



**New York State Office of the State Comptroller**  
Thomas P. DiNapoli  
**Division of State Government Accountability**

# **Financial Condition and Selected Expenses**

## **New York Racing Association, Inc.**



# Executive Summary

## Purpose

To assess the New York Racing Association, Inc.'s financial condition and selected expenses. Our audit covers the period January 1, 2012 through December 31, 2014.

## Background

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. NYRA's annual on-track attendance approximates 1.8 million people, and annual all-source wagering on NYRA races (e.g., on-track, simulcast) totals about \$2.3 billion. In November 2006, NYRA filed for bankruptcy due to its poor financial condition, including a cumulative operating deficit of more than \$135 million. In September 2008, upon renewal of its exclusive franchise, NYRA entered into a bankruptcy settlement agreement conveying all rights, titles, and interests in racetrack properties (land and buildings) to New York State. In return, the State forgave nearly all of NYRA's debt obligations. In addition, a Franchise Oversight Board (FOB) was formed to oversee NYRA's financial operations.

In October 2011, Resorts World New York City Casino (Resorts) opened adjacent to Aqueduct Racetrack. According to NYRA's Franchise Agreement (Agreement), a percentage of Resorts' Video Lottery Terminal (VLT) revenue is directed to NYRA for enhanced purses, operational support, and capital expenditures. The Agreement directs that NYRA receive VLT funding until 2033 unless the franchise is terminated before that time. However, the FOB stressed the need for NYRA to develop a plan to become profitable without reliance on VLT subsidies. In 2012, a temporary, State-controlled Reorganization Board of Directors was created by the Governor to provide further oversight of NYRA operations. Currently, the Reorganization Board is scheduled to expire in October 2016.

## Key Findings

- NYRA's overall financial condition, as a result of VLT revenue subsidies, is sound. However, NYRA's traditional racing operations (which exclude the VLT revenues) have generated multi-million dollar annual deficits. Excluding VLT revenues, NYRA would have generated cumulative operating losses of \$109.3 million from 2010 through 2014 (or an average annual loss of about \$22 million). Moreover, NYRA has not developed a sufficient plan to make operations profitable without VLT subsidies.
- According to senior officials, NYRA generated a surplus of \$1.7 million in 2014, excluding the VLT subsidies. However, officials overstated NYRA's actual financial condition by excluding certain ordinary and necessary expenses (including pension contributions, post-employment health benefits, and depreciation) totaling \$13.2 million from profit and loss calculations. Thus, NYRA actually lost \$11.5 million when VLT funding is excluded. NYRA officials contended that the exclusion of the aforementioned expenses from profit and loss calculations was justified because the costs were beyond NYRA's control. However, there is no authoritative accounting or financial reporting justification for this practice.
- We questioned certain expenses that were not properly supported or did not appear to be

ordinary or necessary for racing operations. These expenses, which included unsupported performance incentives and horse transportation, contributed to NYRA's racing operation deficits.

## Key Recommendations

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

## Agency Comments

In their response, NYRA officials generally defended the practices cited in our report. In particular, officials stated that it was appropriate to exclude certain costs in calculating NYRA's profit or loss from racing operations, and they cited non-GAAP compliant measures as justification for their methodology. According to officials, the exclusions of certain costs were justified because they were "non-controllable by management" and constituted "non-operating expenses." Nonetheless, the excluded expenses directly resulted from management decisions, and therefore, we maintain that such expenses were controllable. Specifically, post-employment benefits resulted from the numbers of employees NYRA hired and the compensation former employees received through salary and benefit plans negotiated by management. Further, depreciation was the result of management's conscious decisions to invest in new capital assets and/or to improve existing assets.

We also doubt that NYRA's classification of these expenses as "non-operating" is substantively consistent with accounting and financial reporting guidance. Typically, non-operating expenses are not related to core business operations and can include costs for items such as organizational restructuring and losses from security sales or currency exchanges. In contrast, depreciation and post-employment benefits are common "operating" costs and are directly related to core operations.

Further, NYRA asserts that EBITDA (earnings before income tax, depreciation, and amortization) is commonly used by financial analysts to value businesses. However, the use of EBITDA to assess financial performance was not prescribed by the Franchise Oversight Board (FOB) or any other authoritative NYRA guidance.

## Other Related Audit/Report of Interest

[New York Racing Association, Inc.: Capital Program Revenue and Expenses \(2014-S-54\)](#)

**State of New York  
Office of the State Comptroller**

**Division of State Government Accountability**

June 10, 2016

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

Dear Mr. Kay:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage government resources efficiently and effectively. By so doing, it provides 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 the New York Racing Association, entitled *Financial Condition and Selected Expenses*. 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 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](http://www.osc.state.ny.us)

## 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. NYRA hosts about 250 race days annually. Annual on-track attendance at NYRA facilities approximates 1.8 million people, and annual all-source wagering on NYRA races (e.g., on-track, simulcast) totals about \$2.3 billion.

In November 2006, NYRA filed for bankruptcy due to its poor financial condition. At that time, NYRA 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 the agreement, NYRA conveyed all rights, titles, and interests in the racetrack properties (land and buildings) to New York State in return for a financial assistance package. As part of this package, the State forgave nearly all of NYRA's debt obligations (totaling \$54.1 million) 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 of about \$25 million. Further, a Franchise Oversight Board (FOB) was formed to oversee NYRA's financial operations.

In October 2011, Resorts World New York City Casino (Resorts), operated by Genting New York (Genting), opened adjacent to Aqueduct Racetrack. According to the new NYRA Franchise Agreement (Agreement), also effective in 2008, a percentage of Video Lottery Terminal (VLT) revenue from Resorts is to be directed to NYRA for enhanced purses, operational support, and capital expenditures. The Agreement directs that NYRA receive VLT payments for 25 years (until 2033), and that such funds can be used for racing operations and operating expenses, including NYRA's legacy pension obligations. The Agreement also sets forth a formula for calculating an annual year-end franchise fee payable to the State, if certain financial conditions are met.

The following table lists VLT revenue received by NYRA during our review period.

(Dollars in Thousands)	2012	2013	2014	Total by Type of Support
<b>Operating Support</b>	\$20,177	\$ 23,554	\$ 24,240	\$ 67,971
<b>Purse Support</b>	44,293	55,202	59,993	159,488
<b>Capital Support</b>	26,903	31,405	32,320	90,628
<b>Total by Year</b>	<b>\$91,373</b>	<b>\$110,161</b>	<b>\$116,553</b>	<b>\$318,087</b>

In 2012, a temporary, State-controlled Reorganization Board of Directors (Board) was created by the Governor to further oversee NYRA operations. The Board, which was scheduled to expire in October 2015, consists of 17 members: eight appointed by the Governor; two each appointed by the Senate and Assembly; and five appointed by the former NYRA Board. In 2015, the Governor and Legislature extended the duration of the Board for an additional year, ending in October 2016.

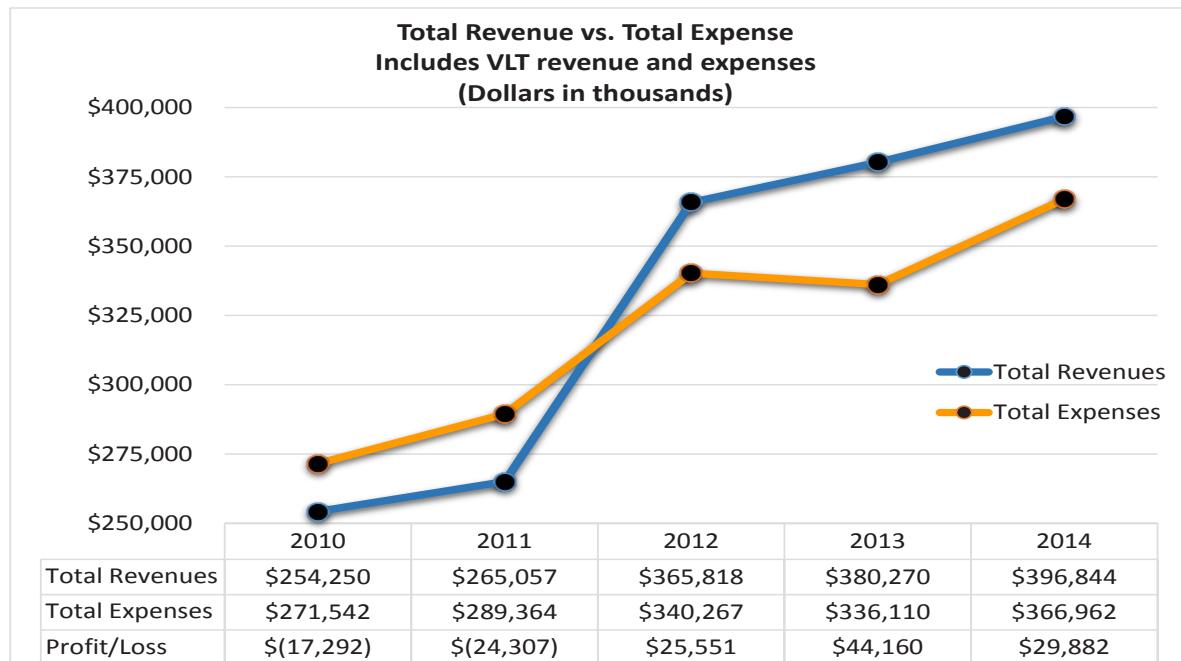
# Audit Findings and Recommendations

Although NYRA's overall financial condition (including VLT revenue subsidies) is sound, NYRA's traditional racing-related operations (excluding VLT funding) continues to produce multi-million dollar annual deficits. From 2010 through 2014, racing operations (excluding VLT funding) generated losses totaling \$109.3 million. Also, NYRA paid certain expenses that were not properly supported or were not ordinary and necessary for racing operations. These expenses contributed to NYRA's racing-related deficits.

## Financial Condition

For each year in our audit period, NYRA reported an annual surplus, due in considerable part to the millions of dollars it received annually from Resort's VLT operations. According to NYRA's certified financial statements, for the three years ended December 31, 2014, NYRA received about \$318 million in VLT revenue. Of this amount, about \$68 million was dedicated to general NYRA operations, \$91 million to NYRA's capital program, and \$159 million to purses.

However, prior to the monthly receipt of VLT revenues (which began in the fall of 2011), NYRA operations resulted in multi-million dollar annual losses. The following line graph illustrates NYRA's total revenues and expenses for the five calendar years 2010 through 2014.



As the graph shows, for the two years (2010 and 2011) with comparatively little or no VLT revenue, NYRA sustained losses totaling almost \$41.6 million. In comparison, for the three years (2012 through 2014) with VLT revenues, NYRA generated surpluses totaling about \$99.6 million.

In a prior OSC audit (Report 2009-S-89, issued July 12, 2010), we noted that from 2006 through

2009, NYRA's annual operating expenses ranged from \$156.1 million to \$183.0 million, while its annual net revenues (i.e., revenues after paying bettors, pari-mutuel taxes, racing purses, and certain other mandated payments) ranged from \$143.5 million to \$154.3 million. In each of those four years, NYRA incurred operating deficits of \$8.9 million to \$34.3 million. Thus, prior to the infusion of VLT revenue subsidies, NYRA had routinely sustained significant annual operating losses for a considerable number of years. Further, without the infusion of VLT revenues, there was a material risk that NYRA would become insolvent over the longer term.

Our prior audit also identified steps NYRA could take to reduce questionable operating expenses. For example, the audit recommended that NYRA perform a staffing analysis to determine the optimal number of employees and pay scales for its operations. In addition, NYRA spent several millions of dollars on contracts for personal and miscellaneous services. However, to adequately ensure that all existing and future contracts were necessary and the prices were reasonable, NYRA needed to support such contracts with documented analyses justifying their cost effectiveness. In our review of such contracts, we identified both potentially unnecessary and potentially overpriced contracts.

Our prior audit also identified almost \$1 million in relatively immediate opportunities that NYRA could likely act upon to save money, including formally evaluating the need for certain horse transportation costs and annual legal fees. Other, longer-term opportunities may have existed requiring more detailed analysis and planning by NYRA, beginning with an internal examination of its expenses. As such, we recommended that NYRA: develop a business plan that aligns its operating expenses with its actual net revenues; implement the plan; monitor adherence to the plan; and prevent future operating losses by promptly taking corrective actions if operating expenses routinely exceeded net revenues. Also, in its 2011 Annual Report, the FOB stressed the need for NYRA to develop a plan to make its racing operations profitable without reliance on VLT subsidies.

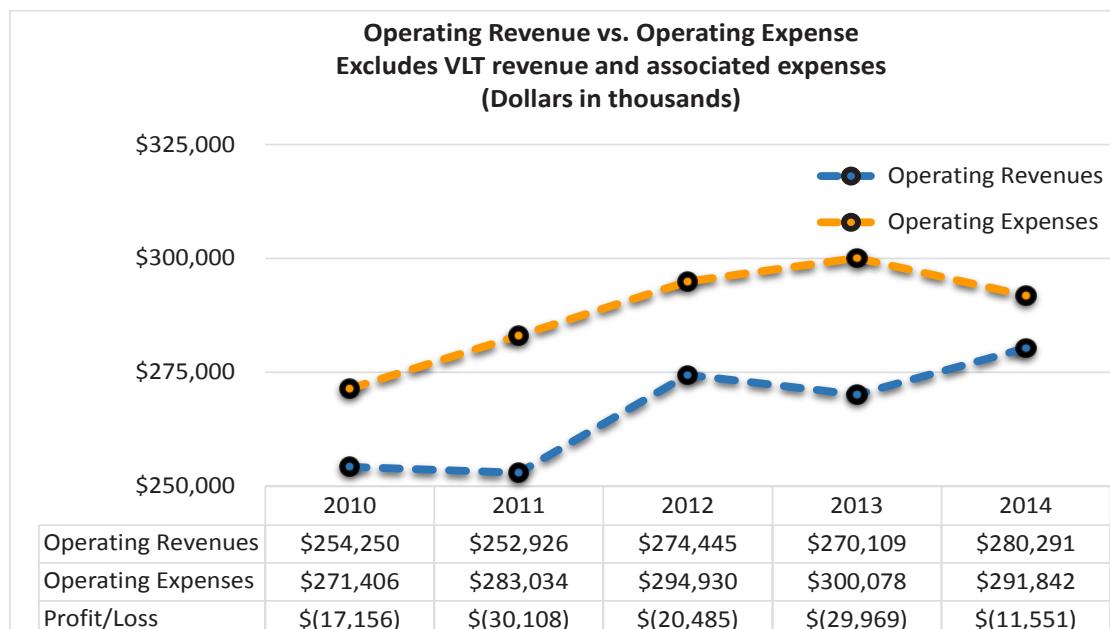
However, as detailed later in this report, we found that NYRA continued to incur questionable expenses that were either unsupported or unnecessary for racing operations. Moreover, we determined that NYRA officials had not developed a formal plan to eliminate operating deficits from racing operations, as otherwise recommended by the FOB.

Nevertheless, in December 2015, NYRA's Chief Executive Officer (CEO) stated that NYRA generated a surplus of \$1.7 million in 2014, with VLT revenues excluded from the calculation. The CEO also projected a surplus of \$4 million (without VLT funding) for calendar year 2015. However, we found significant flaws in NYRA's calculations of net surplus or loss. Specifically, for 2014, NYRA officials excluded pension costs of about \$2 million, other post-employment benefits (OPEB) of about \$5.8 million, and depreciation expenses of about \$5.4 million from their calculations. As such, NYRA understated its actual costs by about \$13.2 million (\$5.8 million + \$5.4 million + \$2 million), with respect to the CEO's assertion.

According to NYRA's Controller, the aforementioned expenses were excluded from the calculations because they were considered "non-controllable." However, pension, OPEB, and depreciation expenses are routine and necessary costs of doing business; operating expenses in accordance

with generally accepted accounting principles; and recognized as such on NYRA's financial statements. Thus, to assert that NYRA generated profits from racing-related operations, through the exclusion of "non-controllable" costs, is very misleading.

Moreover, when pension, OPEB, and depreciation costs are included in the profit/loss calculation, NYRA actually had a racing operations deficit of \$11.5 million (\$280.3 million in revenues less \$291.8 million in operating expenses) for calendar year 2014, excluding VLT revenues. In fact, NYRA ran significant racing operations deficits annually from 2010 through 2013 as well. The following graph illustrates NYRA's annual racing operations deficits from 2010 through 2014.



Also, as shown by the graph, NYRA reduced its deficit from almost \$30 million in 2013 to \$11.5 million in 2014. This was due to a reduction of \$8.2 million in expenses and an increase of \$10.1 million in revenues. According to NYRA officials, the revenue improvement in 2014 was largely attributable to the additional public interest and the corresponding increase in wagering on the Belmont Stakes related to horse racing's "Triple Crown." However, it is unclear that NYRA will benefit from this circumstance on a consistent basis in the future.

Moreover, notwithstanding the decrease in the racing operations loss in 2014, NYRA generated cumulative losses of \$109.3 million from 2010 through 2014. Thus, without the significant amounts of VLT revenue subsidies, there is considerable risk that NYRA would have been financially stressed in recent years.

## Questionable Operating Expenses

As noted previously, OSC's prior audit identified several NYRA operating expenses that were either unsupported or unnecessary for racing operations, thereby contributing to NYRA's racing-related deficits. To determine if NYRA still incurred such expenses, we identified several expense categories based on our prior audit that were at risk of questionable costs. We then selected

individual expense items based on their dollar amounts and/or their nature for detailed review. We also surveyed six other thoroughbred racetracks to determine whether the types of expenses in question were consistent with general industry practice. Based on our testing, we identified a number of questionable expenses, including those for unsupported performance incentives, consultants, horse transportation, and assistant starters.

### *Performance Incentives*

NYRA paid \$897,000 in performance incentives to its employees in 2014. We found that most of these incentives appeared to be reasonable and based on specific goals, such as sales achievements or productivity. However, some incentive payments were not adequately supported.

In particular, NYRA's CEO received a \$250,000 bonus for 2014. According to the evaluation criteria for this bonus (and consistent with the requirements established by the FOB), the CEO was to address revenues and expenses and develop a strategic plan for new technologies, with the goal of a balanced ("break-even") operating budget, excluding VLT funding. However, as previously noted, NYRA incurred a loss of \$11.5 million in 2014, excluding VLT funding, and during our audit period (2012 through 2014) NYRA lost \$62 million, net of the VLT subsidies. If a break-even budget was developed, it was not executed. Thus, significant objectives of the incentive program were not achieved, and therefore we question the propriety of a bonus of this magnitude.

### *Horse Transportation Services*

NYRA paid two vendors a total of \$89,000 for the air and/or ground transportation of certain international and domestic horses that raced at Belmont. According to NYRA officials, the handle generated from the horses offset the shipping expenses. However, officials were unable to support this assertion with documented facts and analysis. Further, we noted that some of the horses went on to race at other U.S. tracks after their NYRA meets. Thus, although NYRA paid these transportation costs, benefits accrued to other (non-NYRA) facilities. The other racing facilities did not share costs to bring international horses to the United States. Moreover, it was unclear that any costs were shared for the transportation of domestic horses.

Representatives of four of the six racetracks we surveyed indicated that their tracks did not pay for horse transportation expenses. The two remaining racetracks told us that they have done so infrequently; however, the transportation expenses are shared with the sponsor of the race(s) in question. As such, the racetracks did not pay the entire amount of the transportation costs.

### *Consultants*

NYRA spent a total of \$4.36 million for consultant services in 2014. We selected a judgmental sample of ten payments for consultant services, totaling \$199,695, to determine if the contracted services were actually provided and necessary for a racing operation. We questioned several of the payments we examined.

Specifically, five of the 10 selected payments were not supported by contracts, agreements, or other sufficient documentation that specified the services requested or the amount to be paid for each service. Further, in four of the five cases, we could not determine if the consultants actually rendered the specific services for which they were paid. For example:

- Two payments (totaling \$4,902, which included \$2,902 for travel expenses) were made to two individuals NYRA hired to provide investigative services in the Belmont backstretch in preparation for the 2014 Belmont Stakes. These payments were purportedly based on daily service rates and the consultants' travel and lodging expenses. However, the only documentation to support the payments was a NYRA-prepared request for payment and a few meal receipts. We could not determine the specific services the individuals were supposed to have rendered or if such services were actually rendered; and
- NYRA paid a total of \$22,773 to three other individuals who reportedly provided mediation services (\$15,000), research and analysis (\$3,900), and executive compensation consulting (\$3,873). Here, too, there was no documentation of the specific services to be rendered or the agreed-upon payment rates. The only supporting documentation that NYRA could provide was a report on executive compensation prepared by one of the consultants.

### *Assistant Starters*

A total of \$7,500 was paid to five Assistant Starters who worked Saratoga's training track through November. However, there was no documentation of how many days – or hours each day – these individuals worked to earn the \$7,500.

## **Recommendations**

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.
2. 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.
3. 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.
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.

## Audit Scope and Methodology

The objectives of our audit were to assess NYRA's financial condition and to determine if selected expenses were consistent with industry norms, adequately supported, and necessary for NYRA operations. Our audit covers the period January 1, 2012 through December 31, 2014.

To accomplish our objectives and assess related internal controls, we interviewed officials from NYRA, the New York State Gaming Commission, Genting, and the Franchise Oversight Board, as well as NYRA's independent CPA. We reviewed relevant laws and regulations; NYRA's general ledger, financial records, and bank statements; the Franchise Agreement between NYRA and the State; monthly VLT revenue reports from Genting; and independent CPA reports. We selected a sample of NYRA expenditures and reviewed the support for and propriety of those expenses.

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; 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

We provided a draft copy of this report to NYRA officials for their review and formal comment. Their comments were considered in preparing this final report and are included in their entirety at the end of it. In their response, NYRA officials generally disagreed with our findings and defended the practices we cited, particularly the methodologies used to calculate NYRA's profit or loss from racing operations. Our rejoinders to certain NYRA comments are embedded in the text of NYRA's response as State Comptroller's Comments.

Within 90 days after the final release of this report, we request that the Chairman or Chief Executive Officer of the New York Racing Association report to the State Comptroller advising what steps were taken to implement the recommendations contained in this report, and where the recommendations were not implemented, the reasons why.

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## Contributors to This Report

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### Vision

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# Agency and State Comptroller's Comments

THE NEW YORK RACING ASSOCIATION, INC. P.O. Box 90, Jamaica, New York 11417-0090

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April 25, 2016

Mr. Ryan Wendolowski and Mr. Keith Dickter  
 Office of the New York State Comptroller  
 110 State Street  
 Albany, New York 12236

Re: Audit Report No. 2015-S-21- Financial Condition and Selected Expenses:

NYRA submits the following responses to your recommendations in Audit Report No. 2015-S-21- Financial Condition and Selected Expenses:

**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.**

NYRA maintains and presents full financial statements in accordance with GAAP. To supplement this information, NYRA management evaluates the company's performance from racing operations by excluding pension, OPEB, depreciation and income tax, in order to provide key insight into operational metrics. This is commonly referred to as a non-GAAP measure. Such measures are widely used by companies, analysts and investors. EBITDA is a common example of this type of measurement. It is intended to allow a comparison of profitability between different companies by discounting the effects of costs that do not occur in the normal cost of business. The calculation allows NYRA management to focus on the outcome of operating decisions while excluding the impacts of non-operating decisions like interest expense (a financing decision), tax rates (a governmental decision), pension and post-retirement obligations (an accounting valuation) and depreciation (an accounting decision). While NYRA can make the calculation you suggest, it is not at all clear what the purpose would be, given NYRA's clear reporting on the horseracing business and the VLT arrangements discussed below.

**State Comptroller's Comment:** NYRA officials cite non-GAAP compliant measures as justification for their methodology to calculate NYRA's racing-related operating profit. According to NYRA officials, this methodology was justified because the excluded costs were "non-controllable by management" and constituted "non-operating expenses." Nonetheless, the excluded expenses were the direct result of management decisions, and therefore, we maintain that such expenses were controllable. Specifically, post-employment benefits directly resulted from the numbers of employees NYRA officials hired and the compensation former employees received through salary and benefit plans negotiated by management. Further, depreciation is the result of management's conscious decisions to invest in new capital assets and/or to improve existing assets.

We also doubt that NYRA's classification of these expenses as "non-operating" is substantively

Aqueduct

Belmont Park

Saratoga

THE NEW YORK RACING ASSOCIATION, INC.

consistent with accounting and financial reporting guidance. Typically, non-operating expenses are not related to core business operations and can include costs for items such as organizational restructuring and losses from security sales or currency exchanges. In contrast, depreciation and post-employment benefits are common "operating" costs and are directly related to core operations.

Further, NYRA asserts that EBITDA (earnings before income tax, depreciation, and amortization) is commonly used by financial analysts and investors to value businesses. However, the use of EBITDA to assess financial performance was not prescribed by the Franchise Oversight Board (FOB) or part of any other authoritative NYRA guidance. We would also note that Warren Buffett (someone with considerable credibility in business valuation) has indicated that the use of EBITDA is a pernicious practice and that the exclusion of depreciation and amortization from earnings calculations is nonsense. Buffett further pointed out that depreciation expense is derived from cash outlays paid up front, before an acquired asset has delivered benefit to a business.

**Recommendation 2. 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.**

Per NYRA's earlier reply to the OSC on July 10, 2015: The bankruptcy settlement agreement, the "State Settlement Agreement," between the State of New York and NYRA, was approved by the United States Bankruptcy Court for the Southern District of New York and directs VLT payments to NYRA. Under the terms of the agreement, the VLT payments continue for the Term of the Franchise – until 2033 – and are to be used for racing operations and operating expenses. This includes funding NYRA's legacy pension obligations, OPEB costs and income tax expenses.

Both the "State Settlement Agreement" and the existing statutory framework found in the New York State Tax Law utilize VLT revenues as a means to support the Thoroughbred and Standardbred racing industries in New York State. NYRA operates within the public mandate to account for VLT revenue in its operating plan, and to seek the best and most profitable use for all revenues.

Notwithstanding the above, we note that NYRA has taken considerable and successful actions to enhance racing and track-related revenues, which are detailed in the public record, and as NYRA has described to the OSC. NYRA had a \$1.7 million surplus from racing operations in 2014, a \$3.6 million surplus from racing operations in 2015, and has budgeted a \$2.3 million surplus from racing operations for 2016.

**State Comptroller's Comment:** We do not dispute that the State Settlement Agreement provides for the monthly payment of VLT revenues to NYRA through 2033. Nevertheless, the fact remains that, in 2011, the FOB stressed the need for NYRA to develop a plan to become profitable without reliance on VLT revenues to pay the costs of racing operations. However, as detailed in our report, NYRA had not developed such a plan at the time of our audit. Further, as also detailed in our report, NYRA would have generated losses totaling \$109.3 million from 2010 through 2014 without VLT revenues. As such, we maintain our conclusions regarding this matter and urge NYRA officials to comply with the FOB's direction.

**Recommendation 3. 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.**

The OSC has identified four categories under the heading of "Questionable Operating Expenses". NYRA rejects the characterization of these expenses as "questionable", and we address each category as follows:

## THE NEW YORK RACING ASSOCIATION, INC.

**Performance Incentives.** The OSC notes that "most incentives appeared to be reasonable and based on specific goals, such as sales achievements or productivity". NYRA agrees with this part of the OSC's assessment. However, NYRA disagrees with the OSC's further assertion that "some incentive payments were not adequately supported". The OSC only cites one example of such inadequate support -- the payment of a \$250,000 bonus in 2014 to the NYRA CEO. But it is simply not the case that this payment was not adequately supported. The record is clear: During the search for a new CEO, the NYRA Reorganization Board contracted with an executive compensation company which advised on an appropriate bonus and prepared a balanced scorecard to be used in evaluating the CEO. A bonus of up \$250,000 was included in the new CEO's contract and a governance process put in place to evaluate the CEO's performance. At the end of the CEO's first year on the job, the Chair of NYRA carefully evaluated the CEO's performance against the scorecard; the Chair, fully supported by the NYRA Reorganization Board Compensation Committee, then awarded the bonus to the CEO. The OSC goes on to say that "significant objectives of the incentive program were not achieved and therefore we question the propriety of a bonus of this magnitude". But the goals were in fact achieved, and assessed by a thorough governance process. Full documentation of this careful process has been provided to the OSC.

**State Comptroller's Comment:** In fact, as detailed on page 9 of the report, the CEO did not comply with requirements to address revenues and expenses and develop a strategic plan for new technologies, with the goal of a balanced ("break-even") operating budget, excluding VLT revenue. Also, see the previous State Comptroller's Comments.

**Horse Transportation Services.** NYRA's decision to pay for the shipment of a small number of international horses to Belmont is a business decision carefully made: our goal is to increase handle and grow the sport. NYRA considers several factors (location, quality of horse, quality of race, etc.) before it makes its decisions to pay for shipping. NYRA will continue to assess the efficacy of this infrequent practice and will make business decisions accordingly.

**State Comptroller's Comment:** We maintain that such practices and related expenses are questionable. It is unclear why NYRA resources should be used to obviate horse owners from their normal financial responsibilities. The costs in question were not consistent with standard industry practice. In addition, when queried, NYRA officials acknowledged that they had not done any specific promotion for the races the horses in question raced in. Thus, we further question the propriety of the horse transportation costs.

**Consultants.** NYRA does not agree with the OSC's finding "five out of ten selected payments were not supported by contracts, agreements, or other sufficient documentation that specified the services requested or the amount to be paid for each service, or that the work was rendered." NYRA requires contracts with standard terms and conditions for all significant engagements with consultants. NYRA's Procurement department operates under a strict policy for procuring outside services. The State's Franchise Oversight Board ("FOB") has approved that policy, and actively monitors NYRA's compliance. The examples cited by the OSC were not correct, as we have already discussed with the OSC.

**State Comptroller's Comment:** The fact remains that NYRA officials did not provide us with the appropriate contract-related documentation to support the consultant payments we cited in the report.

**Assistant Starters.** NYRA does not agree with the OSC assertion that there was no documentation of how many days, or hours each, day five Assistant Starters worked to earn \$7,500 collectively. NYRA explained that \$1,500 was paid to each of five Assistant Starters as an incentive for working Saratoga's training track through November. Detailed weekly payroll records including days and time worked are maintained by NYRA's payroll records through ADP. It is worth noting that the \$7,500 was immaterial (0.0026%) of NYRA budgeted and approved expenses.

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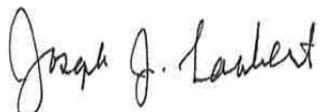
**State Comptroller's Comment:** We do not dispute that data was input by NYRA's payroll vendor to generate the \$7,500 in payments made to assistant starters. However, the fact remains that NYRA officials did not provide us with the documentation necessary to support the "incentive" payments made to these starters.

**Recommendation 4. Determine general horse racing industry practices regarding questionable expenses identified and other material cost items and identify opportunities to enhance revenues and reduce costs. Survey other tracks as necessary or use other available information sources to obtain information on general industry and best practices.**

NYRA is a leader in the horseracing industry. As such NYRA participates in many industry forums, groups, and discussions with other tracks, as well as contributes to and utilizes horseracing data and statistics provided by industry accumulators including Equibase, trade publications, and the New York State Gaming Commission. NYRA employs best practices and frequently updates same. NYRA also has a robust procurement process overseen by the Franchise Oversight Board. NYRA will continue these efforts with the ongoing goal of achieving the most profitable use for all revenue.

**State Comptroller's Comment:** For multiple items, we asked NYRA officials to determine the generally accepted industry practices to assess the necessity and justification for the related expenses. However, they did not provide any documentation to evidence that they had done so.

Best regards,



Joseph J. Lambert