

**STATE OF NEW HAMPSHIRE  
LOTTERY COMMISSION**

**MANAGEMENT LETTER  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**



*To The Fiscal Committee Of The General Court:*

We have audited the financial statements of the New Hampshire Lottery Commission, a department of the State of New Hampshire, as of and for the fiscal year ended June 30, 2006 and have issued our report thereon dated December 20, 2006.

This management letter, a byproduct of the audit of the New Hampshire Lottery Commission for the fiscal year ended June 30, 2006, contains our auditor's report on internal control over financial reporting and on compliance and other matters and related audit findings. The appendix, included as an attachment to the management letter, provides a summary of the status of observations presented in the fiscal year 2005 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 2005 CAFR, and it is believed that the 2006 CAFR also conforms to the certificate of achievement program requirements. A copy of the Commission's 2006 CAFR can be obtained from the New Hampshire Lottery Commission, 14 Integra Drive, Concord, NH 03301.

Office Of Legislative Budget Assistant

December 20, 2006

**STATE OF NEW HAMPSHIRE  
LOTTERY COMMISSION  
2006 MANAGEMENT LETTER**

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This report can be accessed in its entirety on-line at [www.gencourt.state.nh.us/lba](http://www.gencourt.state.nh.us/lba).

## **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 the financial statements of the business-type activities of the New Hampshire Lottery Commission, a department of the State of New Hampshire, as of and for the fiscal year ended June 30, 2006 and have issued our report thereon dated December 20, 2006. We conducted our audit 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.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Lottery Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Observations No. 1 through No. 8 of this report.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

## Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Lottery Commission'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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted a certain matter which is described in Observation No. 9 of this report.

This auditor's report on internal control over financial reporting and on compliance and other matters is intended solely for the information and use of the management of the Lottery Commission and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.

Office Of Legislative Budget Assistant

December 20, 2006

**Internal Control Comments**  
**Reportable Conditions**

**Observation No. 1: Replay Program Should Be Recorded In Accounting Records**

*Observation:*

The Lottery has not established policies and procedures to account for and report the operation of its Replay program. Additionally, there is no evidence that the memorandum of agreement between the Lottery and the advertising agency administering the program was reviewed and approved by the Department of Justice for both form and content and for other legal implications of the program.

The Lottery introduced its Replay program during fiscal year 2006. The Replay program allows Lottery players to sign up for Replay accounts through the internet and “replay” their non-winning Lottery tickets to win instant prizes and to accumulate points towards entry into monthly and quarterly prize drawings. The prizes given away in the Replay program are provided by companies in exchange for advertising opportunities on the Lottery’s website. The Lottery uses information obtained from the player accounts in its marketing efforts. At June 30, 2006, approximately \$83,000 of prizes had been committed to the program by advertisers and approximately \$29,000 of prizes had been awarded. None of this financial activity was reported on the Lottery’s financial statements.

Per the Governmental Accounting Standards Board *Codification of Governmental Accounting and Financial Reporting Standards*, Section 1600.103, financial activity resulting from exchange and exchange-like transactions should be recognized when the exchange takes place.

Reportedly, the original intent was for the advertising agency to run the Replay program, including performing the draws, so that the Lottery would not have to account for the program. However, the cost and logistics drove the decision for the Lottery to handle these areas, yet the Lottery still did not accept responsibility for accounting for the program. Therefore, the Lottery’s financial statements do not include Replay activity other than the advertising expense for administration of the program.

*Recommendation:*

The Lottery should establish policies and procedures to properly account for and report Replay program activity in its financial statements.

The Lottery should request legal counsel review the operation of its Replay program to ensure the program is operating as intended and that the Lottery is protected against unforeseen prize and other liabilities. The Lottery should retain documentation of the legal counsel’s review.

*Auditee Response:*

We concur in part.

The agency will have discussions with the Comptroller's Office in addressing the exchange-like transactions for possible accounting entries that may be required.

The Lottery did request legal counsel to review this subject. Approximately two months prior to the launch of the Replay program the Lottery provided its legal counsel with an outline of Replay operations, acceptance of prizes, and the letter of agreement between the Lottery and its advertising agency. Counsel thoroughly reviewed the documents and provided the Lottery with appropriate written and verbal guidance. The Lottery maintains an electronic file of all attorney/client e-mail correspondence.

*LBA Rejoinder:*

The Lottery did not provide any contemporaneous documentation that evidenced counsel's review and approval of the Lottery's design and operation of the Replay program. While the Lottery provided evidence that it sought legal counsel related to the Replay program, the written guidance was not made available to the auditors.

**Observation No. 2: Lottery Games Should Be Adequately Documented Prior To Introduction**

*Observation:*

The Lottery had not established documented policies and procedures to provide for making annuity payments for the N.H. Millionaire instant ticket game's grand-prize, one of the game's payment options, prior to the introduction of the game.

The Lottery introduced its N.H. Millionaire instant ticket game in December 2005. The game provided three top prizes of a \$1 million annuity, or a lesser cash-value option. The first claim for one of the top prizes occurred in the fall of 2006 and the winner chose the annuity payment option. Reportedly because the Lottery had not expected the annuity option would be chosen, documented policies and procedures for making annuity payments to the winner were not established. While the Lottery did some preliminary research on options for funding an annuity payment option, no decisive plan was documented prior to the winning claim being made, at which time the Lottery requested assistance from the Multi-State Lottery to purchase an annuity from an insurance company to support the prize.

The annuity payment option is clearly a foreseen contingency for the game that should be supported by documented policies and procedures to establish intended best practice.

*Recommendation:*

The Lottery should establish documented policies and procedures for significant aspects of all games, prior to the game's introduction.

While it is unreasonable to expect that all circumstances and contingencies can be addressed by these policies and procedures, all reasonably foreseen contingencies such as how to make payments of claimed prizes should be considered and addressed.

*Auditee Response:*

We do not concur.

The Lottery feels it did adequately plan for the annuity payment of the Instant Millionaire game. One annuity payment has been claimed and paid with great success. The Lottery Director did not allow for the sales of the Instant Millionaire game until there was a plan for purchasing an annuity should a winner choose the annuity option. The Lottery conferred with the State Treasurer, the office of the Attorney General, and employees of the two joint ventures, Tri-State and MUSL to arrive at a plan as to how the Lottery would pay an annuity winner. The plan was in place prior to start of game sales. We are glad to report that the plan was a very easy and successful process. The Lottery will document the procedure for jackpot annuity payments for the instant games directly to the working papers of each game.

*LBA Rejoinder:*

The issue raised in the comment was that there were no documented policies and procedures for jackpot annuity payments in place at the Lottery prior to the enactment of the game. The fact that the Lottery had considered actions and had conferred with entities that could provide services does not evidence a plan of action that should have been vetted and documented prior to the game being sold.

**Observation No. 3: Tracking Controls For Tickets Delivered By Shipping Vendor Should Be Improved**

*Observation:*

The Lottery has not established policies and procedures to respond to the risk of misappropriation of instant tickets delivered to retailers via a shipping vendor.

During fiscal year 2006, the Lottery began using a shipping vendor for the delivery of instant tickets to retailers. Prior to using a delivery service, tickets were delivered by Lottery Field Representatives and remained continuously in the Lottery's possession until the retailer received and activated the tickets.

During fiscal year 2006, the Lottery had not established policies and procedures for following up timely on shipments of tickets that appeared lost in transit or otherwise delayed in receipt at the retailers. While the reported number of lost shipments during fiscal year 2006 was relatively insignificant, the Lottery did not have policies and procedures to ensure that missing shipments were recorded in the Games Management System (GMS) as lost or stolen until the lost status of the shipment was subsequently verified through the vendor's tracking mechanism. The delay in verification of the lost status of the shipment exposes the Lottery to the risk that lost or stolen tickets may be misused.

While the Lottery has a process to follow up on tickets signed for at the retailer as having been delivered by the vendor but not yet "received" in GMS, it does not have a process to follow up on tickets that are still listed as being "in transit".

*Recommendation:*

The Lottery in conjunction with the shipping vendor and the Lottery's ticket retailers should take steps to ensure that appropriate controls are established to immediately recognize and appropriately respond to occasions when shipments of tickets go missing.

The Lottery should implement a process to allow and promote the timely follow up on the status of outstanding ticket deliveries. The Lottery should also consider all risks associated with in transit ticket shipments.

*Auditee Response:*

We concur.

The Lottery's chief of security and other Lottery staff members had a process in place to identify and flag missing ticket shipments. A total of six packages were lost (misplaced) in transit out of more than 75,000 packages shipped in fiscal year 2006, or .008% of all shipped packages. None of the tickets from those six packages have been presented to be cashed and, due to security controls built into the Lottery's gaming system, the State is not liable for any prizes within those tickets. The vendor will reimburse the Lottery for any associated shipping costs.

The Lottery had a process to follow up on packages in transit and has since improved and documented the process. The vendor gave the Lottery access to a vendor web site program on December 15, 2006. This password-protected program enables certain Lottery employees to regularly track all packages in transit on a daily basis and research any package that has been in transit for an unacceptable period (over two days). Once a package is identified as being late, the Lottery immediately researches the status of the package and can enter the tickets as "Lost or Stolen" in GMS, thus rendering the tickets as unusable.

#### **Observation No. 4: Access Privileges Should Be Periodically Reviewed**

*Observation:*

The Lottery has procedures to review access privileges for employees that have formal job changes; however, the Lottery does not periodically perform a review of employee access to monitor for conflicting access privileges when an employee is assigned or takes on additional job responsibilities but does not have a formal job change.

In a review of employee access privileges we noted certain Lottery employees have access privileges within the Lottery building that are incompatible with their access privileges within the Lottery's game systems.

For example, four Lottery employees have incompatible access privileges as they have physical access to the instant ticket inventory and also have access privileges to the Games Management System or to the ticket vending machines. The Lottery normally restricts employees who have game system responsibilities from also having access to ticket inventory. The job responsibilities for each of the four noted employees were changed without formal changes in job positions. Two of the employees became responsible for after-hours alarm recalls and the two others had other ancillary job responsibility changes that did not trigger formal access reviews.

There is no documentation that the risks associated with the accesses granted as a result of these additional responsibilities were assessed by the Lottery.

*Recommendation:*

The Lottery should continually monitor the continued appropriateness of access privileges assigned to employees, both in computer systems and within the building, to ensure that employee access privileges remain compatible with their job responsibilities.

In addition to the formal review performed upon employee job changes, periodic reviews should be performed to monitor for conflicting access privileges that can occur when additional responsibilities are assigned to, or accepted by, employees without a formal job change occurring.

All reviews and risk assessments associated with access privileges should be documented. If Lottery management determines that it is appropriate to accept some risk associated with the assignment of incompatible duties/access conflicts, that determination and acceptance should be documented.

*Auditee Response:*

We concur in part.

The Chief of Security does review data on access privileges and notifies the Executive Director or other members of Lottery management if access conflicts become apparent. We concur that this process is not regularly documented.

The Lottery's staff is small sometimes making it difficult to provide a complete segregation of duties. The daily review of the access logs by the Lottery's Chief of Security does provide a check and balance to mitigate some of these concerns.

The Lottery will continue with its monitoring process and improve its documentation regarding management's review and acceptance, if appropriate, of all risks, including the risks posed by access privileges.

**Observation No. 5: Control Procedures Should Be Consistently Evidenced To Allow For Control Monitoring**

*Observation:*

The Lottery does not consistently follow its established prize payment control procedures including maintaining documentation of the application of the control procedures.

Control procedures for Lottery's prize payments require management review and approval, evidenced by initials on the claim form, of high dollar prize payments. Procedures require the approval of a supervisor for prizes \$600-\$4,999 and approval of an administrator for prizes of \$5,000 or more. The responsible party evidences their approval of the payment by initialing the claim form.

During our test of controls for prize payments, we noted the following instances where the Lottery's requirement for documenting control process were not adhered to:

- Three out of 25 sample selections (12%) that should have had management approval did not have evidence of approval having been given. While one of three exceptions did not have initials indicating manager approval on the claim form, there was clear evidence of management's involvement in the disbursement process, including approval initials on other supporting documentation. The other two exceptions noted had no evidence of management involvement in the prize payments.
- During the test of controls over issuance, return, and activation of instant tickets, we were unable to determine whether the related controls were operating as designed because the Lottery could not locate the Returns Detail Report for two of the nine sample selections (22%).

A lack of adherence to control procedures increases the risk of erroneous prize payments, including an increased risk of payments being made to inappropriate persons or being made for incorrect amounts. The lack of documentation of the application of control procedures prevents the Lottery from appropriately monitoring the application and effectiveness of the intended controls and lessens the effectiveness of the control structure.

*Recommendation:*

The Lottery should improve the consistency of its application of its control procedures, including its control monitoring procedures, to provide assurance that the Lottery's control structure is operating as intended by management.

If the Lottery determines that control procedures are not being regularly complied with, the Lottery should review the procedures to determine whether the procedures remain appropriate and, if so, provide additional training and direction to its employees emphasizing management's concern for, and expectation of, controlled operations.

*Auditee Response:*

We concur. All employees will be notified of the importance of documentation as part of their responsibilities in the performance of their duties. Additional training will be provided to improve the control of the operations.

- Managers and supervisors will be informed of the importance of initialing these documents indicating that they were reviewed.
- The official draw reports were available, but the missing document was a hard copy draw tape review sheet, an electronic format was on file and available for review.
- There was a "Returns Detail Report" hard copy missing, but the data was available electronically through the GMS system.

**Observation No. 6: Inventory Report Discrepancies Should Be Resolved**

*Observation:*

The Lottery has not sought identification and resolution of variances that exist within reports from its Games Management System (GMS). The Lottery uses these reports as source records for posting accounting transactions. Because the reports do not contain consistent information, the Lottery is susceptible to reporting inaccurate information in its financial statements.

Two GMS reports, the *Inventory Summary For 6/30/06* and the *Detail Settle And Returns From 7/1/05 To 6/30/06*, report different amounts for ostensibly the same information. For example, the number of Tickets Settled per the *Detail Settle And Returns* report are approximately 200,000 less than the number of tickets placed into the Sold/Settled status per the *Inventory Summary* report.

The Lottery originally became aware of the discrepancies as a result of auditor questions during the course of the fiscal year 2005 audit. The Lottery has been unable to identify the cause of the discrepancies and has not sought assistance in resolution of the problem from the system vendor. The Lottery's review of the problem has identified that the same book of tickets can show in multiple statuses within the same time period, however the cause of specific variances over a 3-day period could not be identified.

While audit testing did not reveal any material misstatements arising from these discrepancies in reported information, the fact that the Lottery is not able to determine the cause and correction for apparent errors reported from a critical Lottery management information and control system is concerning and increases the risk that other non-currently identified errors may also exist or occur in the future and not be timely detected and resolved.

*Recommendation:*

The Lottery should work with its games system vendor to identify and resolve the causes of the identified discrepancies that exist between GMS reports to ensure the accuracy of its systems data.

In correcting the causes of the discrepancies, the Lottery should also consider whether the causes of the identified discrepancies portend any other previously unrecognized problems in the operation of the GMS, including the reporting from the system.

*Auditee Response:*

We concur. These reports are not used for accounting purposes, but they will be corrected.

The inventory summary report is a "canned" report in the vendor's system. The report contains information that does not concern physical inventory of instant tickets. The information the Lottery uses from this report is correct and does prove to the year end actual physical inventory performed, along with other individual retailer reconciliations performed.

It was not the Lottery's intent to use the inventory summary to record revenues, only to record the actual physical inventory at any given date. The reports the Lottery uses to record "settlements and returns, etc", do reconcile to many sources, including funds collected and the physical inventory reported on the inventory summary report.

**Observation No. 7: Security Of Subscription Information Should Be Resolved**

*Observation:*

A security issue noted in a 2004 Multi-State Lottery Association (MUSL) security audit of the Lottery's Powerball subscription process remains unresolved, reportedly due to technical difficulties.

Prior to the Lottery being allowed to offer subscriptions for the Powerball game in November 2004, MUSL required an audit to be conducted of the Lottery's subscription system to ensure that adequate controls were in place to secure the subscription process and data. Subscription information received by the Lottery is entered into the Games Management System (GMS). The security audit report issued by MUSL indicated improvements should be made to increase the security of the data in that system.

As a result of the audit, the Lottery implemented a mitigating procedure, which was accepted by MUSL as a temporary solution.

As of June 20, 2006, the Lottery had been unsuccessful in its attempts to comply with the original MUSL solution to the noted system weakness and continued to use the temporary solution approved by MUSL.

*Recommendation:*

The Lottery should continue in its attempts to implement a permanent resolution to the issue first raised in the MUSL security audit or consider requesting MUSL approval of an alternative permanent control procedure.

*Auditee Response:*

We concur that this was an issue on June 30, 2006, but it has since been resolved.

A new software program (Subscription Validation v6) was installed on November 15, 2006 by our vendor, Scientific Games. This program enables Lottery staff to verify that no alterations have been made to the subscriptions data (late entries or late deletions) subsequent to the drawing. Access to this program is restricted to two management employees. This is a permanent solution to this issue.

This program was reviewed by MUSL, who conducted an on-site Security and Integrity Review between December 11 and December 15, 2006, and were satisfied with the results. We anticipate that this issue will be considered resolved by the State auditors during their fiscal year 2007 review of the Lottery.

**Observation No. 8: ITVM Reconciliations Should Include Documentation Of Variance Resolution**

*Observation:*

The Lottery's reconciliation control of instant ticket vending machine (ITVM) sales and ending inventory does not appear to have an effective monitoring component to make the reconciliation a useful control procedure. There are no documented policies and procedures to ensure that any variances noted in the reconciliations are appropriately addressed and that management is made aware of variances when appropriate.

The Lottery operated ten ITVMs in restaurants, hotels, and other non-typical locations during fiscal year 2006. Total sales from these machines during fiscal year 2006 were approximately \$651,000.

Lottery Field Representatives are responsible for servicing ITVMs. An assigned Field Representative periodically collects the cash from the ITVM and completes an Inventory Balance Sheet and prints an Inventory Summary Report from the ITVM. These documents are forwarded to a Senior Accounting Technician for reconciliation of tickets sold to cash collected. The Senior Account Technician may change the amounts reported by the Field Representatives without any requirement for a notification to the Field Representative or any guidelines for when to inform management of noted differences. Lottery management is not provided a copy of the reconciliation to review and relies upon the judgment of the preparer of the reconciliation to notify management if problems are encountered.

*Recommendation:*

The Lottery should strengthen its ITVM reconciliation control to include management monitoring of the reconciliations and resolution of any noted variances. The Lottery should consider providing policies and procedures to assist in the reconciliation process including guidelines for making adjustments to amounts reported by Field Representatives and for reporting variances to management in a timely manner. Lottery management should use appropriate control monitoring procedures to gain and maintain confidence that controls are operating as intended.

*Auditee Response:*

We concur.

The Senior Accounting Technician (preparer) does, as stated, use her best judgment in reporting concerns to management. Vending machines, on rare occasions, have malfunctions that result in small discrepancies on the average of \$1-\$2 per machine per week. Lottery staff collected revenues of \$650,917 from the ten ITVM machines in FY 06. Minor errors in transpositions or in recording data do occur. These are usually obvious to the preparer and again she uses her good judgment when adjusting the data. The Lottery will add a report to the current procedures, identifying discrepancies, to be given to the preparer's immediate supervisor (Accountant III) and the Chief Accountant. We will also add to our current procedures guidelines for processing adjustments.

## State Compliance Comment

### **Observation No. 9: Rules For Drawings Should Be Adopted In Accordance With RSA 284:21-I, II (a)**

#### *Observation:*

The Lottery is not in compliance with RSA 284:21-I, II (a), which requires the Lottery to adopt administrative rules under RSA 541-A relative to holding and conducting drawings.

The Lottery conducts drawings for the Replay program, as well as other second-chance drawings, without having adopted administrative rules. The Lottery reportedly did not believe it needed to adopt administrative rules for drawings that are considered short-lived and promotional. The Lottery developed policies and rules for these drawings that have not been subjected to the administrative rule process.

Without properly adopted administrative rules, the Lottery's drawings are subject to dispute, as the public has not had a chance to weigh in on the rules governing those drawings.

#### *Recommendation:*

The Lottery should adopt rules for drawings in accordance with RSA 284:21-I, II (a).

If the Lottery determines that the administrative rule process is not appropriate for certain drawings, the Lottery should request a change in the statute to allow for an exemption.

#### *Auditee Response:*

We concur and will adopt rules for second chance drawing process including the Replay program. The Commission does have Commission approved policies on all these drawings.

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## APPENDIX

### Current Status Of Prior Audit Findings

The following is a summary of the status, as of December 20, 2006, of the observations contained in the New Hampshire Lottery Commission Management Letter for the year ended June 30, 2005. A copy of the prior management letter can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House, Room 102, Concord, NH 03301-4906 or accessed on-line at [www.gencourt.state.nh.us/lba](http://www.gencourt.state.nh.us/lba).

#### *Internal Control Comments*

	<u>Status</u>		
<i>Reportable Conditions</i>			
1. Policies And Procedures Should Be Established For Handling Delinquent Agent Accounts	●	●	●
2. Critical Computer Equipment Should Be Adequately Secured	●	●	●
3. Security of Subscription Information Should Be Resolved ( <i>See Current Observation No. 7</i> )	●	●	○
4. Policies And Procedures Should Be Established For Subscription Over-Payments Received By The Lottery	●	●	●

#### *State Compliance Comment*

5. The Triple Play Game Structure Should Be Consistent With Statutes In Form And Function (Game Ended January 12, 2007)	●	○	○
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#### Status Key

Fully Resolved	●	●	●
Substantially Resolved	●	●	○
Partially Resolved	●	○	○
Unresolved	○	○	○

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