

**STATE OF NEW HAMPSHIRE
LOTTERY COMMISSION**

**MANAGEMENT LETTER
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

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, 2009 and have issued our report thereon dated December 15, 2009.

This management letter, a byproduct of the audit of the New Hampshire Lottery Commission for the fiscal year ended June 30, 2009, 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 2008 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 2008 CAFR, and it is believed that the 2009 CAFR also conforms to the certificate of achievement program requirements. A copy of the Commission's 2009 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/audit.html>.

Office Of Legislative Budget Assistant

December 15, 2009

**STATE OF NEW HAMPSHIRE
LOTTERY COMMISSION
2009 MANAGEMENT LETTER**

TABLE OF CONTENTS

	<u>PAGE</u>
Letter Of Transmittal	i
Auditor’s Report On Internal Control Over Financial Reporting And On Compliance And Other Matters	1
<i>Internal Control Comments</i>	
<i>Significant Deficiencies</i>	
* 1. Sale Of Replay Program Assets Should Be Reviewed.....	3
2. Replay Program Should Be Fully Documented.....	4
3. Segregation Of Duties Should Be Improved Over Merchandise Prizes - Replay Program ...	5
4. Controls Should Be Improved Over Merchandise Prizes - Lottery Games.....	7
5. User Access Change Log Should Be Prepared And Reviewed	8
6. Advertising Costs Should Be Properly Charged To Lottery Advertising Accounts.....	9
7. Reported Prize Reserves Should Be Reviewed For Accuracy.....	11
8. Accountability For Tickets Removed From The Lottery’s Instant Ticket Vending Machines Should Be Improved.....	12
9. Approval Of All Journal Entries Should Be Evidenced.....	13
10. The Lottery Should Prepare All State Required Accounting Reports.....	14
<i>State Compliance Comment</i>	
* 11. Tax Status Of Tri-State Lotto Prizes Should Be Determined.....	15
APPENDIX - Current Status Of Prior Audit Findings	17

* Audit comment may require legislative action.

This report can be accessed in its entirety on-line at www.gencourt.state.nh.us/lba/audit.html.

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 New Hampshire Lottery Commission, for the fiscal year ended June 30, 2009, and have issued our report thereon dated December 15, 2009. 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 as a basis for designing our auditing procedures 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 Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery Commission's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in Observations No. 1 through No. 10 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as described above.

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 the Lottery Commission's 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 an immaterial instance of noncompliance which is described in Observation No. 11.

The Lottery Commission's written response to the observations in this report have not been subject to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the management of the New Hampshire Lottery Commission, others within the Lottery Commission, and the Fiscal Committee of the General Court, and is not intended to be used by anyone other than these specified parties.

Office Of Legislative Budget Assistant

December 15, 2009

Internal Control Comments
Significant Deficiencies

Observation No. 1: Sale Of Replay Program Assets Should Be Reviewed

Observation:

During fiscal year 2008, the Lottery's Executive Director ostensibly sold the Lottery's ownership of the Lottery's Replay and Rep!ayman trademarks and granted ownership of Replay program software to the Lottery's advertising agency for the cost the Lottery incurred in filing and transferring the trademarks, approximately \$4,400. The Lottery recorded the final proceeds from the sale during fiscal year 2009.

In December 2005, Governor and Council approved an amendment to the Lottery's advertising contract totaling \$400,000 which largely centered on the contractor's development of the Replay program. The terms of the initial contract as well as the contract amendment appear to specifically grant ownership of any computer software developed pursuant to the contracted activity to the State.

The Lottery provided no documentation to establish that the sale of the trademark and the granting of the software ownership was valued at a reasonable price, authorized by State statute and rules, or approved by the Lottery Commission or by the Governor and Council. While the Lottery's Executive Director obtained advice from the Department of Justice (DOJ), the Executive Director did not provide the auditors with a copy of the advice received from the DOJ to determine the relevance of the inquiry to the questions at hand and the nature of the advice.

Recommendation:

The Lottery should review with legal counsel the sale of the Replay and Rep!ayman trademarks and the granting of the ownership of the Replay program software, including whether the Executive Director had authority to unilaterally commit the Lottery to the sale.

To provide transparency to the sale of the asset, the Lottery should review with the DOJ the need to keep this legal advice privileged.

The Legislature may want to clarify whether it is appropriate for an agency head to dispose of State assets unilaterally, without Governor and Council approval.

Auditee Response:

We do not concur that the Lottery needs to further review with legal counsel the sale of the Replay and Rep!ayman trademarks. The Office of the Attorney General has forwarded a document containing their opinions of this matter to your office concluding "The Lottery acted appropriately having sought timely and appropriate legal advice, in selling the Replay trademark to [the Lottery's advertising agency]." The Lottery previously obtained a private legal opinion

that determined the two Replay trademarks had little or no value to the Lottery other than the approximate \$4,400 cost to obtain them. The Commission was informed of the legal opinion and of the suggested course of action to transfer the two Replay marks to the Lottery's advertising agency in exchange for a total reimbursement of costs associated with obtaining and transferring the two trademarks. The trademarks have since been transferred and the total reimbursement of costs was received. All other costs associated with Replay were for non-trademark items such as media, production, etc.

The Commission will meet with its attorney to review privileged attorney/client communications.

We concur that if the Legislature believes that current legislation needs to be clarified regarding the transfer of State trademarks, that the Legislature should do so.

Observation No. 2: Replay Program Should Be Fully Documented

Observation:

The Lottery has not documented in revisions to contracts, memorandums of agreement, or other writings significant changes that have occurred in the Lottery's Replay program since Replay was established in June 2006.

The Lottery's Replay Program allows players to enter, via the Internet, codes from non-winning lottery tickets to become eligible for merchandise prize drawings. The Lottery's advertising agency promotes and maintains the Replay program and website, including bartering promotional services for prizes, and compiling entries for prize giveaways. Demographic information gained through the players' interactions with the Replay website is used by the Lottery to better market Lottery games. Currently, the Multi State Lottery Association (MUSL) hosts the Replay website, including the related Lottery player information database, without charge to the Lottery.

The memorandum of agreement entered into by the Lottery and the advertising agency, in conjunction with the advertising contract in effect at the time, outlined certain rights and responsibilities of both the Lottery and the advertising firm with regards to the Replay program at the inception of the Replay program. However, neither the agreement nor subsequent contracts addressed the responsibilities for error detection, security breaches, and processing disruptions or envisioned MUSL hosting the Replay website.

The Lottery's Replay program collects confidential data from players including names, email and residential addresses, and dates of birth. The Lottery relies upon its advertising agency, which operates the Replay program, for the security over that confidential information. There are no documented policies, procedures, or other agreements between the Lottery and its advertising agency describing the rights and responsibilities for the use and security of that confidential information.

The lack of current and comprehensive documentation of the Lottery's Replay program increases the risk that disagreements or misunderstandings between the Lottery and its vendors will impact the Lottery's ability to optimize its return on its Replay program. The Lottery's near complete reliance upon its advertising agency for the operation of the Replay program may place the Lottery at a disadvantage in obtaining competitive bids for future advertising contracts, including the operation of the Replay program.

Recommendation:

The Lottery should ensure all critical aspects of its Replay program are documented with current contracts and agreements which clearly define and document the rights and responsibilities of all parties.

The Lottery should become familiar with the advertising agency's operation of the Replay program, including the process by which data is collected and secured, to ensure the Lottery does not become overly dependent upon the advertising agency for the continued operation of the Replay program. The Lottery should ensure key Lottery employees, along with Lottery information technology personnel, are sufficiently trained in Replay program operations to provide for a continuity of the Replay program, without dependence on the current advertising agency.

Auditee Response:

We concur. The New Hampshire Lottery was proactive in ensuring that the NH Lottery Replay program was and is documented. There is a Memorandum of Agreement between the Lottery and its advertising agency. The Lottery further secured the source code for the NH Lottery Replay website and that code is with the Department of Information Technology (DoIT). The Lottery will work with DoIT to further document the processes for NH Lottery Replay.

DoIT has assured the Lottery that they can take over the information technology support for NH Lottery Replay.

The Lottery will work further to document the NH Lottery Replay program.

Observation No. 3: Segregation Of Duties Should Be Improved Over Merchandise Prizes – Replay Program

Observation:

The design of the Lottery's controls over merchandise prizes used in the Lottery's Replay program does not provide for an adequate segregation of duties to reasonably ensure that control activities are, and remain, effective. During fiscal year 2009, the Lottery reported it awarded \$348,635 in merchandise prizes. At June 30, 2009, the Lottery reported \$98,126 of Replay merchandise prize inventory on hand.

One Lottery employee has the incompatible responsibilities of receiving, accounting for, maintaining custody of, and distributing merchandise prizes used in the Lottery's Replay program. All marketing partner agreements and contributed prizes are sent to this employee, who is responsible for entering all received prize information into spreadsheets used for tracking contributed prizes. There is no subsequent documented supervisory review to ensure the inventory reported on the spreadsheet is complete, accurately updated, and reconciles to inventory provided by the marketing partners. The spreadsheets are periodically forwarded to the Lottery's advertising agency, which operates the Replay program for the Lottery, so the company is aware of what prizes are available to be awarded to Replay program participants. As prizes are awarded, the advertising agency forwards listings of the winners and prizes to the Lottery employee who updates the prize tracking spreadsheets and mails the prizes to the winners. These activities are also not formally reviewed and approved by Lottery management.

The lack of segregation of duties in the Lottery's controls over the receipt, holding, reporting, and disbursement of Replay program merchandise prizes increases the risk that errors or frauds may occur in the merchandise prizes that would not be detected and corrected in the normal course of business.

Recommendation:

The Lottery should establish an effective segregation of duties in its controls over accepting, holding, reporting, and disbursing of merchandise prizes for its Replay program. Responsibilities for the custody and reporting of the merchandise prize inventory should be properly segregated to ensure employees with the ability to cause errors and frauds are not also responsible for detecting the errors and frauds they may cause. Inventory activity and records should be periodically reviewed and compared to ensure that the inventory is properly controlled and reported.

Auditee Response:

We concur. To meet an improved segregation of duties for the receipt of merchandise prizes for the NH Lottery Replay program, the lottery will do the following:

- 1) All merchandise prizes received will be recorded by an employee within the administrative unit of the Lottery. These prizes will be recorded on a spreadsheet upon receipt. The spreadsheet will detail the name of the marketing partner, record the number of prizes received and the date received.
- 2) The prizes are then given to the Director of Marketing for his/her review. The prizes are then provided to the Marketing Coordinator for the inventory process.
- 3) The Marketing Coordinator's inventory process begins with counting the number of prizes received and assigning each prize, via an automated serial number stamp, a unique inventory number. With each prize individually sequentially numbered, the prizes are added to a secondary independent spreadsheet for inventory purpose.

- 4) The Marketing Coordinator then reviews the two sets of documentation for discrepancies.
- 5) During our fiscal year end processing, a full audit of NH Lottery Replay merchandise prizes is performed by two lottery employees. One employee who is independent of the day to day process, counts all prizes on hand and compares that count to the recorded inventory documentation for any discrepancies. The Marketing Coordinator performs an independent similar review.

Observation No. 4: Controls Should Be Improved Over Merchandise Prizes – Lottery Games

Observation:

The Lottery did not utilize established controls over its instant ticket game merchandise prizes during fiscal year 2009. During this period, the Lottery purchased several instant ticket games which had merchandise prizes as well as monetary prizes. These games included Boston Red Sox, Boston Celtics Green, Casholine, and Billboard instant games. These games had as part of their prize structure prize packs of sports tickets, apparel, memorabilia, gas cards, and song downloads. During fiscal year 2009, the Lottery did not account for these merchandise prizes in the general ledger account established specifically to account for merchandise prizes purchased for and awarded as part of the Lottery's instant ticket games.

The Lottery has not used the merchandise prize account for at least the last two fiscal years. Instead, when instant game merchandise prizes were purchased, the Lottery recorded the combined cost of the game tickets and merchandise prizes in the instant ticket inventory account, generally used to account for the cost of the "scratch" tickets purchased for the instant ticket games. When the merchandise prizes were won and claimed during fiscal year 2009, the value of the prizes awarded, through Lottery oversight, was not recognized as a prize expense and deducted from the instant ticket inventory until the auditors identified the issue and suggested the Lottery correct the balances in the accounts for the June 30, 2009 fiscal year end.

At June 30, 2009, the Celtics game had been closed and all the instant tickets for the game had either been settled or destroyed, resulting in a zero balance for instant ticket inventory; however, at June 30, 2009, the Lottery still had 13 undistributed Celtics prize packs valued at \$7,124 on hand which were not accounted for in the Lottery's game and accounting systems.

Recommendation:

The Lottery should establish policies and procedures to account for its merchandise prize inventory in a manner that will improve accountability and control over the items.

To provide management with information necessary to ensure merchandise prize inventory is appropriately safeguarded, the merchandise inventory should be accounted for separately from the instant ticket inventory. The Lottery should use existing and additional general ledger accounts as necessary to account for, report, and control its merchandise prize inventory.

Auditee Response:

We concur.

The Lottery's instant ticket vendor, Scientific Games International, is setting up a system in which all non-cash prizes (merchandise prizes and second-chance drawing prizes) will be assigned special validation codes. These codes will be entered into their Games Management system and will therefore appear in the Validation files. As prizes are claimed, these prizes will be validated using the codes, with the result that the reports will show the prizes claimed for a particular game and the balance remaining. All accounting reports will be updated using this process.

Regarding the distribution of prizes, we currently receive regular reports from the third parties who are responsible for administering the redemption of certain of these prizes. These reports detail who received the prizes, their addresses and the prizes awarded. Lottery staff enter the details into spreadsheets, keeping a running total of inventory and balancing against the third party reports.

Some prizes are handled internally by Lottery staff who keep spreadsheets showing the total number of prizes in inventory. As prizes are awarded, details are entered in the spreadsheet and a running total of inventory is recorded and balanced against the physical inventory in the Lottery Warehouse.

Observation No. 5: User Access Change Log Should Be Prepared And Reviewed

Observation:

The Lottery's control over changes in user access to a critical information system was not documented and lacked sufficient communication of relevant information to allow for effective monitoring during fiscal year 2009.

The Lottery's informal policy requires both the Lottery's Chief Security Officer and Online Games Manager to approve a change in a Lottery employee's user access prior to the vendor implementing the change in the Lottery's Games Management System (GMS), a critical Lottery computer information and control system. It is unclear whether this informal policy is an effective control over unauthorized changes to user access to the GMS, as the control relies upon the Chief Security Officer being aware of all user access changes made to the GMS. During fiscal year 2009, the Chief Security Officer was not provided with a GMS log or other definitive information source to allow the Chief Security Officer to monitor all GMS user access changes.

Without monitoring changes made to the GMS, the Lottery cannot be reasonably certain that the vendor is only implementing approved changes.

Recommendation:

The Lottery should document all significant control activities, including controls intended to restrict user access in the GMS.

The Lottery should work with its Department of Information Technology staff and GMS vendor to establish a log of user access changes in the GMS. The log should be regularly monitored by the Lottery's Chief Security Officer to ensure only approved changes to user access are made.

Auditee Response:

We concur. The On-line Games Manager and the GMS vendor will forward all changes to the Lottery's Chief Security Officer. The Lottery's Chief Security Officer will update the GMS permission matrix report. Effective July 1, 2010 the new on-line system will have an automatic exception log as part of the control process. This log will be monitored by both the Chief of Security and the Lottery Director.

Observation No. 6: Advertising Costs Should Be Properly Charged To Lottery Advertising Accounts

Observation:

The Lottery does not review its advertising invoices to determine and ensure its contracted advertising agency reasonably allocates advertising costs between the Lottery's New Hampshire and Tri-State games advertising accounts. According to Lottery's Contracting Officer for the advertising contracts, the Lottery is unaware of any formal methodology used by the Lottery, Tri-State, or the advertising agency for allocating advertising expenses.

The State's operating budget for fiscal year 2009 appropriated \$1.95 million for advertising and marketing the Lottery's New Hampshire games. In addition, the Lottery had an additional \$1.3 million of advertising expense included in its Tri-State budget plan for fiscal year 2009. The Tri-State budget plan is a budget for the Tri-State joint venture that is not subject to State budgeting controls. The amount budgeted for Lottery advertising in the Tri-State budget plan is in addition to the amount appropriated for advertising in the State's operating budget.

The Tri-State Lotto Commission Policy No. 10 provides, "The participant states may expend their advertising dollars at their own discretion provided that these monies are expended only for the promotion of Tri-State products". Neither the Lottery nor the advertising agency had controls in place to restrict the use of Tri-State advertising dollars to the marketing of Tri-State products during fiscal year 2009.

1. During fiscal year 2009, the Lottery placed into service a mobile sales trailer, which cost the Lottery \$18,324. The trailer is used by the Lottery to sell New Hampshire, Multi-State, and Tri-State game products at temporary locations, commonly fairs and other similar events. The trailer was purchased by the advertising agent and charged to the Tri-State advertising

account. Graphics placed on the trailer costing \$1,900, which are specific to the Lottery and not Tri-State, were also invoiced to, and paid from, the Tri-State advertising account. According to the Lottery, it was unaware the trailer and graphics were charged entirely to the Tri-State account, even though the Lottery's Executive Director and Program Information Officer both reviewed and approved the associated invoices, which charged the purchases to the Tri-State account.

2. The Lottery does not separately account for and report costs associated with the operation of its Replay program. While, according to the Lottery, the advertising and marketing expenses for the Lottery's Replay program are allocated equally between the Lottery's New Hampshire and Tri-State advertising accounts, the invoices from the advertising agency are not sufficiently descriptive to allow for the identification of Replay program costs or to reasonably ensure those costs are allocated to the New Hampshire and Tri-State advertising accounts appropriately.
 - An auditor review of advertising invoices noted charges specifically identified by the advertising agency as Replay related were split 25% to the Lottery's New Hampshire account and 75% to the Lottery's Tri-State account. While the Lottery indicated its subsequent review of the same invoices identified additional charges related to the Replay program which were invoiced to the Lottery's New Hampshire account, the identification of those costs as Replay related was not evident to the auditors from the descriptions on the invoices or any other support available at the Lottery.

Recommendation:

The Lottery should establish policies and procedures for identifying and charging advertising expenses to the Lottery's New Hampshire games and Tri-State games advertising accounts, including expenses related to the Replay program. The Lottery should ensure the policies and procedures are effectively communicated to its contracted advertising agency to promote compliance with the policies.

Lottery employees involved in the Lottery's advertising and marketing strategies and activities should be sufficiently trained in the Lottery's policies and procedures to be able to effectively review and approve advertising invoices for payment, including reviewing the allocation of advertising costs to Lottery and Tri-State advertising expense accounts.

The Lottery should consider tracking, accumulating, and reporting Replay program costs, in order to have objective data to support a regular analysis and evaluation of the costs and benefits of its Replay program to its overall mission.

Auditee Response:

We concur.

The New Hampshire Lottery Commission has been charging advertising invoices to the proper advertising budgets. This invoicing and payment process has been in place for a number of years without issue.

At the end of fiscal year 2009, the Lottery inadvertently charged a mobile sales trailer to the Tri-State advertising budget. The intent was to charge 50% of the cost to the NH Lottery Advertising budget and 50% to the Tri-State Advertising budget but the paperwork was processed due to an oversight to one budget.

However in response to this audit recommendation, the Lottery has implemented a new invoice identification practice. At this time, invoices will be more clearly identified specifically by Lottery product or promotion. Invoices that are split between the Lottery's New Hampshire and Tri-State advertising accounts will be clearly designated as such.

Observation No. 7: Reported Prize Reserves Should Be Reviewed For Accuracy

Observation:

The Lottery does not have policies and procedures to verify the amount of its assets held in the Multi-State Lottery Association (MUSL) prize reserve accounts. The Lottery accepts without review that the MUSL report of the Lottery's share of the balances in the MUSL prize reserve accounts is reasonable and complete. At June 30, 2009, MUSL reported the Lottery's share of the prize reserve accounts was \$2,326,196.

The Lottery, as a member of the MUSL joint venture, offers the Powerball and Hot Lotto games through the Lottery's sales outlets. According to MUSL rules, the Lottery pays a portion of its revenue from the sales of these games into common MUSL prize pools, used to pay jackpot winners. MUSL deposits two percent of the prize pool contributions received from member state lotteries, up to established ceiling amounts, into prize reserve accounts used as contingency accounts in the event winnings exceed the statistically anticipated amounts.

The Lottery reports its share of the balance in the MUSL prize reserve accounts as a restricted asset with a corresponding restricted fund equity balance. Lottery updates the reported balances in these accounts yearly, based on amounts reported by MUSL. While the totals reported in the MUSL reserve accounts are subject to the MUSL audit, the balances in the individual state lottery accounts are not covered by the MUSL auditor's report. The Lottery does not have policies or procedures in place to reasonably ensure that its accounts are properly credited by MUSL.

Recommendation:

The Lottery should establish controls to reasonably ensure the Lottery's share of the MUSL prize reserve accounts is accurately reported.

If needed, the Lottery should request sufficient additional support from MUSL to establish the accuracy of the MUSL reported amounts.

Auditee Response:

We concur; we will communicate with MUSL to resolve this issue.

Observation No. 8: Accountability For Tickets Removed From The Lottery's Instant Ticket Vending Machines Should Be Improved

Observation:

The Lottery has not effectively segregated duties to establish accountability controls over active instant tickets removed from the Lottery's instant ticket vending machines (ITVMs).

One employee at Lottery headquarters receives, maintains custody of, reconciles, and reports to the warehouse active tickets retrieved from the Lottery's ITVMs. The Lottery has no process to ensure all tickets collected from the ITVMs and returned to Lottery headquarters are ultimately forwarded intact to the warehouse for controlled destruction.

Periodically, a Lottery employee visits each ITVM to manage the machine's instant ticket inventory. Occasionally, the employee will retrieve tickets from the ITVM, including tickets which did not dispense properly and, less frequently, tickets for games being removed from ITVM sales. The employee forwards these tickets, which are still in 'active' status, along with an accounting of the remaining ticket inventory in each ITVM to an employee in the Lottery business office. The business office employee is responsible for reconciling the tickets to the ITVM's sales revenue and forwarding the tickets to the warehouse where they are stored until destroyed. There is no subsequent check to establish that all tickets removed from the ITVMs are destroyed intact. While the tickets remain with the employee in the business office, the tickets are in active status and, if presented as a winning ticket, the holder would likely be awarded the indicated prize.

Recommendation:

Accountability for tickets removed from the Lottery's ITVMs should be improved. Active tickets should not be transferred between Lottery employees without documentation supporting the transfer of the accountability for the tickets. The Lottery should review the need for the Lottery business office employee to have custody of active tickets. The reconciliations performed by this employee could be accomplished based on records documenting the transfer of retrieved tickets

between the employee removing the tickets from the ITVM inventory and the Lottery warehouse.

Auditee Response:

We concur. Effective July 1, 2010, the new On-line system will allow return of tickets directly from the ITVMs. This will allow the tracking status of all tickets through the gaming system as is being done with tickets from our retailers currently.

Observation No. 9: Approval Of All Journal Entries Should Be Evidenced

Observation:

Auditor review of journal entry documents for three randomly selected months during fiscal year 2009 revealed the Lottery is not evidencing a review and approval of approximately 3% of these transactions posted to its general ledger. Lottery policy requires all journal entries to be reviewed and approved by either the Chief Accountant or Administrator prior to posting.

Approximately 30 adjusting journal entries were posted by the Lottery during each of the three randomly selected test months of July and September 2008 and April 2009. A review of the supporting documentation for the journal entries posted during these test months indicated that in each month, one entry was not evidenced as having received prior review and approval by either the Chief Accountant or Administrator. It was unclear whether the noncompliance with the policy in these three situations indicated a lack of prior review and approval or a lack of documentation of a review and approval.

Unauthorized journal entries could be used to effect, or hide, errors and frauds.

Recommendation:

The Lottery should review its procedures for management review and approval of general ledger entries to ensure all entries are subject to an effective review and approval control prior to being posted to the Lottery's general ledger. All significant review and approval controls, such as review and approval of journal entries, should be documented in the accounting records.

Auditee Response:

We concur. Management's policy is to have two approvals on all journal entries. The general ledger account reconciliations are performed by Lottery accountants monthly as well as management's analysis of the Lottery's financial statements on a monthly basis.

Observation No. 10: The Lottery Should Prepare All State Required Accounting Reports

Observation:

An incomplete understanding of State financial reporting requirements prevented the Lottery from filing required year-end financial documents in a timely manner.

The Department of Administrative Services, Bureau of Financial Reporting (BFR) requires agencies to complete and submit an Exhibit C (Capital Lease Worksheet) at each fiscal year-end, summarizing leases with annual payments greater than \$50,000. This report was due on June 12, 2009 for fiscal year 2009. The Lottery, believing it was not required to, did not submit an Exhibit C, for fiscal year 2009. The Lottery also had not submitted Exhibit Cs in prior fiscal years. Subsequent to discussions with the auditors, Lottery confirmed with the BFR it was subject to the reporting requirement and the Lottery submitted a fiscal year 2009 Exhibit C in September 2009.

Recommendation:

The Lottery should adhere to all reporting requirements in the State's *Annual Closing Review*. The Lottery should directly confirm with BFR prior to determining it is exempt from any of the *Reviews'* reporting requirements.

Auditee Response:

We concur. After discussion with the BFR we did file an Exhibit C. This has been added to the year end closing process.

State Compliance Comment

Observation No. 11: Tax Status Of Tri-State Lotto Prizes Should Be Determined

Observation:

Application of the State's tax on lottery winnings to Tri-State game prizes is contrary to RSA 287-F:17, which provides "prizes received pursuant to this [Tri-State Lotto] compact shall be exempt from all state, county, municipal and local taxes within the party state."

Chapter 144:249, Laws of 2009 (House Bill 2), effective July 1, 2009, amended RSA 77 to provide for a 10% tax on gambling winnings. The chapter law also repealed RSA 284:21-r relative to the tax exempt status of lottery and sweepstakes winnings. The chapter law did not address RSA 287-F:17, which provides tax exempt status to Tri-State Lotto prizes.

RSA 287-F:7, II, provides "the provisions of this [Tri-State Lotto] compact shall apply and take precedence in the event of any conflict between the provisions contained in this compact and the provisions of other laws of any of the party states."

According to the Lottery, it began withholding taxes due from Tri-State Lotto prizes shortly after the effective date of Chapter 144:249, even though it was aware of the conflicting statute.

Recommendation:

The Lottery should review with legal counsel, the Department of Revenue Administration, the Tri-State Commission, and other interested parties the applicability of the tax provisions of Chapter 144:249, Laws of 2009, to Tri-State Lotto prizes and whether revisions of the Tri-State Lotto Compact, RSA 287-F, should be sought.

Auditee Response:

We concur. This has been forwarded to the Department of Revenue Administration and will be added to the rulemaking process by that department.

Department Of Revenue Administration Response:

The Department of Revenue Administration concurs that RSA Chp. 287-F should be revised to repeal RSA 287-F:17 (exempting Tri-State Lotto winnings from state tax) as a "housekeeping" measure. In 1985, the State of New Hampshire entered into a tri-state compact with Maine and Vermont to implement operation of the Tri-State Lotto to raise additional revenue. At that time, each state enacted Tri-State Compact language in statute. Originally, within the statutory compact language, each state had enacted a provision exempting Tri-State Lotto winnings from all state, county, municipal and local taxes (Maine - ME. REV. STAT. ANN. Title 8, Sec. 423), (New Hampshire- RSA 287-F:17) and (Vermont - VT. STAT. ANN. Title 31, Sec. 674, S.). It is important to note that, in 1987, Maine repealed its tax exemption provision. Likewise, during the

2003-2004 legislative session, Vermont also repealed its tax exemption provision (effective January 1, 2005). Apparently, both repeals were adopted without concurrent legislation from the other party states. Ostensibly, the repeal of the tax exemption by two of the three party states has rendered the tax exemption provision of the original compact ineffectual. Nonetheless, New Hampshire should revise RSA Chp. 287-F to repeal the tax-exemption. This revision should be completed through the introduction of legislation during the current legislative session as a housekeeping measure.

APPENDIX

Current Status Of Prior Audit Findings

The following is a summary of the status, as of December 15, 2009, of the observations contained in the New Hampshire Lottery Commission Management Letter for the fiscal year ended June 30, 2008. The fiscal year 2008 audit of the Lottery was performed by KPMG LLP. A copy of the prior management letter can be accessed online at <http://www.gencourt.state.nh.us/lba/otheraudits.html>.

Internal Control Comments

	<u>Status</u>		
1. Information Technology Review Of Platinum General Ledger	●	●	○
2. Large Prize Claim Process	●	●	●
3. Dedicated Trust Accounts	●	●	○

Status Key

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

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