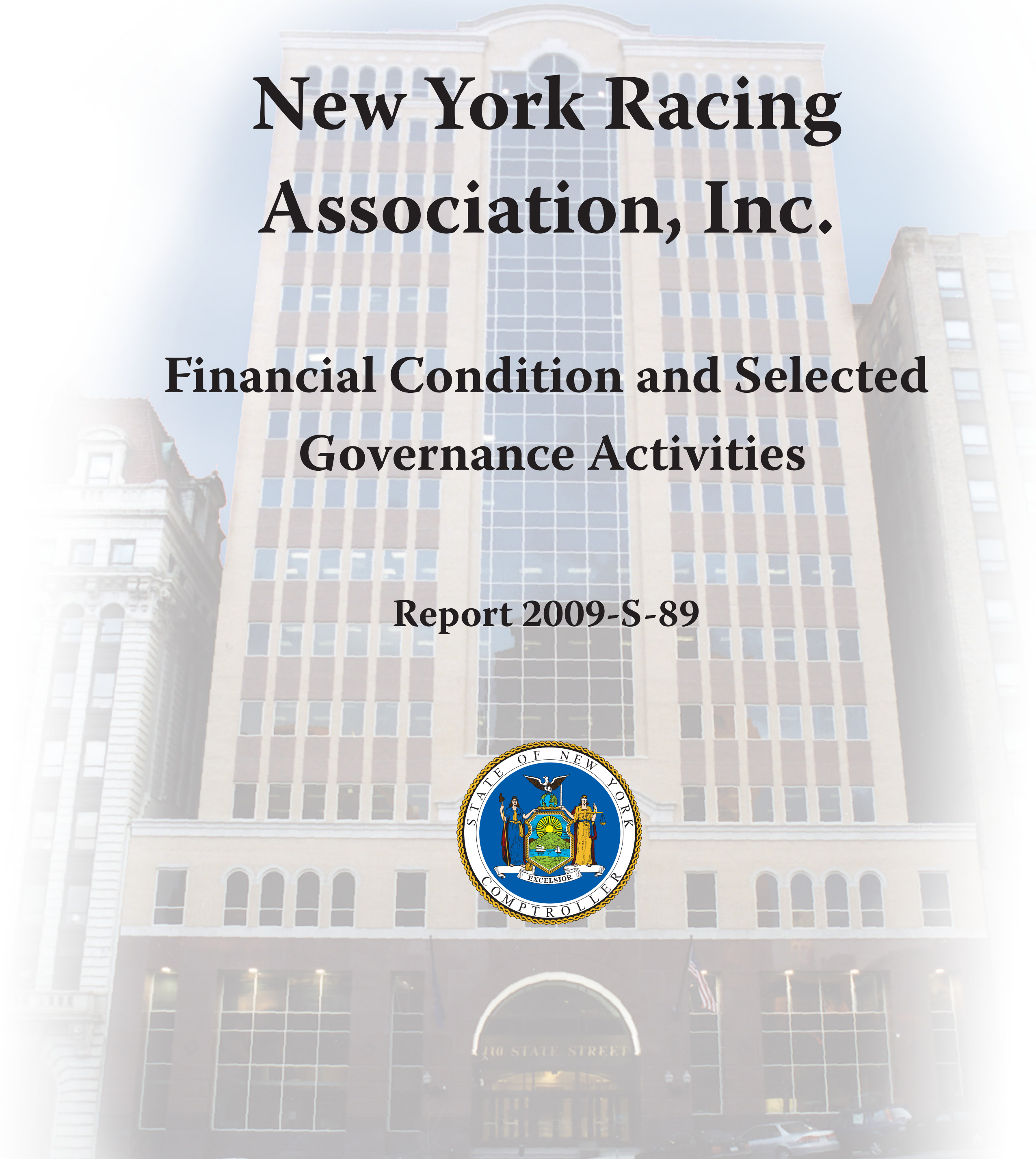
OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF STATE GOVERNMENT ACCOUNTABILITY



New York Racing Association, Inc.

Financial Condition and Selected Governance Activities

Report 2009-S-89

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of State Government Accountability

July 12, 2010

Charles Hayward
President and Chief Executive Officer
New York Racing Association, Inc.
P.O. Box 90
Jamaica, NY 11417

Dear Mr. Hayward:

Following is our report on the New York Racing Association's *Financial Condition and Selected Governance Activities*. The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 209 of the New York State Racing, Pari-Mutuel Wagering and Breeding Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

EXECUTIVE SUMMARY

Audit Objectives

The objectives of our audit were to assess the financial condition and selected governance activities of the New York Racing Association, Inc., since its emergence from bankruptcy.

Audit Results - Summary

The New York Racing Association (NYRA) is a not-for-profit corporation franchised by New York State to conduct racing and pari-mutuel wagering at the State's three major thoroughbred racetracks: Aqueduct Racetrack, Belmont Park and Saratoga Race Course. In November 2006, NYRA filed for bankruptcy, and in September 2008, with a renewed State franchise, the State and NYRA entered into a bankruptcy settlement agreement in which NYRA conveyed all ownership rights in the racetracks it operated to the State. In return, among other actions taken by the State that enabled NYRA to emerge from bankruptcy, the State canceled the majority of NYRA's debt obligations to the State, and provided NYRA with $105 million to pay off about $80 million in non-State debt, leaving NYRA with a cash balance about $25 million.

Despite years of delay, until Spring 2010 NYRA anticipated that the video lottery terminals (VLTs) at the Aqueduct facility would be operational and banked on receiving its percentage of the projected VLT revenue, estimated at approximately $30 million annually. However, because of ongoing delays in the State's selection of a contractor to construct and operate the gaming facility, a VLT contract has yet to be awarded and NYRA has received none of the expected revenue. According to the bankruptcy settlement agreement, in the event of such delays, the State and NYRA are to "negotiate in good faith" to provide NYRA with the funds needed to support its racing operations.

Between September 2008, when NYRA emerged from bankruptcy and January 2010, NYRA reduced its operating expenses by 2.2 percent. However, these reductions were not sufficient considering the continuing reduction in handle and net available revenues. As a result, NYRA's financial condition once again began to deteriorate even after the settlement. In early 2010, NYRA's President warned that NYRA was in imminent danger of running out of cash, potentially shortening the 2010 racing season at Belmont Park and threatening the season at Saratoga Race Course later that summer. As a result, consistent with the State's obligation to negotiate the provision of additional funds to NYRA if the revenue from the VLTs was delayed, on May 24, 2010, the State approved a $25 million loan for NYRA.

In our audit, we reviewed NYRA management's projections of its available cash as of May 20, 2010, for the remainder of 2010, and found that the projections appeared to be reasonable in all material respects. We therefore conclude that, in all likelihood, given NYRA's spending patterns and its continued reliance on VLT revenue that failed to materialize, NYRA would have run out of cash (i.e., not have had sufficient cash to pay its operating expenses) sometime in early June 2010, if it had not secured external financing. Even with this State financial assistance, however, NYRA could again experience a cash shortfall in 2011 if the Aqueduct VLT facility does not become operational and its expenses are not further curtailed.

We identified a number of reasons for NYRA's inability to remain solvent without State assistance, some of which were beyond NYRA's control. For example, in the last year alone, NYRA has not received more than $47 million in expected revenue: $30 million from the not yet operational VLTs at Aqueduct Racetrack, and more than $17 million in unpaid commissions from the bankrupt New York City Off-Track Betting Corporation. Also, horse race wagering has declined in recent years, both in New York and nationally. However, these outside factors were not the only reasons for NYRA's fiscal decline.

NYRA was also slow to act in an area within its control; the reduction of its operating expenses. NYRA did not begin to make significant reductions in these expenses until February 2010, more than a year after it emerged from bankruptcy. If it had acted sooner, done more to reduce its operating expenses by putting more prudent financial management practices in place after emerging from bankruptcy in September 2008, and not relied for so long on the anticipated VLT revenues, it might have deferred its cash crisis in the short term.

We also identified actions that should be taken by NYRA to reduce the risk and extent that NYRA may need further State financial assistance in the future. In particular, NYRA needs to perform a staffing analysis to determine the optimal number of employees and pay scales for its operations. In addition, in 2009, NYRA spent more than $6 million on contracts for personal and miscellaneous services. However, to adequately assure that all existing and future contracts are necessary and the prices are reasonable, NYRA needs to support such contracts with documented analyses justifying that they are cost effective. In our limited review of such contracts, we identified both potentially unnecessary and potentially overpriced contracts.

Our limited review also identified over $1 million in relatively immediate opportunities that NYRA can likely act on quickly to begin saving money, including formally evaluating the need for about $900,000 in horse transportation costs, and about $320,000 in annual legal fees. Other, longer-term opportunities may also exist that will require more detailed analysis and planning by NYRA, which should begin with an internal examination of its expenses. We therefore recommend NYRA develop a business plan that aligns its operating expenses with its actual net revenues; implement the plan; monitor its adherence to the plan; and promptly take corrective action if its operating expenses routinely exceed its net revenues.

Our report contains five recommendations. NYRA officials agree with our recommendations and plan to implement them as appropriate.

This report, dated July 12, 2010, is available on our website at: http://www.osc.state.ny.us
Add or update your mailing list by contacting us at (518) 474-3271 or

Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Introduction

Background

The New York Racing Association, Inc. (NYRA) is a not-for-profit corporation that holds the exclusive franchise to operate New York State's three major thoroughbred racetracks: Aqueduct Racetrack, Belmont Park and Saratoga Race Course. In return for this exclusive franchise, NYRA is required to remit to the State a pari-mutuel tax (a percentage of each on-track wager), and if certain conditions exist, an end-of-year franchise fee. In 2009, NYRA remitted a total of $5.5 million in pari-mutuel taxes to the State and paid a franchise fee of $0.

Due to its chronically poor financial condition, in November 2006, NYRA filed for bankruptcy. At that time, it had incurred an accumulated operating deficit of more than $135 million. In September 2008, upon renewal of its exclusive franchise, NYRA entered into a bankruptcy settlement agreement. Under this agreement, NYRA conveyed all rights, titles and interests in the racetrack properties to New York State in return for a financial assistance package from the State. As part of this package, the State canceled essentially all of NYRA's debt obligations to the State (totaling $54.1 million) and provided NYRA with $105 million to pay off about $80 million in non-State debt, leaving NYRA with a cash balance about $25 million.

It was anticipated that by the Spring of 2010, the long-awaited installation of video lottery terminals (VLTs) at NYRA's Aqueduct facility, under the jurisdiction of the New York State Division of the Lottery, would have been completed, resulting in millions of revenue dollars being remitted to the State each year. NYRA would be receiving a percentage of the anticipated VLT revenue estimated at approximately $30 million annually. However, because of ongoing delays in the State's selection of a contractor to construct and operate the gaming facility, a contract has yet to be awarded and NYRA has received none of the expected revenue. In accordance with the bankruptcy settlement agreement, in the event of such delays, the State and NYRA are to "negotiate in good faith" to provide NYRA with the funds needed to support its racing operations.

In the absence of the VLT revenue and certain other expected (e.g., New York City Off Track Betting) revenue, NYRA's financial condition once again began to deteriorate. In 2009, NYRA incurred an operating deficit of $8.9 million, and for 2010, it was projecting a deficit of $19.0 million. In early 2010, NYRA's President warned that NYRA was in imminent danger of running out of cash, and in May 2010, he publicly stated that, because of the lack of cash, NYRA might have to cease operations in early June. According to NYRA, such an action would have shortened the 2010 racing season at Belmont Park and threatened the season at Saratoga Race Course later that summer.

NYRA employs more than 1,200 permanent workers and hundreds of seasonal workers, and is integral to the State's multi-billion dollar horse racing industry, which includes horse owners, trainers, breeders, OTB operations, simulcast facilities, and the communities in which NYRA operates. Accordingly, its inability to continue operations would result in considerable financial hardship for the State. To prevent such hardship, and consistent with the State's obligation to negotiate in good faith with NYRA if the VLTs at Aqueduct Racetrack were delayed (i.e., not operational by April 2009), on May 24, 2010, the State approved a $25 million loan for NYRA.

Between 2006 and 2009, NYRA's annual operating expenses totaled between $156.1 and $183.0 million, while its annual net revenues (i.e., its remaining revenues after paying bettors, pari-mutual taxes, racing purses and certain other required payments in support of the State's racing industry) totaled between $143.5 and $154.3 million. In each of those four years, NYRA incurred an annual operating deficit of between $8.9 and $34.3 million.

About 40 percent of NYRA's operating expenses are payroll-related (i.e., employee salaries and fringe benefits). Other significant operating expenses include personal service contracts, advertising and promotions, and routine grounds work and maintenance. NYRA's revenues are generated primarily from on-site and off-site wagering on races held at its three racetracks, as well as simulcast wagering at NYRA facilities for races held at non-NYRA tracks. Off-site wagering locations include New York State-based OTB parlors and other racetracks and wagering facilities both in and out of State.

Audit Scope and Methodology

We assessed NYRA's financial condition as of May 20, 2010, and we audited selected governance activities for the period September 12, 2008 through March 31, 2010. To accomplish our objectives, we reviewed NYRA's independent certified financial statements for 2008 and 2009, NYRA's supporting books of record, and NYRA's internally prepared cash flow summaries and operating budgets. We also interviewed NYRA officials and representatives of NYRA's independent auditors, and reviewed the bankruptcy settlement agreement, renewed franchise agreement and selected expense transactions.

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

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits or assessments of program activities.

Authority

This audit was performed pursuant to the State Comptroller's authority under Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 209 of the New York State Racing, Pari-Mutuel Wagering and Breeding Law.

Reporting Requirements

A draft copy of this report was provided to NYRA officials for their review and comment. Their comments were considered in preparing this final report and are attached in their entirety at the end of the report.

NYRA officials agreed with most of our conclusions and all of our recommendations. They also offered clarification on some of the issues addressed in our draft report. The wording in this final report was revised to address those clarifications.

Within 90 days of the final release of this report, we request that NYRA officials report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement our report recommendations, and where our recommendations were not implemented, the reasons therefore.

Contributors to the Report

Major contributors to this report include Frank Patone, Michael Solomon, Stu Dolgon, Salvatore D'Amato, Anthony Carlo, Ira Lipper and Dana Newhouse.

Audit Findings and Recommendations

Financial Condition

According to NYRA's cash flow projections for the 2010 calendar year, as of May 20, 2010, NYRA was projecting that it would run out of cash (i.e. not have sufficient cash to pay its operating expenses) in early June 2010. We reviewed these cash flow projections and the assumptions on which they were based. We found that the projections appeared to be reasonable in all material respects. We also note that the $25 million loan approved by the State on May 24, 2010 should enable NYRA to continue operations through the end of 2010. However, it is also likely that NYRA will need additional financial assistance sometime in 2011 if the Aqueduct VLT facility does not become operational in the interim and it does not significantly curtail expenses.

Reasons for NYRA's Insolvency

We identified several reasons for NYRA's inability to remain solvent. Some of these reasons are due to factors that are largely beyond NYRA's control, as follows:

- Most of NYRA's revenue is generated from wagers on horse races, and such wagering has steadily declined in recent years, both nationally and in New York State. Between 2006 and 2009, nationwide wagering on horse races declined by 16.7 percent from $14.8 billion to $12.3 billion. Wagering on NYRA's races has fared slightly better over the same period, having declined by 13.2 percent from $2.56 billion to $2.22 billion. Still, this decline has made it more difficult for NYRA to generate enough revenue to cover its operating expenses.

- NYRA has yet to receive any revenue from the planned VLTs at Aqueduct Racetrack. If the VLTs had been operational by April 2009, as anticipated, NYRA could have received more than $30 million in VLT revenue by June 1, 2010.

- As of April 30, 2010, NYRA was owed $17.1 million by the New York City Off-Track Betting Corporation (NYC OTB). This amount represents commissions owed to NYRA by NYC OTB for wagers placed on certain races at NYC OTB locations since early 2009. According to NYRA, this receivable is growing by an average of $1.7 million per month. NYC OTB has not made these payments because of its own poor financial condition. In June 2008, NYC OTB was taken over by the State to prevent it from being shut down by the City. The organization then filed for its own bankruptcy protection in December 2009.

Just as importantly, NYRA has not sufficiently reduced its operating expenses. We found that NYRA officials did not begin to make significant reductions in operating expenses until February 2010; more than a year after NYRA emerged from bankruptcy, when the pending contract for the racino facility at Aqueduct Racetrack was rejected by the State and NYRA officials acknowledged the fact that the anticipated VLT revenues would not be available anytime soon. At this time, they began to reduce the purses for certain races and laid off 12 professional staff, for a combined projected annual savings of more than $5 million.

Two other cost-reduction initiatives planned by NYRA officials at that time are estimated to save as much as $4.7 million a year: the closing of the Aqueduct training facility saving about $3.5 million annually, and the closing of Aqueduct's back stretch security barn saving about $1.2 million annually. NYRA officials also informed us that they are looking to refocus their capital expenditures to allow for more operating cash in the immediate future.

These actions should help NYRA in its efforts to balance its books, but we believe NYRA could, and should, have acted sooner and done more to reduce its operating expenses after emerging from bankruptcy in September 2008. Had NYRA officials acted sooner, and more forcefully, to align operating expenses with actual net revenues, it might have deferred its cash crisis and reduced the amount of the financial assistance necessary from the State.

Long-Term Actions to Promote Solvency

NYRA's eventual receipt of VLT revenues will undoubtedly relieve a significant amount of financial pressure and produce significant benefits in areas such as capital improvements and increased purses. However, these additional revenues will not negate NYRA's fiduciary responsibility to operate in a prudent, cost-effective manner. In that regard, we have also identified additional opportunities for reductions in NYRA's future operating expenses.

For example, since emerging from bankruptcy, NYRA's overall payroll costs have increased. In 2008, NYRA's payroll costs totaled $67.3 million for 1,273 employees; in 2010, payroll costs are budgeted at $69.2 million for 1,279 employees, a net increase of $1.9 million (2.8 percent). We note that NYRA recently conducted an executive compensation analysis covering its seven most senior executives, who are paid about $2.5 million annually as shown in Exhibit A. However, this analysis only included executive compensation and compared NYRA to other racing entities that operate under different corporate structures. More importantly, NYRA has not performed a formal staffing analysis to determine the optimal number of employees and salary scale for its other operations.

We recommend that such an analysis be performed and the staffing and salary be adjusted accordingly.

In addition, in 2009, NYRA spent more than $6 million on contracts for personal and miscellaneous services. However, NYRA does not require that the need for, and the price of, such contracts be formally justified with a documented analysis. As a result, there is inadequate assurance that the contracts are necessary, and if necessary, that the prices are reasonable. In our limited review of these contracts, we identified at least one contract that may not be necessary and at least one contract that may be overpriced, as follows:

- In 2009, NYRA paid a media consultant more than $1 million for consulting services and the procurement of advertising, reportedly to secure favorable advertising rates. However, we note that NYRA has its own media advertising department and has not provided us with documentation to evidence that the advertising rates secured by the consultant were in fact lower than what it could have secured on its own.

- Pursuant to the State's Racing Law and as ordered by the U.S. Bankruptcy Court, on July 25, 2007, NYRA hired an Integrity Counsel to help guide its management decisions. NYRA hired the same law firm that had previously been appointed by the U.S. District Court to serve as its "Independent Private Sector Inspector General" (IPSIG) during a time when NYRA was under a federal indictment. NYRA entered into a contract with this firm that provides for a minimum monthly fee of $125,000 or $1.5 million annually; approximately 50 percent of the average monthly fee the firm had previously been paid to act as IPSIG. However, based on our observations and review of the firms invoices illustrating actual hours of work and agreed to billing rates, it appears that it would be more cost-effective for NYRA to acquire these legal services on a pay-as-you-go basis, rather than under the current minimum fee arrangement.

  We analyzed the number of billable hours that the firm reported working for NYRA over the 17 months September 2008 through January 2010 and calculated the amount that the firm would have normally billed for these services based on its published hourly rates. Our analysis valued these services at about $1,771,274; or $451,691 less than the $2.2 million actually paid by NYRA over the 17 month period. Potential savings could therefore approximately $320,000 annually.

  We were informed that the contract payment terms we cite were approved by the U.S. Bankruptcy Court. We were also told that the difference between the minimum monthly payments made by

NYRA, and the amount that would have been billed to NYRA each month based on actual hours worked and the agreed upon hourly rates, is carried forward as a monthly credit to be absorbed by any future invoices for months where the actual hours and rates might exceed the monthly minimum (e.g., during the Saratoga season). The monthly minimum was also developed to ensure that NYRA would not be in a position to control the amount of work deemed necessary by the firm. Further, the firm is committed to providing NYRA with professional services up to the unabsorbed value of the accumulated credit upon expiration of the contract.

We respect the necessary independence of the firm and the need to have the payment for its work guaranteed. However, we also note that our invoice review period accounted for the 2009 Saratoga racing meet at which time the accumulated credit of $488,027 was reduced to a credit of $386,545 – still a substantial amount. We have not seen any evidence that the 2010 Saratoga season would incur significantly greater costs. Further, based on NYRA's current financial condition, the firm's commitment to provide NYRA with future professional services up to the amount of the accumulated credit does not help NYRA's actual cash position. Only applying the accumulated credits on a month to month basis would accomplish that. We recommend NYRA and the firm revisit the payment terms of the contract to ensure that the billing arrangement is appropriate for maintaining the objectives for the Integrity Counsel as well as the financial stability of NYRA.

We also question the economy and necessity of one of the services NYRA provides to the horse owners and trainers participating in its meets. We found NYRA routinely transports horses between its three tracks at no cost to the owners and trainers. NYRA incurs about $900,000 in staffing and contractor costs annually to provide this service. According to NYRA officials, the service is a courtesy to the owners and trainers in an effort to encourage them to participate in NYRA races. NYRA also notes that several major track operators, such as Gulfstream and Santa Anita, also perform this service. We recommend that NYRA evaluate whether, and to what extent, this practice is necessary for NYRA to remain competitive. Depending on the results of this evaluation, NYRA may need to consider either charging a fee for the service or discontinuing it.

Some of the savings opportunities we identified from just our limited review represent relatively immediate opportunities that NYRA can act on quickly to begin saving money, such as the $900,000 in horse transportation costs and over $320,000 in annual legal fees. Others, including reductions in payroll costs and service contracts, are longer term opportunities that will require more detailed analysis and planning by NYRA, which should begin with an internal examination of its expenses and the degree to which its operations deviate from standard industry practices.

Recommendations

1. Develop a business plan that aligns NYRA's operating expenses with its actual net revenues; implement the plan; monitor NYRA's adherence to the plan; and promptly take corrective action if the operating expenses routinely exceed the net revenues.

2. Prepare a staffing analysis for each NYRA department to determine the optimal number of employees and salary for that department, and adjust the staffing accordingly.

3. Justify with documented analysis the need for, and the price of, all existing and future prospective contracts for personal and miscellaneous services; modify or discontinue the existing contracts that cannot be justified; and do not enter into prospective contracts that cannot be justified. Monitor contract awards to determine whether the contracts have been appropriately justified, and take corrective action if this is not the case.

4. Evaluate whether, and to what extent, the practice of transporting horses between NYRA tracks at no cost is necessary for NYRA to remain competitive and, depending on the results of the evaluation, consider either charging a fee for the service or discontinuing it.

5. Identify the extent to which other NYRA operations and services deviate from standard industry practices and evaluate whether such departures are necessary and cost-effective.

Exhibit A

New York Racing Association Inc.
Schedule of Senior Executive Compensation

Senior Executive Position	Salary Level Before Bankruptcy (2007)	Current Annual Compensation (2010)
Chief Executive Officer	$ 422,129	$ 460,000
Chief Operating Officer	n/a	440,000
General Counsel	398,484	413,000
Chief Financial Officer	221,290	325,000
Chief Administrative Officer	279,290	295,000
Chief Information Officer	n/a	260,000
Vice President - Human Resources & Labor	242,895	255,000
Total		**$ 2,448,000**

(n/a – Prior year information is derived from NYRA's 2007 corporate income tax returns. Because certain positions were not filled for the full year, the associated salaries reported on the return are not comparable and are therefore not presented.)

1

Agency Comments

THE NEW YORK RACING ASSOCIATION, INC. 110-00 Rockaway Blvd, Ozone Park, NY 11417 (718) 659-3537
www.nyra.com

NYRA

Ellen McClain
Senior VP, Chief Financial Officer

July 2, 2010

BY E-MAIL and U.S. MAIL

Mr. Frank Patone, CPA
Office of the State Comptroller
Division of Government Accountability
123 William Street – 21st Floor
New York, NY 10038

Dear Mr. Patone:

Enclosed please find the following two documents submitted by The New York Racing Association, Inc. ("NYRA") which collectively constitute our response to the New York State Office of the State Comptroller draft audit report, *"New York Racing Association, Inc.: Financial Condition and Selected Governance Activities"* (Report 2009-S-89 submitted to NYRA on June 4, 2010):

- July 2, 2010 letter from NYRA Chief Executive Officer Charles E. Hayward; and

- July 2, 2010 letter from James P. Heffernan, as Chairman of the Special Oversight Committee of the NYRA Board of Directors, responding to that portion of the draft audit report concerning NYRA's retainer agreement contract with its independent business integrity counsel.

We thank you again for your efforts in this matter and look forward to our continued working relationship.

Respectfully submitted,

Ellen McClain
Senior Vice President and
Chief Financial Officer

A q u e d u c t *B e l m o n t P a r k* *S a r a t o g a*

THE NEW YORK RACING ASSOCIATION, INC. P.O. Box 90, Jamaica, New York 11417-0090 (718) 659-2311
www.nyra.com

CHARLES E. HAYWARD
PRESIDENT
CHIEF EXECUTIVE OFFICER

July 2, 2010

Mr. Frank Patone, CPA
Office of the State Comptroller
Division of Government Accountability
123 William Street – 21st Floor
New York, NY 10038

Dear Mr. Patone:

The New York Racing Association, Inc. ("NYRA") writes in response to your draft audit report *"New York Racing Association, Inc.: Financial Condition and Selected Governance Activities"* (Report 2009-S-89) submitted to NYRA on June 4, 2010.

NYRA Operating Strategy

NYRA's operating strategy is to maximize on-track attendance and wagering revenue, prudently manage expenses and utilize cash flow from video lottery terminals at Aqueduct to invest in the business for the long term. Funds from operations and proceeds from video lottery terminals are expected to be sufficient to weather difficult macro economic and competitive industry dynamics and allow NYRA to a) maintain the three race tracks consistent with environmental and other regulatory requirements; b) attract new on track customers c) enhance the wagering experience and d) invest in technology to operate more efficiently.

The franchise agreement requires NYRA to conduct racing at least 246 days a year, including at least 120 days at Aqueduct, 90 days at Belmont and 36 days at Saratoga, and maintain its tracks and facilities so that their physical appearance and conditions do not detract from the communities in which we operate. On a combined basis, Aqueduct, Belmont and Saratoga encompass 1,005 acres of property, 3 main tracks plus 5 turf courses; 1 dirt course and 2 training tracks. The historic facilities span 1.9 million square feet and seat 68,000 patrons. Lastly, 166 barns have the capacity to stable 4,577 horses, which is necessary to support the racing program.

NYRA management believes the future of horse racing in New York is promising and has identified several opportunities to meaningfully enhance NYRA revenue and cash flow including: a) the build out of a 20,000 square foot Sports Bar/Simulcast Center at Aqueduct, open year round; b) regulatory change to enable horses trained by the same to trainer (but owned by different owner) to compete individually and c) consolidating downstate training to one facility.

When Video Lottery Terminals Did Not Materialize
NYRA Adjusted Its Business Plan

As the audit report correctly points out, anticipated VLT revenue has not been realized due to delays in the selection of an operator. Exacerbating NYRA's financial condition, New York City Off-Track Betting Corporation ("NYC OTB") has defaulted on the payment of statutory payments to NYRA. As of May 31, 2010, NYCOTB owed NYRA $19.9 million. Furthermore, NYRA did not receive support payments from the State of New York in 2009 even though the franchise agreement contemplated financial support to NYRA in the event video lottery terminals were not operational by April 2009. Instead, NYRA adjusted its business plan to conserve cash.

Over the last two years NYRA's management has focused on cost savings in several areas. From 2008 to 2010, operating expenses declined 2.2%. 2010 budgeted operating expenses are approximately $146 million, $9.0 million below the level contemplated in the bankruptcy reorganization business plan. Notably, as of May 2010, year-to-date operating expenses are $1.5 million or 3.1%, below budget.

Cost savings have been realized in the area of advertising and promotion expense which declined more than 19% between 2008 and 2010. Facility related expenses remain flat despite wage inflation associated with collective bargaining agreements and the high fixed costs of maintaining three racetracks and grandstands. Lastly, the administrative staff has not received pay raises for two consecutive years and as a further cost reduction measure, NYRA eliminated 5% of its administrative workforce in February 2010.

By actively managing expenses NYRA successfully operated for almost two years without the required VLT financing or financial support from the State of New York. NYRA management has demonstrated a willingness to reduce operating expenses where feasible and will continue to explore further opportunities to reduce costs and improve the efficiency of its operations.

Factoring Video Lottery Terminals Into the Business Plan Going Forward

In order to emerge from bankruptcy, the court required NYRA to submit a comprehensive, viable plan of reorganization. The business plan relied heavily on VLT cash flow as the major source of new capital to finance its operation and improve the New York horse racing industry purse structure, among other things. NYRA believes VLT proceeds are an appropriate and necessary source of capital to finance the business going forward. In September 2008, management had every reason to believe video lottery terminals would be installed at Aqueduct in the near term.

In the fall of 2008, the then Governor actually selected a partnership lead by Delaware North to operate the VLT facility at Aqueduct. In March 2009, Delaware North withdrew its offer to provide VLT operations due to an inability to secure the necessary financing during the deepening economic crisis in 2009.

During the spring and summer of 2009, Governor Paterson reiterated the State's commitment to "provide much needed economic development to the racetrack and critical funding for education in New York" and stated he would select a VLT operator before the end of the 2009 Saratoga race meet. In February 2010, the Governor announced that Aqueduct Entertainment Group was selected to operate the VLT facility at the Aqueduct Racetrack.

Under the management of the Division of the Lottery, the VLT selection process is underway and NYRA management believes the professionally managed process will result in the successful implementation of video lottery terminals at Aqueduct in the foreseeable future. Therefore, NYRA management believes it should factor VLT revenue into its business plan. To reduce NYRA's cost structure without regard to VLT revenue would require an estimated 25% to 30% reduction in personnel, forcing a painful restructuring of more than 25 union contracts. Such drastic cuts would compromise our ability to fulfill the franchise and ultimately jeopardize the long term future of the New York State equine industry.

Commitment to Cost Management With or Without Video Lottery Terminals

NYRA is committed to operating as cost effectively as possible. Although NYRA is a not-for-profit corporation, the objective is to generate cash flow sufficient to fund its operation without the need for external financing. Although cash flow from video lottery terminals is critical to the long term financial stability of NYRA, VLTs do not eliminate the need to reduce operating costs to the extent possible without compromising the New York horse racing franchise or the safety of horses, horsemen or patrons.

Strong internal controls over purchasing support our cost control objectives. During 2009, NYRA worked closely with the New York State Lottery Division to upgrade its purchasing policy and, in February 2010, the updated policy was approved by the Franchise Oversight Board. The Purchasing Department is continually negotiating contracts in order to minimize NYRA operating expenses.

Response to Specific Findings

Media Consultant

"In 2009, NYRA paid a media consultant more than $1 million to secure favorable advertising rates, even though NYRA has its own media advertising department. NYRA officials provided no justification explaining why this outside consultant was necessary and no documentation showing the benefits that were realized as a result of the consultant's actions."

In 2009 NYRA paid $1,000,275 to GC Consulting as follows: $874,275 was applied directly to the purchase of advertising and $126,000 compensated GC Consulting for media buying and other services. GC Consulting purchases advertising on NYRA's behalf and pays the media outlets directly. Since GC Consulting serves as a media buyer for a number of clients, to the extent GC Consulting extracts volume discounts or priority ad placements, NYRA benefits in terms of 1) lower prices and 2) more favorable time slots on television or ad positions in print or on-line. Going forward, NYRA will require GC Consulting to better document the value of their media buying service by routinely providing comparisons of actual rates to published rates for all significant media buys.

* Comment 1

Transportation of Horses

"We also question the economy and necessity of one of the services NYRA provides to the horse owners and trainers participating in its meets. We found NYRA routinely

* See State Comptroller's Comments, page 33.

transports horses between its three tracks at no cost to the owners and trainers. NYRA incurs about $900,000 in staffing costs and $300,000 in contractor costs, annually to provide this service. According to NYRA officials, the service is a courtesy to owners and trainers in an effort to encourage them to participate in NYRA races. However, this is not a standard industry practice."

In 2009 NYRA incurred costs of approximately $900,000 in total (which included internal costs of $600,000 and external contractor costs of $300,000) to transport horses between its three training locations in an effort to encourage entries into our races to maintain a healthy field size which enhances handle. We transport approximately 10,000 horses throughout the course of a year. During 2009, NYRA held 2,347 races with an average field size of 7.96 horses per race. Maximizing field size is essential to maximizing handle because a healthy field size is required to offer certain handle enhancing exotic wagers which contribute disproportionately to revenue. Now is not the time to increase costs to horsemen who themselves have been negatively impacted by the delay in launching video lottery terminals.

* Comment 2

It should be noted that NYRA management believes it is standard industry practice to offer vanning services. The major racing operations offer free transportation as follows:

- Between Gulfstream Park and the Palm Meadows Training Center
- Between Arlington Park and Churchill Downs
- Between Keeneland Race Course and Churchill Downs
- Between the Maryland Racetracks
- Between Del Mar Race Track, Santa Anita, Hollywood Park and off-track training centers

Response to Recommendations

1. NYRA is committed to operating as cost effectively as possible and will update its business plan to reflect on-going cost saving initiatives. Although NYRA is a not-for-profit corporation, the objective is to generate cash flow sufficient to fund its operation without the need for external financing. Although cash flow from video lottery terminals is critical to the long term financial stability of NYRA, VLTs do not eliminate the need for NYRA to reduce its operating costs to the extent possible without compromising the New York horse racing franchise or the safety of horses, horsemen or patrons.

2. In the context of preparing the 2011 Operating Budget, NYRA (using existing personnel and information systems) will prepare a staffing analysis for each department.

3. NYRA is committed to routinely evaluating the necessity of all service contracts and will endeavor to enhance the documentation of the economic and competitive analysis underlying the decision to enter into service contracts.

* See State Comptroller's Comments, page 33.

4. NYRA will continue to evaluate the practice of transporting horses between NYRA tracks every year during the annual budgeting process and on an interim basis if circumstances warrant. NYRA will make every effort to reduce the cost of providing the service.

5. NYRA agrees that benchmarking NYRA practices against industry standards is a worthy exercise. However, a comprehensive, formally documented analysis will be very difficult to accomplish in the short term with existing resources.

Respectfully submitted,

Charles E. Hayward

JAMES P. HEFFERNAN

July 2, 2010

VIA E-MAIL & U.S. MAIL

Mr. Frank Patone, CPA
Office of the State Comptroller
Division of State Government Accountability
123 William Street – 21st Floor
New York, NY 10038

Re: Draft Report 2009-S-89: *New York Racing Association, Inc.: Financial Condition and Selected Governance Activities*

Dear Mr. Patone:

I am a member and Vice Chairman of the New York Racing Association ("NYRA") Board of Directors. On April 27, 2010, Stuart Subotnick, in his then-capacity as Chairman of the Special Oversight Committee of the Board ("SOC"), responded in writing to the New York State Office of the State Comptroller ("OSC") regarding questions posed by OSC during its audit of NYRA relating to our retainer agreement contract ("Retainer Agreement") with NYRA's independent business integrity counsel Getnick and Getnick ("Integrity Counsel") (his letter incorporated by reference a responsive letter from Integrity Counsel to OSC, collectively referred to herein as the "April 27th Response"). As the current Chairman of SOC, I am writing to respond to OSC's comments of the Retainer Agreement in its draft audit report delivered to NYRA on June 4, 2010 ("Draft Audit Report").

NYRA's Integrity Counsel reports to NYRA's Chairman of the Board and the SOC, the function of which, among other things, is to address integrity matters that arise at NYRA. The goals for an independent private integrity oversight entity associated with NYRA were first conceived and articulated by the OSC in its September 2003 report on NYRA and later promoted by the Governor in July 2007 during the franchise bidding process, reflecting OSC's call in August 2006 for the continuation of NYRA's integrity and reform program by the next franchisee. An independent business integrity counsel contract or retainer agreement is not designed to maximize economy, but rather to maximize independence, while doing so cost effectively.

At the start of its audit, OSC asked for "an explanation of the need for NYRA to contract with an outside firm to act as Business Integrity Counsel as opposed to using in-house General Counsel staff." The answer, provided to you both orally and in the April

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27th Response is that, "By definition, an independent business integrity counsel must be an outside, independent entity and not part of NYRA's in-house legal staff," both conceptually and according to the specific requirements of the Racing Law Sec. 206(5).

As to the essential element of maximum independence, the Retainer Agreement specifically states:

> NYRA agrees and acknowledges that it is the intent of both NYRA and G&G to afford maximum independence to G&G in performing its function as business integrity counsel, including, but not limited to, interacting with governmental entities and industry regulators, consistent with the underlying counsel relationship between NYRA and G&G.

As explained in our April 27th Response:

> The provisions in the Retainer are designed to ensure and maximize this independence. First, the Retainer specifies a non-exhaustive list of subject matter areas for Getnick & Getnick to address. Highlighting these areas – areas that were previously emphasized by the OSC – is intended to ensure that Getnick & Getnick is not prevented from continuing to address these important integrity matters. Second, the agreement is in effect for a five-year period. This precludes a potential short-term strategy by management to impede, obstruct, or ignore integrity efforts. Third, the Retainer contains a monthly minimum fee for professional services designed to ensure that the efforts of business integrity counsel can not be limited by having its funding restricted. The minimum fee amount was derived from the average monthly fees that Getnick & Getnick earned during the federal court-appointed monitorship (approved at the time by the OSC, USAO [United States Attorney's Office for the Eastern District of New York] and Federal Court) pursuant to the DPA [Deferred Prosecution Agreement], and was set at ½ that amount. The Bankruptcy Court specifically approved these provisions.

*
Comment
3

The operative factual premises in OSC's Draft Audit Report regarding the Retainer Agreement are inaccurate, leading OSC to an erroneous conclusion. Below is a line-by line-analysis of the relevant paragraph in OSC's Draft Audit Report.

* See State Comptroller's Comments, page 33.

OSC states: "On July 25, 2007, NYRA hired an Integrity Counsel to help guide its management decisions. NYRA hired the same law firm that had previously been appointed by the U.S. District Court to serve as its 'Independent Private Sector Inspector General' (IPSIG) during a time when NYRA was under a federal indictment." That statement is correct as far as it goes, but fails to acknowledge that OSC, along with the United States Attorney's Office for the Eastern District of New York ("USAO EDNY"), conducted the RFP (i.e. Request for Proposal) process and made recommendations to the appointing Federal judge leading to the selection and appointment of Getnick & Getnick.

* Comment 3

OSC states: "NYRA entered into a contract with this firm that provides for a monthly minimum fee of $125,000 or $1.5 million annually; the same amount the firm had been paid to act as IPSIG." In fact, as communicated to OSC in our April 27th response as excerpted above, the minimum monthly fee amount was set at ½ the average monthly fees that were earned during the federal court-appointed monitorship as supervised and approved by OSC. Furthermore, the hourly rate structure afforded NYRA under the Retainer Agreement is the same as the discounted public rate structure approved by the applicable local, state and federal government authorities when Getnick & Getnick served as one of the four integrity monitors for the post 9/11 recovery and clean-up for the City of New York (starting in 2001) and as the Federal monitor of NYRA (starting in 2004 as approved by OSC and USAO EDNY). In addition, Getnick & Getnick has refrained over the three years of its retention from periodically raising its rates pursuant to the Retainer Agreement terms authorizing the firm to do so and, starting in February 2010, the firm voluntarily elected to temporarily lower its monthly minimum fee by 20% to accommodate NYRA's economic situation this year.

* Comment 3

OSC states: "However, we found the firm's role as IPSIG required it to devote a much greater level of resources than does its current role as Integrity Counsel, including hiring several sub-contracted investigators and accountants." The IPSIG role did require greater services than the Integrity Counsel role which is why the Retainer Agreement monthly minimum fee was calculated and set at ½ of the average monthly fees under the IPSIG arrangement. In addition, OSC's comparison regarding the nature of required services for the Integrity Counsel engagement is inaccurate. Integrity Counsel uses a multi-disciplinary methodology including investigative and forensic auditing services, and continues to utilize the services of sub-contracted professionals.

* Comment 3

OSC states: "As a result, it appears that it would be more cost-effective for NYRA to acquire these legal services on a pay-as-you-go basis, rather than under the current minimum fee arrangement." First, as detailed above, each of the factual premises allegedly supporting this conclusion are not accurate. Second, as explained in our April 27th Response and above, the monthly minimum fee is an integral part of a retainer structure designed to maximize the independence of business integrity counsel. Third, the Retainer Agreement provides for a professional services carry-over credit in the event that fees for billable hours are less than the monthly minimum fee in any given month, which procedure was refined and approved by the Federal Bankruptcy Court. In addition, in the unlikely event that any carry-over credit exists at the end of the term of the contract, Integrity Counsel has entered into a written agreement with NYRA to

* Comment 3

* See State Comptroller's Comments, page 33.

provide professional services equivalent to the full value of that credit, subject to NYRA fulfilling its contractual obligations and adjusting for potential rate increases allowed for under the Retainer Agreement.

OSC states: "We analyzed the number of billable hours that the firm reported working for NYRA over the 10 months from September 2008 through June 2009 and estimated the amount that the firm would have normally billed for these services based on its published hourly rates." Although the audit period referenced in OSC's report was September 2008 through March 2010, the time period selected by OSC for its analysis of Integrity Counsel's billable hours specifically excluded the Saratoga season, the peak period of Integrity Counsel's work. OSC's methodology is analogous to undertaking a home heating bill analysis and specifically excluding the winter months. Although OSC refers to Integrity Counsel's "published hourly rates," as stated in our April 27th Response: "It is significant to note that the rates that [Getnick & Getnick] currently use[s] to bill NYRA for [its] services date back to 2001 and are substantially less than market value. The rate charged for Neil Getnick is less than half of his hourly retail rate. Despite the fact that the Retainer allows for periodic increases to these rates [Getnick & Getnick has] never increased them."

* Comment 3

OSC states: "Our analysis valued these services at about $762,000; or $488,000 less than the $1.25 million actually paid by NYRA over the 10 month period." Although OSC refers to its "analysis," in fact the cited figures are taken directly off Integrity Counsel's invoices, albeit those figures are misinterpreted by OSC. The Draft Audit Report creates the misimpression that Integrity Counsel pocketed $488,000 for professional services never rendered or to be rendered. The draft report failed to disclose that amount was for a "Professional Services Credit Due to NYRA," transparently set forth as a separate line item on Integrity Counsel's August 6, 2009 summary invoice. The draft report further failed to disclose that, as of the end of the period covered under that invoice (for professional services rendered through June 30, 2009), Integrity Counsel had unpaid hourly billings for services already rendered and expenses already incurred of $460,795.18. Moreover, NYRA did not pay $1.25 million over the 10 month period selected by OSC; NYRA paid $625,000 during that period against the $762,000 in services rendered and billed (a net negative of $137,000). NYRA did not pay the balance of the $1.25 million until October 2, 2009, by which time NYRA accrued further unpaid services and expenses for the months of July though September 2009, including the peak period of the Saratoga season.

* Comment 3

OSC states: "Potential savings could therefore exceed $600,000 annually." OSC fails to report or otherwise acknowledge that NYRA receives a professional services carry-over credit in the event that fees for billable hours are less than the monthly minimum fee in any given month. In short, NYRA receives full value and OSC's reported savings are non-existent.

* Comment 3

* See State Comptroller's Comments, page 33.

After NYRA presented all of the above information to OSC in response to its Draft Audit Report, OSC wrote to NYRA on June 30, 2010 saying:

> We've agreed to modify the existing paragraph in the report to be more accurate regarding the billing terms and better explain the workings of the accumulated credit and Getnick's commitment to NYRA with post-contract services up to the dollar value of the accumulated credit. However, the final report will continue to point out that we conclude that the payment terms of the contract are not in NYRA's best interest.

* Comment 3

OSC's rationale supporting its continuing conclusion is unclear. Apparently, OSC remains focused on the fact that the monthly minimum fee at times generates a carry-over credit to NYRA which may result in NYRA paying in advance for services. To the extent that situation may occur, it has been greatly ameliorated by Integrity Counsel's practice of managing the timing of its invoices and extending time for payment, working to NYRA's benefit from a cash flow perspective.

* Comment 3

For example, as of Integrity Counsel's most recent invoice to NYRA, dated June 14, 2010, for professional services rendered through May 31, 2010, NYRA is at a net negative of $9,431.99 for services rendered and expenses already incurred (i.e. $421,163.99 is due to Integrity Counsel versus a $411,732.00 professional services credit due to NYRA). In addition to that amount, NYRA has accrued a further obligation based on services delivered and expenses already incurred, but not yet billed, from June 1, 2010 to date.

* Comment 3

As explained above, the monthly minimum fee is an integral component of the terms assuring Integrity Counsel's "maximum independence." It also allows for the smooth and predictable funding of Integrity Counsel providing an available reserve during peak periods such as the Saratoga season or during times of intensive investigative activity. Likewise, it allows for adaptation during fiscal downturns, e.g. the 20% voluntary discount in the monthly minimum fee afforded by Integrity Counsel during NYRA's most recent fiscal crisis, without sacrificing the scope and quality of professional services. Perhaps most importantly, one of the reasons that NYRA continues to receive such credits is due to the fact that Integrity Counsel, on its own initiative, has continued to bill NYRA at its 2001 rate structure, even though the Retainer Agreement provides for periodic escalations.

* Comment 3

Some of the above-described benefits are the result of Integrity Counsel's voluntary practices, rather than written contractual requirements. During the IPSIG monitorship as well, Getnick & Getnick afforded NYRA voluntary professional discounts, unbilled services, and fee deferrals over and above the requirements of the retainer agreement (reviewed and approved by OSC) which was then in effect. NYRA

* Comment 3

* See State Comptroller's Comments, page 33.

recognized and took into account the established billing practices of Getnick & Getnick when entering into this Retainer Agreement.

The terms of the Integrity Counsel Retainer Agreement are fair to both parties. OSC should be guided accordingly.

Yours truly,

James P. Heffernan

State Comptroller's Comments

1. Our final report has been revised to reflect the total services received by NYRA for the $1 million paid to this contractor.
2. Our final report was revised to note that, according to NYRA, several other track operators perform a similar horse vanning service.
3. We revised our final report to reflect the additional information we received on this topic from NYRA's Board of Trustees after issuing our draft report.