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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: Capital Program Revenue and Expenses
Report 2017-F-26

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, *Capital Program Revenue and Expenses* (2014-S-54).

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 (Net Win) is to be directed to NYRA for enhanced purses, operational support, and capital expenses. 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. Since the VLTs were put in place in 2011, NYRA received almost $190 million in VLT capital revenues as of December 2017.

Our initial audit report, which was issued on October 14, 2015, determined if NYRA received the appropriate amount of VLT revenues for its capital program and whether NYRA officials used these monies appropriately. We found that there were adequate controls in place over the VLT revenues collected by Resorts and transferred to NYRA. However, we found NYRA lacked a formal long-term capital planning process given the magnitude of those revenues. In addition, the annual plans used by NYRA lacked supporting documentation for the resources and/or costs associated with the projects. There was no formal project management system implemented to effectively monitor project status. We also found NYRA used VLT revenues for operating expenses, which was not in accordance with prescribed professional standards.

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 officials have made limited progress in addressing the issues in our prior report. Of the initial report's four audit recommendations, two were partially implemented while the other two were not implemented.

Follow-Up Observations

Recommendation 1

Develop long-term (multi-year) capital plans that outline how available capital program monies will be used to promote NYRA's long-term capital program goals and operational goals (e.g., enhanced safety, attraction of additional customers).

Status – Not Implemented

Agency Action – In response to our initial report, NYRA stated that it was engaged in significant long-term planning for Saratoga Race Course, and that it would be developing a new five-year capital plan for presentation to the FOB. When we asked for evidence of this long-term planning, we were presented with a document entitled "5-Year Capital Expenditure Plan 2017-2021." In this plan, which was formally submitted to the FOB in October 2016, NYRA officials explain that "it would not be appropriate for this Reorganization Board to formally recommend a long-term capital expenditure plan for Aqueduct and Belmont," and that "it is more appropriate at this point in time for NYRA to provide the FOB with some strategic thoughts regarding possible projects." We note that the document presents possible future capital projects for Saratoga Race Course, including creating junior suites and conducting preliminary work associated with the construction of a new building, but with no associated estimated costs or timetables. The plan also describes how NYRA has utilized capital funds in the past to enhance the guest experience at Saratoga Race Course.

For Belmont Park and Aqueduct Racetrack, the plan notes the following three options (referred to as strategic thoughts) regarding possible projects, with no associated costs or timetables:

1. *Keep both facilities open*

2. *Vacate Aqueduct Racetrack and operate at Belmont*

3. *Vacate Belmont and operate exclusively at Aqueduct*

Given that NYRA's Reorganization Board was re-privatized in June 2017, we believe there is no longer any impediment for NYRA to have a long-term capital plan detailing how it would use VLT revenue for all of its facilities.

Recommendation 2

Develop annual capital plans that detail project needs and justifications, timeframes for completion, and estimates of costs, as well as an explanation of how each project relates to NYRA's long-term capital plans and operational goals.

Status – Partially Implemented

Agency Action – NYRA provided us with its 2017 Capital Spending Budget, which lists the planned projects for each racetrack, divided into various categories, such as "Guest Area Improvement," "Barn Area Construction," and "Track & Infield Maintenance." NYRA included estimated total costs for each area and a general justification for each project.

However, the Capital Spending Budget was prepared in a general manner. There is no prioritization of projects, detailed justifications, completion timeframes, or itemized cost estimates for each proposed project. The budget also did not include any unimplemented or incomplete projects carried over from previous years. In addition, NYRA did not provide any documents to support the cost estimations for each area shown on the budget.

The objective of a thorough short-term plan is to prevent material deviation from estimated timeline and cost. An annual budget that only has a simple list of projects is not sufficient to ensure that goals are met.

Recommendation 3

Develop and implement a formal project management system to effectively monitor the status of projects in long-term and annual capital plans.

Status – Partially Implemented

Agency Action – NYRA officials informed us that they implemented a project management system in fiscal year 2016 to monitor the status of each project in its annual capital plan. The system is designed to cover three project phases: Project Planning, Execution, and Project Closure. Based on documentation provided to us by NYRA, we verified that the system is in place as stated by NYRA, and that it also tracks labor and material costs. According to NYRA, approximately 20 projects (valued at $25 million) have been tracked using the system. However, the system does not monitor smaller projects with no specified construction phases.

Recommendation 4

Minimize the extent to which VLT capital revenues are used for non-capital (operational) purposes. Further, use applicable generally accepted accounting principles and Internal Revenue Service guidelines to distinguish costs for capital projects from those normally incurred for routine maintenance (operating) needs.

Status – Not Implemented

Agency Action – In our prior audit, we found that NYRA used $11.7 million in VLT capital revenues for repair and maintenance expenses from 2012 through 2013, and none for the first six months of 2014. At the time, NYRA officials responded that they had the right to do so under the Agreement, and we acknowledged that in our report. Despite this, NYRA claims that it has not used VLT capital funds for non-capital purposes since 2014, and that it has no current intent to do so. In order to verify this assertion, we requested a summary of VLT capital revenue usage for the period after our prior audit; however, NYRA did not provide such a summary. We note that, in its 2017 Capital Spending Budget, NYRA presents an estimated cost for each program area, such as Guest Area Improvements or Dorms, but there are no estimated costs for the components of the program areas, including maintenance Capex (capital expenditures). Despite the language of "maintaining and upgrading" in the Agreement, routine repairs and maintenance are not generally considered to be "capital expenditures," and therefore we still believe that the use of VLT capital revenue for such should be minimized.

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 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