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September 2015

John Signor, President
Members of the Board of Directors
Capital Off-Track Betting Corporation
1629 State Street
Schenectady, NY 12304

Report Number: S9-14-63

Dear Mr. Signor and Members of the Board of Directors:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and Board of Directors' governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

In accordance with these goals, we conducted an audit of five regional Off-Track Betting Corporations (OTB) throughout New York State. We included the Capital OTB in this audit. The objective of our audit was to determine whether the financial condition of OTBs is deteriorating. The audit period was from January 1, 2009 through August 31, 2014. Following is a report of our audit of the Capital OTB. This audit was conducted pursuant to the State Comptroller's authority as set forth in Article 5, Section 516 of the New York State Racing, Pari-Mutuel Wagering and Breeding Law (Racing Law).

This report of examination letter contains our findings and recommendations specific to the Capital OTB. We discussed the findings and recommendations with Capital OTB officials and considered their comments, which appear in Appendix A, when preparing this report. Capital OTB officials generally agreed with our recommendations and indicated they planned to initiate corrective action. At the completion of our audit of the five OTBs, we prepared a global report that summarizes the significant issues we identified at all of the units audited.

Summary of Findings

Over the past five years, Capital OTB's overall financial condition has deteriorated at a steady pace. Capital OTB has experienced annual decreases in net handle (wagering) due to a general decline in interest in horse racing and increased competition from other entities in the gaming industry. Net handle declined 13 percent (\$22.9 million) over the past five years, and for the six months ended June 2014, was down approximately \$3.6 million compared to the same period in 2013.

Capital OTB officials have implemented the previous recommendations from the Office of the State Comptroller (OSC).¹ However, the statutory and contractual expenses paid from the net handle makes operations difficult to sustain financially in an environment where net handle is declining. The declining handle has reduced distributions to local governments from Capital OTB as well.

Background and Methodology

Capital OTB was formed as a public benefit corporation in 1975 and its geographic area is comprised of 16 counties and the cities of Albany and Schenectady. The Board of Directors (Board) is the governing body. The Board has 17 members, one from each of the participating counties and one from the City of Schenectady, who are appointed by their respective governing boards.

Capital OTB offers off-track pari-mutuel² wagering on horse racing for the objective of promoting the horse racing industry, providing revenues to State and local governments and diminishing the role of illegal bookmakers. As of September 10, 2014, Capital OTB operated 33 branch locations, 31 EZ Bet locations,³ two tele-theaters, a bet mobile,⁴ an Internet wagering system and telephone account wagering operations. However, during the audit period, additional facilities were in operation that were subsequently closed by September 2014, including 14 additional branches and 11 additional EZ Bet locations.

While an OTB collects revenue, it does not retain these funds; rather it must distribute funds to various entities according to statutes and contracts. An OTB may not retain its net revenues to fund future operations. Net handle (wagers) represents the amount wagered by patrons throughout branches, EZ Bet locations, tele-theaters, bet mobile, telephone and Internet venues. The winning patrons receive back a percentage of the net handle on each race. Each OTB retains a percentage that must be distributed to various entities across New York State, including the State's horse racing industry, New York State and local governments. These statutory distributions are based on formulas in the Racing Law. In addition, OTBs makes payments to certain out-of-state racetracks with negotiated simulcast contracts. These statutory and contractual expenses represent a

¹ Capital Off-Track Betting Corporation, Report Number S9-9-81, issued May 20, 2010

² Pari-mutuel refers to a betting pool in which winners divide the total amount wagered, after management expenses are deducted.

³ EZ Bet is a machine in an establishment where patrons can place bets through the machine.

⁴ According to Capital OTB officials, the bet mobile allows Capital OTB to bring gaming to different venues. Locations are limited, as Capital OTB needs permission from the Saratoga Raceway to bring the bet mobile within 40 miles of their racetrack.

significant portion of the OTB's annual expenses, with the remaining expenses attributed to maintaining operations.

Racing Law governs how an OTB distributes surcharge revenues and net revenues derived from the operations. Each regional OTB or off-track betting operator conducting off-track betting must impose a surcharge of 5 percent on the portion of pari-mutuel wagering pools distributable to persons placing bets at OTB facilities. OTBs distribute these surcharge revenues monthly to the participating local governments and to local governments where the tracks are located. The net revenues from operations are distributed on a quarterly basis to the participating local governments after contributions to the capital acquisitions fund⁵ are deducted. For the year ended December 31, 2013, Capital OTB distributed surcharge revenues and net revenues of \$2.1 million to local governments.

We examined the financial condition of Capital OTB for the period January 1, 2009 through August 31, 2014. We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). Such standards require that we plan and conduct our audit to adequately assess the Capital OTB operations within our audit scope. Further, those standards require that we understand Capital OTB's management controls and those laws, rules and regulations that are relevant to Capital OTB operations included in our scope. An audit includes examining, on a test basis, evidence supporting financial activities and applying such other auditing procedures we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for the findings, conclusions and recommendations contained in this report. More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

Audit Results

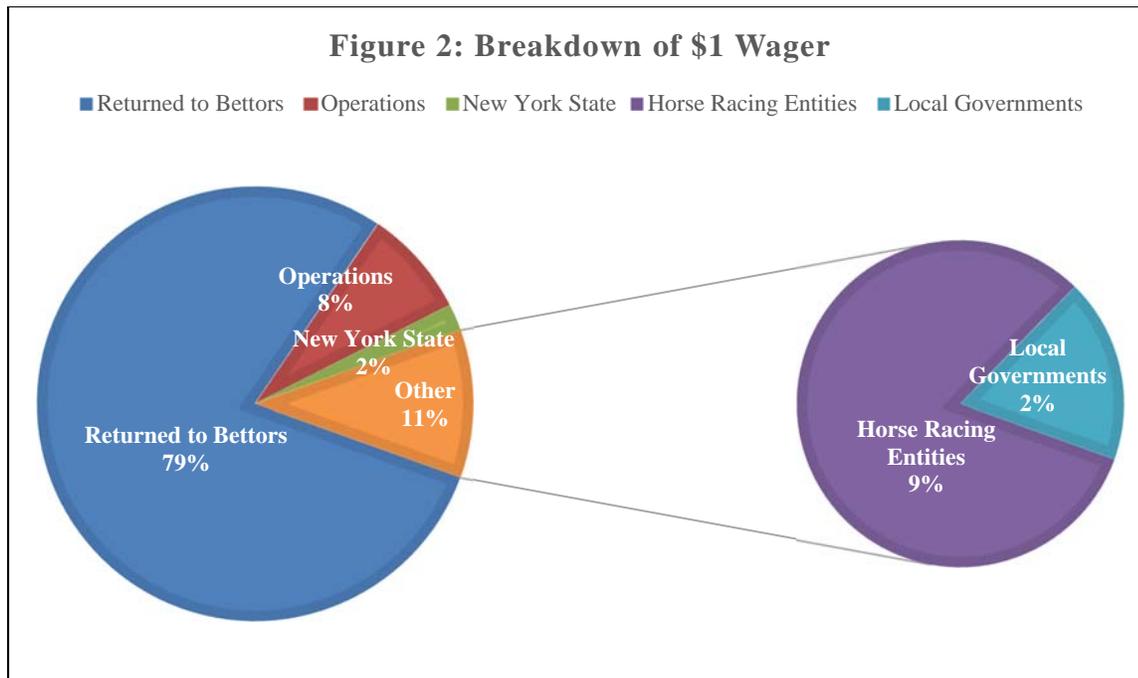
Financial Condition Analysis

Net Handle – Over the five-year period 2009 through 2013, Capital OTB has experienced a 13 percent decline (\$22.9 million) in net handle, from \$176.6 million to \$153.7 million. Further, the net handle for the six months ended June 30, 2014 was lower by approximately \$3.6 million compared to the same period the prior year. Figure 1 shows the change in Capital OTB's net handle during the last five years:

⁵ The intent of the capital acquisition fund is to permit OTBs to reserve revenue for the payment of debt service and acquisition of capital assets without negatively affecting the respective OTB's cash flow required for operations.

Figure 1: Capital OTB Net Handle					
	2009	2010	2011	2012	2013
Net Handle	\$176,566,467	\$165,688,551	\$156,960,633	\$159,563,685	\$153,656,891
Dollar Value Change From Prior Year	N/A	(\$10,877,916)	(\$8,727,918)	\$2,603,052	(\$5,906,794)
Percent Change From Prior Year	N/A	(6.16%)	(5.27%)	1.66%	(3.70%)

In 2013, Capital OTB paid approximately 79 percent (over \$121 million) of the net OTB handle collected to winning patrons. It also paid a portion of the surcharge revenues, as stipulated by statute, to participating local governments (over \$2.1 million) and local governments with tracks (approximately \$731,000). Capital OTB kept the remaining surcharge revenues collected by funding its capital acquisition fund (approximately \$491,500). For perspective, Figure 2 demonstrates the distribution of handle generated by Capital OTB.



Several factors have contributed to the decline in overall net handle at Capital OTB. These include a fluctuating economy, a general decline in interest in horse racing (as evidenced by declines from 2009 to 2013 of net handle of the racing industry) and competition from other entities in the gaming industry, such as casinos and government-sponsored lotteries. Capital OTB officials have also attributed the decline in net handle to the increased number of out-of-state and offshore advance deposit wagering sites.

Statutory Distributions – Capital OTB must make statutory distributions before paying its operating expenses. These distributions represent a significant financial outlay and the largest is

made to the horse racing industry.⁶ During the five years ended December 31, 2013, these distributions totaled approximately \$68 million and accounted for more than 74 percent of Capital OTB's total \$91.7 million in statutory distributions. The distributions to the horse racing industry are made to the following entities:

- In-state racetracks, based on statutory rates dependent on the type of wager and other contractual agreements;
- Out-of-state racetracks, based on specific contractual agreements; and
- Certain designated horse breeding funds that were created to support and promote in-State activities related to horse breeding and racing.

Figure 3 details the statutory distributions paid during the five years ended December 31, 2013.

	2009	2010	2011	2012	2013
Track Compensations	\$14,080,244	\$13,247,815	\$13,246,758	\$13,744,790	\$13,643,562
New York State	\$3,054,574	\$2,830,389	\$2,576,000	\$2,599,518	\$2,479,196
Breeding and Development Funds	\$1,295,011	\$1,194,050	\$1,118,384	\$1,138,462	\$1,067,117
Allocations to Local Governments	\$1,052,253	\$962,172	\$848,178	\$793,139	\$731,062
Total	\$19,482,082	\$18,234,426	\$17,789,320	\$18,275,909	\$17,920,937

Track Compensation – Capital OTB features broadcasted races from various locations in both the United States and Canada. Those raced in New York, as well as the Triple Crown and Breeders' Cup races, are subject to statutory limitations on what can be charged. Any other racetrack or conglomeration of tracks hosting a race individually negotiates track compensation with Capital OTB. Capital OTB relies on having races to broadcast in its betting parlors.

The contractually-negotiated fee paid to broadcast races is a percentage of the handle derived from the races at the applicable tracks. For example, if the average fee in 2014 on all tracks totaled 6.05 percent for every \$100 in handle, then Capital OTB would pay slightly more than \$6 to broadcast a race. This is in addition to other statutory payments that Capital OTB makes. The major tracks throughout the country have consolidated into collective organizations and contracted with OTBs to simulcast races. The two largest organizations have increased rates 300 percent over the six-year period from 2009 through 2014. Because of these increases, Capital OTB retains smaller percentages of the funds remaining after paying winners and, as such, retains less for operations.

Due to the declining handle, allocations to local governments have decreased approximately 31 percent over the five-year period. Capital OTB officials have indicated that the statutory structure they are held to prevents them from being competitive in the industry and significantly limits their ability to fund operations.

⁶ These payments are commissions to the tracks and payments for breeding and developmental funds.

Operating Revenues and Expenses

Capital OTB operating revenues consist of the remaining net handle after winning bettors are paid and monthly surcharge revenues and statutory distributions are allocated, plus other miscellaneous revenues. These revenues are generated from branch locations with restaurant operations, income derived by a portion of surcharges, uncashed tickets⁷ and other miscellaneous incomes. Over the five-year period from 2009 through 2013, Capital OTB operating revenue has decreased approximately \$7 million (27 percent).

Capital OTB's operating expenses have decreased about \$3.5 million (17 percent) over the same five-year period, excluding statutory payments. When statutory payments are included, the overall operating expenses decreased 13 percent (\$5.1 million) over the last five years. A significant portion of Capital OTB's operating expenses is employment-related (e.g., employee salaries and fringe benefits⁸). While branch and corporate salaries and fringe benefits accounted for approximately \$9 million (51 percent) of Capital OTB's operating expenses in 2013, salaries have decreased by approximately 25 percent and fringe benefits have decreased by approximately 3 percent since 2009. Figure 4 illustrates these financial trends for Capital OTB:

	2009	2010	2011	2012	2013	Percentage Change 2009-2013
Racing and Gaming Revenue	\$45,133,218	\$40,784,870	\$38,208,570	\$37,769,152	\$36,583,523	(19%)
OTB Operating Expenses	\$21,189,408	\$20,404,866	\$20,569,955	\$18,351,515	\$17,656,326	(17%)
Total Statutory Payments	\$19,482,082	\$18,234,426	\$17,789,320	\$18,275,909	\$17,920,937	(8%)
Total Expenses	\$40,671,490	\$38,639,292	\$38,359,275	\$36,627,424	\$35,577,263	(13%)
Net Revenue From Operations	\$4,461,728	\$2,145,578	(\$150,705)	\$1,141,728	\$1,006,260	(77%)

Previous Audit

Our previous audit recommended Capital OTB review its operational locations to shift to the most cost effective means of operation. This included exploring the expansion of EZ Bet locations as a cost effective alternative to branch locations. From 2009 through 2013, Capital OTB decreased the number of EZ Bet locations from 36 to 33 locations. During our audit scope period, Capital OTB had up to 43 branch locations and 36 EZ bet locations opened. However, by the end of 2013, only 34 branch locations and 33 EZ bet locations were open. For the 34 branch locations that were active in 2013, none had operating losses. For the 33 EZ bet locations that were active in 2013, one⁹ had an operating loss of \$447.

⁷ Capital OTB remits all 2013 uncashed tickets to New York State by April 2014.

⁸ Fringe benefits include group insurance, retirement and vacation benefits, Social Security taxes and unemployment insurance expense items.

⁹ This EZ bet location opened on December 5, 2013.

We analyzed handle and expenses by location and found the branch locations have an 11 percent ratio of expenses to handle, while the EZ Bet locations have a ratio of approximately 6 percent expenses to handle. EZ Bet locations, however, only accounted for approximately 7 percent of the net handle generated during the audit scope period.

While Capital OTB has implemented the recommendations from the previous audit by closing poorer performing branch locations, it continues to experience a decline in financial condition.

Recommendations

The Board should:

1. Explore opportunities to increase revenues to stabilize the continuing declining net handle.
2. Review and renegotiate contractual expenses to achieve lower costs.
3. Continue to analyze the cost-benefit of operations and determine the appropriate mix of business activities.

Good management practices dictate that the Board has the responsibility to initiate corrective action. As such, the Board should prepare a corrective action plan (CAP) that addresses the recommendations in this report and forward the plan to our office. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the Capital OTB's administrative offices.

We thank the officials and staff of the Capital OTB for the courtesies and cooperation extended to our auditors during this audit.

Sincerely,

Gabriel F. Deyo
Deputy Comptroller

APPENDIX A

RESPONSE FROM CAPITAL OTB OFFICIALS

The Capital OTB officials' response to this audit can be found on the following pages.



Capital District Regional Off-Track Betting Corporation

510 Smith Street, Schenectady, New York 12305
(518) 344-5200

January 20, 2015

Ms. Ann Singer
Chief Examiner
Office of the State Comptroller
State Office Building, Room 1702
44 Hawley Street
Binghamton, New York 13901-4417

Dear Ms. Singer:

Capital District Regional Off-Track Betting Corporation appreciates this opportunity to respond to the draft report of examination letter S-9-14-63 dated December 23, 2014.

The draft report has been reviewed by the Corporation's upper management as well as the Chairman of the Board of Directors, the Chairman of the Board's Finance Committee and the Chairman of the Audit and Policy Committee.

Capital OTB's management believes that the issues discussed in the report outline the relevant circumstances (economic fluctuations, competition, restrictions for siting remote wager locations and the statutory distributions and surcharges that represent a significant financial outlay for the Corporation) that have resulted in the financial decline within the State's off-track betting corporations. While the report notes that the Corporation's handle declined 13 percent over the five-year audit period, handle for 2014 ended just 1.6 percent lower than the previous year. This was a dramatic turn-round from the 5 percent June 30 year to year decline noted in the report. Furthermore the Corporation's handle outpaced the national trend which resulted in a 2014 handle decline for all U.S. races of 4.3 percent.

Converting to a new, robust advanced deposit wagering platform in late 2013 has resulted in continued growth in the Corporation's Internet wagering. Over the five year audit period Internet wagering increased 372 percent and now constitutes just under 30 percent of overall Corporate handle. Through aggressive marketing, a competitive reward program and personalized customer service the Corporation has achieved year after year higher performance measures than other horse racing entities and it continues to promote, through its OTBTV television station, an industry that is a "vital sector of New York state's overall economy" (Racing, Pari-Mutuel Wagering and Breeding Law Section 100)

While there are numerous external forces that have negatively impacted the Corporation's bottom line, the audit report recognized the Corporation's successful efforts to reduce operating costs and maximize the return to its participating municipalities. Utilizing technology (the Corporation upgraded to all new wagering terminals during 2014) has allowed the Corporation to achieve operating efficiencies, through reduced man power. Through contract negotiations and branch relocations, occupancy costs have been reduced. Top management has and continues to turn over every stone to find ways to maximize the bottom line.

Recent legislation meant to level the playing field with out-of-state Internet betting sites (ADWs) by placing a surcharge on wagers these sites take from New York residents has been undermined by several NY race tracks, Finger Lakes and Saratoga Harness, which has cut in half the anticipated revenues to OTB corporations. We do not believe the intent of the law was for these types of contracts and by these tracks doing so it has cost OTBs millions in revenues.

Despite management's efforts to increase revenue and reduce expense, statutory actions must be taken to move the State off-track betting model out of the 1970 era of limited gaming competition in which the OTBs are still required to operate in. While your report does allude to this, I believe stronger emphasis should be placed on this vital fact in your report. Certain legislative actions would help to level the playing field:

1. Close the loop-hole that has allowed certain out-of-state advance deposit wagering (ADW) sites to avoid paying the tax for taking wagers from New York residents. Either the Gaming Commission or legislative action should be taken to make these contracts with out of state sites null and void as they undermine the intent of the law, and in doing so it would bring millions in revenues to OTB corporations and county taxpayers.
2. Allow OTB Corporations to retain uncashed tickets. Years ago the State imposed a regulatory fee that mandated OTBs to pay the Gaming Commission a percentage of gross handle. Therefore, OTBs are already paying the State millions of dollars in revenues. By allowing the OTB Corporations to retain uncashed tickets, it would provide a boost to cash flow and additional revenues to our county taxpayers.
3. Eliminate the hold harmless payments that OTBs are mandated to pay regional harness tracks. Taxpayers, through OTB corporations, should not be subsidizing privately owned casinos and these payments to regional harness tracks are nothing more than corporate welfare.
4. Eliminate or reduce payments OTB Corporations make to New York race tracks (both harness and thoroughbred). New York tracks have been operating as casinos for many years and have generated tens, if not hundreds, of millions of dollars in revenues from their VLT operations. OTB monies that go to tracks, in

our view, should be redirected to help fund county budgets and help county taxpayers. Legislative action should be taken to reduce or eliminate these payments to New York tracks/casinos.

5. Eliminate the provision that allows harness tracks to deny placement of OTB branch sites. This provision is giving harness tracks the ability to make OTB less efficient by denying branch sitings. This provision gives harness tracks the ability to make OTB less cost-effective which negatively impacts the revenues we provide to taxpayers. This law should be eliminated immediately.
6. Reform the statutory distribution formula that requires OTBs to pay off the gross handle and provide upfront money without taking into account costs for operations.
7. Amend the Racing, Pari-Mutuel Wagering and Breeding Law to allow all, not just the Long Island OTBs, to operate VLTs. Current law authorizes all State pari-mutuel wagering entities except Capital and Catskill OTB from having VLTs. If authorized, VLTS at Capital OTB would provide a much needed revenue stream to increase the amount money that would be provided to the taxpayers within Capital's participating municipalities.

The changes outlined above would go a long way in making the off-track betting corporations more profitable and in turn provide more revenues to the taxpayers that they represent. We urge State leaders to take action on these issues which would protect taxpayers, direct monies back to OTBs from tracks that have VLT revenue, and fully return the ADW legislation back to its original intent, resulting in millions more in revenues to OTB Corporations statewide.

Sincerely,

John F. Signor
President/CEO

Cc: Chairman of the Board Marcel Webb
Finance Chairman Willis Vermilyea
Audit and Policy Chairman Michael Nabozny

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

We conducted this performance audit in accordance with GAGAS. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

To complete the audit objective, we interviewed Capital OTB officials regarding budgeting practices and monitoring. We reviewed documents prepared by Capital OTB's external CPA firm regarding Capital OTB's financial activities and financial information provided by Capital OTB. We analyzed trends of revenue, expenses and gambling activity to reach our conclusions.