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September 2015

Donald Groth, President
Members of the Board of Directors
Catskill Off-Track Betting Corporation
PO Box 3000
Pomona, NY 10970

Report Number: S9-14-62

Dear Mr. Groth 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 Catskill 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 July 31, 2014. Following is a report of our audit of the Catskill 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 Catskill OTB. We discussed the findings and recommendations with Capital OTB officials and considered their comments, which appear in Appendix A, when preparing this report. Catskill 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, Catskill OTB's overall financial condition has deteriorated at a steady pace. Catskill 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 racing industry. Net handle declined 18 percent (\$19.7 million) over the past five years and, for the six months ended June 2014, was down approximately \$5.2 million compared to the same period in 2013.

Catskill OTB officials 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 Catskill OTB as well.

Background and Methodology

Catskill OTB was formed as a public benefit corporation in 1976 and its geographic area is comprised of 10 counties. The Board of Directors (Board) is the governing body. The Board has 10 members, one from each of the participating counties, who are appointed by their respective governing boards.

Catskill 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 August 26, 2014, the Catskill OTB operated 19 branch locations, 12 self-serve wagering locations,³ one tele-theater, an Internet wagering system and telephone account wagering operations. During the audit period, an additional six self-serve locations were in operation that were subsequently closed by August 2014.

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, self-serve locations, tele-theater and 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 significant portion of the OTB's annual expenses, with the remaining expenses attributed to maintaining operations.

¹ Catskill Off-Track Betting Corporation, Report Number S9-9-83, 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 A self-serve wagering location is a machine in an establishment where patrons can place bets through the machine.

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 fund⁴ are deducted. For the year ended December 31, 2013, Catskill OTB distributed surcharge revenues and net revenues of \$1.4 million to local governments.

We examined the financial condition of Catskill OTB for the period January 1, 2009 through July 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 Catskill OTB operations within our audit scope. Further, those standards require that we understand Catskill OTB’s management controls and those laws, rules and regulations that are relevant to Catskill 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

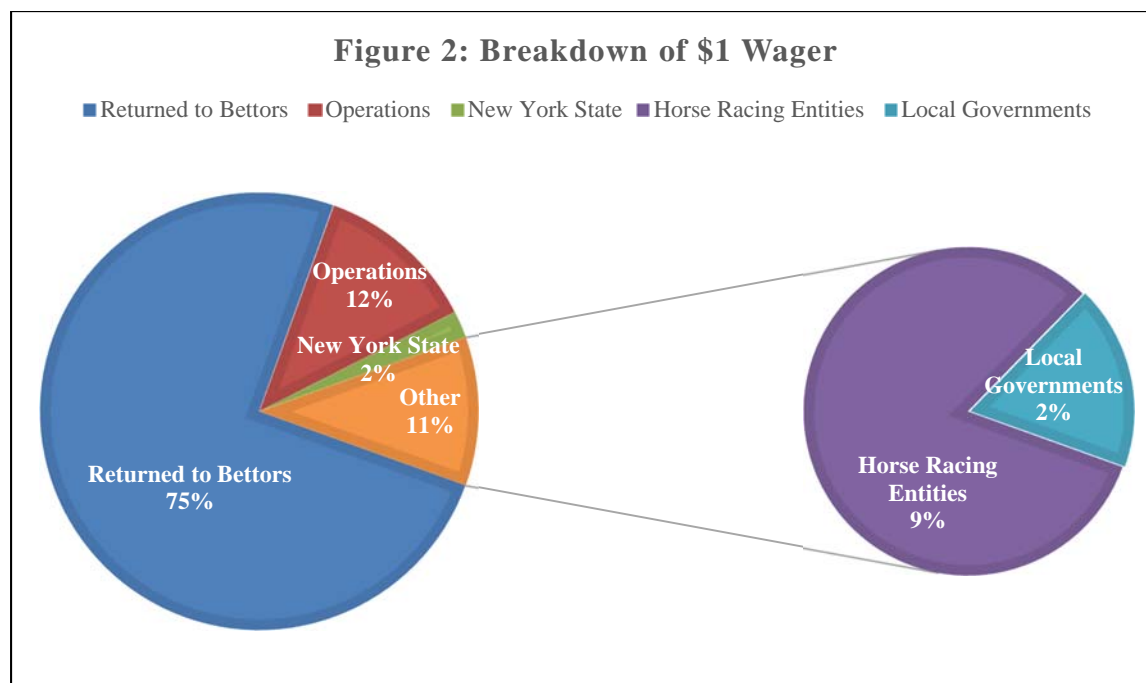
Net Handle – Over the five-year period 2009 through 2013, Catskill OTB has experienced an 18 percent decline (\$19.7 million) in net handle, from \$107.4 million to \$87.7 million. Further, the net handle for the six months ended June 30, 2014 was lower by approximately \$5.2 million compared to the same period the prior year. Figure 1 shows the change in Catskill OTB’s net handle during the last five years:

Figure 1: Catskill OTB Net Handle					
	2009	2010	2011	2012	2013
Net Handle	\$107,401,445	\$99,604,857	\$98,021,201	\$97,613,210	\$87,654,538
Dollar Value Change From Prior Year	N/A	(\$7,796,588)	(\$1,583,656)	(\$407,991)	(\$9,958,672)
Percent Change From Prior Year	N/A	(7.26%)	(1.59%)	(0.42%)	(10.20%)

In 2013, Catskill OTB paid over 75 percent (over \$65 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 \$1.4 million) and local governments with tracks

⁴ 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.

(approximately \$674,000). Catskill OTB kept the remaining surcharge revenues collected by funding its capital acquisition fund (approximately \$391,500). For perspective, Figure 2 demonstrates the distribution of handle generated by the OTB.



Several factors have contributed to the decline in overall net handle at the Catskill 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. Catskill 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 – Catskill 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.⁵ During the five years ended December 31, 2013, these distributions totaled approximately \$43.5 million and accounted for approximately 77 percent of Catskill OTB’s total \$56.4 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.

⁵ These payments are commissions to the tracks and payments for breeding and developmental funds.

Figure 3: Statutory Distributions 2009-2013					
	2009	2010	2011	2012	2013
Track Compensations	\$9,254,707	\$8,654,917	\$8,701,607	\$8,787,419	\$8,071,188
New York State	\$1,846,271	\$1,741,265	\$1,752,140	\$1,738,064	\$1,585,467
Allocations to Local Governments	\$1,083,257	\$1,027,108	\$753,353	\$743,353	\$674,035
Total	\$12,184,235	\$11,423,290	\$11,207,100	\$11,268,561	\$10,330,690

Track Compensation – Catskill 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 Catskill OTB. Catskill 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 6.31 percent for every \$100 in handle, then Catskill OTB would pay slightly more than \$6.30 to broadcast a race. This is in addition to other statutory payments that Catskill 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 200 and 300 percent over the six-year period from 2009 through 2014. Because of these increases, the Catskill 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 38 percent over the five-year period. Catskill 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.

Operating Revenues and Expenses

Catskill 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 and services, income derived by a portion of surcharges, uncashed tickets and other miscellaneous income. Over the five-year period from 2009 through 2013, Catskill OTB operating revenue has decreased approximately \$3.5 million (21 percent).

Catskill OTB’s operating expenses have decreased about \$866,000 (7 percent) over the same five-year period, excluding statutory payments. When statutory payments are included, the overall operating expenses decreased 11 percent, or approximately \$2.7 million over the last five years. A significant portion of Catskill OTB’s operating expenses is employment-related (e.g., employee

salaries and related costs⁶). While branch and corporate salaries and related costs accounted for approximately \$6.2 million (55 percent) of Catskill OTB’s operating expenses in 2013, salaries have decreased by approximately 15 percent and fringe benefits have increased by approximately 10 percent since 2009. Figure 4 illustrates these financial trends for Catskill OTB:

Figure 4: Catskill OTB Financial Trends

	2009	2010	2011	2012	2013	Percentage Change 2009-2013
Racing and Gaming Revenue ^a	\$28,631,811	\$26,501,753	\$25,883,296	\$25,562,873	\$23,247,136	(19%)
OTB Operating Expenses	\$12,153,387	\$11,582,849	\$11,843,251	\$11,541,589	\$11,287,773	(7%)
Total Statutory Payments	\$12,184,235	\$11,423,290	\$11,207,100	\$11,268,561	\$10,330,690	(15%)
Total Expenses	\$24,337,622	\$23,006,139	\$23,050,351	\$22,810,150	\$21,618,463	(11%)
Net Revenue From Operations	\$4,294,189	\$3,495,614	\$2,832,945	\$2,752,723	\$1,628,673	(62%)

^a Includes other non-operating revenue which is presented differently in the audited financial statements.

Previous Audit

Our previous audit recommended Catskill OTB review its operational locations to shift to the most cost effective means of operation. This included exploring the expansion of self-serve wagering locations as a cost effective alternative to branch locations. From 2009 through 2013, Catskill OTB increased the number of self-serve wagering locations from seven to 12 locations. During our audit scope period, Catskill OTB had a total of up to 19 branch locations and 12 self-serve locations opened. For the 19 branch locations that were active in 2013, eight had operating losses ranging from \$14,452 to \$165,748. For the 12 self-serve locations that were active in 2013, five had operating losses ranging from \$1,787 to \$17,557. Catskill OTB officials continue to monitor the profitability of branch locations; however, they need to balance the availability of their product with cost concerns. According to Catskill OTB officials, the large geographic area the Catskill OTB covers makes closing an unprofitable location difficult, as the associated handle will not be absorbed into the other Catskill OTB locations.

We analyzed handle and expenses by location and found the branch locations have an average of approximately 10 percent ratio of expenses to handle over the period 2009 to 2013, while the self-serve locations have a ratio of approximately 7 percent expenses to handle over the period 2009 to 2013. Self-serve locations, however, only accounted for approximately 3 percent of the net handle generated during the audit scope period.

While Catskill OTB has implemented the recommendations from the previous audit by expanding self-serve locations, it continues to experience a decline in financial condition.

⁶ Related costs include pension costs, payroll taxes, employee business expenses, employee reimbursed education and health insurance. Included as part of related costs are training; however, during the period 2009 to 2013, Catskill OTB did not have any training expenses recorded.

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 Catskill OTB's administrative offices.

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

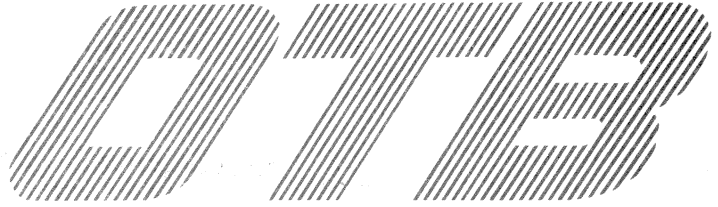
Sincerely,

Gabriel F. Deyo
Deputy Comptroller

APPENDIX A

RESPONSE FROM CATSKILL OTB OFFICIALS

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



Donald J. Groth
President & Chief Executive Officer

January 16, 2015

Email: caps@osc.state.ny.us

Ann C. Singer, Chief Examiner
State Office Building, Suite 1702
44 Hawley Street
Binghamton 13901-4417

Dear Ms. Singer,

We are in receipt of the December 19, 2014 preliminary draft findings by the Office of the State Comptroller entitled Report Number S9-14-62.

An audit of the five regional Off-Track Betting Corporations (OTB) was conducted with the objective of determining whether the financial condition of the OTBs is deteriorating. The period covered was from January 1, 2009 through July 31, 2014.

We are responding to the findings and recommendations specific to Catskill OTB.

In summary, findings are as follows:

- The "...overall financial condition has deteriorated at a steady pace."
- Annual decreases in handle were "... due to a general decline in horse racing and increased competition..."
- Catskill OTB implemented previous recommendations by the Office of the State Comptroller.

One clarification note: The draft report analyzes branch operating revenues/losses for year ending 2013, but does not note specific extenuating circumstances. This includes months when locations were not in operation during 2013 due to fire (Fred's Inn), relocations/closings (Norwich, Nanuet, Suffern), new locations (Taylors, Wheelers), etc., each affecting year-end profit/loss. We also note that seven locations are on the Southern Tier and in Chenango County, an area that has been particularly affected by competition from Tioga Downs harness track/ teletheater/ casino, as well as particular economic woes.

We agree with the findings of the audit, which are similar to findings in the previous Global Audit of the Off-Track Betting Corporations in New York State. We concur that we have implemented the prior audit findings, and have worked to effect legislative changes recommended at that time, without success thus far. Thus, a dearth of legislative changes, increased track commissions, with concurrent industry wide and regional declines in horseracing interest all have contributed to the continuing deteriorating financial conditions.

This letter is intended to serve as our audit response as well as our Corrective Action Plan (CAP).

Recommendations are as follows:

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.

Recommendation #1 - Explore opportunities to increase revenues to stabilize the continuing declining net handle.

Plan of Action, Implementation Schedule, and Responsible Party:

The Corporation will continue to explore opportunities to increase revenues by:

- **On-Line** – Enhance and implement a marketing plan including on-line advertising, promotions and handicapping contests to expand wagering and internet customer base. A program for implementation is currently in place and remains active throughout the calendar year.
- **Branch** - Develop and implement a marketing plan for increasing in-branch wagering participation and customer education at branch betting centers through promotions, instant winner “voucher” days, seminars and handicap contests. A branch marketing program remains active throughout the calendar year.
- **Relocate to smaller, more efficient locations/close locations.** With lease expirations, many leases have been negotiated downward, relocations to smaller and more efficient facilities have occurred already in 2015 (Arlington). Relocation to a new and enhanced facility is projected for another facility which will, hopefully, result in increased sales activity (Brewster). A branch posting a loss (New Paltz) was closed upon expiration of the lease late 2014. A satellite location that was losing money was closed already in 2015 (Wheelers). Other locations and prospective locations are on the table. Implementation is ongoing.
- **Promote non-racing products** - Lottery, for example, now returns more for participating counties than the racing product. We are adding NYS Lottery marketing and POS devices in an ongoing effort to sell lottery products. Implementation is ongoing, as we focus further on lottery sales and other alternative sources of revenue, including on-line alternatives as well.
- **Legislative Change** – Catskill will continue to work for legislative change to increase OTB product offerings to include other gaming opportunities (Historical/Instant Racing, VLTs, sports wagering, other gaming) at branches and on-line. We will also continue to seek legislative change to reduce OTB statutory payments and excessive compensation to VLT enhanced racetracks. We will continue to work for legislative change to increase OTB geographic market. We are seeking enactment of legislation that would allow us to implement these. Our legislative action plan is currently in place and will be ongoing throughout the year until accomplished.

Responsible Parties – The Operations and Marketing teams play an integral part in implementing promotional and marketing initiatives. The Accounting team is responsible for assisting with proper revenue analyses of branch efficiencies and non-racing product revenues. Real estate/facilities team will be locating branch offices and renegotiating existing leases.

Executive staff is responsible for communicating legislative plan with proper and appropriate representatives

Recommendation #2 - Review and renegotiate contractual expenses to achieve lower costs.

Plan of Action, Implementation Schedule, and Responsible Party:

The Corporation has been reviewing and renegotiating contractual expenses throughout and since the prior report by the Office of the State Comptroller. We have effected many lease reductions but will continue to negotiate for reductions with expiring contracts. The success we have had in the past will not be easy, as the real estate market has improved in recent years. Contractual rates for offering out of state racing have drastically increased in recent years. New York State OTBs currently negotiate as a group for these rates and we anticipate as a result of this audit, the OTBs will better negotiate rates for upcoming contracts. Implementation has been in place and is ongoing throughout the year.

Responsible Parties – Accounting team and the executive staff are responsible for contract analysis with landlords and vendors to assist in negotiating contracts. In the case of out of state racetracks, the simulcast director provides responsible communication with other OTBs to impart the importance of and accomplish rates that are more favorable for OTBs.

Recommendation #3 - Continue to analyze the cost-benefit of operations and determine the appropriate mix of business activities.

Plan of Action, Implementation Schedule and Responsible Party

The Corporation regularly analyzes the cost benefit of operations to determine the proper mix of business activities. As stated earlier, with lease expirations, many leases have been negotiated downward; one location is being moved to a smaller and a more efficient facility this month (Arlington). Relocation to a new and enhanced facility is projected for another facility which will, hopefully, result in increased sales activity (Brewster). A branch posting a loss (New Paltz) was closed upon expiration of the lease late 2014. A satellite location that was losing money was closed already in of 2015 (Wheelers). Other locations and prospective locations are on the table. Review and implementation is ongoing.

Responsible Parties – Accounting team and the executive staff are responsible for regular and periodic analysis of revenues from operations.

The Board of Directors, Executive Staff and Management are responsible for relaying the importance of the Office of the State Comptroller’s recommendations and implementing the Corrective Action Plan to be approved by the governing board.

We commend the State Comptroller’s staff for their professionalism and diligence during their review here.

Yours truly,

Donald J. Groth
President & Chief Executive Officer

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