



New York State Office of the State Comptroller
Thomas P. DiNapoli

Division of State Government Accountability

Administration of Video Lottery Terminal Revenues

Division of the Lottery



Report 2010-S-56

July 2012

Executive Summary

Purpose

To determine whether video lottery terminal revenues are adequately controlled, accurately reported, used only for their intended purposes, and have improved racetrack attendance and handle. Our audit covered the period April 1, 2008 through March 31, 2012.

Background

The historical mission of the New York State Division of the Lottery (Lottery) is to raise revenue for education by administering Lottery games. In 2001, the State legislature approved the installation of Video Lottery Terminals (VLTs) at the State's horse racing facilities (Video Lottery Terminal Facilities [VLT Facilities]) to complement the Lottery's pre-existing games of chance. In addition to providing additional funds for education, the VLT revenues are to provide much needed financial assistance to the racetracks. VLTs in New York State are currently located at nine of the State's racetracks. The VLTs pay bettors prizes averaging a minimum of 90 percent of credits played, the dollar amounts received from the bettors. The remaining VLT revenues ("net win") are paid to education; the respective VLT Facility operators for purses, marketing and capital projects; and the Lottery, to cover its costs of administering the VLT program. The VLT operators also retain a percentage of net win as a commission for administering the VLTs. The 17,270 VLTs operating at the nine VLT Facilities as of March 31, 2012 have collected a total of \$81.2 billion in credits played, and distributed more than \$3.7 billion to education and the associated VLT and racetrack facilities.

Key Findings

- VLT revenues are adequately controlled, accurately reported, and distributed in compliance with the enabling legislation.
- Marketing and capital project funds retained by VLT Facilities were spent appropriately, with the exception of \$13,917 in unsupported marketing expenditures at Batavia.
- We are unable to determine whether the VLT revenues used to enhance racetrack purses have aided racetrack attendance and handle.

Key Recommendations

- Continue to monitor VLT Facilities' use of funds earmarked for marketing and capital projects and recoup such funds as appropriate.
- Work with racetrack officials and industry professionals to develop performance measures to assess the benefits of diverting millions of dollars in VLT Facility revenues to their companion racetracks.

Other Related Audits/Reports of Interest

[Division of the Lottery: Controls and Accountability Over Video Lottery Revenue \(2006-S-4\)](#)

State of New York
Office of the State Comptroller

Division of State Government Accountability

July 12, 2012

Gordon Medenica
Director
New York State Division of the Lottery
One Broadway Center
Schenectady, New York 12305

Dear Mr. Medenica:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of *Administration of Video Lottery Terminal Revenues*. The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. 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

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This report is also available on our website at: www.osc.state.ny.us

Background

The historical mission of the New York State Division of the Lottery (Lottery) is to raise revenue for education by administering Lottery games (e.g., scratch-off tickets, daily numbers.). In 2001, the State legislature approved the installation of Video Lottery Terminals (VLTs) at certain horse racing facilities (VLT Facilities) to complement the Lottery's pre-existing games of chance. In addition to providing additional funds for education, the VLT revenues are to provide much-needed assistance to the associated racetracks. The governing legislation outlines how the VLT Facilities, and in the case of Aqueduct, the New York Racing Association (NYRA), are to use the VLT revenues.

VLTs resemble "casino" slot machines. The fundamental difference is that the results of each play on a VLT are determined by a central computer located at a Lottery facility to which all VLTs are connected. A predetermined random formula is used for each play of the machine.

VLTs in New York State are located at seven harness racetracks and two thoroughbred racetracks. The VLTs are required to pay bettors a minimum return of 90 percent of credits played, the actual monies bet by patrons. The remaining VLT funds ("net win") are distributed to education; the respective VLT Facility operators and NYRA for purses, marketing, and capital projects; and the Lottery, to cover its costs of administering the VLT program. The VLT operators also retain a percentage of net win as a commission for administering the VLTs.

As of March 31, 2012, there were 17,270 VLTs operating at the nine VLT Facilities. As illustrated in Table 1, the VLTs have collected a total of \$81.2 billion from patrons and distributed more than \$3.1 billion to education, and \$571 million to the VLT Facilities and NYRA (excluding purses and commissions) for Marketing and Capital.

Location	Date Opened	VLTs	Credits Played	Net Win	Education	Marketing	Capital
Yonkers	October 2006	5,050	\$34,384	\$2,819	\$1,445	\$203	\$10
Aqueduct	October 2011	4,992	4,453	253	111	20	0
Saratoga	January 2004	1,778	12,764	1,030	519	80	10
Finger Lakes	February 2004	1,191	9,805	789	390	65	10
Monticello	June 2004	1,110	6,463	486	223	40	0
Hamburg	March 2004	940	4,771	412	172	35	9
Tioga	July 2006	802	3,547	285	115	27	8
Vernon	October 2006	767	2,358	208	79	20	6
Batavia Downs	May 2005	640	2,644	224	98	21	6
Totals		17,270	\$81,189	\$6,505	\$3,152	\$511	\$60

Audit Findings and Recommendations

We found that the Lottery has adequate systems and controls in place to ensure the accurate collection, recording, reporting, and distribution of VLT revenues. We also found that the revenue distributions made to designated VLT Facilities for marketing and capital projects were generally being used for their intended purposes.

However, performance measures have not been established to determine whether the \$1.023 billion of VLT monies that have been distributed to the racetracks for purse enhancements, and in the case of Aqueduct purses, marketing, and capital projects, has had a positive effect on racetrack attendance and handle. In fact, between 2004 and 2010, on-track handle at these racetracks has suffered an overall decrease of approximately 13 percent.

Revenue Collections and Distributions

Lottery has contracted with three vendors responsible for the design, manufacture, installation, and maintenance of the VLTs. It also contracts with another vendor that operates the VLT's central computer system (System). The System determines the results of each play, and calculates the payouts to winners and the distributions to all mandated parties.

We selected a sample of four VLT Facilities (Empire City, Saratoga, Finger Lakes, and Batavia Downs) to determine whether their respective VLT revenues, for the period April 1, 2008 through November 16, 2010, had been accurately accounted for and distributed as required. Each VLT Facility is required to make daily deposits of all monies collected via its VLTs and related voucher machines into a dedicated bank account via electronic funds transfer. The System performs daily reconciliations of the monies collected to the readings on the various VLTs and voucher machines to ensure that the correct amount of money was collected for each play, and that all revenue collections are properly accounted for. The Lottery then makes weekly electronic transfers of these monies to Education and the VLT Facilities, etc., in accordance with the governing legislation.

The System is also subject to an annual "Statement on Auditing Standards 70" Type II Report, by an independent qualified consultant, that assesses the controls over its operational effectiveness. For the two fiscal years ended March 31, 2010, the System received clean opinions, meaning no significant deficiencies were identified. We reviewed these independent reports and the methodologies employed by the independent consultants who prepared them, to assess their compliance with industry standards, and did not identify any exceptions.

Marketing Allowance Expenditures

Each VLT Facility is authorized to retain a percentage of net win to spend on marketing either its VLTs, or a related operation (e.g., restaurant, horse racing, etc). During our audit period, legislation set the marketing allowance rate between 8 and 10 percent of net win, depending on the VLT Facility. Therefore, the greater the net win, the greater the amount of funds available for marketing. The accrued marketing funds may not be used for any purpose other than marketing.

The VLT Facilities are required to prepare annual marketing and promotional plans describing their planned activities over the upcoming 12-month period. Any unspent marketing funds from the prior year may be carried forward to the ensuing year provided the 12-month plan accounts for those monies. The VLT Facilities are also required to have an independent audit firm perform an annual review of their compliance with the statutes governing the marketing funds.

We reviewed the use of the marketing funds retained by the four VLT Facilities we visited (Empire City, Saratoga, Batavia Downs and Finger Lakes) and found that, in general, the correct percentages of net win were retained; and based on available paper work and our physical observations, the monies were used for appropriate marketing purposes. However, we did question a few of the “marketing” expenditures made by Batavia Downs.

At Batavia Downs, our review of 60 non-personal service expenditures found that six items, totaling \$13,917, had no supporting documentation. After we notified Lottery officials of this observation, they requested that Batavia Downs reimburse those funds. In response, Batavia reimbursed its Marketing Allowance account the full amount from its non-VLT revenues. Lottery also asked Batavia Downs officials to hire an outside firm to assist them in improving controls where appropriate, including those related to the use of marketing funds.

Capital Expenditures

Each VLT Facility, except for Genting at Aqueduct and Monticello, is also authorized to retain four percent of its net win as a reserve for capital projects. The funds retained for this purpose may not be spent without Lottery’s prior approval. VLT Facility officials must demonstrate to Lottery, via a five-year capital improvement plan, that the project(s) for which funds are requested should increase patronage and thereby increase the amount of revenues generated by the VLTs to support State education programs.

Capital project awards are not to exceed \$2.5 million per year for each eligible VLT Facility, and those with more than 1,100 VLTs are required to match each award with their own funds. These capital project awards are available to the VLT Facilities for a five-year period beginning April 1, 2008 and ending March 31, 2013. There is no time limit on the use of these awards as long as the funded projects are approved by April 1, 2013 and completed by April 1, 2015.

During the period, April 1, 2008 through December 21, 2010, a total of \$41.7 million in capital reserves was earned and allocated into segregated capital awards accounts, and \$8.2 million of

this amount was spent at six of the eight VLT Facilities operating at the time. Empire City and Monticello, as of December 21, 2010, had yet to expend any of their respective capital awards.

We found that the capital funds used by the three VLT Facilities we selected for review (Vernon, Finger Lakes, and Saratoga) were supported and used for approved purposes as outlined in their respective five-year plans. Lottery staff tracked all payments related to their capital projects and confirmed that the capital expenditures were properly supported and in compliance with the governing statute. We reviewed their work and independently verified the capital projects completed at the three VLT Facilities.

Racetrack Handle

According to the VLT's enabling legislation, the VLT Facilities are to have a physical layout that provides for easy access to the Racetrack portion of their facilities to encourage patronage of live horse racing. Pursuant to the Tax law, the commissions paid by VLT Facilities to enhance racetrack purses are expected to result in an eventual increase in the number of horses entered in each race, an increase in the quality of the horses racing, and ultimately in increased wagering and more financially-stable racetracks.

To determine whether VLT revenue contributions to racetrack facilities have achieved these objectives, we reviewed purse and handle statistics available from the NYS Racing and Wagering Board, which trends such data. We found that, despite the influx of VLT monies since calendar year 2004, handle at their associated racetracks has continued to decrease. In fact, total handle on live racing in New York decreased from \$53 million in 2004 to \$46 million in 2010, a decrease of 13 percent. Although one could say that the VLT contributions may have slowed down the rate of decline at New York's racetracks, we are unable to determine whether the millions of dollars that pay for increased purses, rather than for education, are having their intended effect.

Recommendations

1. Continue to monitor VLT Facility use of funds earmarked for marketing and capital projects. As with Batavia Downs, recoup such funds where associated expenditures are either unsupported or used inappropriately.
2. Work with racetrack officials and industry professionals to develop performance measures to assess the benefits of diverting millions of dollars in VLT revenues to their companion racetracks.

Audit Scope and Methodology

The objective of our audit was to determine whether video lottery terminal revenues are adequately controlled, accurately reported, used only for their intended purposes, and have improved racetrack attendance and handle. Our audit covered the period April 1, 2008 through March 25, 2011.

To accomplish our objective, we interviewed relevant officials and staff at the Lottery and at each VLT Facility we visited: Saratoga, Finger Lakes, Batavia Downs, Vernon Downs, and Empire City. We also spoke with representatives from the operator of the VLTs central computer system as well as their independent accountants and system consultants. To test revenue transactions, we judgmentally selected four months of revenues to verify that the correct amounts were recorded, reported and deposited into the appropriate accounts. To assess the support and propriety of marketing and capital project funds, we reviewed the records maintained at seven VLT Facilities: (Empire City, Saratoga, Batavia Downs and Finger Lakes) for marketing funds, and (Vernon, Finger Lakes and Saratoga) for capital projects, reviewed the supporting documentation and made physical observations as appropriate.

We conducted our performance 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 of program performance.

Authority

This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

Reporting Requirements

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

Lottery officials thanked us for our audit and suggestions for improvement. However, they assert that the policy issues we raise in the report are beyond the Lottery's purview, but should be part of the scope of the new "Gaming Commission" scheduled to begin operation in the fall (2012), of which Lottery will be a component. Lottery officials also cited a couple of inaccuracies in our paragraphs on Marketing and Capital allowances. Our final report wording was revised to address those inaccuracies.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Director of the Division of the Lottery shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons why.

Contributors to This Report

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Vision

A team of accountability experts respected for providing information that decision makers value.

Mission

To improve government operations by conducting independent audits, reviews and evaluations of New York State and New York City taxpayer financed programs.

Agency Comments



Gordon Medenica, Director

June 5, 2012

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

Dear Mr. Patone:

We have received the Office of the State Comptroller's Draft Report of its Audit of the Lottery's Video Gaming Casinos. We applaud the Comptroller's Office for a thorough and professional audit and we appreciate the positive feedback on the Lottery's integrity and proper management of the program. We also thank you for giving us the opportunity to comment on the report and to make suggestions for improvement.

Clearly, the public policy issues raised in the report are beyond the purview of the Lottery, although we share the concern expressed. We have no authority to regulate horse racing or alter the distribution of VLT revenue to horse racing entities, or to measure the impact of these subsidies. Anecdotally, we know from all our facility operators that there is almost no overlap or synergy between the casino patrons and the horse racing patrons at the facilities. Many of the facilities lose money on their horse racing operations (in addition to the subsidies they are required by law to contribute) but consider it simply a cost of doing business for having the VLT license and operating the gaming facility. In the past, one could characterize the facilities as horse racetracks with gaming machines, but now it is much more accurate to describe them as casinos (with a legally required track on the property).

The situation at the Batavia casino would benefit from clearer explanation. As the OSC audit team was aware, the Lottery had a long-standing series of regulatory issues with Batavia, from poor internal controls, weak management, questionable hiring practices, weak policy enforcement (e.g., underage play) and sloppy accounting. The Lottery required Batavia to hire an independent outside firm (Ernst & Young) to perform a thorough review of all management and internal control systems. This project was performed over the period November 2010 to November 2011, during which time the former CEO announced his retirement and a wholesale upgrade to management

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performance expectations was implemented. The undocumented marketing expenditures noted in the report were typical of the types of errors Lottery had previously uncovered that led to the Ernst & Young engagement. We continue to monitor Batavia closely and appreciate the Comptroller's support for our rigorous oversight.

Also, please note two corrections for the report. Genting *does* receive a marketing allowance for the Aqueduct casino but Monticello does *not* receive a capital allowance for its casino.

As mentioned earlier, we share the Comptroller's concern about the effectiveness of the horse racing subsidies generated by the Video Lottery program. With the new Gaming Commission scheduled to begin operation in the fall, we would expect such issues to be within its scope of responsibility.

Again, thank you for the opportunity to comment on the audit report and its finding. We are proud of the excellent performance of the Lottery and the high standards of integrity and accountability we maintain.

Sincerely,

A handwritten signature in blue ink, appearing to read "Fredo Aledemica". The signature is fluid and cursive, with a large initial "F" and "A".

cc: Thomas Lukacs, NYS Division of Budget