THOMAS P. DiNAPOLI
COMPTROLLER

110 STATE STREET
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

January 24, 2018

Mr. Christopher K. Kay
President and Chief Executive Officer
New York Racing Association, Inc.
PO Box 90
Jamaica, NY 11417-0090

Re: Financial Condition and Selected Expenses
Report 2017-F-27

Dear Mr. Kay:

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, 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 report, *Financial Condition and Selected Expenses* (2015-S-21).

Background, Scope, and Objective

The New York Racing Association, Inc. (NYRA) holds the exclusive franchise to operate New York State's three major thoroughbred racetracks: Aqueduct Racetrack, Belmont Park, and Saratoga Race Course. Annual attendance at NYRA facilities approximates 1.8 million each year, with about $2.5 billion in all-sources wagering handle (e.g., on-track, simulcast) in fiscal year 2016. In November 2006, NYRA filed for bankruptcy due to its poor financial condition. In September 2008, upon renewal of its exclusive franchise, NYRA entered into a bankruptcy settlement agreement that conveyed all rights, titles, and interests in the racetrack properties (land and buildings) to New York State in return for a financial assistance package. A Franchise Oversight Board (FOB) was formed to oversee NYRA's financial operations.

In 2011, Resorts World New York City Casino (Resorts), operated by Genting New York (Genting), opened adjacent to Aqueduct Racetrack. According to NYRA's Franchise Agreement with New York State (Agreement), a percentage of Resorts' Video Lottery Terminal (VLT) revenues is to be directed to NYRA for operational support, capital expenses, and enhanced purses. In 2012, a temporary, State-controlled (Reorganization) Board of Directors was put in place to oversee NYRA operations. In June 2017, the temporary Reorganization Board was dissolved, and control of NYRA was returned to a private not-for-profit organization. For the period January 1, 2016 through June 30, 2017, NYRA received about $177 million in revenue from Resorts, distributed as follows: $37 million for operations; $91 million for purses; and $49 million for NYRA's capital program. Accordingly, for 2016, NYRA reported a profit of $26.2 million, which included the VLT revenues. Since the VLTs were put in place in 2011, NYRA has received $140 million in VLT operating revenues.

Our initial audit report, which was issued on June 10, 2016, assessed NYRA's financial condition and selected expenses. We found that although NYRA's overall financial condition (including VLT revenue subsidies) was sound, its traditional racing-related operations (excluding VLT funding) continued to produce multi-million-dollar annual deficits. Also, NYRA had paid certain expenses that were not ordinary or necessary for racing operations, which contributed to NYRA's racing-related deficits.

The objective of our follow-up review was to assess the extent of implementation, as of December 7, 2017, of the four recommendations included in our initial report.

Summary Conclusions and Status of Audit Recommendations

We found that NYRA has made some progress addressing the issues identified in our prior report. Of the four prior report recommendations, two were partially implemented and two were not implemented. Moreover, NYRA's racing operations continue to produce annual deficits, increasing to $18.1 million for 2016 and continuing for the first six months of 2017.

Follow-Up Observations

Recommendation 1

To calculate the results of NYRA's racing-related financial operations, include all ordinary and necessary expenses, such as pension contributions, OPEB, and depreciation.

Status – Not Implemented

Agency Action – In our prior audit, we took issue with NYRA excluding certain expenses necessary for racing operations from its operating profit calculation. These expenses were for Pension Contributions, Other Post-Employment Benefits (OPEB), and depreciation. Excluding these expense categories allowed NYRA to claim that it had a profit from racing operations, exclusive of VLT revenues, of $1.7 million for 2014, whereas inclusion of such expenses showed that NYRA had actually operated at a loss of $11.5 million. In their response to our initial report, NYRA officials disagreed with this recommendation, stating that exclusion of these expenses is a common way to assess management performance. For fiscal year 2016, NYRA officials once again announced a surplus from racing operations, excluding the expenses discussed above, of $4.6 million, while inclusion of such expenses results in an operating loss of $18.1 million. We maintain that reporting such numbers to the general public and to the NYRA Board in this way is not a fair presentation of the profitability of NYRA's racing operations, and can leave decision makers with the false impression that no actions are required.

NYRA's current position is that its financial statements are prepared in conformity with generally accepted accounting principles, and that all of its operating expenses have been consistently accounted for under this framework. NYRA also describes how it is entitled to the VLT funds until 2033 (the year the Agreement expires). NYRA also states that the exclusion of the expenses discussed above provides an additional means to evaluate and compare its operating performance from period to period in a consistent manner. We agree that NYRA has the right to evaluate the performance of its executive management in a manner of its own choosing. However, when publicly reporting the financial results of its racing operations, it has an obligation to ensure that such reporting fully discloses the methodology used to allow the public to make an informed opinion on such. At this point, such disclosure is not made.

For example, in December 2016, NYRA posted on its website that it forecasts to conclude 2016 with a third consecutive operational profit based on income from racing operations, an announcement that was made at its Reorganization Board meeting. In addition, in a description of the CEO's accomplishments posted on NYRA's website, NYRA reported that he had "secured NYRA's first operating profit in 13 years (fiscal 2014) … and expanded that profit margin in each fiscal year thereafter." Neither of these pronouncements disclosed, for example, that $4.6 million in Pension expense and $6 million in OPEB were excluded from this calculation.

We note that, in the FOB's evaluation of NYRA's performance for the period January 1, 2009 through December 31, 2012, it determined that NYRA failed the Agreement standard related to expenses. The FOB took exception to NYRA's position that the above-discussed expenses not be considered in evaluating NYRA's performance. In response to NYRA's objections, the FOB wrote, "They are costs associated with the employment of the labor force and impact business's financial position. Therefore, the Franchise Oversight Board believes it is wholly appropriate to consider these costs when evaluating NYRA's expenditures." We concur with the FOB's position.

<u>Recommendation 2</u>

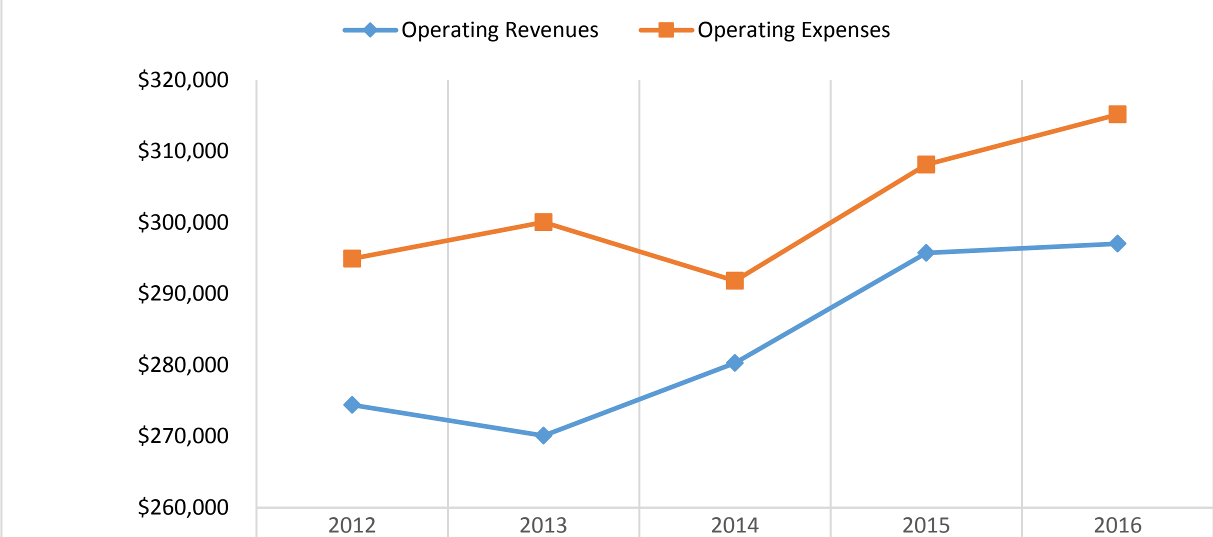
Develop a detailed plan to eliminate NYRA's annual deficits from racing operations (excluding VLT subsidies) with specific actions to enhance racing and track-related revenues and diminish unnecessary and unsupported expenses.

Status – Not Implemented

Agency Action – Although NYRA continues to indicate that it has surpluses from its racing operations ($4.6 million in 2016) without VLT revenues, in fact, it continues to have significant losses when all racing-related operating expenses are accounted for. As shown in the following graph, NYRA had an $18.1 million loss from racing operations in 2016, an increase of about 46 percent from its $12.4 million loss in 2015. NYRA officials continue to maintain that they are not operating at a deficit, that VLT funds will be available until 2033, and that none of their expenses are unnecessary or unsupported. While NYRA did not provide us with a detailed plan to eliminate its annual deficits from racing operations, it did describe a number of initiatives it has undertaken to enhance revenues, such as upgrading its facilities to improve the guest experience; increasing prices for admission, seating, and parking; and launching NYRA Bets, its own national Advanced Deposit Wagering platform.

However, these efforts have not yet been successful, as the gap between NYRA's racing-related expenses and revenues continued for the first six months of 2017. For this period, racing-related expenses grew by $5.3 million, while revenues from racing grew by only $2.2 million, resulting in a loss of $16.3 million for the six months ended June 30, 2017. We believe that NYRA needs to work toward reducing its racing-related operating deficits and reaching the goal of generating a profit without VLT funds.

Operating Revenue vs. Operating Expense
Excludes VLT Revenue and Associated Expenses
(dollars, in thousands)



	2012	2013	2014	2015	2016
Operating Revenues	$274,445	$270,109	$280,291	$295,769	$297,045
Operating Expenses	$294,930	$300,078	$291,842	$308,153	$315,182

<u>Recommendation 3</u>

Formally assess the propriety of the questionable expenses we identified and develop and implement written policies to minimize the risk of excessive payments for the goods and services in question.

Status – Partially Implemented

Agency Action – In NYRA's response to our prior report, officials stated that they had considered the propriety of the expenses we identified and found them to be appropriate. However, they did not provide documents to evidence whether they developed or implemented written policies to minimize the risk of excessive payments for the goods and services in question. Currently, NYRA continues to assert that the expenses we highlighted were appropriate, and provided us with their justifications for said expenditures. For example. NYRA described the role of the Management and Development Compensation Committee in ensuring the appropriateness of the compensation and bonus levels of the CEO. NYRA did not provide information on new written policies put in place to minimize the risk of future excessive payments.

Recommendation 4

Determine general horse racing industry practices regarding the questionable expenses we identified and other material cost items and identify opportunities to enhance revenues and reduce costs. Survey other race tracks as necessary or use other available information sources to obtain information on general industry and best practices.

Status – Partially Implemented

Agency Action – NYRA disagreed with this recommendation in its response to our prior report, stating that it did not have any "questionable expenses." For our follow-up, in addition to the initiatives to enhance revenues described in Recommendation 2 above, NYRA indicated that it has created what it calls "must see" big event days as well as "guest centric" days, such as the Stars and Stripes Day, in an effort to enhance revenues. NYRA did not provide any evidence or claim to have taken actions to reduce costs. NYRA also claimed to be a national leader in the industry, and claimed it is in touch with counterparts as appropriate to share information in formal and informal ways to develop best practices.

Major contributors to this report were Diane Gustard, Rita Verma-Kumar, and Shengyu Gu.

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 NYRA management and staff for the courtesies and cooperation extended to our auditors during this process.

Very truly yours,

Michael Solomon
Audit Manager

cc: M. Kim, NYRA