

**STATE OF NEW HAMPSHIRE  
LOTTERY COMMISSION**

**MANAGEMENT LETTER  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**



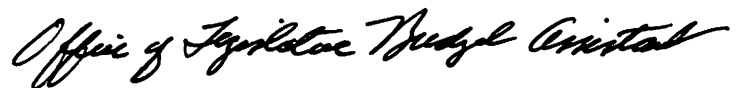
*To The Fiscal Committee Of The General Court:*

We have audited the financial statements of the New Hampshire Lottery Commission (Lottery), a department of the State of New Hampshire, as of and for the fiscal year ended June 30, 2013 and have issued our report thereon dated December 13, 2013.

This management letter, a byproduct of the audit of the New Hampshire Lottery Commission for the fiscal year ended June 30, 2013, contains our auditor's report on internal control over financial reporting and on compliance and other matters and related audit findings. The appendix provides a summary of the status of observations presented in the fiscal year 2012 management letter of the Lottery Commission.

The Lottery is again submitting its comprehensive annual financial report (CAFR) to the Government Finance Officers Association (GFOA) for consideration for the GFOA's Certificate of Achievement for Excellence in Financial Reporting. A certificate of achievement is a prestigious national award for CAFRs that are prepared in accordance with program standards. The program standards are intended to promote easily readable and understandable financial reports that demonstrate financial accountability and comparability. The Lottery received GFOA certification for its 2012 CAFR, and it is believed that the 2013 CAFR also conforms to the certificate of achievement program requirements. A copy of the Lottery's 2013 CAFR can be obtained from the New Hampshire Lottery Commission, 14 Integra Drive, Concord, NH 03301. The Lottery CAFR can also be accessed online at:

[http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/Lottery\\_2013\\_CAFR.pdf](http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/Lottery_2013_CAFR.pdf)



Office Of Legislative Budget Assistant

December 13, 2013

**STATE OF NEW HAMPSHIRE  
LOTTERY COMMISSION  
2013 MANAGEMENT LETTER**

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\* No audit comments suggest legislative action may be required.

This report can be accessed in its entirety on-line at:  
<http://www.gencourt.state.nh.us/LBA/AuditReports/financialreports.aspx>

## **Independent Auditor's Report On Internal Control Over Financial Reporting And On Compliance And Other Matters**

*To The Fiscal Committee Of The General Court:*

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the New Hampshire Lottery Commission (Lottery) which comprise the Statement of Net Position as of June 30, 2013 and the related Statements of Revenues, Expenses, and Changes in Net Position and Cash Flows for the year then ended and the related notes to the financial statements and have issued our report thereon dated December 13, 2013.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Lottery Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses.

However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control that we consider to be significant deficiencies. We consider the deficiencies described in Observations No. 1 through No. 5 to be significant deficiencies.

### **Compliance And Other Matters**

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, rules, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in Observation No. 6.

### **Lottery's Responses To Findings**

Lottery's responses to the findings identified in our audit are included with each reported finding. Lottery's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

### **Purpose Of This Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Office Of Legislative Budget Assistant

December 13, 2013

**Internal Control Comments**  
**Significant Deficiencies**

**Observation No. 1: Document All Critical Game Procedures**

*Observation:*

The Lottery had not developed formal winning number draw procedures for its GIMME 5 Game, prior to the May 2013 start of the game. According to the Lottery, a draft of the draw procedures was to be reviewed by the Tri-State Commission in August 2013.

Implementing a draw-based game prior to the establishment of formal draw procedures for the game increases the risk that draws may not occur as intended. Without approved, documented procedures, draw employees may be left to interpret how the draw is to be conducted and what actions to take if unexpected issues arise during a game draw.

*Recommendation:*

To limit operational and financial risks, all critical game procedures, including game draw procedures, should be settled, documented in policy and procedure guidance, approved by management, and tested with appropriate employee training prior to the implementation of a game.

*Auditee Response:*

We concur. The formal and updated draw procedures for all Tri-State Draw games were brought to the Tri-State Lotto Commission at the August 9, 2013 meeting at which time the Tri-State Lotto Commission was apprised of activity pertaining to the new procedures for the Gimme 5 winning number drawings. Previously, at the February 15, 2013 meeting, the Tri-State Lotto Commission approved the expenditure of money to purchase new drawing balls following a competitive bid process. At the April 12, 2013 Tri-State Lotto Commission meeting, the Commission was informed of the procedures for the Tri-State Gimme 5 game and that the new drawing balls had arrived. Formal procedures were updated and provided to the Chief of Security for this further review. Following that review, and as mentioned above, the procedures were provided to the Tri-State Lotto Commission at the August 9, 2013 meeting.

**Observation No. 2: Strengthen Controls Over Game Draw Systems And Processes**

*Observation:*

The Lottery's controls over the draw room and draw procedures continue to exhibit weaknesses that should be mitigated to improve employee control consciousness and lessen the risk that security over the draw facilities and procedures may be compromised.

Prior management letter comments recommended the Lottery strengthen its controls over its draw process including further limiting access to the draw room and draw equipment, improving the attention of the draw staff in the handling of draw equipment, and ensuring that draw policies and procedures adequately address game draw processes.

During fiscal year 2013, Lottery revised certain of its draw room access practices which did not adhere to Lottery's policies and procedures and unintentionally resulted in a control becoming less effective.

Draw policies direct that the Lottery's chief security officer (CSO) is to receive advanced email notification of an employee's intention to enter the draw room. The CSO also receives a security system "pop-up" notification when the room is entered. Adherence to the policy allows the CSO to anticipate the employee's entry into the room and also the opportunity to view the employee's activity in the room real-time on a video monitor. Subsequent to the revision in practice, the CSO only receives the pop-up notification when the room is entered. Email notices, if made, are directed to the Lottery's assistant executive director, sometimes in advance of the employee entering the room and sometimes after the fact. Without advanced notice of the intent to enter the room, the CSO is unable to determine whether the employee's access to the room had prior authorization and whether the employee's activities in the room are consistent with the authorized access.

Certain employees continue to have access authorities to the draw room, even though it is not clear their job responsibilities require such access. During fiscal year 2013, the CSO participated in certain draw activities by accessing the random number generator used to draw winning entries. By becoming involved in draw activities, the CSO lost independence as a monitoring control over those activities.

Opportunities to improve security over game draw equipment remain. Prior management letters noted improvements could be made in the secure handling of the numbered game balls. Certain employees with access to the draw room also have access to the numbered balls. The fiscal year 2012 management letter also noted game balls had been mishandled during the pre and post draw processes, including balls being dropped on the floor. In the one fiscal year 2013 game draw video reviewed, auditors again noted a ball was dropped on the floor by the game draw technician.

*Recommendation:*

The Lottery should continue to review and strengthen its controls over its game draw systems and processes.

The Lottery should review its draw room facilities and processes to determine the cause for employees to enter the draw room at non-draw times. Facilities and processes should be revised as necessary to further limit or eliminate risk related to unplanned employee access to the draw facilities. All access to the draw room at non-draw times should have prior approval and be subject to a segregation of duties control between having access to the draw room and equipment and authorizing and monitoring that activity. At a minimum, the CSO should be copied on



approvals to enter the draw room so that monitoring performed by the CSO can be a timely and efficient control.

The Lottery should review its controls over the handling of draw equipment, including game balls. Proper and secure handling of game balls should be emphasized with game draw technicians and others having access to draw equipment.

*Auditee Response:*

We concur. The Lottery has reviewed the procedures and will implement the following: Prior to any point that a Lottery employee enters the Draw room during non-draw times, they will notify in writing both the Deputy Director and Chief Security Officer. In addition, the previous assigned duties of the CSO relating to the second chance drawing have been reassigned to a member of the Accounting Department. Access by the CSO will be limited to emergencies and will include written documentation to the Deputy Director.

All policies regarding handling of draw balls will be reviewed with all draw personnel and an emphasis will be placed on the importance of proper handling.

**Observation No. 3: Improve Controls Over Instant Ticket Reconstruction Requests**

*Observation:*

The Lottery's policies and procedures to control risks from unauthorized instant ticket reconstructions were not effectively designed during fiscal year 2013.

If an instant ticket is presented as a winning ticket but is damaged in a way that makes it unreadable for the Lottery's normal validation procedures, the Lottery can request the ticket vendor to perform an instant ticket "reconstruction" which can establish if the ticket is a winner and the ticket's prize value. Controls over the instant ticket reconstruction process are critical, as information from reconstructions could be used to perpetrate a fraud.

The Lottery controls the risk from unauthorized ticket reconstructions by limiting the authority to request ticket reconstructions to certain Lottery employees and having the Lottery's Security Director monitor all requests for ticket reconstructions. Pursuant to Lottery's agreement with the vendor, reconstruction requests require approval from one of the authorized requestors for prizes less than \$1,000 and approvals from two authorized requestors for prizes of \$1,000 and above. The agreement identifies the Executive Director, Instant Games Manager, and Security Director as officials authorized to request, approve, and receive reconstruction reports.

The control of having the Security Director monitor all ticket reconstruction requests was ineffective during fiscal year 2013 as that employee initiated all ticket reconstructions during the year. In addition, the vendor did not require a second authorizer for either of two \$1,000 winning ticket reconstructions requested during fiscal year 2013.

*Recommendation:*

The Lottery should redesign its controls for requesting, approving, and monitoring the reconstruction of instant tickets to effectively segregate those duties and allow the controls to operate as intended. The Lottery should consider strengthening its controls by having all reconstruction requests require authorization by two approved Lottery employees.

The Lottery should update as necessary the control procedure in its vendor agreements for ticket reconstructions.

The Lottery should communicate with its instant ticket vendor the importance of complying with those control procedures to limit the risk of employees, or others without proper authorization, identifying winning instant tickets and prizes.

*Auditee Response:*

We concur. As of January 30, 2014, the Lottery, positioned with guidance acquired from the instant ticket vendor, initiated the redesign of its controls for requesting, approving, and monitoring the reconstruction of instant tickets to effectively segregate those duties and allow the controls to operate as intended.

In summary, the redesign replaces manual tasks with automated security verifications and provides useful measures which strengthen the controls. Prior to roll out, all authorized employees successfully completed mandatory training.

**Observation No. 4: Submit Certifications Required By MUSL Rules**

*Observation:*

Lottery did not comply with the Multi-State Lottery Association's (MUSL) Rule 2.3, as Lottery did not file the annual certification required by the rule.

“MUSL Rule 2 sets out the goals for controlling cross-jurisdictional risk associated with participating in a multi-jurisdictional game. Controls shall include a computer gaming system environment (CGS), an Internal Control System environment (ICS), and physical and logical controls to protect unauthorized access, tampering, outages, and any event or combination of events that may affect the security or integrity of a MUSL game.”

Per Rule 2.3 *Lottery Rule 2 Administrator*, “The Lottery Rule 2 Administrator shall file an annual certification reporting changes made to the CGS or ICS or that no changes were made.”

“Each Member Lottery shall name a Lottery employee, who is not under the supervision or control of data processing division to ensure compliance with Rule 2 and to be the primary contract with the Committee [MUSL Security and Integrity Committee].”

The Lottery reported that while in the past it received annual MUSL systems certification requests, it did not receive a request for fiscal year 2013.

*Recommendation:*

The Lottery should comply with MUSL Rule 2.3 and submit annual certifications reporting whether or not changes were made to their CGS or ICS.

*Auditee Response:*

We concur. We have received guidance from MUSL that they do not expect lotteries to provide this pro-active notification. However, in strict compliance with the rule, we have submitted a notification (on 1/24/14) that no changes were made in 2013.

**Observation No. 5: Improve Controls Over Replay Program**

*Observation:*

Unaddressed weaknesses in Lottery's controls over its Replay program increase the risks the program will not operate as intended by Lottery management, exposing the Lottery to unanticipated risks to financial operations and customer confidence. Risks to Lottery's operations from the lack of documentation of the Replay program was first reported in a fiscal year 2009 audit management letter comment. Lottery has not significantly improved its controls over the Replay program system since that initial observation.

The Lottery's Replay program is primarily an Internet-based, non-lottery game where players, upon registering and providing certain personal information, can enter non-winning Lottery tickets in exchange for Replay Points. These points can be used to purchase entries for drawings to win various merchandise prizes, which have been provided by businesses (advertising partners) in exchange for promotional consideration on the Replay website. The Lottery and its advertising vendor use the players' demographic information in marketing the Lottery's games. The Replay system is comprised of a website, database, and random number generator (RNG) operated by the Lottery's advertising vendor. Drawings are held monthly using the RNG to select winners from the population of entries.

Observations in the four prior fiscal year management letters have commented on lack of documentation of Lottery and vendor rights and responsibilities, and concerns over process and information security related to the Replay program.

During fiscal year 2013, the Lottery arranged for its advertising vendor to have an independent review of the Replay program conducted as a precursor to having a report on controls at a service organization relevant to security, availability, processing integrity, confidentiality and privacy (commonly known as a SOC 2 report) prepared. The review report identified a number of concerns consistent with the issues noted in the prior management letters. As of December 13, 2013, only limited actions have been taken to resolve the issues identified. According to the

Lottery, the preparation of a SOC 2 report will be put off until the Lottery and its vendor have had an opportunity to resolve certain of the issues noted in the review report.

*Recommendation:*

As recommended in prior management letters, the Lottery should ensure that all critical aspects of, and responsibilities for, the Replay program and system are fully understood and documented by current contracts, agreements, and system documentation.

The Lottery should require its advertising vendor to establish and document the controls provided in the Replay system to ensure that any risk in the Replay system does not call into question the integrity of the Lottery's games. Those documented controls should include information technology general and application controls, including administrative and other access controls, program change controls, regular plans of system monitoring and testing, and reviews of the security over the Replay system, and the information the system contains.

The Lottery should hasten its plan for the advertising vendor to procure and provide to the Lottery a SOC 2 report on controls over the operation of the Replay program.

*Auditee Response:*

We concur. The NH Lottery Replay program was reviewed by an independent auditing firm in preparation for the SOC 2 report. The review identified areas in need of improvement and the advertising vendor has embarked on a two-year plan to address those areas. At the end of the two years, a SOC 2 will be performed. The two-year plan was agreed upon by the Lottery in order to continue serving the NH Lottery Replay customers while the process improvements are being made.

## State Compliance

### **Observation No. 6: Request Legal Opinion For Use Of Lottery Money To Fund The Gaming Regulatory Oversight Authority**

#### *Observation:*

During the period subsequent to June 30, 2013 but prior to the release of the audit report, the Lottery expended approximately \$117,000 of Lottery money, as authorized by RSA 284-A:2, as amended, to support the Gaming Regulatory Oversight Authority (Authority) established in RSA 284-A:1.

The Authority is to “insure integrity and public confidence in gaming regulation and to oversee and assess the current regulation of gaming activities authorized pursuant to New Hampshire law and recommend the appropriate regulation of casino gambling in New Hampshire.”

Part 2, Article 6-b of the State Constitution states, “All moneys received from a state-run lottery and all the interest received on such moneys shall, after deducting the necessary costs of administration, be appropriated and used exclusively for the school districts of the state. Such money shall be used exclusively for the purpose of state aid to education and shall not be transferred or diverted to any other purpose.”

As there is no direct connection between the Authority’s operations and the necessary cost of administration of the Lottery, the use of Lottery money for this purpose appears contrary to Part 2, Article 6-b of the State Constitution.

#### *Recommendation:*

The Lottery should request an opinion from the Attorney General as to whether the use of Lottery money to fund the Authority is in compliance with Part 2, Article 6-b of the New Hampshire Constitution.

#### *Auditee Response:*

As this relates to legal interpretation, we neither concur nor disagree with this observation, but will consult with counsel as to the authorization and expenditure.

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## APPENDIX

### Current Status Of Prior Audit Findings

The following is a summary of the status, as of December 13, 2013, of the observations contained in the New Hampshire Lottery Commission Management Letter for the fiscal year ended June 30, 2012. That report can be accessed at, and printed from, the Office of Legislative Budget Assistant website: <http://www.gencourt.state.nh.us/LBA/AuditReports/financialreports.aspx>.

#### Status

#### *Internal Control Comments*

##### *Significant Deficiencies*

1. Perform Risk Assessments	●	●	●
2. Comply With Draw Room Policies And Procedures ( <i>See Current Observation No. 2</i> )	●	○	○
3. Establish Policies And Procedures To Prevent Prize Payments To Ineligible Players	●	●	●
4. Improve Controls Over Replay Program ( <i>See Current Observation No. 5</i> )	●	○	○
5. Improve Segregation Of Duties Over Merchandise Prizes For The Replay Program	●	●	●
6. Expand Scope Of Policies And Procedures To Include Instances When Usual Practices Cannot Be Applied	●	●	●
7. Correct Prize Reserve Account Reconciliation Procedure	●	●	●
8. Correct Ineffective Control For Claim Validation Or Document And Mitigate Increased Risk	●	●	●
9. Monitor Compliance With Filings Of Statements Of Financial Interests	●	●	●
10. Obtain Evidence Of ICS Controls	●	●	●
11. Update And Augment Disaster Recovery Plan	●	●	○
12. Review Offsite Access To Secured Information System	●	●	●

<u>Status Key</u>				<u>Count</u>
Fully Resolved	●	●	●	9
Substantially Resolved	●	●	○	1
Partially Resolved	●	○	○	2
Unresolved	○	○	○	0

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