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COMPTROLLER

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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

January 24, 2012

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

Re: Report 2011-F-16

Dear Mr. Hayward:

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 Article 2, Section 209 of the NYS Racing, Pari-mutuel Wagering and Breeding Law, we have followed up on the actions taken by officials of the New York Racing Association, Inc., to implement the recommendations contained in our prior audit reports: *Financial Condition and Selected Governance Activities* (Report 2009-S-89 issued July 12, 2010), and *First Interim Report on our Ongoing Audit of NYRA Operations* (Report 2010-S-54 issued August 31, 2010).

Background, Scope and Objectives

The New York Racing Association, Inc. (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 tracks: Aqueduct Racetrack, Belmont Park and Saratoga Race Course. Throughout the years, NYRA has been plagued by stagnant revenues, increasing expenses, financial deficits, and past allegations of criminal activity. In 2006, NYRA ultimately petitioned the Federal court for bankruptcy protection and, in September 2008, the State and NYRA entered into a bankruptcy settlement agreement. Pursuant to the agreement, NYRA conveyed all ownership rights in its racetrack facilities to the State. In return, the State provided NYRA with a financial assistance package that would provide NYRA with the funds needed to support its racing operations until an Aqueduct-based Video Lottery Terminal (VLT) operator was secured. Once secured, NYRA is to receive a percentage of the VLT revenue, initially estimated at $30 to $50 million annually. On May 24, 2010, the State approved a $25-million loan for NYRA, which could be accessed as necessary based on NYRA's internally-prepared cash flow projections. As of March 24, 2011, all $25 million had been drawn.

In Report 2009-S-89, we assessed the reasonableness of NYRA's cash flow projections as of May 20, 2010, and its need to draw upon the $25-million operating loan approved by the State to maintain fiscal solvency. We also assessed the actions taken by NYRA officials to eliminate its continuing financial deficits. Our audit found that NYRA's cash flow projections were supported properly and based on reasonable assumptions. However, we also concluded that NYRA had not done enough, or acted quickly enough, to reduce expenses, especially in light of the uncertainties associated with several of its major revenue sources, including the continually-delayed VLT installations and the failing, and ultimately defunct, New York City Off-Track Betting Corporation (NYC OTB).

After the completion of Report 2009-S-89, we immediately initiated another audit (Report 2010-S-54) to provide real-time monitoring of NYRA's financial condition and operating practices. In that audit, which covered the period July 28, 2010, through August 23, 2010, we re-confirmed the reasonableness of NYRA's ongoing cash flow projections; and noted that NYRA officials had developed plans to take certain actions that would result in reduced operating expenses and increased revenues. We also identified improvement opportunities for NYRA to enhance controls over its non-gaming revenues (i.e., concessions and kiosks) during the Saratoga meet. Nevertheless, NYRA's financial condition continued to deteriorate and NYRA officials reported an operating loss of $17.3 million for 2010. This deficit was largely the result of the demise of NYC OTB, which previously provided NYRA with about $20 million in revenues annually, without a corresponding decrease in what NYRA officials categorize as uncontrollable expenses such as pension contributions and employee health care costs.

The objective of our follow-up review was to assess, as of September 30, 2011, the extent of implementation of the nine recommendations included in the above-noted prior reports.

Summary Conclusions and Status of Audit Recommendations

We found that NYRA officials made some progress in addressing the recommendations we made in the two prior audit reports. However, much more needs to be done. For example, of our nine report recommendations, four were not implemented, and five were only partially implemented. We are concerned with the limited responsiveness to our prior audit report recommendations, particularly because NYRA may have less incentive to be attentive to cost savings initiatives as its financial condition improves with the influx of VLT revenues. In this regard, NYRA has collected over $7 million in operating and capital funds from VLTs through January 7, 2012, and NYRA projects its net revenues for 2012 to increase by about $48 million as a result of its share of VLT revenues.

We would also note that recently, during our ongoing audit of financial practices at the New York State Thoroughbred Breeding and Development Fund, our inquiries regarding the statutory payments to the Fund by NYRA found that NYRA had been underpaying its statutory payouts to bettors by 1 percent over the course of 15 months - saving NYRA at least $2 million in payouts during that period, according to media reports. NYRA's State regulator is requiring NYRA to reimburse its bettors, which will correspondingly reduce its anticipated profit for 2012. That such an error could remain unchecked by NYRA for such a period of time further increases our concerns over NYRA's fiscal management. We intend to follow up with NYRA to determine the exact dollar impact on NYRA and bettors, as well as exactly what corrective action NYRA has taken.

Follow-up Observations

2009-S-89

Recommendation 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

Status - Partially Implemented

Agency Action - In August 2011, NYRA officials issued a strategic plan (Plan) to the NYS Thoroughbred Racing Oversight Board. The Plan outlined recently-initiated steps, as well as future plans, to enhance NYRA revenues and decrease expenses. Enhanced revenues would be received through venues such as courtesy customer transportation, telephone wagering, NYRA Rewards, and enhanced simulcasting. Significant decreased expenses are to be achieved through the transferring of certain expenses to Aqueduct's VLT franchisee (Genting New York LLC) and reduced employee retirement and health care costs. Nevertheless, NYRA projects an $11.5-million deficit for calendar year 2011, but anticipates a year-end profit of $18.7 million for calendar year 2012 largely due to NYRA's share of estimated VLT revenues in addition to the implementation of the previously-noted cost saving and revenue enhancement initiatives. Since the Plan was only recently issued, NYRA has not yet started to monitor compliance with the Plan and take corrective action should expenses continue to exceed revenues.

Recommendation 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.

Status - Partially Implemented

Agency Action - NYRA officials did not prepare a staffing analysis for each of its departments outlining the optimal number of employees in each. However, NYRA officials did provide us with a headcount summary, prepared by NYRA department heads, which showed NYRA cut its overall staffing by 3 percent from 2009 to 2010. In addition, we have been informed that NYRA officials plan on reducing their custodial staff by 35 positions as a result of the VLT operator assuming most of the responsibility to maintain the Aqueduct facility. NYRA also hired an outside consultant to integrate its human resources and payroll databases to enhance the preparation of periodic payroll-related reports including departmental headcounts.

Recommendation 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.*

Status - Partially Implemented

Agency Action - NYRA officials did not document a top-to-bottom analysis of either their existing or prospective contracts for personal and miscellaneous services. However, we note that NYRA officials did terminate NYRA's contract with its former integrity counsel and awarded a new, more cost-effective, contract to a different integrity counsel. In addition, NYRA officials prepared an adequate justification for the contract award noted in Recommendation 2.

Recommendation 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.

Status - Partially Implemented

Agency Action - NYRA officials did not document that they have performed such an evaluation. However, NYRA officials did assess the cost benefits of transporting horses between NYRA tracks using NYRA vehicles and staff versus continuing to outsource this function. Their analysis reports a potential cost savings of $92,688 annually and the transition has already begun. Although NYRA officials did not implement our specific recommendation, cost savings in this area have been achieved.

Recommendation 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.

Status - Not Implemented

Agency Action - NYRA officials asserted that they do not pay for any practices that deviate from industry practice. However, they have not supported their assertion with any documented analysis.

2010-S-54

Recommendation 1

Be as expeditious as possible in undertaking strategic efforts and initiatives to achieve reforms that save costs.

Status - Partially Implemented

Agency Action - In responding to Report 2010-S-54, NYRA officials cited several planned cost-cutting initiatives. For example, NYRA forecasted an annual savings of $3.6 million by closing the Aqueduct training facility and $1.2 million by closing the security barns. As of the end of our field work, the security barns had been discontinued, and NYRA officials were pursuing the feasibility of employee health insurance reforms that would reportedly save NYRA about $4 million annually. As stated in Recommendation 1, NYRA has since outlined, and in some cases initiated, several other cost-cutting initiatives. NYRA officials ultimately chose not to close the Aqueduct training facility based on an in-house analysis of cost effectiveness.

Recommendation 2

Conduct periodic cash counts and other verification activities on a surprise basis.

Status - Not Implemented

Agency Action - During the 2010 Saratoga meet, we found that "surprise" cash counts of the Mutuel Department clerks were known by NYRA's then Chief Financial Officer – who was ultimately responsible for the management of all NYRA fiscal operations. NYRA officials did not provide proof that subsequent cash counts at any of the tracks were undertaken on a surprise basis. In fact, we were informed during our follow-up review that NYRA's Internal Audit Unit notifies the head of the Mutuel Department, the person responsible for NYRA's mutuel clerks and their corresponding collections, one day before a cash count is conducted.

Recommendation 3

Require concessions to utilize appropriate systems to establish accountability over sales and periodically verify that those systems are being used as intended.

Status - Not Implemented

Agency Action - While this requirement is incorporated into NYRA's vendor contracts, NYRA officials do not enforce it. As a result, NYRA concession operations continue to report their profits, which are used by NYRA to calculate its share of the revenue, on an honor system basis.

Recommendation 4

Develop an automated system to provide an accurate and up to date inventory of all concession operations, which is periodically verified on a surprise basis.

Status - Not Implemented

Agency Action - NYRA officials have not yet developed an independent accurate inventory of concession operations. As such, they have no assurance they are receiving all of the concession revenue NYRA is due.

Major contributors to this report were Michael Solomon, Stu Dolgon, Lisa Duke, Jay Gwak, Laurie Burns, and Constance Walker.

We would appreciate your response to this report within 30 days, indicating any actions planned to address the unresolved issues discussed in this report. We also thank the management and staff of NYRA for the courtesies and cooperation extended to our examiners during this engagement.

Very truly yours,

(original signed)

Frank Patone, CPA
Audit Director

cc. Ellen McClain, Chief Operating Officer
Tom Lukacs, Division of the Budget