical performance of the athletes in real-world competition. The U.S. DFS industry is dominated by two companies: FanDuel and DraftKings. As of September 2015, both companies had an estimated value of \$1 billion and controlled 95 percent of the market. The Fantasy Sports Trade Association reported the average DFS player spends \$465 annually and estimated total annual spending on fantasy sports reached \$26 billion in the U.S. and Canada during 2015.

Seven states: Kansas, Colorado, Missouri, Mississippi, Tennessee, Indiana, and Virginia, have enacted laws legalizing and regulating DFS games. Twenty-one other legislatures, including New Mexico, declined to take action this year before adjourning. Many bills would treat the games as distinct from legalized gambling and impose a range of requirements like licensing and registration fees, taxes on revenues, independent audits, minimum age requirements, and state oversight.



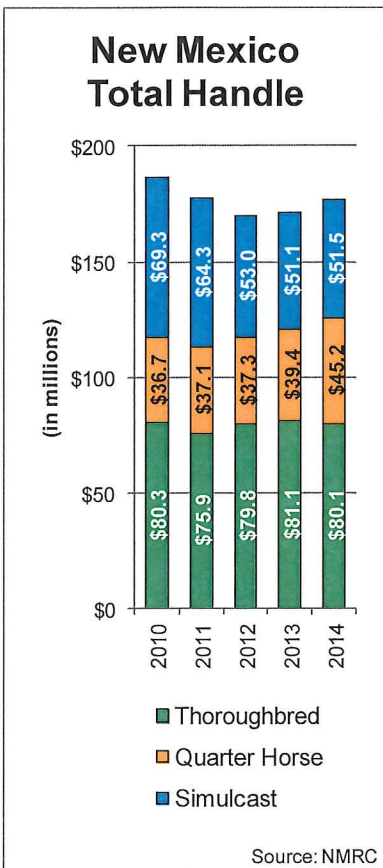


\$217.8 million per year. Two prior NMSU reports varied widely in estimating the economic impacts of the industry, ranging from \$791 million (in 2000) to \$214 million (in 2003). The 2012 study suggested horseracing industry’s impact on New Mexico’s economy was about \$386 million in 2006, not including the effects of racetracks or associated gaming activities.

According to a 2005 study commissioned by the American Horse Council Foundation, New Mexico’s horseracing industry ranked 13th in the nation for number of horses, 14th in state gross domestic product (GDP), 10th in industry participation, and 6th in employment. This study found horseracing had a \$751 million effect on New Mexico’s GDP and involved 91 thousand industry participants. Between FY10 and FY14, total attendance at New Mexico racetracks declined 17.2 percent, despite increases in purses and little change in total race days. According to NMRC, total state revenues increased 21.4 percent, mostly attributable to occupational fines and pari-mutuel taxes. Total handle decreased slightly by 5.1 percent.

Horseracing Compliance and Enforcement

A 2012 New York Times article highlighted concerns in New Mexico horseracing related to a high prevalence of horse breakdowns and equine doping. In two June 2012 LFC briefs, staff highlighted various issues with horse racing in New Mexico including insufficient equine drug testing, gaming revenues subsidizing horse race purses, and declining or flat general fund appropriations for regulatory agencies. A May 2013 LFC evaluation found NMRC did not adequately test for equine doping compared to other states; did not fully audit simulcast revenues, gaming revenues allocated for purses, and state tax payments by racetracks; and lacked sufficient resources to properly vet potential licensees.



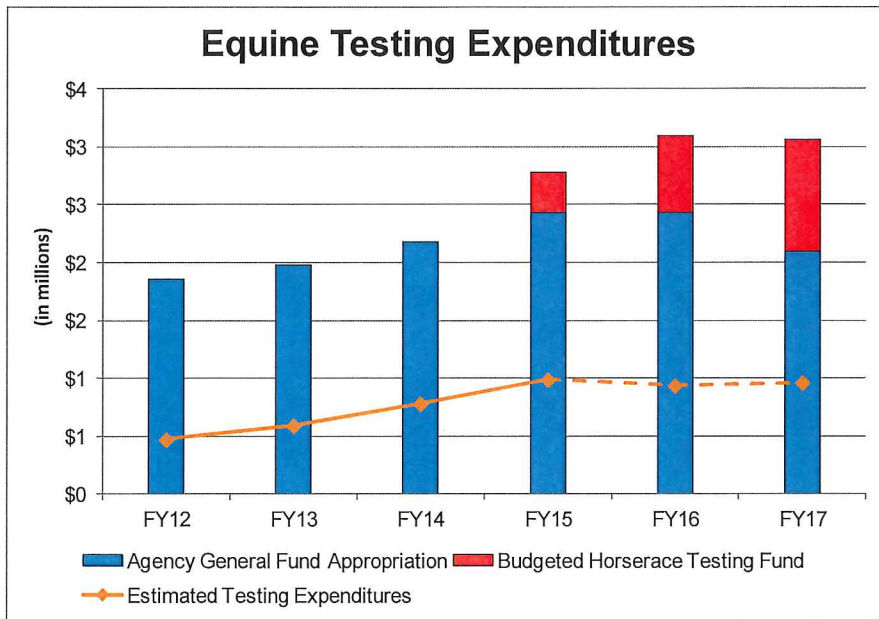
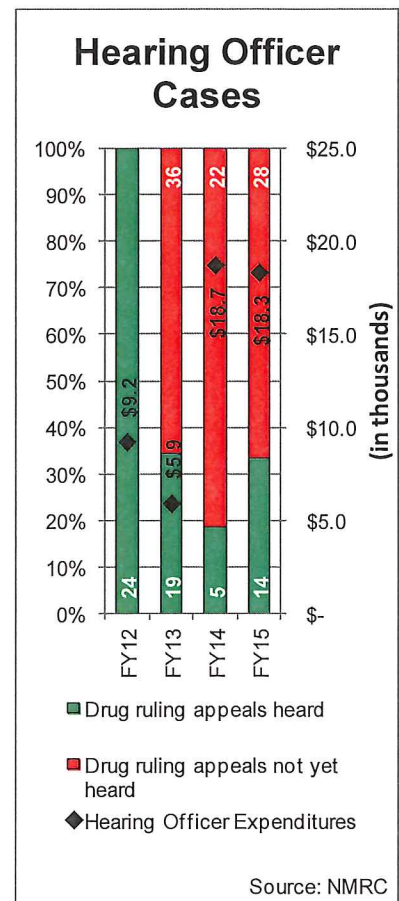
Laws 2013, Chapter 102 created the racehorse testing fund to be administered by the NMRC for the handling and testing of urine and other specimens taken from racehorses pursuant to the Horse Racing Act (HRA). The legislation took effect in January 2015 and stipulated 50 percent of the pari-mutuel tax collected from both class A and class B racetrack licensees be transferred to the racehorse testing fund instead of the general fund. Laws 2013, Chapter 103 gave NMRC the authority to levy fines up to a maximum of \$100 thousand or the total purse amount, whichever is greater, for violations. The Racing Commission has failed to reach its stated goal of testing four horses per race over the past three years. NMRC continues to struggle with high personnel turnover and an average 17 percent vacancy rate from FY12 to FY15, which has placed a strain on drug enforcement and testing.

New Mexico Racing Commission Issues

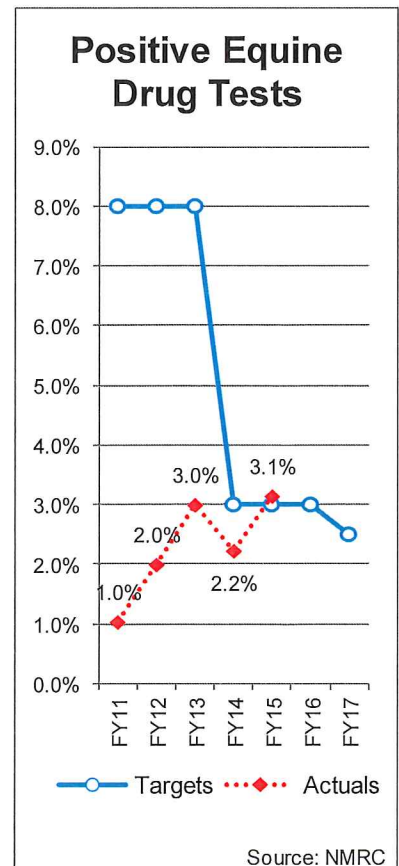
Annual Audit. The Office of the State Auditor released the NMRC’s FY15 audit with two significant findings concerning the collection of revenue and racing purses. The audit found NMRC not in compliance with state statute and rules requiring the commission to receive and maintain monthly reconciliations provided by the New Mexico Horsemen’s Association and Horse Breeders Association. Second, due to lack of oversight, independent auditing was only conducted during live race

sessions and not the remainder of the year. As a result, the state may have received less tax revenue than it was owed.

Appeals Processing. During an October 2014 LFC hearing, NMRC expressed concern about the timeline to resolve appeals of horseracing rulings and the number of rulings appealed to district court. Additionally, NMRC was concerned about licensees appealing rulings in court and getting temporary restraining orders to continue racing until appeals were resolved. A December 2014 LFC staff analysis found significant backlogs in NMRC’s own appeals process, resulting in \$448 thousand in unpaid fines from appeals that had been delayed by an average of 429 days. In March 2016, NMRC Acting Director Dan Fick hired three new hearing officers to expedite processing of new doping cases and address the current case backlog. According to Fick, the Office of the Attorney General was also prosecuting one to three NMRC cases per day, once or twice a week. Despite increases in hearing officer expenditures for FY14 and FY15, the backlog of drug ruling appeals does not appear to have decreased.



Equine Testing. NMRC conducted 17 out-of-competition tests in FY14 and 200 tests in FY15. In FY15, 242 horses tested positive for illegal stimulants, mostly attributable to the class III drug, clenbuterol. NMRC voted unanimously to implement a new rule, effective June 29, 2016, that suspends any horse with a positive test report from the official laboratory for: any substance listed in the Penalty Class A category of the Association of Racing Commissioners International’s uniform classification guidelines for foreign substances; prohibited androgenic steroid or anabolic steroid in excess of permitted concentrations; clenbuterol or other beta-agonist drugs with significant anabolic effects; other drugs designed to promote muscle growth, including but not limited to growth hormones, somatotropins, insulin growth factors; and gene-modifying agents and colbalt in excess of allowable concentrations. The new rule mandates that the horse stays on the stewards list for a minimum of 60 days before a second test for prohibited substances. If the sample is positive, the horse shall remain on the stewards list for an additional 60 days; otherwise, the horse will be permitted to enter and run in races again.



Equine Herpes Virus

In January 2016, a case of equine herpes virus (EHV-1) broke-out at the Sunland Park racetrack and some of the surrounding stables. In response to EHV-1, the New Mexico Livestock Board placed all of the facilities under quarantine. Over 1,600 horses were not allowed to race or leave the track for over one month. Overall, 73 horses were confirmed positive with the virus and 5 were euthanized.

EHV-1 has symptoms including fever, decreased coordination, loss of balance, lethargy, and can be fatal in the worst cases. There is no cure for the virus but the symptoms can be treatable. Almost all horses are infected with some strain of the virus, which can lie dormant for long periods of time.

According to the industry, the EHV-1 incident created a \$7.2 million negative impact to the local economy from lost purses.

Members of the horseracing community criticized Sunland Park for the decision to continue live racing even after the initial case was diagnosed. Sunland Park lost 15 race days due to EHV-1. In response NMRC gave the track eight additional racing days to make up for the lost revenue. This caused significant overlap with the previously scheduled meet at Sunray Park in Farmington. As a result, Sunray Park struggled to fill the field and had to cancel some races entirely.

Ruidoso Downs recently lifted its 14-day equine herpes virus (EHV-1) quarantine of one barn. Officials did not find any positive tests in the weeks after June 18 when one horse tested positive for EHV-1 and was euthanized. Ruidoso Downs did not alter its schedule during the quarantine.

NMRC recently updated protocols for contagious equine disease prevention. All racehorses entering any NMRC licensed racetrack or training center must be accompanied by copies of the horse's registration certificate, a current health certificate, and vaccination records. Health certificates must have been issued within the last 72 hours for horses traveling intra-state and seven days for horses traveling inter-state.

Race Manipulation. On July 19, 2016, the racing industry held the first New Mexico Racing Summit at the Ruidoso Downs racetrack. Attendees included representatives from all five New Mexico racetracks, the New Mexico Horsemen's Association, the New Mexico Horse Breeders Association, the Jockeys' Guild, and trainers. At the summit, stakeholders discussed the problem of jockey agents selecting which horses to race instead of trainers. In recent years, a small number of jockey agents have assumed the role of entering the majority of the horses (95 percent in some cases) for each day's races. Traditionally horses are entered into a race blind, meaning information about other competing horses in that race is unknown. Few controls exist to prevent race manipulation as agents are able to cancel races and enter horses in more favorable races where they will personally profit. Members of the Horsemen's Association stated some agents were betting \$4,000 to \$5,000 per day on these races. Track operators, starting in September with Zia Park, will now extend entry deadlines and require trainers to enter horses rather than jockey agents.

Recommendations

In January 2015, an LFC Subcommittee on Racing Commission Budget and Compliance proposed legislation amending the Horse Racing Act to transfer appeals of commissioners' rulings to the Court of Appeals, prohibit same day licensure, administratively attach NMRC to the Gaming Control Board (GCB), change the penalty for a third class I or class II category A drug violation to a lifetime ban from racing, make possession of non FDA-approved drugs on the grounds of a racetrack a felony, require NMRC hearing officers to render decisions within 90 days, require licensees to place a review fee in an escrow account for appeals, suspend horses that were drugged until appeals are settled, expand uses of the horserace testing fund to include enforcement activities, make operation of an illegal racetrack a felony, make attendance at an illegal race a misdemeanor, and appropriate \$100 thousand to the Administrative Office of the Courts for expenses related to direct appeals of NMRC adjudicatory decisions. Bills related to these changes did not pass in the 2015 regular session. LFC staff recommends a reevaluation of these proposals.

LFC staff also recommends revisiting proposals to administratively attach NMRC to GCB during the commission's sunset review hearing on September 27, 2016. A 2010 New Mexico Government Restructuring Task Force Report estimated \$396.4 thousand in potential cost savings from combining the two boards, which are housed in the same building. GCB could also provide IT resources to improve NMRC databases and address auditing weaknesses related to tax revenue collection and horse racing purses, a recommendation made in the 2013 LFC evaluation. Additionally, GCB employs investigators with law enforcement training, which NMRC currently lacks and has previously cited as a reason for inadequate enforcement action on illegal racetracks.

Additionally, LFC staff notes concerns over NMRC's inability to create a competitive procurement for an independent equine testing laboratory, prosecute HRA violators, respond consistently to race horse diseases, and adjust race days to address market demand. NMRC should report back to the Legislature with a proposal to bolster enforcement of HRA and integrate recommendations into the agency's FY18 budget request.



Timothy M. Keller
State Auditor

Sanjay Bhakta, CPA, CGFM, CFE, CGMA
Deputy State Auditor

State of New Mexico
OFFICE OF THE STATE AUDITOR

January 21, 2016

Dan Fick, Interim Executive Director
New Mexico Racing Commission
4900 Alameda NE,
Albuquerque, NM 87113

Re: FY 2015 New Mexico Racing Commission Annual Audit

Dear Mr. Fick:

On January 21, 2016 the Office of the State Auditor (OSA) released the Fiscal Year (FY) 2015 financial audit for the New Mexico Racing Commission (Commission). At the request of the OSA, MP Group, Inc., the independent accounting firm that conducted the FY 2015 audit, reviewed various concerns regarding racing purses and the collection of revenue.

The Commission is responsible for ensuring racetracks abide by state law in payment of pari-mutuel taxes. Legislative Finance Committee report #13-02 stated that racetracks self-report and pay pari-mutuel wagering taxes and the Commission does not regularly audit these taxes.

As indicated in Finding 2015-001 "Review of Licensee Taxes," the independent auditing of pari-mutuel taxes and the 20% purse requirement only occurred during live race sessions and not the remainder of the year. As a result the state may have received artificially lower amounts of tax revenue. To address this lack of oversight, the independent auditor recommended that the Commission's policies and procedures be strengthened in order to ensure that race tracks accurately report taxes, and therefore purse revenues, to the Commission.

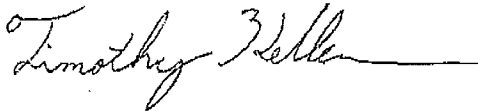
The LFC report also indicated significant differences between the revenues allocable to horse racing purses by the Commission and the revenues allocable to horse racing purses by the Gaming Control Board (GCB). The Commission stated that it is making efforts to manage the information electronically so that revenues can be compared with those on the books of the GCB. This first step will enable greater scrutiny of any unresolved differences between revenues reported by the GCB and revenues reported by the Commission.

In addition, the Commission's audit report included Finding 2015-002 "Reconciliation of Purses," which noted that the Commission is not in compliance with state statute and rules requiring the Commission to receive and maintain monthly reconciliations provided by the New Mexico Horsemen's Association and Horse Breeder's Association. In a positive development, management agreed with the auditor's recommendation to maintain and review these reports moving forward. We also note that the Commission has resolved the two findings from last year,

including a significant deficiency, which we brought to the attention of former Director Mares in FY 2014.

Considering the importance of the issues identified in the audit, we expect these matters to be resolved when the OSA reviews next year's audit. Lack of progress may result in a special audit or other actions by this office. We appreciate the Commission's attention to these issues and please let us know if we can be of assistance in any way.

Sincerely,

A handwritten signature in cursive script that reads "Timothy Keller". The signature is written in black ink and includes a long horizontal flourish extending to the right.

Timothy M. Keller
State Auditor

cc: Robert M. Doughty, III, Chairman
Beverly Bourguet, Commissioner
Jerry Coper, DVM, Commissioner
Gayla McCulloch, Commissioner
Ray Willis, Commissioner
David Abbey, Director, Legislative Finance Committee

Section I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unmodified

Internal Control Over Financial Reporting:

- Material weakness(es) identified? No
- Significant deficiencies identified that are not considered to be material weakness(es)? Yes
- Finding 2015-001
- Noncompliance and other matters identified? Yes
- Finding 2015-002

Section II - Financial Statement Findings

2015-001 - Review of Licensee Taxes (Significant Deficiency)

CONDITION

The agreed upon procedures performed by independent public accountants concerning the testing of the pari-mutuel taxes and 20% purse requirement does not cover the entire year ended June 30, 2015.

CRITERIA

The NMRC requires taxes paid to be audited during live race meets by their contracted auditors, and confirmed to the LFC that they randomly check tax revenues at other points in the year as well. The Taxation and Revenue Department (TRD) does not track these tax dollars, so the NMRC becomes the de facto enforcement entity to ensure racetracks are abiding by state law in payment of pari-mutuel taxes.

CAUSE

The Commission has only contracted with the IPA's during live race sessions and not the remainder of the year.

EFFECT

The Commission is not auditing the remainder of the year that the race track is not running live races. Because of this, the tracks could be improperly reporting the information to the Commission.

RECOMMENDATION

The Commission should establish policies and procedures to monitor the tracks activity that is not comprised during live race days.

MANAGEMENT RESPONSE

Upon receipt of an LFC audit of our agency, areas were identified that needed improvement, one of these areas is racing oversight. In order to improve on racing oversight, management concluded that successful compliance would require additional staff. In April 2015, the agency hired an internal auditor to concentrate on strengthening audit and racing oversight including pari-mutuel taxes. During fiscal year 2015, staff developed a work sheet to ensure receipt of PM taxes, this worksheet is compared monthly by the Administrative Manager to ITW reports received from respective racetracks, however, in previous years, the comparison was completed randomly. Changes have been made to ensure that this process is improved and that receipt of taxes is timely, calculations are correct and the reporting of information is accurate. This task is the responsibility of our internal auditor and is currently being completed on a weekly basis manually thru a mix of paper and electronic reporting. If any errors are found, the reports are looked at daily until corrections are complete. Management is seeking to obtain a program to manage the information electronically (i.e. live, comparable to Gaming Control Board). Staff has already begun to reach out to companies that can provide the software. This will require additional staff and funding, which receipt of this funding is unknown at this time.

Section III - Other Matters as Required by New Mexico State Statute 12-6-5, NMSA 1978

2015-002 - Reconciliation of Purses (Other noncompliance)

CONDITION

The Horseman's and Horsebreeder's associations are required to provide monthly reconciliations of amounts collected to the account statements. The reconciliations could not be located.

CRITERIA

Per that state statutes Chapter 60 NMSA 1978, and NMAC 15.2.2.9, The Commission is required to receive and maintain the monthly reconciliations provided by the NM Horseman's and Horsebreeder's Associations.

CAUSE

The Commission didn't appropriate sufficient resources to perform the work needed for the review and reconciliation of the purses from the tracks.

EFFECT

The Commission is not in compliance with the State statutes in Section 60 of the Horse Racing Compliance Act

RECOMMENDATION

The management at the Commission should establish policies and procedures related to reconciliations to ensure that they are maintained and reviewed on a regular basis. In addition the Commission should ensure that monthly reports from the NM Horseman's and Horsebreeder's Associations are maintained and reviewed.

MANAGEMENT RESPONSE

The staff did not receive the monthly reconciliations as stated above in the Condition, per NMSA 15.2.2.9. The Internal Auditor is responsible for receipt of these reports; they will be requested from both the NM Horseman's and the NM Horse Breeder's Associations to allow Internal Auditor a monthly review of reconciliation to ensure accuracy and accountability; the monthly reports will be maintained at the Commission. During the first week of the following month, if the reports have not been received, the Internal Auditor will contact the respective associations for submittal. It should be noted that currently these reports are being provided to the auditor.

For the Year Ended June 30, 2015

An exit conference was held on December 1, 2015, with the following in attendance:

New Mexico Racing Commission

Jerry G. Coper, DVM, Board Member

Vince Mares, Agency Director

Laura Valencia, CFO

MP Group, Inc.

Scott Peck, Partner

MP Group, Inc. prepared draft financial statements and note disclosures from trial balances and records provided by the Commission's management which was subsequently reviewed and approved by management.