

**STATE OF NEW HAMPSHIRE
LOTTERY COMMISSION**

**MANAGEMENT LETTER
FOR THE FISCAL YEAR ENDED JUNE 30, 2023**



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To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Lottery Commission as of and for the fiscal year ended June 30, 2023 and have issued our report thereon dated December 20, 2023.

This management letter, a byproduct of the audit of the New Hampshire Lottery Commission for the fiscal year ended June 30, 2023, contains our Independent Auditor's Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*, and related audit findings. The current status of prior audit findings, beginning on page 11, provides a summary of the status of observations presented in the fiscal year 2022 and fiscal year 2021 New Hampshire Lottery Commission management letters.

The New Hampshire Lottery Commission is again submitting its Annual Comprehensive Financial Report (ACFR) 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 ACFRs 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 New Hampshire Lottery Commission received GFOA certification for its 2022 ACFR, and it is believed that the 2023 ACFR conforms to the certificate of achievement program requirements. A copy of the New Hampshire Lottery Commission's 2023 ACFR can be obtained from the New Hampshire Lottery Commission, 14 Integra Drive, Concord, NH 03301. The New Hampshire Lottery Commission ACFR can also be accessed online at:

<https://www.gencourt.state.nh.us/lba/auditreports/financialreports.aspx>

Office of Legislative Budget Assistant

Office of Legislative Budget Assistant

December 20, 2023

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**STATE OF NEW HAMPSHIRE
LOTTERY COMMISSION
2023 MANAGEMENT LETTER**

TABLE OF CONTENTS

	<u>PAGE</u>
TRANSMITTAL LETTER	i
INDEPENDENT AUDITOR’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	1
<i>INTERNAL CONTROL COMMENTS</i>	
<i>SIGNIFICANT DEFICIENCIES</i>	
Observation No. 1: Revenue Reconciliation Control For Historical Horse Racing Revenues Should Be Strengthened	3
Observation No. 2: Ineligible Players Listings Should Be Complete.....	4
Observation No. 3: Quarterly Reviews Of User Access Permissions Should Be Evidenced	5
Observation No. 4: Formal Approval Process For Retailer Promotional Credits Should Be Developed.....	6
<i>COMPLIANCE COMMENTS</i>	
Observation No. 5: Systems And Organization Controls Reports Covering Historical Horse Racing Tote Systems Should Be Obtained As Required By Administrative Rule	8
Observation No. 6: Comply With Or Amend Biennial Transfer Limit*	9
<i>CURRENT STATUS OF PRIOR AUDIT FINDINGS</i>	11

* Comment suggests legislative action may be required.

ABBREVIATIONS USED

ACFR	Annual Comprehensive Financial Report
BOS	Back Office System
CFO	Chief Financial Officer
CUECs	Complementary User Entity Controls
GFOA	Government Finance Officers Association
HHR	Historical Horse Racing
ICD	Investigation and Compliance Division
Lottery	New Hampshire Lottery Commission
L4L	Lucky for Life
MUSL	Multi-State Lottery Association
SOC	System and Organization Controls



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Independent Auditor's Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

To The Fiscal Committee Of The General Court:

We have audited, in accordance with the 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 which comprise the Statement of Net Position as of June 30, 2023 and the related Statements of Revenues, Expenses, and Changes in Net Position and Cash Flows for the fiscal year then ended, and the related notes to the financial statements, which collectively comprise the New Hampshire Lottery Commission's basic financial statements, and have issued our report thereon dated December 20, 2023.

Report On Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the New Hampshire Lottery Commission's internal control over financial reporting (internal control) as a basis for designing 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 New Hampshire Lottery Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the New Hampshire Lottery Commission'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 a 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. We did identify certain deficiencies in internal control, described in Observations No. 1 through No. 4, that we consider to be significant deficiencies.

Report On Compliance And Other Matters

As part of obtaining reasonable assurance about whether the New Hampshire Lottery Commission's financial statements are free from 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 financial statements. 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in Observations No. 5 and No. 6.

New Hampshire Lottery Commission's Responses To Findings

Government Auditing Standards require the auditor to perform limited procedures on the New Hampshire Lottery Commission's responses to the findings identified in our audit and described in the accompanying observations. The New Hampshire Lottery Commission's responses to the findings identified in our audit are included with each reported finding. The New Hampshire Lottery Commission'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 results of that testing, and not to provide an opinion on the effectiveness of the New Hampshire Lottery Commission'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 New Hampshire Lottery Commission's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Office of Legislative Budget Assistant

Office of Legislative Budget Assistant

December 20, 2023

INTERNAL CONTROL COMMENTS
SIGNIFICANT DEFICIENCIES

Observation No. 1

Revenue Reconciliation Control For Historical Horse Racing Revenues Should Be Strengthened

The New Hampshire Lottery Commission (Lottery) is unable to develop complete and accurate expectations of Historical Horse Racing (HHR) revenues submitted by the gaming operators as part of their monthly revenue reconciliation process.

The HHR operations within the State began in April 2022. HHR machines are located in numerous gaming facilities throughout the State. The machines resemble slot machines and allow players to bet on replays of historical horse races. HHR revenues are tracked and processed via four tote systems which operate on the HHR machines. The gaming operators are required to remit 16.25% of total HHR commissions excluding free play wagers (i.e. promotional wagers) to the Lottery on a monthly basis.

HHR machines simulate racetrack betting, also known as parimutuel wagering. In parimutuel wagering, odds are calculated by sharing the pool among all winning bets. The total amount wagered by all players is referred to as the “handle.” The gaming facilities retain a portion of the handle, which is split between the gaming facility, charitable organizations, and the Lottery, and the remainder is paid out to winners in proportion to the size of their bets. A totalizator, or “tote” system runs on the HHR machines, and registers bets, computes the odds, and calculates winner payouts. The Lottery’s Investigation and Compliance Division (ICD) receives daily reports from the tote systems, which are used to develop an expectation of HHR revenues to be remitted by the gaming operators for the month. The expectation is then compared to the HHR revenues remitted to Lottery along with the gaming operators’ monthly financial reports. During fiscal year 2023, the ICD was unable to develop a complete expectation of the HHR revenue owed to Lottery, as only one of the four tote system daily reports provided included free play wager data. A second tote system began including the free play wager data in their daily reports at the end of June 2023, the last month of the fiscal year. Tote providers are not currently required by regulation to include free play data in their reports.

Lottery reports that, while it is not able to recalculate the HHR revenue completely on a monthly basis, additional reports are available from the gaming operators’ back office and player card systems reports. However, additional reports from the gaming operators systems are typically only requested and reviewed when the gaming facilities are undergoing an audit by the ICD.

Free play wagers reported by the one tote system vendor which collected such data amounted to approximately \$1.9 million in fiscal year 2023 for the State’s largest gaming facility.

The tote systems’ inability to include all necessary information within the daily reports provided to Lottery increases the risk that Lottery may not be collecting all HHR revenues due from gaming operators. Amounts due to Lottery could be reported incorrectly due to fraud or error and

potentially go unnoticed unless detected as part of an ICD audit. This category of revenue is growing rapidly, with \$10.1 million in revenues collected during fiscal year 2023 and is expected to exceed \$20 million in revenues for fiscal year 2024.

Tote systems reporting is further discussed in Observation No. 5.

Recommendation:

Lottery should consider amending administrative rule *Lot 8204.08 Required Reports, Audits and Inspections* to include the submission of free play activity.

If amending the administrative rule is not deemed feasible, Lottery should evaluate whether its current mitigating control of reviewing reports detailing free play activity from gaming operators back-office and player card systems during the ICD's biennial audits is sufficient to ensure HHR revenue completeness, or whether further mitigating controls should be implemented. Further mitigating controls could include requesting gaming operators to provide reports detailing free play activity from their back-office and player card systems along with the monthly financial reports currently remitted to Lottery.

Auditee Response:

Lottery concurs and will evaluate whether an amendment to the administrative rules is feasible and necessary. Lottery is working with the tote companies to voluntarily include the free play in the reports and anticipates that this data will be included by FY25. In the interim, the Lottery will strengthen its current audit of free play by increasing the cadence of those audits.

Observation No. 2

Ineligible Players Listings Should Be Complete

Lottery's policy regarding ineligible players listings, for the purpose of ensuring prize claims are not made by ineligible players, is not consistent with Multi-State Lottery Association (MUSL) or Lucky for Life (L4L) game rules and vendor contracts.

Certain individuals are specified in game rules or contract agreements as ineligible to play Lottery games and win Lottery prizes. The Lottery's controls to ensure that ineligible players are not awarded game prizes consist largely of checking higher-tier winners' names against listings, completion of winner certifications, and reliance upon the integrity of vendors' employees.

In response to prior year *Observation No. 2 Ineligible Players Listings Should Be Updated Routinely*, Lottery enacted a new policy for maintaining listings of ineligible players. The new policy, which became effective in June 2023, specifies the following: "Compliance/Security will ensure that it received an updated list of New Hampshire based employees who qualify as ineligible players from all relevant contractors every six (6) months."

Although the policy was enacted to ensure up to date listings are obtained, it does not completely address the risk of ineligible players claiming prizes, as the policy directs staff to obtain only a list of **New Hampshire**-based employees despite neither MUSL, or L4L game rules, or applicable vendor contracts limiting ineligible players to only New Hampshire-based employees.

Lottery's inability to obtain complete vendor employee listings increases the risk that Lottery will improperly award game prizes to ineligible players, leading to the impression that vendor employees or other personnel with inside information could claim prizes. Awarding prizes to ineligible players could potentially erode public trust in the Lottery, impacting future revenues.

Recommendation:

Lottery should update its ineligible players listings policy to require vendors and partner organizations provide listings of all employees working in the United States to help ensure completeness in identifying ineligible players. Lottery should ensure relevant staff are aware of, and trained on the policy, and monitor to ensure the ineligible player listing control is working as intended.

If Lottery believes its current practice to be sufficient to identify ineligible players, Lottery should inquire with MUSL and the L4L game administrator to determine whether its current policy aligns with the game's rules. Additionally, Lottery should amend its current vendor contracts to ensure contract language matches current practice.

Auditee Response:

Lottery concurs. The Lottery agrees to review this policy with MUSL and make any changes required or suggested after that review.

Observation No. 3

Quarterly Reviews Of User Access Permissions Should Be Evidenced

Lottery's quarterly monitoring control of reviewing user access permissions to vendor data systems was not operating effectively during fiscal year 2023.

Lottery's *Account Level User Access to Vendor Data Systems Policy (Policy)* requires the Director of Security to document findings resulting from the quarterly review of vendor data systems' access permissions listing on the *Quarterly Access Control Review Worksheet (Worksheet)*. Specifically, the *Policy* states:

“On a quarterly basis, the Director of Security will review account level access to ensure that only those employees authorized to retain access remain valid. The Director of Security will document the findings on the *Quarterly Access Control Review Worksheet* and submit the findings to the CCO [Chief Compliance Officer].”

The *Policy* is in place to ensure Lottery employees' user access permissions to its vendor-supported gaming systems remains appropriate based on the nature of their positions; and to ensure that access is removed timely for employees who are no longer employed by Lottery, or who move to a different position which no longer requires access. The *Policy* also serves to satisfy complementary user entity controls (CUECs) required to be in place to ensure that its vendors' System and Organization Controls (SOC) reports can be relied upon for financial reporting purposes.

The Lottery reports that, while the quarterly reviews were performed during fiscal year 2023, the results of the reviews were not documented in writing on the *Worksheet*, in accordance with the *Policy*.

Additionally, auditor review of user access permissions listings noted that five out of 22, or approximately 23%, of the employees for one vendor system retained access for between two and eight months after leaving employment with Lottery or moving on to another position within the Lottery Commission. Lottery reported that employee access to the vendor system is typically updated once a new employee has been hired or transferred to fill the position.

Neglecting to ensure that employee access to vendor systems is updated or removed timely increases the risk that systems could be accessed inappropriately.

Recommendation:

Lottery should comply with its *Policy* and formally document its quarterly reviews of user access permissions, including the results of such reviews on the *Quarterly Access Control Review Worksheet*. Additionally, Lottery should implement procedures to ensure user access is immediately removed for any employees who leave the Lottery Commission or move to a new role where access is no longer required.

Auditee Response:

The Lottery concurs with this finding. While the quarterly reviews were conducted as required, the documentation was not completed in accordance with the Lottery approved policy. The extended access referenced in the observation referred to read only or test account access for sports betting systems, which would have no impact on the integrity of Lottery operations. We will ensure that the policy is implemented and that access is removed in a timely manner.

Observation No. 4

Formal Approval Process For Retailer Promotional Credits Should Be Developed

Lottery does not have a formal process in place for the approval of retailer credit incentives.

Throughout the year, Lottery runs numerous promotions via its retailers. For example, during the month of December 2022, one promotion granted the purchaser of a Tri-State Megabucks ticket of \$6 or greater the chance to win \$25 instantly. Such promotions are processed through Lottery's

Back Office System (BOS), and are reflected as a promotional credit, impacting the weekly net amount due from the retailer. While all other retailer adjustments processed through the Lottery's BOS require review and approval by the Lottery's Chief Financial Officer (CFO), promotional credits are processed automatically by the system, and no such review and approval is evidenced.

In addition, Lottery does not have a procedure in place to formally document management's initial review and approval of the promotional credits, which are processed automatically by BOS, prior to their roll-out to retailers. Management reports that, while the promotions are discussed among multiple Lottery staff members during various internal meetings, the results of the discussions are not documented, and evidence of management's approval is not formally documented.

A review of ten retailer adjustments processed through BOS identified three retailer promotional adjustments, for which CFO or other management approval was not evidenced. Support provided for the validity of the promotional adjustments was limited to emails sent to Lottery retailers from either the Director of Marketing or the Online Games Manager, notifying the retailers of upcoming promotions.

The lack of a formal approval process for promotional credits increases the risk that promotional adjustments which are not valid may be processed within BOS, and negatively impact the Lottery's weekly amount due collected from retailers, without being detected and corrected by management.

Promotional credits processed during fiscal year 2023 amounted to approximately \$200,000.

Recommendation:

Lottery should establish and document a formal management approval control procedure for retailer promotional credits and adjustments, supported by formally documented policies and procedures. The policy should provide for the formal review and approval of retailer promotional credits, by the appropriate level of management. Lottery should make sure all relevant employees are aware of the process. Management's approval should be periodically monitored to ensure the control procedure is operating effectively.

Auditee Response:

The Lottery concurs with the recommendation and will develop a formal approval control and procedure for promotional events and adjustments. This will include management level approvals based on promotional costs.

COMPLIANCE COMMENTS

Observation No. 5

System And Organization Controls Reports Covering Historical Horse Racing Tote Systems Should Be Obtained As Required By Administrative Rule

Lottery has not obtained System and Organization Controls (SOC) reports for all tote systems responsible for processing Historical Horse Racing (HHR) revenues in the State of New Hampshire.

Administrative rule Lot 8204.08 (e) states: “On an annual basis, the HHR licensee or terminal provider(s) under contract with the licensee shall obtain and submit a SOC 1 SSAE 18 Type 2 report issued by a licensed CPA.” A SOC 1, Type 2 report is an internal control report that is intended to provide information to its clients and their auditors, to be used in evaluating the effect of the system organization’s controls on the user’s own controls for financial reporting purposes.

As previously discussed in Observation No. 1, there are four tote systems which track and process HHR revenues on the HHR machines located in the numerous gaming facilities throughout the State. A review for compliance with administrative rule revealed that two out of the four tote system providers operating in the State during fiscal year 2023 did not provide a SOC 1 Type 2 report to Lottery covering the entirety of fiscal year 2023, as further described below:

- One of the tote system providers was able to produce a SOC report covering the first half of the fiscal year. Requests by Lottery for the management of the tote system to provide a bridge letter, went unanswered. Bridge letters are typically provided to fill the gap between the SOC report date and the fiscal year-end and are reviewed to confirm whether there have been any changes in the control environment or internal control processes noted in the SOC report.
- A second tote system provider submitted a letter from its CPA firm explaining their belief that the SOC report was not required. However, auditor review of the letter provided determined it appears to be referring to the requirements of a SOC 2 report which has more to do with security and confidentiality of information, versus a SOC 1 report as required in administrative rule, which concentrates on financial controls.

Failing to obtain and review SOC 1, Type 2 reports as required by administrative rule, increases the risk that there could be control gaps at the tote system provider which go unmitigated, potentially negatively impacting HHR revenues due to Lottery.

Recommendation:

Lottery should implement policies and procedures to ensure that all tote system providers operating in the State provide SOC 1, Type 2 reports, as required in administrative rule. Any tote systems not providing SOC reports covering the full fiscal year should provide bridge letters covering periods of time not covered by the SOC report. Management should

consider whether refusal to provide SOC reports should result in penalties and potential loss of ability to operate within the State until they are fully compliant with administrative rule.

Auditee Response:

The Lottery concurs. Lottery intends to implement a process for either the collection of an annual SOC report or a valid waiver from the requirement. The Lottery notes that there are significant controls on tote systems outside of the SOC reports. The tote systems and companies that are subject to the reports do not handle any of the funds associated with historic horse racing. Rather, the tote is designed to produce a gaming result and manage prize calculation. These aspects of the system are already subject to independent third-party testing by Gaming Laboratories International prior to being shipped to the casino and are also subject to an annual field audit by an independent gaming lab. While Lottery acknowledges that this is a legal requirement, we do not agree with the Auditors that failure to provide these reports increases risk of control gaps, as these gaps are monitored by testing of the gaming components themselves.

Observation No. 6

Comply With Or Amend Biennial Transfer Limit

Lottery was not in compliance with the \$6 million biennial transfer limit required by Chapter Law 90:4, *Laws of 2021*, for the biennium ended June 30, 2023.

Chapter 90:4, *Laws of 2021* states the following:

For the biennium ending June 30, 2023, in order to provide sufficient funding to the lottery commission to carryout lottery games that will provide funds for the distribution in accordance with RSA 284:21-j, the commission shall apply to the fiscal committee of the general court for approval of any new games, the expansion of any existing lottery games, or for the purchase of any tickets for new or continuing games. Additionally, no expenditures for consultants shall be made without prior approval by the fiscal committee. If approved, the commission may then apply to the governor and council to transfer funds from the sweepstakes revenue special account. The total of such transfers shall not exceed \$6,000,000 for the biennium ending June 30, 2023.

Upon initial inquiry with management, Lottery reportedly was unaware of the Chapter Law requirement. Lottery implemented a change with its instant ticket vendor during fiscal year 2022 which resulted in a move from Lottery owning instant-ticket inventory, to the vendor retaining ownership of the instant tickets and Lottery paying for services as a percentage of instant ticket sales.

The change in contract terms resulted in Lottery exceeding the \$6 million transfer limit for the biennium ended June 30, 2023, by \$2.8 million. As similar language is also included within Chapter 106:4, *Laws of 2023*, Lottery may also potentially exceed the \$6 million transfer limit for the biennium ending June 30, 2025.

Recommendation:

Lottery should comply with, or seek to amend, the biennial transfer limits outlined in chapter law, for the biennium ending June 30, 2025. Lottery should seek to amend language in future chapter laws governing such transfer limits to ensure the limits remain reasonable and align with current practice.

Auditee Response:

The Lottery concurs. The Lottery will seek to amend the statute to increase this limit during the next budget session. This is necessary due to the large increase in sales of instant tickets and associated costs.

CURRENT STATUS OF PRIOR AUDIT FINDINGS

The following is a summary of the status, as of December 20, 2023, of the observations contained in the New Hampshire Lottery Commission’s Management Letters for the fiscal years ended June 30, 2022 and 2021. Those reports can be accessed at, and printed from, the Office of Legislative Budget Assistant website: <https://www.gencourt.state.nh.us/lba/auditreports/financialreports.aspx>

	2022 Audit Comments		<u>Status</u>
	Internal Control Comments		
	<u>Significant Deficiencies</u>		
2022-1	<p>iLottery Revenue Reconciliation Control Should Be Strengthened <i>Review current iLottery revenue reconciliation procedures, and work with the vendor to ensure that all relevant data points used in the reconciliation are agreed to valid supporting documentation. Support existing iLottery revenue reconciliation procedures with a formal, management-approved policy document.</i></p>	●	○
2022-2	<p>Ineligible Players Listings Should Be Updated Routinely <i>Implement procedures to ensure the gaming-system vendor provides routine and timely updates to the listings of individuals used to identify ineligible players, as required by individual game rules or contract. (See Current Observation No. 2)</i></p>	●	○
	Compliance Comment		
	<u>State Compliance</u>		
2022-3	<p>Administrative Rules Should Be Adopted And Statutory Language Clarified <i>Continue to take steps towards developing and adopting administrative rules relative to qualifications for enhanced penalties, in accordance with RSA 284:21-i, VII. Consult with the Attorney General’s office to determine whether statutory revision is necessary.</i></p>	●	○

2021 Audit Comments
Internal Control Comments

Status

Material Weakness

2021-1	<p>Lottery Should Develop And Implement Effective Internal Controls Over Sports Betting Revenues</p> <p><i>Reconsider amending contract with vendor to require the annual acquisition of a SOC 1 Type 2 report pertaining specifically to the NH Lottery; implement policies and procedures to review and assess risks associated with outsourced services, including when SOC 1 Type 2 reports should be written into contracts, as well as ensuring relevant CUECs are in place and operating effectively. Additionally, formally document policies and procedures covering the major areas of its sports betting operations including its process for completing monthly revenue reconciliations, acceptance of the monthly revenue share amount, and documenting the review of the vendor’s cash reserves in accordance with statute.</i></p>	●	●
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Significant Deficiencies

2021-2	<p>Lottery Should Formally Document Policies And Procedures Covering Significant Aspects Of Its Financial Reporting Process</p> <p><i>Enhance financial accounting and reporting staff to account for the ever-increasing scope and complexity in Lottery’s operations and consider the establishment of a Director of Finance or similar position. Additionally, begin to formally document policies and procedures that address significant aspects of the financial reporting process, including but not limited to: the development of significant estimates, monthly reconciliations, year-end accruals and adjusting entries, and the compilation and review of the Annual Comprehensive Financial Report.</i></p>	●	○
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2021-3	<p>Council For Responsible Gambling Expenses Should Be Adequately Supported</p> <p><i>The Council should implement formal policies and procedures to ensure all invoices are adequately supported in accordance with contracted terms, prior to being submitted to Lottery for payment. Duties should be appropriately segregated to allow for an independent review of invoices prior to payment, to ensure that expenses are valid and made in accordance with contracted terms.</i></p>	●	○
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<u>Status Key</u>	<u>Status</u>		<u>Count</u>
Resolved	●	●	1
Remediation In Process (Action beyond meeting and discussion)	●	○	5
Unresolved	○	○	0

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