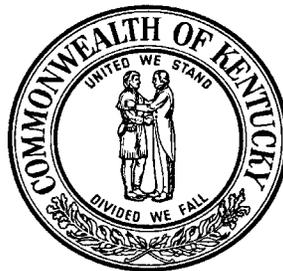


**REPORT OF THE AUDITOR OF PUBLIC ACCOUNTS  
AGREED-UPON PROCEDURES ENGAGEMENT  
OF THE  
KENTUCKY THOROUGHBRED DEVELOPMENT FUND**

**For The Period July 1, 1999  
Through April 30, 2006**



**CRIT LUALLEN  
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**Kentucky Thoroughbred Development Fund**  
**Executive Summary**  
**July 1, 1999 - April 30, 2006**

The Cabinet for Environmental and Public Protection, Department of Public Protection, contracted with the APA to perform an agreed upon procedures engagement on the Kentucky Thoroughbred Development Fund (KTDF) for the period July 1, 1999 through April 30, 2006. An agreed-upon procedures engagement is one in which an independent accountant is engaged to perform specific procedures which are directed by management and to report findings. The accountant does not perform an audit or provide an opinion relating to the subject matter. Rather, the accountant performs only those procedures that have been agreed upon by the agency's management and reports findings based on the outcome of those procedures. An audit, on the other hand, is more comprehensive and would include an opinion on financial statements and compliance with applicable laws and regulations.

The procedures agreed upon by the Department for Public Protection are outlined in the report. Key findings and recommendations resulting from this engagement are outlined below.

General Information

KTDF expenditures were approximately \$55,633,630 during the period July 1, 1999 through April 30, 2006.

KTDF revenues, generated from an allocation of pari-mutuel taxes paid by the various thoroughbred racetracks, were approximately \$55,370,962 during the period July 1, 1999 through April 30, 2006.

Summary of Significant Findings

- Kentucky Horse Racing Authority (KHRA) did not perform reconciliations of the KTDF to provide the status of each racetrack's position in the fund.
- KHRA, or its predecessor agency, the Kentucky Racing Commission (KRC), did not maintain adequate documentation to support beginning fund balances by racetrack for the purposes of this report.
- KHRA did not maintain all documentation necessary to determine that reimbursements to racetracks were in compliance with the requirements of the fund.
- Based on the information available, three (3) of the four (4) thoroughbred racetracks had deficits in the fund at various points during the period under review. In addition, the information provided indicated that three (3) of the four (4) racetracks had negative balances in 1999.
- Based on the information provided to the APA from various sources, including the KHRA, the Kentucky Department of Revenue (DOR), and the financial accounting system maintained by the Kentucky Finance and Administration Cabinet (FAC), and recognizing that the beginning balances in 1999 are based upon an internal unaudited KRC document that was prepared by a former director and distributed to the KTDF Advisory Committee, our procedures resulted in two racetracks, Churchill Downs and Keeneland, having deficits in the fund at the end of 2005 of \$2,024,031 and \$567,118, respectively. The two other racetracks, Ellis Park and Turfway Park, had surpluses at the end of calendar year 2005 of \$504,234 and \$2,099,632, respectively. The internal KRC memo utilized for this reconciliation could not be substantiated and did not appear to agree to the financial accounting system. Whereas the APA understands the limitations of this unaudited document, it was the only evidence obtained from KHRA that provided a starting point for the reconciliation of this fund.



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CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS

**Independent Accountant's Report  
On Agreed-Upon Procedures**

Lisa Underwood, Executive Director  
Kentucky Horse Racing Authority  
4063 Ironworks Parkway, Building B  
Lexington, KY 40511

Dear Ms. Underwood:

We have performed the procedures enumerated in Appendix 2 related to the Kentucky Thoroughbred Development Fund (KTDF), which were requested and agreed to by the Department of Public Protection, Environmental and Public Protection Cabinet. The procedures were performed solely to assist the Department of Public Protection to determine whether overpayments were made to Kentucky thoroughbred racetracks from the fund, to determine whether payments were made to racetracks in accordance with statute, and to reconcile the fund. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our report provides background information related to the establishment and responsibilities of the Kentucky Horse Racing Authority (KHRA) and establishment of the KTDF. The background section is followed by the procedures agreed upon for this engagement, our results, recommendations, and supplemental information.

We were not engaged to, and did not conduct an examination, the objective of which would be the expression of an opinion on the procedures described above. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.



Department of Public Protection  
Lisa Underwood, Deputy Commissioner

This report is intended solely for the information and use of the Commissioner of the Department of Public Protection and the management of the Kentucky Horse Racing Association, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen  
Auditor of Public Accounts

December 12, 2006

**Kentucky Thoroughbred Development Fund**  
**Appendix 1**

***Background Information***

On January 6, 2004, by executive order the Kentucky Horse Racing Authority was created and established as an independent agency of state government charged with the responsibility of regulating the conduct of horse racing and pari-mutuel wagering on horse racing and related activities within the Commonwealth of Kentucky. KHRA administratively falls within the Department of Public Protection, Cabinet for Environmental and Public Protection.

KHRA consists of 13 members appointed by the governor. In addition to these members, the secretaries of the Environmental and Public Protection Cabinet, Commerce Cabinet, and Economic Development Cabinet serve as ex officio nonvoting members. One member is appointed to serve as chairperson of KHRA. A second member is designated to serve as vice chair of KHRA to act in the absence of the chair.

Except as otherwise provided, KHRA shall be responsible for the following:

- a) Developing programs and procedures that will aggressively fulfill its oversight and regulatory role on such matters as race day medications;
- b) Recommending tax incentives and other incentive options to ensure the strength and growth of the thoroughbred industry so as to preserve Kentucky's horse farms and keep them economically viable and competitive;
- c) Designing and implementing programs that strengthen the ties between Kentucky's horse industry and the state's universities with the goal of significantly increasing the economic impact of the horse industry to Kentucky's economy;
- d) Developing and supporting programs that ensure Kentucky remains on the cutting edge of equine research; and
- e) Developing and implementing programs that promote Kentucky's horse and tourism industry.

As part of its responsibilities, KHRA is the administrator of the Kentucky Thoroughbred Development Fund. The KTDF is authorized by KRS 230.400 to collect funds allocated from the pari-mutuel wagering taxes and other funds, and use these funds to "promote, enhance, improve, and encourage the further and continued development of the thoroughbred breeding industry in Kentucky by providing out of the Kentucky Thoroughbred Development Fund, supplemental purses for designated stakes, handicap, allowance, and nonclaiming maiden races contested at licensed thoroughbred race meetings in Kentucky, the awarding and payment of which supplemental purses shall be conditioned upon the winning or placing in designated races by Kentucky bred thoroughbred horses." During the period covered by this engagement, July 1, 1999 through April 30, 2006, total expenditures in the KTDF were \$55,633,630, with total revenues of \$55,370,962.

**Kentucky Thoroughbred Development Fund**  
**Appendix 2**

*Agreed Upon Procedures and Findings*

**A. Determine that the Kentucky Department of Revenue (DOR) is properly collecting the pari-mutuel tax as authorized under KRS 138.510:**

- 1) Document the system of controls at KHRA for collecting the tax from the various racetracks, and procedures for crediting the KTDF with those funds.
  - We will document the internal controls over pari-mutuel tax receipts and the controls over sweeping those funds to the KTDF in a narrative.
- 2) We will select a sample of pari-mutuel tax forms for the period July 1, 1999 through April 30, 2006, and test to determine the amount due agrees to the amount of receipts recorded in the financial accounting system (STARS/MARS).

**Findings:**

*We documented internal controls over pari-mutuel tax receipts collected by the DOR. We also documented internal controls within KHRA for the reconciliation of these receipts to determine whether each racetrack is credited with the proper amount. Our recommendations based on our review of internal controls are presented in Appendix 3.*

*We also tested a sample of pari-mutuel tax forms for the period July 1, 1999 through April 30, 2006, ensuring that each thoroughbred racetrack was represented in the sample every calendar year. We tested the reports for mathematical accuracy, recalculating the KTDF allocation. To agree the individual pari-mutuel tax forms to the financial accounting system (STARS/MARS) for the KTDF portion, we traced them to an internal DOR racing sheet, which provides the validating number for the receipt, and then to a DOR mixer program report that shows the detail KTDF transaction for that validating number. Our procedures did not disclose any errors.*

**Management's Response:**

*KHRA in conjunction with the Department of Revenue (DOR) and the Kentucky horse racing tracks has developed new practices and procedures to verify pari-mutuel tax fund transfers. The new procedures include matching the track's tax forms (sent to the Authority by the tracks) to the amounts transferred from DOR; the procedures ensure that the taxes are set aside for the Kentucky Thoroughbred Development Fund. (See Attachment 1's Exhibit A.)*

**Kentucky Thoroughbred Development Fund**  
**Appendix 2**  
**Agreed Upon Procedures and Findings**  
(Continued)

**B. Determine that the Kentucky Department of Revenue is crediting the proper amount to the KTDF as described under KRS 138.510 :**

- 1) Document the procedures for crediting the KTDF with those funds.
  - We will document the procedures for sweeping those funds to the KTDF in a narrative.
- 2) We will select a sample of transfers for the period July 1, 1999 through April 30, 2006, to the KTDF to verify the accuracy and propriety of the transactions.

**Findings:**

*We documented the DOR procedures for uploading the tax receipt information and transferring the receipts into the KTDF fund in the financial accounting system. We did not identify any findings or recommendations related to these procedures.*

*We traced all DOR transfers into the KTDF in STARS/MARS from the mixer program that provides details of the pari-mutuel tax receipts. We reconciled the transfers over the entire period to within \$124,624. These reconciling items were presented to DOR for follow up, and DOR was able to substantiate all reconciling items except two transfers reported in MARS that were not detailed in the mixer program report. These transfers led to the KTDF balance in MARS exceeding the supporting records, and therefore this does not create a shortage to the fund.*

**Management's Response:**

*KHRA also reconciled the revenue transferred from the Department of Revenue; we concur with the findings of the Auditor of Public Accounts.*

**Kentucky Thoroughbred Development Fund**  
**Appendix 2**  
**Agreed Upon Procedures and Findings**  
(Continued)

**C. Determine that the amount KHRA paid to racetracks for the benefit of thoroughbred owners from the KTDF was accurately calculated and paid under the provisions of KRS 230.400, and identify the existence of overpayments.**

- 1) Document the procedures for and payments of amounts due to the various racetracks.
  - We will document the procedures for verification and payment of invoices from the KTDF in a narrative.
  - We will document the procedures for invoice preparation to the KTDF by the various racetracks and by the track identifier in a narrative.
  - We will document the procedures for the establishment of the supplemental purse amount paid by the KTDF by the various racetracks, the Kentucky Thoroughbred Association-Kentucky Thoroughbred Owners and Breeders (KTA-KTOB) in a narrative.
- 2) We will select a sample of Authority payments from the KTDF for the period July 1, 1999 through April 30, 2006, to verify the accuracy and propriety of the transactions.

**Findings:**

*We documented the procedures for record keeping and submission of invoices by the four thoroughbred racetracks in the state (Churchill Downs, Ellis Park, Keeneland, and Turfway Park). We also documented internal controls related to KHRA verification, approval and payment of these invoices. Our recommendations based on our review of internal controls are presented in Appendix 3.*

*We also documented the process for establishing the supplemental purse by the various racetracks. We noted that KTA-KTOB does not participate in the process of establishing the supplemental purses. Our recommendations based on our review of these procedures are presented in Appendix 3.*

*We selected a sample of KHRA payments made to the various racetracks during the period under review, and tested these payments for mathematical accuracy, proper supporting documentation, appropriate verification and proper approval. We noted the following:*

- *We were unable to test five (5) of sixty-eight (68) requested KTDF invoices and Horse Identifier Reports because KHRA could not locate*

**Kentucky Thoroughbred Development Fund**  
**Appendix 2**  
**Agreed Upon Procedures and Findings**  
(Continued)

*the invoices. We were unable, therefore, to verify the propriety of racetrack reimbursements and that payments were for registered Kentucky-bred horses finishing first through fourth.*

- *Of the KTDF sixty-three (63) invoices tested, seventeen (17) did not include a Horse Identifier Report. Therefore, we were unable to determine if payments to the corresponding racetracks were reimbursements for Kentucky-bred horses finishing first through fourth in the noted races.*
- *Four (4) KTDF reimbursements to Keeneland were for horses that were not registered Kentucky-bred horses. These invoice payments were as follows: (1) 2001 Fall Meet: \$1,770; (2) 2003 Fall Meet: \$4,875; (3) 2004 Fall Meet: \$1,880; (4) 2004 Fall Meet: \$225.*
- *One (1) invoice tested did not agree to supporting documentation. The KTDF invoice amount was \$387.50 less than the supporting detail.*

*See our recommendations for improvement in Appendix 3.*

**Management's Response:**

*The Kentucky Thoroughbred Development Fund's independent track allocations have since been reconciled with all involved parties with a signed legal KTDF Settlement Agreement and Memorandum of Understanding. See Attachment 1.*

*KHRA has developed new practices and procedures in conjunction with the Department of Revenue and the Kentucky horse racing tracks to verify all fund transfers that are collected from pari-mutuel taxes that are set aside for the Kentucky Thoroughbred Development Fund. These new procedures will utilize the eMARS system's ability to track individual track accounts payable and accounts receivable in accordance with KRS 230.400. The new procedures are detailed in Attachment 1, Exhibit A.*

**Kentucky Thoroughbred Development Fund**  
**Appendix 2**  
**Agreed Upon Procedures and Findings**  
(Continued)

**D. Make recommendations for improvement of the administration of the KTDF.**

*Refer to Appendix 3.*

**E. We will perform a reconciliation of the fund balance, for the period July 1, 1999 through April 30, 2006, in the KTDF and determine the amount of net over/underpayment related to each racetrack. We will provide recommended procedures for the KHRA to maintain the fund reconciliation going forward.**

**Findings:**

*Based on current practices of KHRA and its interpretation of statute, each thoroughbred racetrack receives credit for the KTDF payments made to the fund from all sources (host and receiving track payments) for the period it hosts live racing. Each racetrack is limited to receiving KTDF reimbursement only up to the amount it has credited in the fund. Therefore, it is important to maintain an up-to-date reconciliation of the fund in order to know the status of each racetrack prior to making reimbursements.*

*Since reconciliations have not been maintained for the KTDF, in order to perform this reconciliation, to determine the amount of overpayments to the fund, and the status of each racetrack at April 30, 2006, we attempted to locate (a) beginning balances reconciled to the financial accounting system (STARS/MARS) or otherwise substantiated by supporting documentation, and (b) detailed activity for the period that agrees to the financial accounting system and included not only information on receipts from and reimbursements to the racetracks, but also that included the tax period and host track to be credited. Obtaining this information presented various challenges described in more detail below.*

*KHRA did not maintain balances by racetrack, and was not aware of the existence of reconciled balances during the period under review. We were provided with a memorandum dated March 19, 1999, that was prepared by a former KRC director and addressed to the KTDF Advisory Committee that contained beginning and ending balances from 1998 (presumably calendar year). We were unable to tie these balances into the financial accounting system (STARS) and did not locate any other supporting evidence to substantiate the accuracy of these balances. Whereas we understand the limitations of using this unverifiable document, we also were unable to locate*

**Kentucky Thoroughbred Development Fund**  
**Appendix 2**  
**Agreed Upon Procedures and Findings**  
(Continued)

*any other evidence that provided substantiated balances, and therefore this was the only source we had as a basis for our beginning amounts.*

*We were able to obtain detailed payments for reimbursement to racetracks from STARS/MARS, and requested supporting documentation from KHRA to test the validity of those payments. KHRA did not have detailed records that would enable us to determine and summarize the receipts paid by the racetracks during the entire period, or to determine which racetrack should receive credit for specific payments. The reports generated from STARS/MARS do not contain receipt details because the racetracks submit these payments to DOR with pari-mutuel tax filings. The detail of taxpayer payments was provided by DOR via a mixer program report. However, this program maintains the detail of taxpayer accounts credited with the receipt, but does not maintain additional information from the pari-mutuel reports such as host track or racing dates.*

*To obtain the additional detail, DOR Miscellaneous Tax was able to provide internal racing spreadsheets it maintains to reconcile and monitor pari-mutuel tax payments. These spreadsheets summarize the pari-mutuel tax reports, and are maintained by tax year. Because the racing sheets are maintained by tax year, and subsequent amended returns and other adjustments may impact that tax year, the racing sheets do not readily agree to STARS/MARS. Therefore, the auditor tested the racing sheets to determine if the individual payments agree to the DOR mixer system report, which was reconciled within an immaterial amount to STARS/MARS. Although these procedures identified some errors in the racing sheets, it did not identify any significant errors that would preclude it from being used for the KTDF reconciliation by racetrack. It was also noted that there were approximately \$1.5 million more revenues in the KTDF than the racing sheets detailed for the period under review. Much of the information for these revenues could be inferred in the racing sheets, which assisted in completing the detail for the reconciliation, but also added additional validity concerns to this detail. Whereas the auditor noted that the racing sheets are internal spreadsheets maintained for a purpose other than specific administration of the KTDF, and that these reconciling differences and errors put into question the complete accuracy of the information, again, this was the only source of this data available without recreating the details by manually entering the pari-mutuel forms for the entire period under review.*

*Using the data available to us, including the beginning balances from the March 19, 1999 memo, the detailed payments to the racetracks from STARS/MARS, and the detailed KTDF credits to the host tracks as detailed in the DOR racing sheets, the beginning balances were adjusted to arrive at*

**Kentucky Thoroughbred Development Fund**  
**Appendix 2**  
**Agreed Upon Procedures and Findings**  
(Continued)

*ending balances for each racetrack. This allocation of KTDF activity is presented in Appendix 4. We noted that the KTDF allocation was out of balance with the KTDF cash balance as of April 30, 2006, by \$1,123,604. Since all other activity agrees to STARS/MARS, this reconciling difference appears to be related to unknown differences in the beginning balances.*

**Management's Response:**

*KHRA reconciled historical, beginning fund balances for over fifteen years. It was during the initial attempts at determining amounts payable to/receivable from the independent tracks (which make up a large portion of the Kentucky Thoroughbred Development Fund) that the KHRA requested the aid of the Office of Auditor of Public Accounts. The Kentucky Thoroughbred Development Fund's independent track allocations have since been reconciled and all involved parties have signed a KTDF Settlement Agreement and Memorandum of Understanding (Attachment 1).*

**Kentucky Thoroughbred Development Fund**  
**Appendix 3**

***Recommendations***

**A. KHRA should have procedures in place to reconcile the KTDF by racetrack.**

KHRA should develop an agreement with the Department of Revenue's (DOR) Miscellaneous Tax Section for an exchange of information. DOR maintains detailed spreadsheets for the pari-mutuel tax reports that would minimize KHRA's data entry. Also, since transfers to the KTDF via MARS are uploaded from the DOR's system, the details by racetrack are only available via reports generated from this system. DOR appears to be open to an agreement with KHRA for an exchange of this information. [NOTE: since the detail reports would require COT resources, charges may apply.]

**Management's Response:**

*KHRA in conjunction with the Department of Revenue (DOR) and the Kentucky horse racing tracks has developed new practices and procedures to verify pari-mutuel tax fund transfers. The new procedures include matching the track's tax forms (sent to the Authority by the tracks) to the amounts transferred from DOR; the procedures ensure that the taxes are set aside for the Kentucky Thoroughbred Development Fund. (See Attachment 1's Exhibit A.) It is our understanding that the agreement and these procedures will lead to unqualified, clean audit opinions in the future.*

**Auditor Reply:**

In order to provide clarification to the management's response regarding future audit opinions, this Agreed Upon Procedures Report does not provide an opinion of the KTDF. However, a separately issued audit of the KHRA, required by House Bill 380, includes a report that encompasses the KTDF and other funds of the Authority. It should be noted that any future findings and audit opinions will be the result of the facts, circumstances and results of testing procedures for the year under audit.

**Kentucky Thoroughbred Development Fund**  
**Appendix 3**  
**Recommendations**  
(Continued)

**B. KHRA should actively monitor each racetrack's position in the fund.**

Procedures should be implemented to have up-to-date comparisons of the revenues paid in by each racetrack compared to payments made to the racetracks, arriving at each racetrack's balance, or position in the fund. These balances should be reconciled in total to the fund balance in MARS.

Prior to making any payments to a racetrack, KHRA should ensure that the racetrack's balance is sufficient to cover any payment. If the racetrack's balance is insufficient to pay an invoice, KHRA should consider making partial payments and deferring the balance of the invoice until such time that the racetrack's payments into the fund are sufficient to cover the remaining balance. (Payments made over the racetrack's balance would constitute an advancement and should not be permitted.) Procedures are needed to monitor any deferrals, so that the racetracks can receive the remaining balance of any invoice when its position in the fund permits it.

**Management's Response:**

*New procedures were developed. (See Attachment 1's Exhibit A.) It is our understanding that the agreement and these procedures will lead to unqualified, clean audit opinions in the future. Monthly/Meet End meetings will be conducted with each track to assure agreement with payments and fund balances.*

**Auditor Reply:**

Refer to the auditor's reply for Recommendation A above as it relates to management's response regarding future audit opinions.

**Kentucky Thoroughbred Development Fund**  
**Appendix 3**  
**Recommendations**  
(Continued)

**C. KHRA should periodically report the status of the fund, including each racetrack's position in the fund, to the KTDF Advisory Committee and to the participating racetracks.**

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The KHRA should consider including such information in the biennial report. Each track should receive a notice of its position in the fund at least annually, and at the time of any payment deferral.

The KHRA should discuss the communication of the fund's position with the KTDF Advisory Committee in a timeframe agreed upon with the committee.

**Management's Response:**

*More detailed information concerning the KTDF will be included in future biennial reports of the KHRA.*

*Procedures have been developed that will require a greater involvement by the KTDF Advisory Committee. The KTDF Advisory Committee approved the KTDF Settlement Agreement and Memorandum of Understanding. This committee has planned to meet on a more regular basis to fulfill the duties they are required to perform by statute.*

**D. KHRA should develop procedures to standardize the establishment of the supplemental purse amount by each racetrack. The supplemental purse should not rely on contingent future events, but should be based on actual activity in the fund.**

---

Because the supplemental purse amounts are currently set prior to the KTDF assessment is known, modifying this methodology to create a timing lag should take into consideration funding concerns.

**Management's Response:**

*Procedures are now in place for the establishment of supplemental purses and the associations agree to this approach (see Attachment 1's Exhibit A).*

**Kentucky Thoroughbred Development Fund**  
**Appendix 3**  
**Recommendations**  
(Continued)

- E. To reduce the risk that a supplemental purse structure could be intentionally or unintentionally overstated, KHRA should implement procedures for each racetrack to submit its KTDF supplemental purse structure for approval prior to each meet.**
- 

These KTDF purses should be reviewed in a timely manner by the KHRA and approved if KHRA believes that the purses are appropriate and that funds are likely to be available.

Any problems with the purse structure should be worked out with the racetrack prior to the meet.

**Management's Response:**

*The new procedures contain guidelines that will lead to KHRA compliance in the future.*

- F. KHRA should have a formal policy requiring that for all racetrack invoices submitted for KTDF reimbursement, KHRA obtain a Horse Identification Report listing the registered Kentucky bred horses who ran in the race. In addition, the Horse Identification sheet should indicate KTDF Earnings for those registered Kentucky bred horses finishing first, second, third, and/or fourth. All Horse Identification sheets should include the racetrack name, meet, racing date, race number, and race class.**
- 

Of the KTDF invoices tested, seventeen (17) did not include a Horse Identifier Report, therefore we were unable to determine if payments to the corresponding racetracks were reimbursements for Kentucky-bred horses finishing first through fourth in the noted races.

**Management's Response:**

*The new procedures contain guidelines that will lead to KHRA compliance in the future.*

**Kentucky Thoroughbred Development Fund**  
**Appendix 3**  
**Recommendations**  
(Continued)

**G. KHRA procedures should require that for each KTDF invoice, KHRA verify that Horse Identification Reports indicate that only registered Kentucky bred horses finishing first, second, third, and/or fourth, eligible for KTDF reimbursement will be paid. In addition, KHRA procedures should require verification of invoice details (e.g., date, race number, first, second, third and fourth finishers) by matching the amounts to the corresponding Horse Identification Report's KTDF Earnings column.**

---

We determined that four (4) KTDF reimbursements to Keeneland were for horses that were not registered Kentucky-bred horses. Incorrect invoice payments to Keeneland were as follows: 1) 2001 Fall Meet: \$1,770; 2) 2003 Fall Meet: \$4,875; 3) 2004 Fall Meet: \$1,880; 4) 2004 Fall Meet: \$225.

**Management's Response:**

*The new procedures contain guidelines that will lead to KHRA compliance in the future.*

**H. KHRA should verify KTDF invoice totals prior to processing payment.**

---

The total for one (1) invoice tested was incorrect. The KTDF invoice amount was \$387.50 less than the supporting invoice details.

**Management's Response:**

*The new procedures contain guidelines that will lead to KHRA compliance in the future.*

**Kentucky Thoroughbred Development Fund**  
**Appendix 3**  
**Recommendations**  
(Continued)

**I. KHRA should develop and implement a formal record retention policy requiring KTDF invoices and Horse Identification Reports be maintained for an appropriate time period.**

---

We were unable to test five (5) of the requested KTDF invoices and Horse Identifier Reports because KHRA could not locate the records. We were unable, therefore, to verify the propriety of racetrack reimbursements and that payments were for registered Kentucky-bred horses finishing first, second, third, and/or fourth.

**Management's Response:**

*The new procedures contain guidelines that will lead to KHRA compliance in the future.*

**J. KHRA should have a formal policy and implement procedures requiring independent verification checks be performed, on a limited test basis, whereby the registration of those Kentucky-bred horses listed by the Horse Identifier as having finished a given race first through fourth, are in fact confirmed with the KTA Kentucky Registry. The procedures should require formal documentation of having performed such verification checks.**

---

KHRA has no formal policy requiring independent verification checks be performed confirming that Kentucky-bred horses listed by the Horse Identifier, for those horses having finished a given race first through fourth, are in fact confirmed with the KTA Kentucky Registry.

**Management's Response:**

*The new procedures contain guidelines that will lead to KHRA compliance in the future.*

**Kentucky Thoroughbred Development Fund**  
**Appendix 3**  
**Recommendations**  
(Continued)

**K. KHRA should develop and implement guidelines and regulations with the advice and assistance of the KTDF Advisory Committee.**

KHRS and the Advisory Committee should consider including guidelines for the provision of supplemental purses, the amount thereof, the races for which the purses are to be provided and the conditions thereof, manner and method of payment of supplemental purses, registry of thoroughbred stallions standing within the Commonwealth of Kentucky, registry of Kentucky bred thoroughbreds, nature and type of forms and reports to be employed and required in connection with the establishment of, provision for, award and payment of supplemental purses pursuant to KRS 230.400(3) (a).

**Management's Response:**

*The new procedures contain guidelines that will lead to KHRA compliance in the future.*

**Kentucky Thoroughbred Development Fund**  
**Appendix 3**  
**Recommendations**  
(Continued)

**L. KHRA should ensure that racetracks are periodically audited to ensure the accuracy of pari-mutuel reports submitted to DOR.**

KHRA should take steps to ensure that racetracks are periodically audited to ensure compliance with pari-mutuel reporting and tax requirements. As the regulatory agency responsible for horse racing and pari-mutuel wagering, it should create policies and procedures to monitor these reporting requirements. Since taxes paid on pari-mutuel taxes are collected by the Department of Revenue, KHRA should consider DOR a tax audit resource and consider entering into an agreement with the agency for the periodic audits. KTDF may be assessed the necessary costs incurred based on the provisions of KRS 230.400 (3) (b).

**Management's Response:**

*The information obtained by this audit and the agency review were instrumental in developing procedures included in the KTDF Settlement Agreement and Memorandum of Understanding to assure proper oversight of this fund. The KHRA very much appreciates the thought and effort of all involved parties in its effort to unravel the complexities of this fund and its fairly loose history.*

*A meeting was held with representatives from the tracks, Auditor of Public Accounts, Department of Revenue, Kentucky Horse Racing Authority, Office of the Commissioner of Environmental and Public Protection Cabinet to provide information to the track representatives. Each track was given an opportunity to verify payments and earned credits from 1999 through April of 2006. All tracks were in agreement with the KTDF Settlement Agreement and Memorandum of Understanding concerning payments and credit earned. Each track was also asked to provide any verifiable information that could assist with a determination of beginning balances. No information concerning beginning balances could be substantiated. Attachment 1's Exhibit A KTDF reconciling procedures were also signed into agreement.*

**Auditor Reply:**

The APA participated with the KHRA to provide information and respond to questions concerning the draft report to the representatives of the racetracks. The APA did not participate in any discussion related to the Settlement Agreement and Memorandum of Understanding.

## Kentucky Thoroughbred Development Fund Appendix 4 Allocations

*Allocation by Thoroughbred Racetrack  
January 1, 1999\* - April 30, 2006*

	CALENDAR YEARS							
	1999	2000	2001	2002	2003	2004	2005	2006
<b>Churchill Downs</b>								
Carryforward from previous year <sup>b</sup>	\$ (729,628.60)	\$ (380,899.68)	\$ (1,214,197.53)	\$ (1,032,582.57)	\$ (1,463,022.28)	\$ (1,630,681.18)	\$ (1,701,994.55)	\$ (2,024,030.78)
Earned (Credits for Live Race Dates)	2,926,415.11	2,971,853.90	2,818,126.97	2,804,234.82	2,540,465.05	2,300,133.34	2,453,169.69	-
Reimbursed & Advertising	(2,377,686.19)	(3,805,151.75)	(2,636,512.01)	(3,234,674.53)	(2,728,123.95)	(2,336,446.71)	(2,755,205.92)	(203,012.28)
Balance ending	\$ (380,899.68)	\$ (1,214,197.53)	\$ (1,032,582.57)	\$ (1,463,022.28)	\$ (1,630,681.18)	\$ (1,701,994.55)	\$ (2,024,030.78)	\$ (2,229,043.06)
<b>Elitis Park</b>								
Carryforward from previous year <sup>b</sup>	\$ (408,040.60)	\$ (263,496.40)	\$ (101,198.62)	\$ (41,725.03)	\$ 71,897.51	\$ (8,320.92)	\$ (335,844.20)	\$ 504,233.60
Earned (Credits for Live Race Dates)	1,749,020.42	1,271,597.78	1,212,478.59	1,143,970.54	1,236,931.57	734,781.72	840,077.80	-
Reimbursed & Advertising	(1,604,476.22)	(1,109,300.00)	(1,153,005.00)	(1,030,348.00)	(1,317,150.00)	(1,062,303.00)	-	-
Balance ending	\$ (263,496.40)	\$ (101,198.62)	\$ (41,725.03)	\$ 71,897.51	\$ (8,320.92)	\$ (335,844.20)	\$ 504,233.60	\$ 504,233.60
<b>Keeneland</b>								
Carryforward from previous year <sup>b</sup>	\$ (178,561.77)	\$ (99,299.21)	\$ (317,227.52)	\$ (278,696.94)	\$ (164,805.12)	\$ (48,922.78)	\$ (533,088.31)	\$ (567,117.71)
Earned (Credits for Live Race Dates)	1,322,923.83	1,299,487.19	1,291,973.08	1,336,369.32	1,188,014.84	883,544.47	1,128,120.60	273,047.72
Reimbursed & Advertising	(1,243,661.27)	(1,517,415.50)	(1,253,442.50)	(1,222,477.50)	(1,072,132.50)	(1,367,710.00)	(1,162,150.00)	-
Balance ending	\$ (99,299.21)	\$ (317,227.52)	\$ (278,696.94)	\$ (164,805.12)	\$ (48,922.78)	\$ (533,088.31)	\$ (567,117.71)	\$ (293,069.99)
<b>Turfway Park</b>								
Carryforward from previous year <sup>b</sup>	\$ 817,635.66	\$ 1,303,576.57	\$ 1,652,309.18	\$ 1,021,103.99	\$ 1,019,397.88	\$ 1,036,637.73	\$ 1,874,207.35	\$ 2,099,632.03
Earned (Credits for Live Race Dates)	3,940,326.50	3,681,267.30	3,350,435.26	3,100,077.29	2,755,267.69	3,599,430.38	2,526,846.64	1,429,176.86
Reimbursed & Advertising	(3,463,385.59)	(3,332,534.69)	(3,981,640.45)	(3,101,783.40)	(2,738,027.84)	(2,761,860.76)	(2,301,421.96)	(2,176,004.64)
Balance ending	\$ 1,303,576.57	\$ 1,652,309.18	\$ 1,021,103.99	\$ 1,019,397.88	\$ 1,036,637.73	\$ 1,874,207.35	\$ 2,099,632.03	\$ 1,552,304.25
<b>Unallocated activity:</b>								
Unallocated transfers in / revenues	\$ 388.94	\$ 16,921.58	\$ 42,455.00	\$ -	\$ 5,637.11	\$ (5,009.00)	\$ -	\$ 34,369.12
Kentucky Downs KTDF receipts	-	29,083.95	32,962.85	16,657.24	2,457.23	17,759.27	16,008.85	-
Unallocated expenditures (administrative, misc)	-	(130,000.00)	-	(1,316.43)	-	-	-	-
<b>TOTALS</b>								
Carryforward from previous year <sup>b</sup>	\$ (498,595.51)	\$ 1,683,874.35	\$ 1,619,686.11	\$ 763,517.99	\$ 574,227.25	\$ 447,566.45	\$ 434,884.16	\$ 1,169,329.86
Unknown Difference <sup>c</sup>	1,123,694.13	-	-	-	-	-	-	-
Transfers In / Revenues	9,948,974.89	9,279,213.79	8,748,431.75	8,491,309.21	7,728,773.49	7,535,640.18	6,944,223.58	1,738,593.79
Reimbursed to racetracks	(8,389,209.27)	(9,764,491.94)	(9,024,599.96)	(8,589,283.43)	(7,835,434.29)	(7,548,322.47)	(6,218,777.88)	(2,381,016.92)
Transfers Out and other unallocated expenditures	-	(159,090.09)	-	(1,316.43)	-	-	-	-
Balance ending	\$ 1,683,874.35	\$ 1,619,686.11	\$ 1,619,686.11	\$ 763,517.99	\$ 574,227.25	\$ 447,566.45	\$ 434,884.16	\$ 1,169,329.86

*a For the purpose of this allocation, the period covered was extended to begin on January 1, 1999, in order to report on a calendar year basis.*

*b 1999 beginning balances obtained from 1999 internal ERC memo. See additional note below.*

*c The unknown difference is assumed to be in the beginning balance. All other activity agrees to the financial accounting system (MARS).*

The above data is subject to the following limitations and must be considered in the review of this information:

1. The 1999 beginning balances are unaudited and could not be substantiated through other procedures. The APA relied upon information from a 1999 memo to the KTDF Advisory Committee for this information, and was unable to tie these amounts to the financial accounting system.
2. The KTDF earned amounts are based on KTDF payments into the fund during a racetrack's live meet. These KTDF payments are based on a percentage of wagering. The racetracks' calculations of this payment have not been subject to audit during the period presented.
3. The allocation of the earned amounts to the various racetracks is based on internal DOR documentation. This information was not reviewed or verified for accuracy by the KHRA.
4. The annual reimbursement amounts for each track displayed were summarized from the financial accounting system maintained by Finance and Administration Cabinet. It includes amounts reimbursed for supplemental purses as well as advertising costs allowed by statute from the KTDF. This information was not derived from track-level information.

**Kentucky Thoroughbred Development Fund**  
**Appendix 4**  
**Allocations**  
(Continued)

*Allocation for Churchill Downs  
January 1, 1999<sup>a</sup> - April 30, 2006*

	CALENDAR YEARS							
	1999	2000	2001	2002	2003	2004	2005	2006
<b>Churchill Downs</b>								
Carryforward from previous year <sup>b</sup>	\$ (729,628.60)	\$ (380,899.68)	\$ (1,214,197.53)	\$ (1,032,582.57)	\$ (1,463,022.28)	\$ (1,650,681.18)	\$ (1,701,994.55)	\$ (2,024,030.78)
Earned (Credits for Live Race Dates)	2,926,415.11	2,971,853.90	2,818,126.97	2,804,234.82	2,540,465.05	2,305,133.34	2,433,169.69	-
Reimbursed & Advertising	(2,377,686.19)	(3,805,151.75)	(2,636,512.01)	(3,234,674.53)	(2,728,123.95)	(2,356,446.71)	(2,755,205.92)	(205,012.28)
Balance ending	\$ (380,899.68)	\$ (1,214,197.53)	\$ (1,032,582.57)	\$ (1,463,022.28)	\$ (1,650,681.18)	\$ (1,701,994.55)	\$ (2,024,030.78)	\$ (2,229,043.06)

*a For the purposes of this allocation, the period covered was extended to begin on January 1, 1999, in order to report on a calendar year basis.*  
*b 1999 beginning balances obtained from 1999 internal KRC memo. See additional note below.*

The above data is subject to the following limitations and must be considered in the review of this information:

- 1 The 1999 beginning balances are unaudited and could not be substantiated through other procedures. The APA relied upon information from a 1999 memo to the KTDF Advisory Committee for this information, and was unable to tie these amounts to the financial accounting system.
- 2 The KTDF earned amounts are based on KTDF payments into the fund during a racetrack's live meet. These KTDF payments are based on a percentage of wagering. The racetrack's calculations of this payment have not been subject to audit during the period presented.
- 3 The allocation of the earned amounts to the various racetracks is based on internal DOR documentation. This information was not reviewed or verified for accuracy by the KHRA.
- 4 The annual reimbursement amounts for each track displayed were summarized from the financial accounting system maintained by Finance and Administration Cabinet. It includes amounts reimbursed for supplemental purses as well as advertising costs allowed by statute from the KTDF. This information was not derived from track-level information.

**Kentucky Thoroughbred Development Fund**  
**Appendix 4**  
**Allocations**  
(Continued)

*Allocation for Ellis Park  
January 1, 1999<sup>a</sup> - April 30, 2006*

	CALENDAR YEARS							
	1999	2000	2001	2002	2003	2004	2005	2006
<b>Ellis Park</b>								
Carryforward from previous year <sup>b</sup>	\$ (408,040.60)	\$ (263,496.40)	\$ (101,198.62)	\$ (41,725.03)	\$ 71,897.51	\$ (8,320.92)	\$ (335,844.20)	\$ 504,233.60
Earned (Credits for Live Race Dates)	1,749,020.42	1,271,597.78	1,212,478.59	1,143,970.54	1,236,931.57	734,781.72	840,077.80	-
Reimbursed & Advertising	(1,604,476.22)	(1,109,300.00)	(1,133,005.00)	(1,030,348.00)	(1,317,150.00)	(1,062,305.00)	-	-
Balance ending	\$ (263,496.40)	\$ (101,198.62)	\$ (41,725.03)	\$ 71,897.51	\$ (8,320.92)	\$ (335,844.20)	\$ 504,233.60	\$ 504,233.60

**a** For the purposes of this allocation, the period covered was extended to begin on January 1, 1999, in order to report on a calendar year basis.  
**b** 1999 beginning balances obtained from 1999 internal KRC memo. See additional note below.

The above data is subject to the following limitations and must be considered in the review of this information:

- 1 The 1999 beginning balances are unaudited and could not be substantiated through other procedures. The APA relied upon information from a 1999 memo to the KTDF Advisory Committee for this information, and was unable to tie these amounts to the financial accounting system.
- 2 The KTDF earned amounts are based on KTDF payments into the fund during a racetrack's live meet. These KTDF payments are based on a percentage of wagering. The racetracks' calculations of this payment have not been subject to audit during the period presented.
- 3 The allocation of the earned amounts to the various racetracks is based on internal DOR documentation. This information was not reviewed or verified for accuracy by the KHRA.
- 4 The annual reimbursement amounts for each track displayed were summarized from the financial accounting system maintained by Finance and Administration Cabinet. It includes amounts reimbursed for supplemental purses as well as advertising costs allowed by statute from the KTDF. This information was not derived from track-level information.

**Kentucky Thoroughbred Development Fund**  
**Appendix 4**  
**Allocations**  
(Continued)

*Allocation for Keeneland*  
*January 1, 1999<sup>a</sup> - April 30, 2006*

	CALENDAR YEARS							
	1999	2000	2001	2002	2003	2004	2005	2006
<b>Keeneland</b>								
Carryforward from previous year <sup>b</sup>	\$ (178,561.77)	\$ (99,299.21)	\$ (317,227.52)	\$ (278,696.94)	\$ (164,805.12)	\$ (48,922.78)	\$ (533,088.31)	\$ (567,117.71)
Earned (Credits for Live Race Dates)	1,322,923.83	1,299,487.19	1,291,973.08	1,336,369.32	1,188,014.84	883,544.47	1,128,120.60	275,047.72
Reimbursed & Advertising	(1,243,661.27)	(1,517,415.50)	(1,253,442.50)	(1,222,477.50)	(1,072,132.50)	(1,367,710.00)	(1,162,150.00)	-
Balance ending	\$ (99,299.21)	\$ (317,227.52)	\$ (278,696.94)	\$ (164,805.12)	\$ (48,922.78)	\$ (533,088.31)	\$ (567,117.71)	\$ (292,069.99)

*a For the purposes of this allocation, the period covered was extended to begin on January 1, 1999, in order to report on a calendar year basis.*  
*b 1999 beginning balances obtained from 1999 internal KRC memo. See additional note below.*

The above data is subject to the following limitations and must be considered in the review of this information:

- 1 The 1999 beginning balances are unaudited and could not be substantiated through other procedures. The APA relied upon information from a 1999 memo to the KTDF Advisory Committee for this information, and was unable to tie these amounts to the financial accounting system.
- 2 The KTDF earned amounts are based on KTDF payments into the fund during a racetrack's live meet. These KTDF payments are based on a percentage of wagering. The racetrack's calculations of this payment have not been subject to audit during the period presented.
- 3 The allocation of the earned amounts to the various racetracks is based on internal DOR documentation. This information was not reviewed or verified for accuracy by the KHRA.
- 4 The annual reimbursement amounts for each track displayed were summarized from the financial accounting system maintained by Finance and Administration Cabinet. It includes amounts reimbursed for supplemental purses as well as advertising costs allowed by statute from the KTDF. This information was not derived from track-level information.

**Kentucky Thoroughbred Development Fund**  
**Appendix 4**  
**Allocations**  
**(Continued)**

*Allocation for Turfway Park  
January 1, 1999<sup>a</sup> - April 30, 2006*

	CALENDAR YEARS							
	1999	2000	2001	2002	2003	2004	2005	2006
<b>Turfway Park</b>								
Carryforward from previous year <sup>b</sup>	\$ 817,635.66	\$ 1,303,576.57	\$ 1,652,309.18	\$ 1,021,103.99	\$ 1,019,397.88	\$ 1,036,637.73	\$ 1,874,207.35	\$ 2,099,632.03
Earned (Credits for Live Race Dates)	3,949,326.50	3,681,267.30	3,330,435.26	3,100,077.29	2,755,267.69	3,599,430.38	2,526,846.64	1,429,176.86
Reimbursed & Advertising	(3,463,385.59)	(3,332,534.69)	(3,981,640.45)	(3,101,783.40)	(2,738,027.84)	(2,761,860.76)	(2,301,421.96)	(2,176,004.64)
Balance ending	\$ 1,303,576.57	\$ 1,652,309.18	\$ 1,021,103.99	\$ 1,019,397.88	\$ 1,036,637.73	\$ 1,874,207.35	\$ 2,099,632.03	\$ 1,352,804.25

**a** For the purposes of this allocation, the period covered was extended to begin on January 1, 1999, in order to report on a calendar year basis.  
**b** 1999 beginning balances obtained from 1999 internal KRC memo. See additional note below.

The above data is subject to the following limitations and must be considered in the review of this information:

- 1 The 1999 beginning balances are unaudited and could not be substantiated through other procedures. The AFA relied upon information from a 1999 memo to the KTDF Advisory Committee for this information, and was unable to tie these amounts to the financial accounting system.
- 2 The KTDF earned amounts are based on KTDF payments into the fund during a racetrack's live meet. These KTDF payments are based on a percentage of wagering. The racetracks' calculations of this payment have not been subject to audit during the period presented.
- 3 The allocation of the earned amounts to the various racetracks is based on internal DOR documentation. This information was not reviewed or verified for accuracy by the KHRA.
- 4 The annual reimbursement amounts for each track displayed were summarized from the financial accounting system maintained by Finance and Administration Cabinet. It includes amounts reimbursed for supplemental purses as well as advertising costs allowed by statute from the KTDF. This information was not derived from track-level information.

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## Attachment I

### **KTDF Settlement Agreement and Memorandum of Understanding among Keeneland Association, Turfway Park, LLC, Churchill Downs Incorporated and Ellis Park Race Course, Kentucky Horse Racing Authority and Kentucky Thoroughbred Development Fund Advisory Committee**

**THIS KTDF SETTLEMENT AGREEMENT AND MEMORANDUM OF UNDERSTANDING** (this "Agreement"), dated as of the 18<sup>th</sup> day of December 2006, is entered into by and among Keeneland Association, PO Box 1690, Lexington, Kentucky 40588 ("Keeneland"), Turfway Park, LLC, 7500 Turfway Road, PO Box 8, Florence, Kentucky 41022 ("Turfway"), Churchill Downs Incorporated, 700 Central Avenue, Louisville, KY 40208 ("Churchill") and Ellis Park Race Course, Inc. 3300 US Highway 41 North, Henderson, Kentucky 42420, ("Ellis"), the Kentucky Horse Racing Authority, an independent agency of the Commonwealth of Kentucky, organized pursuant to the laws of the Commonwealth of Kentucky with its principal place of business located at 4063 Iron Works Pike, Building B, Lexington, KY 40511 ("KHRA"), and the Kentucky Thoroughbred Development Fund Advisory Committee, a committee established under the general jurisdiction of the KHRA with its principal place of business located at 4063 Iron Works Pike, Building B, Lexington, KY 40511 ("KTDF Advisory Committee"). Keeneland, Turfway, Churchill and Ellis shall be collectively referred to herein as the Associations or tracks.

WHEREAS, the Kentucky Thoroughbred Development Fund ("KTDF") was established in 1978.

WHEREAS, pursuant to KRS 230.400 money contributed to the KTDF is required to be allocated to each Association in an amount equal to the amount the Association contributed to the KTDF.

WHEREAS, the KTDF is funded from the tax paid by (i) the host tracks in the amount of 0.75 percent of the total live handle for thoroughbred racing and (ii) all thoroughbred tracks in the amount of 2 percent of the simulcast handle for thoroughbred racing.

WHEREAS, the amount of money each Association distributes to supplement purses has not been reconciled against the amount of money contributed to that Association's account for many years.

WHEREAS, an attempt was made in 1999 to reconcile the KTDF balances and such attempt was unsuccessful.

WHEREAS, the Associations and the KHRA desire to agree to and follow

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procedures to be used after the date of this Agreement.

WHEREAS, the Associations understand that the KHRA can only reimburse the Associations that amount which has been contributed to the KTDF.

WHEREAS, the Associations desire to be compensated for the amount of the invoices they have submitted to the KHRA as of October 2, 2006 in the total amount of \$ 3,032,455.94 ("Total Invoices").

WHEREAS, after a contribution of \$150,000 by the KHRA ("KHRA Contribution") and KHRA's decision not to submit the invoice by the Auditor of Public Accounts in the amount of \$ 27,084.00 to the KTDF for payment, a total of \$ 2,509,048.71 ("Total Available") exists for reimbursement to the Associations under the KTDF program.

WHEREAS, the KTDF Advisory Committee has been consulted about this Agreement and has recommended it to the KHRA for approval.

WHEREAS, the KTDF Advisory Committee will advise and assist the KHRA in the manner and method of payment of supplemental purses in connection with this Agreement, as well as other activities as directed by KRS 230.400.

**INTENDING TO BE LEGALLY BOUND HEREBY**, the parties hereto agree as follows:

1. Reimbursement to the Associations.
  - a. Each Association shall be reimbursed for the amount of the invoices submitted as of October 2, 2006 for that Association, less \$130,000 per Association. Each Association acknowledges that once the reimbursement amounts are paid neither the KTDF, the KHRA nor the Commonwealth of Kentucky is obligated to pay the Association any additional amount for the period prior to October 2, 2006, except as set forth in subsection 1 (c ) below. The Associations submitted invoices for the following amounts as of October 2, 2006 and shall be reimbursed in the following amounts which upon receipt shall be considered to be payment in full:

<u>Track</u>	<u>Invoice</u>	<u>Reimbursement</u>
Keeneland	\$ 0	(\$130,000.00)
Turfway	\$ 502,750.94	\$ 372,750.94
Churchill and Ellis	\$ 2,529,705	\$ 2,269,705.00
<u>Rounding for Convenience</u>		<u>(\$3,407.23)</u>
<b>Total</b>		<b>\$ 2,509,048.71</b>

## Attachment 1

- b. Invoices submitted by an Association after October 2, 2006 will be paid in full up to the amount credited to the account of the Association, except for Keeneland, which next invoice(s) will be reduced by \$130,000 before being paid.
- c. If Keeneland's KTDF Account earns funds in excess of the amount Keeneland distributes in purse money prior to December 31, 2008 Keeneland shall be reimbursed up to a total of \$130,000 which represents the total amount withheld from invoices submitted by Keeneland and agreed due by the KHRA as of October 2, 2006. If Turfway's KTDF Account earns funds in excess of the amount Turfway distributes in purse money prior to December 31, 2008 Turfway shall be reimbursed up to a total of \$130,000 which represents the total amount withheld from invoices submitted by Turfway and agreed due by the KHRA as of October 2, 2006. If Churchill's KTDF Account earns funds in excess of the amount Churchill distributes in purse money up to December 31, 2008 Churchill shall be reimbursed up to a total of \$260,000 which represents the total amount withheld from invoices submitted by Churchill and Ellis agreed due by the KHRA as of October 2, 2006. Any reimbursement under this subsection 1 (c ) must be earned and requested prior to December 31, 2008 and may be earned and reimbursed sooner.
- d. Churchill owned Ellis until September 28, 2006. For purposes of this paragraph 1, Churchill shall be entitled to the reimbursement due to Ellis based on invoices submitted prior to October 2, 2006.

### 2. Contribution by KHRA.

The KHRA agrees that it will contribute \$150,000 to the KTDF as reimbursement for a \$150,000 fee that was paid to the former Kentucky Racing Commission during 2001. The KHRA further agrees that the KTDF will not be charged for the invoices sent by the Auditor of Public Accounts (APA) for the audit regarding the KTDF during 2006.

### 3. Procedures in the Future.

- a. Each Association and the KHRA agree that they will comply with the procedures attached hereto as Exhibit A from the time of this Agreement until such procedures are amended and agreed to in writing by the Association and the KHRA.
- b. The KHRA agrees to cooperate with each Association in a timely

## Attachment 1

manner so that the records will remain in balance for each Association's KTDF account for a rolling twelve month period. In the event an individual Association requests an amount for reimbursement that is greater than the amount present in the Association's KTDF account at the time, the Association shall only be reimbursed up to the amount available in the Association's KTDF account. After January 1, 2009 or the complete reimbursement of the Association of amounts due under paragraph 1 (c) of this Agreement, whichever occurs first, the amount requested in excess of that available may be reimbursed within the following twelve month period if the Association earns more than it has distributed in KTDF purse supplements during that twelve month period.

- c. Each Association and the KHRA agree that, after following the procedures outlined in Exhibit A for at least one race meet for each Association, each Association and the KHRA will review the procedures for the administration of the KTDF in light of the intent behind KRS 230.400.
- d. Prior to finalizing a purse structure for a meet, each Association shall submit a description of its purse structure to the KTDF Advisory Committee for the Advisory Committee's advice and review. The KTDF Advisory Committee shall assist each Association in structuring a purse program intended to allow that Association to obtain a reimbursement as provided for in this Agreement and to comply with the procedures set forth in Exhibit A. The KTDF Advisory Committee shall make recommendations to the KHRA as needed.

#### 4. Limitation of Liability.

A. EXCEPT AS OTHERWISE PROVIDED IN THIS AGREEMENT, IN NO EVENT WILL A PARTY BE LIABLE TO ANOTHER PARTY HEREUNDER FOR ANY INDIRECT, CONSEQUENTIAL, SPECIAL, EXEMPLARY, OR INCIDENTAL DAMAGES, WHETHER IN CONTRACT, TORT, NEGLIGENCE OR OTHERWISE ARISING FROM OR RELATING TO THIS AGREEMENT.

B. EACH PARTY RECOGNIZES AND AGREES THAT THE LIABILITY LIMITATIONS IN THIS AGREEMENT HAVE BEEN MATERIALLY BARGAINED FOR IN CONNECTION WITH THIS AGREEMENT AND THAT THEY HAVE BEEN TAKEN INTO ACCOUNT

## Attachment 1

AND REFLECTED IN DETERMINING THE CONSIDERATION TO BE GIVEN BY EACH PARTY UNDER THIS AGREEMENT AND IN THE DECISION BY EACH PARTY TO ENTER INTO THIS AGREEMENT.

### 5. Notices.

A. Unless provided for otherwise, all notices required to be given pursuant to any of the provisions of this Agreement shall be in writing and shall be deemed to have been duly given or made for all purposes if sent by (i) certified or registered mail, return receipt requested, and postage prepaid, (ii) confirmed electronic means, or (iii) express mail service or other verified overnight courier service to a party at the address first above written, or at such other address as has been given in accordance with the preamble.

B. Unless provided for otherwise, the date any such notice shall be deemed to have been received is: (i) if sent by registered or certified mail, five business days following the posting of the mail, (ii) if sent by confirmed electronic means, the date when sent or the next business date following transmission if not sent on a business day, or (iii) if sent by express mail or other verified overnight courier service, two business days following delivery to the post office or other verified overnight courier service.

### 6. Miscellaneous.

A. Notwithstanding anything contained herein to the contrary, in the event either party to this Agreement fails to perform any obligations hereunder assumed by it and such failure is due to acts of God, injunctions, lockouts, riots or civil unrest, fires, epidemics, casualties, boycotts, technical difficulties (whether computer related or otherwise), failure of suppliers to supply data, strikes or labor disputes, acts of a governmental authority, or other interference through legal proceedings or for any other cause which is not due to the fault or negligence of such party, such failure shall not be deemed to be a breach by such party of its obligations hereunder, although such party shall use its best efforts to put itself in a position to carry out all of the obligations which, by the terms hereof, it has assumed irrespective of the occurrence of any force majeure event.

B. Nothing contained in this Agreement shall be construed to place the parties in the relationship of partners or joint venturers.

C. No waiver, modification or cancellation of any term or condition of this Agreement shall be effective unless executed in writing by the party so granting in the case of waivers or cancellations, and both parties, in the

# Attachment 1

case of modifications. A waiver of any breach of this Agreement by one party to the other shall not be construed to have been given in perpetuity. A failure or delay of either party hereto to enforce at any time any of the provisions of this Agreement or to require at any time performance of any of the provisions hereof shall in no way be construed to be a waiver of any provision of this Agreement.

D This Agreement contains the entire understanding of the parties hereto with respect to the transactions contemplated hereby, and supersedes all prior agreements, understandings, and negotiations, both written and oral, between the parties with respect to the subject matter hereof.

E This Agreement shall be governed by and interpreted and enforced in accordance with, the laws of the Commonwealth of Kentucky, without regard to the conflicts of laws rules thereof. The parties hereby consent to the jurisdiction of the federal and state courts located in the County of Franklin, Commonwealth of Kentucky for the purpose of any action or proceeding brought by either of them on or in connection with this Agreement or any alleged breach thereof.

F The captions of the sections in this Agreement are inserted for convenience only and shall not affect the interpretation or construction of this Agreement.

G This Agreement may be signed in counterparts.

**IN WITNESS WHEREOF**, the parties hereto have caused this Agreement to be executed as of the date first above written.

Keeneland Association

By: Leah T. Beal

Title: Director of Accounting

Turfway Park, LLC

By: \_\_\_\_\_

Title: \_\_\_\_\_

# Attachment 1

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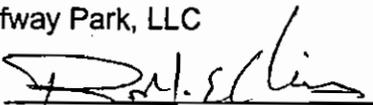
**IN WITNESS WHEREOF**, the parties hereto have caused this Agreement to be executed as of the date first above written.

Keeneland Association

By: \_\_\_\_\_

Title: \_\_\_\_\_

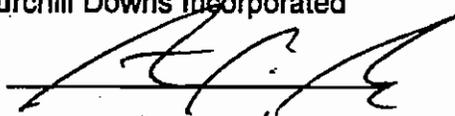
Turfway Park, LLC

By: 

Title: President / CEO

# Attachment 1

Churchill Downs Incorporated

By: 

Title: President

Ellis Park Race Course

By: \_\_\_\_\_

Title: \_\_\_\_\_

Kentucky Horse Racing Authority

By: \_\_\_\_\_

Title: \_\_\_\_\_

Kentucky Thoroughbred Development Fund Advisory Committee

By: \_\_\_\_\_

Title: \_\_\_\_\_

## **EXHIBIT A**

Procedures for handling KTDF reconciliation:

- All licensed pari-mutuel outlets will send a copy of the pari-mutuel tax form filed with the Department of Revenue to the KHRA along with a copy of the check submitted for each report on a weekly basis. These reports are usually filed every Friday.
- KHRA will prepare and provide an unaudited report that shows live handle, simulcast handle, track reporting, live track, the amount submitted for equine drug research, KTDF and KSDF.
- Department of Revenue sends two reports every 30 days. The first report is a mixer report that provides transaction date, group number, transaction sequence number, tax id number, track and validation number. The second report is the emars report that provides the document number of the transfer, start through end validation number, amount and group number.
- KHRA will then reconcile the weekly reports submitted by the tracks with revenues reports and deposits made every 30 days.

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Churchill Downs Incorporated

By: \_\_\_\_\_

Title: \_\_\_\_\_

Ellis Park Race Course

By: *Randy Gentry*

Title: *President*

Kentucky Horse Racing Authority

By: *Lisa E. Underwood*

Title: *Executive Director*

Kentucky Thoroughbred Development Fund Advisory Committee

By: *David Robinson*

Title: *CHAIR*

## EXHIBIT A

Procedures for handling KTDF reconciliation:

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- For Keeneland and Churchill, thirty days after the end of each racing meet the KHRA will produce a report for the track that has just completed the live meet. For Turfway and Ellis, fifteen days after the end of each month during which Turfway or Ellis conducts live racing, the KHRA will produce a report for the track that has just completed the live racing month. The report will show the amount of KTDF funds accumulated during the live racing meet or month (as applicable), with a break down for each location from which the credits were earned. This will then be used to compare to the track's actual disbursements.
- KHRA will then meet with each track to verify and agree on the totals for the pari-mutuel tax forms and checks submitted to DOR, the deposits made by DOR, and the actual KTDF money paid out by the track.
- The tracks sign an agreement stating that they agree with the reconciliation prior to reimbursement of any KTDF funds.
- KHRA will then issue reimbursement checks to the track from the KTDF fund but reimbursements will not exceed the sum of amount earned by the track at the live racing meet or month completed (as applicable) plus any accumulated KTDF carryforward from previous live meets.
- Purse Structure recommendations shall be approved by the KTDF advisory committee.
- Reasonable and customary administrative charges for time spent reconciling the KTDF account will be charged by the percentage of funds generated by each track for the previous calendar year.
- Advertising charges will be paid but deducted from KTDF available balances.
- KHRA shall verify that Horse Identification Reports indicate that only registered Kentucky bred horses finishing first, second, third and/or fourth, eligible for KTDF reimbursement will be paid. Invoice details will be compared to the corresponding Horse Identification Report's KTDF Earnings column.
- KHRA shall develop and implement a record retention policy for KTDF invoices and Horse Identification Reports.
- KHRA shall verify on a limited test basis that horses listed as qualifying for KTDF awards are registered with the KTOB Kentucky Registry. KHRA will retain documentation for 3 years verifying that such limited tests have been performed.

