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September 2015

Joseph G. Cairo, President
Members of the Board of Directors
Nassau Off-Track Betting Corporation
139 Liberty Avenue
Mineola, NY 11501

Report Number: S9-14-64

Dear Mr. Cairo 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 Nassau OTB in this audit. The objective of our audit was to determine whether the financial condition of OTBs is deteriorating. The audit period was from January 1, 2009 through August 31, 2014. Following is a report of our audit of the Nassau 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 Nassau OTB. We discussed the findings and recommendations with Nassau OTB officials and considered their comments, which appear in Appendix A, when preparing this report. Nassau 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, Nassau OTB's overall financial condition has deteriorated at a steady pace. Nassau 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 15 percent (\$38.1 million) over the past five years and, for the six months ended June 2014, was down approximately \$10.7 million compared to the same period in 2013.

Nassau 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 Nassau OTB as well.

Background and Methodology

Nassau OTB was formed as a public benefit corporation in 1975 and its geographic area is comprised of Nassau County. The Board of Directors (Board) is the governing body. The Board is comprised of three members who are appointed by the Nassau County Legislature.

Nassau OTB offers off-track pari-mutuel² wagering on horse racing for the objective of promoting the horse racing industry, providing revenues to State and local governments and diminishing the role of illegal bookmakers. As of September 25, 2014, Nassau OTB operated six branch locations, 13 Fast Track locations,³ an Internet wagering system, a tele-theater and telephone account wagering operations. However, during the audit period, additional facilities were in operation that were subsequently closed by September 2014, including six additional branches and six additional Fast Track locations.

While an OTB collects revenue, it does not retain these funds; rather it must distribute funds to various entities according to statutes and contracts. An OTB may not retain its net revenues to fund future operations. Net handle (wagers) represents the amount wagered by patrons throughout branches, Fast Track locations, tele-theaters 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 Nassau OTB's annual expenses, with the remaining expenses attributed to maintaining operations.

¹ Nassau Off-Track Betting Corporation, Report Number S9-9-85, 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 Fast Track 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 basis⁴ to the participating local governments after contributions to the capital acquisitions fund⁵ are deducted. For the year ended December 31, 2013, Nassau OTB distributed surcharge revenues and net revenues of \$2.8 million to Nassau County.

We examined the financial condition of Nassau OTB for the period January 1, 2009 through August 31, 2014. We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). Such standards require that we plan and conduct our audit to adequately assess Nassau OTB operations within our audit scope. Further, those standards require that we understand Nassau OTB’s management controls and those laws, rules and regulations that are relevant to Nassau 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

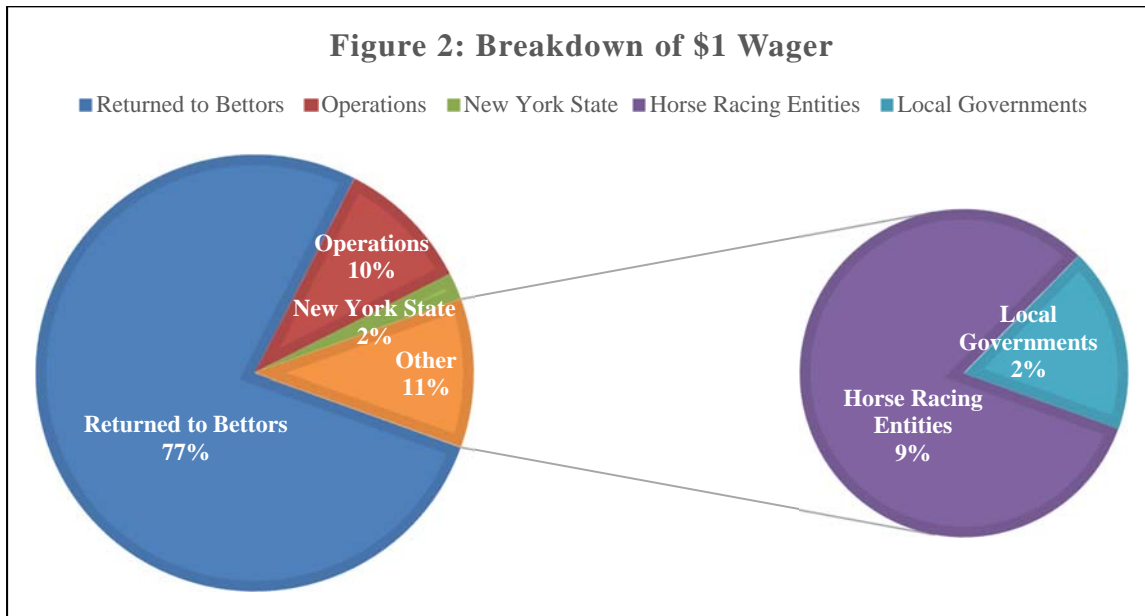
Net Handle – Over the five-year period 2009 through 2013, Nassau OTB has experienced a 15 percent decline (\$38.1 million) in net handle, from \$257.6 million to \$219.5 million. Further, the net handle for the six months ended June 30, 2014 was lower by approximately \$10.7 million compared to the same period in the prior year. Figure 1 shows the change in Nassau OTB’s net handle during the last five years:

Figure 1: Nassau OTB Net Handle					
	2009	2010	2011	2012	2013
Net Handle	\$257,581,744	\$235,993,822	\$257,074,414	\$229,698,269	\$219,492,548
Dollar Value Change From Prior Year	N/A	(\$21,587,922)	\$21,080,592	(\$27,376,145)	(\$10,205,721)
Percent Change From Prior Year	N/A	(8.38%)	8.93%	(10.65%)	(4.44%)

⁴ Nassau OTB has a Support Agreement with Nassau County that allows for an annual distribution in place of a quarterly distribution.

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

In 2013, Nassau OTB paid approximately 77 percent (over \$169 million) of the net OTB handle collected to winning patrons. It also paid a portion of the surcharge revenues, as stipulated by statute, to participating local governments (over \$2.8 million) and local governments with tracks (approximately \$687,000). Nassau OTB kept the remaining surcharge revenues collected by funding its capital acquisition fund (approximately \$725,000). For perspective, Figure 2 demonstrates the distribution of handle generated by Nassau OTB.



Several factors have contributed to the decline in overall net handle at Nassau 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), competition from local entities and competition from other entities in the gaming industry, such as casinos. Nassau OTB officials have also attributed the decline in net handle to the increased number of race cancellations because of weather events.

Statutory Distributions – Nassau OTB must make statutory distributions before paying its operating expenses. These distributions represent a significant financial outlay and the largest is made to the horse racing industry.⁶ During the five years ended December 31, 2013, distributions to the horse racing industry totaled \$108.9 million and accounted for approximately 83 percent of Nassau OTB’s total \$130.8 million in statutory distributions. The distributions to the horse racing industry are made to the following entities:

- In-state racetracks, based on statutory obligations and rates dependent on the type of wager and other contractual agreements;
- Out-of-state racetracks, based on specific contractual agreements; and

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

- 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.

Figure 3: Statutory Distributions 2009-2013					
	2009	2010	2011	2012	2013
Track Compensations	\$22,451,684	\$20,397,268	\$23,687,369	\$21,330,131	\$21,016,109
New York State	\$3,960,289	\$3,482,297	\$3,859,409	\$3,468,999	\$3,295,586
Allocations to Local Governments	\$893,065	\$796,815	\$773,245	\$747,916	\$687,267
Total	\$27,305,038	\$24,676,380	\$28,320,023	\$25,547,046	\$24,998,962

Track Compensation⁷ – Nassau 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 Nassau OTB. Nassau 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 6.17 percent for every \$100 in handle, then Nassau OTB would pay slightly less than \$6.20 to broadcast a race. This is in addition to other statutory payments that Nassau OTB makes. The major tracks throughout the country have consolidated into collective organizations and contracted with OTBs to simulcast races. The two largest organizations have increased rates 300 percent⁸ over the six-year period from 2009 through 2014. Because of these increases, Nassau 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 23 percent over the five-year period. Nassau 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

Nassau OTB operating revenues consist of the remaining net handle after winning bettors are paid and monthly surcharge revenues and statutory distributions are allocated, plus other miscellaneous revenues. These revenues are generated from branch locations with restaurant operations, concession income, lottery income and other miscellaneous incomes. Over the five-year period from 2009 through 2013, Nassau OTB operating revenue has decreased approximately \$6 million (17 percent).

⁷ This section addresses only the fees paid to the tracks to host the races that are broadcast, and does not include any additional fees paid.

⁸ This 300 percent includes the advanced deposit wagering fees that the tracks charge for online wagers through the OTBs.

Nassau OTB’s operating expenses have decreased about \$2.2 million (6 percent) over the same five-year period, excluding statutory payments. When statutory payments are included, the overall operating expenses have decreased 7 percent (\$4.5 million) over the last five years. As a service organization, a significant portion of Nassau OTB’s operating expenses is employment-related (e.g., employee salaries and fringe benefits⁹). While branch and corporate salaries and fringe benefits accounted for \$19.9 million (62 percent) of Nassau OTB’s operating expenses in 2013, salaries have decreased by approximately 26 percent and fringe benefits have increased by approximately 65 percent since 2009. However, the decline in operating revenue has outpaced cost-cutting efforts, which has contributed to the overall decline in the net revenue from operations. Figure 4 illustrates these financial trends:

Figure 4: Nassau OTB Financial Trends						
	2009	2010	2011	2012	2013	Percentage Change 2009-2013
Racing and Gaming Revenue	\$62,546,960	\$57,249,816	\$62,405,137	\$55,874,724	\$53,167,295	(15%)
Other Revenue	\$452,176	\$775,806	\$877,538	\$820,968	\$1,515,833	235%
Total Revenue	\$62,999,136	\$58,025,622	\$63,282,675	\$56,695,692	\$54,683,128	(13%)
OTB Operating Expenses	\$34,569,025	\$33,485,541	\$23,020,358	\$29,983,443	\$32,363,263	(6%)
Total Statutory Payments	\$27,305,038	\$24,676,380	\$28,320,023	\$25,547,046	\$24,998,962	(8%)
Total Expenses	\$61,874,063	\$58,161,921	\$51,340,381	\$55,530,489	\$57,362,225	(7%)
Net Revenue From Operations	\$1,125,073	(\$136,299)	\$11,942,294	\$1,165,203	(\$2,679,097)	(338%)

Previous Audit

Our previous audit recommended Nassau OTB review its operational locations to shift to the most cost effective means of operation. This included exploring the expansion of Fast Track locations as a cost effective alternative to branch locations. From 2009 through 2013, Nassau OTB did increase the number of Fast Track locations from nine to 16 locations. During our audit scope period, Nassau OTB had up to 13 branch locations and 16 Fast Track locations opened. However, by the end of 2013, only seven branch locations and 16 Fast Track locations were open. For the seven branch locations that were active in 2013, all seven had operating losses that ranged from \$250,126 to \$1 million. In addition, the tele-theater also had an operating loss of \$1.1 million in 2013. Nassau OTB officials continue to monitor the profitability of branch locations; however, they need to balance the availability of their product with cost concerns.

We analyzed handle and expenses by location and found the branch locations have 11 percent ratio of expenses to handle while the Fast Track locations have a ratio of approximately 4 percent expenses to handle. Fast Track locations, however, only accounted for approximately 3 percent of the net handle generated during the audit scope period.

⁹ Includes post-employment retirement benefits

While Nassau OTB has implemented the recommendations from the previous audit by increasing the number of Fast Track locations and closing poorer performing branch locations, it continues to experience a decline in financial condition.

Recommendations

The Board should:

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

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

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

Sincerely,

Gabriel F. Deyo
Deputy Comptroller

APPENDIX A

RESPONSE FROM NASSAU OTB OFFICIALS

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



February 4, 2015

VIA FEDEX

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

Re: Response to Draft Audit Report S9-14-64

Dear Ms. Singer,

We have reviewed the draft report of the examination of Nassau Regional Off-Track Betting Corporation (“Nassau OTB”) for the period January 1, 2009 through August 31, 2014. Please accept this letter as our official response to that report.

SUMMARY OF FINDINGS

FINDING:

Nassau OTB has experienced annual decreases in net handle (wagering) due to a general decline in interest in horse racing and increase competition from other entities in the racing industry.

RESPONSE:

Nassau OTB has experienced annual decreases in net handle (wagering) due to a general decline in interest in horse racing and increase competition from other entities to the racing industry. In addition to competition within the industry, several other competitive platforms such as, but not limited to, increased regional casino/Video Lottery Terminal (VLT) presence and other discretionary entertainment opportunities currently available.

FINDING:

Several factors have contributed to the decline in overall net handle at Nassau 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), competition from local entities, and competition from other entities in the gaming industry, such as casinos.





RESPONSE:

Specific factors having an adverse effect on Nassau OTB handle include, but are not limited to: (1) opening by NYRA of the Belmont Café located in the franchise territory of Nassau OTB within Nassau County (2) out of state Advanced Deposit Wagering (ADW) competition (3) decline in the availability of racing events (4) regional economic decline resulting in patron's limited discretionary funds and (5) weather related cancellations.

FINDING:

While branch and corporate salaries and fringe benefits accounted for \$19.9 million (62 percent) of Nassau OTB's operating expenses in 2013, salary has decreased 26 percent and fringe benefits have increased 65 percent.

RESPONSE:

While the audit acknowledges that Nassau OTB had a drastic reduction in salary of 26 percent, it should be noted that the increase in fringe benefits are predominately driven by corporate mandated annual costs including pension obligation and employee health insurance coverage.

FINDING:

Nassau OTB officials continue to monitor the profitability of branch locations; however, they need to balance the availability of their product with costs concerns.

RESPONSE:

Management continues to strive in its objective to proactively adjust operations to yield the most cost effective profitable results. As has been demonstrated repeatedly, in accordance with the current negotiated Collective Bargaining Agreement (CBA), management has adjusted employee scheduling and closed branch locations where appropriate.

Respectfully,


Joseph G. Cairo, Jr.
President

cc: Joseph Bentivegna, Board Chairman
Eric Harkin, Board Member
Frank DeStefano, Board Member

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