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September 2015

Michael Kane, President  
Members of the Board of Directors  
Western Off-Track Betting Corporation  
8315 Park Road  
Batavia, NY 14020

Report Number: S9-14-61

Dear Mr. Kane 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 Western 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 15, 2014. Following is a report of our audit of the Western 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 Western OTB. We discussed the findings and recommendations with Western OTB officials and considered their comments, which appear in Appendix A, when preparing this report. Western OTB officials generally agreed with our recommendations. 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, Western OTB's overall financial condition has improved due to increased wagering in its video gaming operation. However, the core OTB operations have deteriorated at a steady pace over the five-year period ended December 31, 2013. Western 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 gaming industry. Net handle declined 23 percent (\$27.6 million) over the past five years and, through June 2014, was down over \$3 million compared to the same time last year. In addition, live racing and inter-track wagering at the Batavia Downs Gaming Facility (Batavia Downs) has declined 17 percent over the period, from \$7.3 million in 2009 to \$6.1 million in 2013. However, Western OTB's video gaming has generated additional revenues. Overall, video gaming revenues have increased 35 percent, from \$419 million in 2009 to \$566 million in 2013.

While Western OTB's overall financial condition has improved due to video gaming, its OTB operations, live racing and inter-track wagering continue to decline despite the actions of Western OTB officials that included carrying out previous recommendations from the Office of the State Comptroller (OSC).<sup>1</sup> The statutory and contractual expenses paid from the net handle, live racing and inter-track wagering segments make those operations difficult to sustain financially in an environment where net handle is declining. The declining handle has also reduced distributions to local governments from the OTB, live racing and inter-track wagering operations.

## Background and Methodology

The Western OTB was formed as a public benefit corporation in 1973 and its geographic area is comprised of 15 counties and the Cities of Buffalo and Rochester. The Board of Directors (Board) is the governing body. The Board has 17 members, one from each of the participating municipalities, who are appointed by their respective governing boards.

The Western OTB offers off-track pari-mutuel<sup>2</sup> 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 July 31, 2014, the Western OTB operated 26 branch locations, 27 EZ Bet locations,<sup>3</sup> an Internet wagering system and telephone account wagering operations. However, during the audit period, additional facilities were in operation that were subsequently closed by July 2014, including 12 additional branches, 11 additional EZ Bet locations and a tele-theater. The Western OTB also owns and operates Batavia Downs, which conducts live harness racing and simulcasts to and from other racetrack facilities (inter-track wagering). In addition, the Western OTB has a video gaming license, which allows for video gaming operations.

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

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<sup>1</sup> Western Off-Track Betting Corporation, Report S9-9-82, issued May 20, 2010

<sup>2</sup> Pari-mutuel refers to a betting pool in which winners divide the total amount wagered, after management expenses are deducted.

<sup>3</sup> EZ Bet is a machine in an establishment where patrons can place bets through the machine.

future operations. Net handle (wagers) represents the amount wagered by patrons throughout branches, EZ Bet 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, 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.

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 5 percent surcharge 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 fund<sup>4</sup> are deducted. For the year ended December 31, 2013, the Western OTB distributed surcharge revenues and net revenues of \$2.6 million to local governments.

We examined the financial condition of the Western OTB for the period January 1, 2009 through July 15, 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 the Western OTB operations within our audit scope. Further, those standards require that we understand the Western OTB's management controls and those laws, rules and regulations that are relevant to the Western 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 C of this report.

## **Audit Results**

### **Financial Condition Analysis**

Net Handle – Over the five-year period 2009 through 2013, Western OTB has experienced a 23 percent decline (\$27.6 million) in net handle, from \$121.9 million to \$94.2 million. Further, the net handle for the six months ended June 30, 2014 was lower by over \$3.1 million compared to the same period the prior year. Figure 1 shows the annual change in Western OTB's net handle during the last five years:

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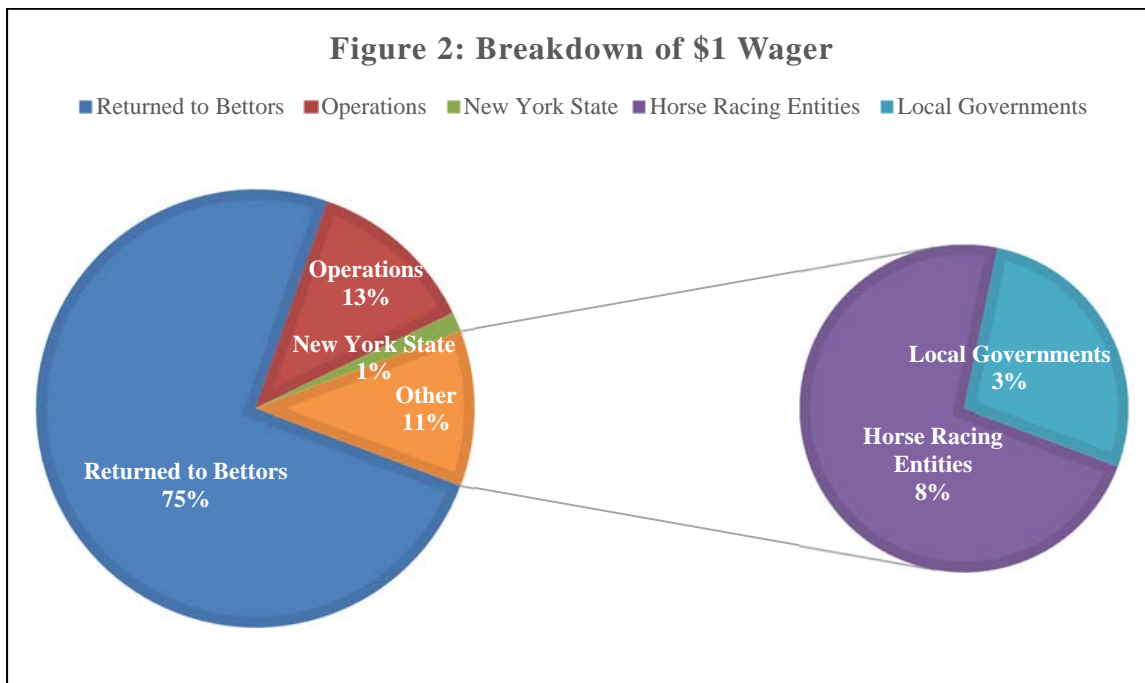
<sup>4</sup> The intent of the capital acquisition fund is to permit OTBs to reserve revenue for the payment of debt service and acquisition of capital assets without negatively affecting the respective OTB's cash flow required for operations.

	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Net Handle	\$121,882,680	\$114,037,661	\$106,031,058	\$98,840,851	\$94,245,876
Dollar Value Change From Prior Year	N/A	(\$7,845,019)	(\$8,006,603)	(\$7,190,207)	(\$4,594,975)
Percent Change From Prior Year	N/A	(6.44)%	(7.02)%	(6.78)%	(4.65)%

In addition, live racing and inter-track wagering at Batavia Downs in 2013 generated an additional \$6 million in handle for Western OTB, a decrease of over \$1 million or 14 percent from the prior year. Live racing and inter-track wagering at Batavia Downs has experienced an overall 17 percent decrease from 2009 when handle was \$7.3 million to \$6.1 million in 2013. The Western OTB’s video gaming facility generated \$566 million in credits played in 2013, an increase of \$19.2 million or 4 percent from the prior year. Video gaming operations increased substantially from \$419 million in 2009 to \$566 million in 2013, a 35 percent increase. See Appendix A for information on Western OTB’s racing handle and gaming wagering.

Despite the overall gains from the video gaming operations, the net handle generated from Western OTB’s pari-mutuel operations, as well as from live racing and inter-track wagering at Batavia Downs, continues to be on the decline.

In 2013, Western OTB paid approximately 75 percent (over \$70 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 \$2.5 million) and local governments with tracks (approximately \$630,000). Western OTB kept the remaining surcharge revenues collected by funding its capital acquisition fund (approximately \$174,000). 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 Western OTB. These include a fluctuating economy, a general decline in interest in horse racing (as evidenced by declines in attendance and net handle at most racetracks in the State, including Batavia Downs), and competition from other entities in the gaming industry, such as casinos and government-sponsored lotteries. Western 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 – Western 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.<sup>5</sup> During the five years ended December 31, 2013, these distributions totaled \$55.7 million and accounted for more than 93 percent of Western OTB’s total \$59.6 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.

<b>Figure 3: Statutory Distributions 2009-2013</b>					
	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Track Compensation	\$9,303,180	\$8,760,528	\$8,434,711	\$7,876,264	\$7,209,441
New York State	\$2,347,184	\$2,142,979	\$2,022,543	\$1,850,062	\$1,776,725
Breeding and Development Funds	\$923,893	\$876,827	\$798,808	\$747,068	\$694,329
Allocations to Local Governments	\$921,234	\$821,583	\$755,563	\$718,282	\$630,677
<b>Total</b>	<b>\$13,495,491</b>	<b>\$12,601,917</b>	<b>\$12,011,625</b>	<b>\$11,191,676</b>	<b>\$10,311,172</b>

Track Compensation – Western 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 Western OTB. Western 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 5.03 percent for every \$100 in handle, then Western OTB would pay slightly more than \$5 to broadcast a race. This is in addition to other statutory payments that Western OTB makes. The major tracks throughout the country have consolidated into collective organizations and contracted with OTBs

<sup>5</sup> These payments are commissions to the tracks and payments for breeding and developmental funds.

to simulcast races. The three largest organizations have increased rates an average of 233 percent over the five-year period from 2009 through 2013. Because of these increases, the Western 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 31 percent over the five-year period. Western 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**

Western 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, income derived by a portion of surcharges, uncashed tickets<sup>6</sup> and other miscellaneous incomes. Over the five-year period from 2009 through 2013, Western OTB off-track betting operating revenue has decreased approximately \$4.5 million (23 percent). As a whole, Western OTB operations, including live racing and video gaming operations, have experienced a 3 percent decrease, or \$1 million over the last five years.

Overall, Western OTB operating expenses, including those from video gaming and live racing, in conjunction with the off-track betting operations have increased 2 percent (\$580,000), excluding the statutory payments. When statutory payments are included, the overall operating expenses increased 5 percent (\$3 million) over the last five years. Operating expenses for the off-track betting operation alone have decreased about \$2.1 million (10 percent) over the same five-year period. A significant portion of Western OTB's operating expenses for the off-track betting operations is employment-related (e.g., employee salaries and fringe benefits).<sup>7</sup> While branch and corporate salaries and fringe benefits accounted for \$10.2 million (57 percent) of the operating expenses in 2013, salaries have decreased by 24 percent and fringe benefits have increased 6 percent since 2009. Figure 4 illustrates these financial trends for Western OTB:

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<sup>6</sup> Uncashed ticket moneys are turned over to New York State at the end of the State's fiscal year. These funds are not retained by the OTB for operations.

<sup>7</sup> Excluding post-employment health benefits

<b>Figure 4: Western OTB Financial Trends – Off-Track Betting Operations</b>						
	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>Percentage Change 2009-2013</b>
Racing and Gaming Revenue	\$26,082,323	\$24,461,263	\$22,818,212	\$21,210,079	\$20,145,914	(23%)
Other Revenue	\$6,940,569	\$6,409,782	\$5,992,008	\$5,688,785	\$5,213,674	(25%)
Total Revenue	\$33,022,892	\$30,871,045	\$28,810,220	\$26,898,864	\$25,359,588	(23%)
OTB Operating Expenses	\$19,824,884	\$19,647,733	\$18,904,910	\$17,412,968	\$17,743,946	(10%)
Total Statutory Payments	\$13,495,491	\$12,601,917	\$12,011,625	\$11,191,676	\$10,311,172	(24%)
Total Expenses	\$33,320,375	\$32,249,650	\$30,916,535	\$28,604,644	\$28,055,118	(16%)
<b>Net Revenue From Operations</b>	<b>(\$297,483)</b>	<b>(\$1,378,605)</b>	<b>(\$2,106,315)</b>	<b>(\$1,705,780)</b>	<b>(\$2,695,530)</b>	<b>(806%)</b>

### Previous Audit

Our previous audit recommended Western OTB review its operational locations to shift to the most cost effective means of operation. This included exploring the expansion of EZ Bet locations as a cost effective alternative to branch locations. Western OTB did increase the number of EZ Bet locations through the scope period, from seven in operation in 2009 to 27 in operation in July 2014. During our audit scope period, Western OTB had up to 38 branch locations and 38 EZ bet locations in operation; however, the EZ Bet locations are relatively easy to open and close so the numbers in operation fluctuated. However, by the end of 2013, only 28 of this type of location were open. For the 30 branch locations that were active in 2013, 22 had operating losses that ranged from \$5,600 to \$124,000. Western OTB officials continue to monitor the profitability of branch locations; however, they need to balance the availability of their product with cost concerns. Western OTB covers a large geographic area and closing an “unprofitable” location has other economic impacts.

We analyzed handle and expenses by location and found the branch locations have a 13 percent ratio of expenses to handle, while the EZ Bet locations have a ratio of 6 percent expenses to handle. EZ Bet locations, however, only accounted for approximately 2 percent of the net handle generated during the audit scope period.

While Western OTB has implemented the recommendations from the previous audit by increasing the number of EZ bet 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 the Western OTB's administrative offices.

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

Sincerely,

Gabriel F. Deyo  
Deputy Comptroller



## APPENDIX A

### WESTERN OTB RACING AND GAMING HANDLE

<b>Figure 5: Western OTB Corporation Racing and Gaming Handle</b>					
	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Corporate and Branch Operations	\$121,882,680	\$114,037,661	\$106,031,057	\$98,840,851	\$94,245,876
Batavia Downs	\$7,363,314	\$6,955,322	\$6,776,826	\$7,139,914	\$6,080,417
Video Gaming	\$419,540,825	\$429,634,724	\$473,755,412	\$547,263,631	\$566,510,901
<b>Total</b>	<b>\$548,786,819</b>	<b>\$550,627,707</b>	<b>\$586,563,295</b>	<b>\$653,244,396</b>	<b>\$666,837,194</b>

## **APPENDIX B**

### **RESPONSE FROM WESTERN OTB OFFICIALS**

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



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*Local Chambers  
 of Commerce*

WESTERN REGIONAL OFF-TRACK  
 BETTING CORPORATION

January 7, 2015

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

RE: Report No.:S9-14-61 / Audit of Western Regional  
 Off-Track Betting Corporation

Dear Ms. Singer:

On behalf of the members of the Board of Directors, management and staff of the Western Regional Off-Track Betting Corporation ("Western"), allow me to thank you for this opportunity to respond to the findings and recommendations set forth in the State Comptroller's Office draft audit of the public benefit corporation dated December 11, 2014.

Having previously had an opportunity to provide input in the subject audit, and pleased that our observations were considered and addressed, Western believes that the pertinent off-track business data employed is, for the most part, appropriately interpreted and that evident trends reported.

Western is unique among New York State OTB Corporations, operating its gaming and racing facility, and we feel that this circumstance is properly identified, noted and explained within the audit findings.

While Western's gaming business has grown consistently from its inception, providing revenues for distributing to our member municipalities, Western OTB operations continue to decline as noted. The reason for that decline are appropriately identified and explained within the audit findings of particular note, the role of statutory distributions and track compensation in this decline are properly identified.



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 Breeders' Inc.*

*Local Chambers  
 of Commerce*

WESTERN REGIONAL OFF-TRACK  
 BETTING CORPORATION

Although Western over the audit period has followed the recommendations noted in the 2009 audit, which undoubtedly demonstrated the decline of the OTB segment of our business, the steady decline of revenues from the OTB operations persists. It is obvious to us that the current statutory model must be altered to allow NYS OTBs to generate needed revenues to their municipalities.

Very Truly Yours,

WESTERN REGIONAL OFF-TRACK  
 BETTING COPORATION

Michael D. Kane, President & CEO

## **APPENDIX C**

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