

**STATE OF NEW HAMPSHIRE
LOTTERY COMMISSION**

**MANAGEMENT LETTER
FOR THE FISCAL YEAR ENDED JUNE 30, 2016**



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To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Lottery Commission (Lottery), a department of the State of New Hampshire, as of and for the fiscal year ended June 30, 2016 and have issued our report thereon dated December 30, 2016. Effective July 1, 2015, the operations of the prior Racing and Charitable Gaming Commission were absorbed by the Lottery Commission, with the prior Racing and Charitable Gaming Commission becoming the Racing and Charitable Gaming Division of the Lottery Commission.

This management letter, a byproduct of the audit of the New Hampshire Lottery Commission for the fiscal year ended June 30, 2016, contains our auditor's report on internal control over financial reporting and on compliance and other matters and related audit findings. The appendix, on page 15, provides a summary of the status of observations presented in the fiscal year 2015 Lottery Commission management letter.

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 2015 CAFR, and it is believed that the 2016 CAFR also conforms to the certificate of achievement program requirements. A copy of the Lottery's 2016 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.nhlottery.com/Files/PDFs/CAFR>

Office of Legislative Budget Assistant

Office Of Legislative Budget Assistant

December 30, 2016

**STATE OF NEW HAMPSHIRE
LOTTERY COMMISSION
2016 MANAGEMENT LETTER**

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* Comment suggests legislative action may be required.

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



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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 (Lottery) which comprise the Statement of Net Position as of June 30, 2016 and the Statements of Revenues, Expenses, and Changes in Net Position and Cash Flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 30, 2016.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or 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. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control that we consider to be significant deficiencies. We consider the deficiencies described in Observations No. 1 through No. 10 to be significant deficiencies.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, rules, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards*, which is described in Observation No. 11.

Lottery Commission's Responses To Findings

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

Purpose Of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Lottery'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 Lottery'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 30, 2016

Internal Control Comments
Significant Deficiencies

Observation No. 1: Expand Scope Of Service Auditor's Report

Observation:

The scope of the current service auditor's report of the controls in place at the Lottery's gaming-system service provider does not include consideration of the controls in place over the Lottery's Fast Play games, a series of programmed online Lottery games.

The Lottery's Fast Play games are online games similar to instant scratch games in that a player can determine instantly if a play is a winner, but is dissimilar in that a winning play is determined by computer programming and not by printed information on a paper ticket. Ineffective controls over programming and other aspects of the information technology systems used in the Fast Play games could jeopardize the security and integrity of the games. Due to the design of the operation of the games, the Lottery is dependent upon the effectiveness of the controls in place at the gaming-system service provider.

The Lottery has not requested its gaming-system service provider to expand the scope of its contracted service auditor's report (SSAE 16 report) to include coverage of the systems and controls in place on which the Lottery relies for the secure operation of its Fast Play games. Without understanding the controls in place, the Lottery cannot fully understand and appropriately address the risks in operating the Fast Play games.

Recommendation:

The Lottery should request its gaming-system service provider expand the scope of its annual services auditor's report to include the identification and testing of controls that ensure the security and integrity of the Lottery's Fast Play games.

Auditee Response:

We concur.

A request to our vendor will be made to expand the scope of the SSAE 16 to include Fast Play games.

Observation No. 2: Lottery Funds On Deposit With Treasury Should Be Credited With Interest

Observation:

Interest earned on Lottery funds on deposit with the State Treasury is not credited to the Lottery fund, contrary to statute.

RSA 284:21-j, states, "I. The state treasurer shall credit all moneys received from the lottery commission..., and interest received on such moneys, to a special fund...." During fiscal year 2016, the Lottery received \$321 of interest from the State Treasury credited on a relatively small Lottery account held for a portion of fiscal year 2016. The Lottery received no interest earnings on its primary \$9.2 million average monthly balance of Lottery funds held at the State Treasury during fiscal year 2016.

A similar comment was included in the fiscal year 2015 management letter.

Recommendation:

The Lottery should request the State Treasury to comply with State statute and credit the Lottery Fund with interest earned on the Lottery's balances on deposit at the State Treasury. While the State Treasury generally pools the State's cash, that pooling does not prevent interest from being credited to special funds that warrant interest earnings.

Auditee Response:

We concur.

The Lottery has received interest on our funds for fiscal years 2015 and 2016.

State Treasury Response:

State Treasury concurs. Beginning in fiscal year 2015, the Treasury's liquidity levels were sufficient to enable the deployment of pooled cash in a manner that generated net interest earnings in excess of the cost of banking (pursuant to RSA 6:7-a). During fiscal year 2016 Treasury finalized a methodology to allocate net interest earnings to those funds entitled to them, but did not complete the allocation in the accounting system due to a misperception regarding the proper entries required. This issue was recently resolved and the Lottery Fund was credited with its fiscal year 2015 and 2016 earnings allocations in the amounts of \$12,190 and \$19,726 respectively. Going forward, the earnings allocation will continue to be performed annually, in arrears, upon completion of the statewide financial audit for the preceding fiscal year.

Observation No. 3: Improve Operation Of Controls To Ensure Ineligible Players Are Not Awarded Prizes

Observation:

The Lottery has limited controls in place to ensure that certain ineligible players are not awarded Lottery game prizes.

There are certain individuals who, either by statute, game rules, or policies, are ineligible to play Lottery games and win Lottery prizes. The Lottery's controls to ensure that ineligible players are not awarded game prizes largely consist of checking higher-tier winners' names against listings, winner certifications, and reliance upon the integrity of vendors' employees. Due to difficulties in maintaining current employee listings and reliance upon the forthrightness of game winners, the Lottery is at risk that the controls intended to ensure that ineligible players are not awarded Lottery game prizes will be ineffective.

Recommendation:

The Lottery should review its documented policies and procedures for prize claim payments to ensure they are complete and sufficiently detailed to provide the intended control. The Lottery should ensure that all relevant staff are aware of, and trained in, the operation of the controls and monitor the performance of the controls to ensure that Lottery staff understand and consistently perform prize claim control activities.

Lottery should ensure that its vendors and partner organizations periodically and timely provide updates to listings used to identify ineligible players.

Auditee Response:

We concur.

The Lottery will improve upon its compliance controls of higher-tier prize awards by comparing known claimant personal identifiers to known vendor employee personnel data provided and updated by our vendor. Lottery staff assigned to the Claims Department will conduct the comparison tasks and prior to the issuance of a higher-tier prize award(s); management will continue to review each higher-tier claim to ensure that the claims process has satisfied all of the necessary control requirements in accordance with the applicable statutes, game rules, and policies.

Observation No. 4: Improve Due Care Over Game Draw Activities

Observation:

A viewing of a sample of the security videos for three game draws showed opportunities for game draw personnel to exercise additional due care in the performance of their responsibilities.

- During the March 2, 2016 MegaBucks Plus game draw, a game ball used in the drawing was dropped on the floor as the balls were being reloaded into the machine for the post-draw test drawing. The Tri-State representative simply picked the ball off the floor and the post-draw test drawing continued with no apparent regard for the security or condition of the dropped ball.
- During the May 6, 2016 Pick 4 game draw, a game ball used in the drawing was dropped as the balls were being placed back into their respective case after the post-draw test. Again, the Tri-State representative picked the ball off the floor and put back into the case with no apparent regard for the security or condition of the dropped ball.

The Lottery on behalf of the Tri-State Lottery contracts with a local accounting firm to have a certified public accountant (CPA) present to witness game draws. The draw process observed on the videos showed the game-draw witness participating in the game draw process by taking the balls from the Tri-State representative and placing them into the storage cases after the post draw tests. Having the game-draw witness participate in the game draw process may not be appropriate as it detracts from the witness's ability to be an independent observer of the game draw procedures.

Recommendation:

The Lottery should improve controls, and its level of due care, over the performance of all game draw activities.

The Lottery should establish policies and procedures for an appropriate process to ensure the security and integrity of the game when game balls are dropped during and after the draw process.

The Lottery should reconsider its practice of having the CPA game-draw witness participate in the actual draw activities.

Auditee Response:

We concur.

The procedures will be reviewed for opportunities to minimize involvement by the game-draw witness during the draw proceeding. Any proposed procedure change will need to be brought to the Tri-State Lotto Commission's attention for review and approval.

Observation No. 5: Review Employer/Employee Status Of Workers Performing Tri-State Duties

Observation:

In response to a fiscal year 2000 management letter comment, the Lottery Commission obtained legal advice regarding the employer/employee relationship of Lottery employees hired in the name of the Tri-State Lottery to perform game draw and related duties. At that time, the Lottery reported that the Department of Justice did not identify any legal concerns with that practice. A recent State review of its single versus multiple employer status related to federal wage and hour concerns suggests that a new review of the Lottery's employer status may be appropriate.

Certain Lottery employees perform Tri-State Lottery game draw activities. When Tri-State draw duties are performed during normal business hours, the Lottery is considered to be the draw team's employer and the work is performed as part of their daily work activities. When the draws are performed outside of normal business hours (evening game draws), the Tri-State Lottery is considered the draw team's employer. The venue, management, and tasks performed by the teams are the same for the day draws and the evening draws.

The employees performing evening Tri-State game draws sign employment agreements with the Tri-State Lottery and the Tri-State Lottery issues the employees paychecks for this work. Because Lottery considers this work to be separate employment, this work is not included as Lottery wages and hours when determining Lottery employee overtime and other benefits and retirement contributions.

Recommendation:

The Lottery should again request the Department of Justice to review whether the Tri-State Lottery and the New Hampshire Lottery should continue to be considered separate employers for the activities performed by these employees, or whether the Tri-State and Lottery should be considered a single employer for application of federal wage and hour and applicable State law.

Auditee Response:

We concur.

The Tri-State Lottery is a separate legal entity. While this issue has previously been reviewed by the Division of Personnel, a request for current redetermination will be made to the Department of Justice.

Observation No. 6: Review Communication Controls

Observation:

Lottery’s lack of internal communication of a taxpayer’s inconsistencies in reporting and paying Bingo taxes to the Lottery is indicative of a weakness in the Lottery’s internal controls.

Audit testing of a sample of Bingo tax returns identified a taxpayer that regularly made over and underpayments of taxes due. While this taxpayer’s history of not making accurate payments had also been recognized by the Lottery staff processing the tax returns, this information was not forwarded to Lottery supervisors for their consideration of the cause and appropriate remedy of the problematic reporting, including whether such reporting could be indicative of more significant risks to the Lottery.

In discussing the lack of communication, the Lottery reported that it did not have policies and procedures addressing the need for staff to communicate tax payment concerns to supervisors, as it assumed employees understood management’s expectation that it is to be notified of anomalies noted by staff.

Recommendation:

The Lottery should design and implement controls that address the need for all levels of its employees to be observant for anomalies in operations that potentially represent irregularities or other risks that may affect the ability of the Lottery to meet its objectives, and to communicate that information to appropriate levels of management.

Auditee Response:

We concur.

We concur such instances should be brought to the supervisor’s attention for appropriate action to remedy identified problems. However, we believe this was an isolated instance and not symptomatic of a larger communication problem within the agency. Employees have been instructed to keep supervisors informed of anomalies in their day to day functions.

Observation No. 7: Establish Controls Over Unclaimed Wager Revenue

Observation:

The Lottery has not established controls to ensure that regulated entities offering simulcast wagering accurately report and remit unclaimed ticket revenue to the Lottery.

RSA 284:31 states, “On or before January 31 of each year every person, association, or corporation conducting a race or race meet, whether live racing or simulcast racing, hereunder shall pay to the state treasurer all moneys collected during the previous year of pari-mutuel pool

tickets and vouchers which have not been redeemed. The books or records of said person, association, or corporation, which clearly show the ticket entitled to reimbursement in any given race, live or simulcast, shall be forwarded to the lottery commission.” During fiscal year 2016, the Lottery reported it received \$350,572 of unclaimed wager revenues from licensed operators of simulcast racing venues.

While Racing and Charitable Gaming Division staff report that there are no formal policies and procedures requiring a reconciliation between reports submitted by licensees’ totalizer system contractors and unclaimed ticket revenues remitted to the Division, such reconciliations have been done in the past. No reconciliations between the reported activity and the revenues received were performed during fiscal year 2016. As a result of not performing these reconciliations, the Lottery accepted the revenue remitted as accurate.

Recommendation:

The Lottery should design and perform reasonable control activities to test the completeness and accuracy of unclaimed ticket revenue remitted by regulated entities offering simulcast wagering. The control activities should be documented in policies and procedures and regularly performed. Management should monitor the controls to ensure they remain in place and operating as intended and that the controls remain appropriate in the event of any changes in the simulcast wagering statutes, licensees, processes, or the Lottery’s organization and objectives.

Auditee Response:

We concur.

The Racing and Charitable Gaming Division has now formalized and documented the reconciliation procedures for unclaimed ticket revenue. The reconciliation of unclaimed ticket revenue for calendar year 2016 has been performed and amounts received verified with reports submitted by the Totalizer system.

Observation No. 8: Implement Controls For Timely Submission Of Distributor Fees

Observation:

The Lottery has not designed and implemented control activities to ensure that Lucky 7 game distributors submit Lucky 7 fees timely. During fiscal year 2016, there were five licensed distributors of Lucky 7 games, and the Lottery collected approximately \$1 million of Lucky 7 game fees.

RSA 287-E:22, V, states, “A licensed distributor shall pay the fees collected pursuant to this section to the commission within 15 days of the distribution of the tickets.” The time requirement is also addressed in N.H. Admin. Rule Pari 1105.03 which states, “Licensed distributors shall: ... (f) Invoice and collect all deal fees from the charitable organizations, and submit payment of

such fees to the commission within 15 days of the distribution, electronic transmission or shipping date of the deal...”.

During tests of Lucky 7 fees, auditors noted that 13 out of 18 (72.2%) monthly Lucky 7 fee payments tested were not submitted by distributors within the 15 days of the invoice date supporting distribution. Fees identified as late submissions were received between one and 71 days after the due date.

The Lottery reported it was aware that the Lucky 7 reporting and fees were not submitted timely and attributed the introduction of electronic Lucky 7 as being a contributing factor. Lottery reported the statute is vague and there was confusion on how the distributors were to report the electronic Lucky 7 activity. The Lottery also reported that it has no way to establish when the Lucky 7 tickets were distributed, as an invoice date is not necessarily the date that the tickets were distributed.

Recommendation:

The Lottery should establish policies and procedures to prompt Lucky 7 game distributors to comply with RSA 287-E:22 and submit Lucky 7 fees timely. The Lottery should consider whether it needs additional reporting from the distributors to verify the distribution and reporting dates.

If the Lottery determines the statute and rule are not clear, the Lottery should request that the statute and or rule be appropriately amended.

Auditee Response:

We concur.

The majority of late payments noted in the LBA observations pertains to the distribution of electronic Lucky 7 tickets, which became available in 2015. As electronic tickets have become more widely available, the agency has become aware of some inconsistencies, and confusion on the part of distributors regarding the point at which electronic tickets are distributed and fees are collected and remitted to the State. The Lottery will review and clarify the payment requirements with distributors of Lucky 7 tickets, and will develop written policies and procedures to ensure consistency.

Observation No. 9: Perform Lucky 7 Game Controls

Observation:

The Lottery did not perform certain Lucky 7 game control activities over its regulation of the games played and fees collected during fiscal year 2016.

The Lottery's Racing and Charitable Gaming Division has a control, supported by a *Lucky 7 Distributor Fee Remittance Reconciliation Policy and Procedure*, which requires Division audit staff perform a quarterly reconciliation of Lucky 7 fees remitted by game distributors to the fees reported monthly by charitable and other organizations as paid to the distributors. The monthly financial reports are supported by vendor invoices. The policy and procedure requires the staff to select and test the reporting of ten Lucky 7 charitable organizations each quarter to determine that fees related to the tickets purchased by the tested charitable organizations reconcile to the fees paid by the ticket distributors.

- Division audit staff did not perform the Lucky 7 reconciliation for the quarter ended March 31, 2016, reportedly due to time constraints resulting from an office move. It is not clear that management was aware of and authorized the decision to not perform the control for the March 31 quarter end.
- The policies and procedures and forms used by the Division to perform the reconciliation activity were not updated to incorporate the sale of "electronic" tickets (tickets or "pull-tabs" sold from machines) as opposed to tickets sold by staff of the charitable and other organizations. We noted that those quarterly reconciliations which were performed were incomplete, as only paper ticket fees were reconciled. Fees for the distribution of electronic tickets were not included in the reconciliations.

Recommendation:

Lottery controls should include monitoring controls to ensure control activities established by approved policies and procedures are performed as designed. Controls should not be disregarded without documented management direction and authority.

The Lottery should update its policies and procedures and forms to include coverage of "electronic" tickets in its reconciliations.

Auditee Response:

We concur.

As noted in the audit observation, the distributor fee remittance reconciliation for the quarter ended March 2016 was not performed by the auditors due to the office move and time constraints. This was the result of the merger of the former Racing and Charitable Gaming and Lottery Commissions and assimilation of staff between the two agencies. Nonconformity with established procedures by staff is informally approved by management for good cause.

The electronic Lucky 7 tickets were not included in the fee remittance reconciliation process as the old forms used by the charitable organizations to report distributor fees did not have provisions for reporting electronic Lucky 7 sales until the forms were revised in April 2016 through the rulemaking process.

In the future, Lottery will formally document management approvals of deviations from established procedures. The Lottery will also include the electronic Lucky 7 fee remittance in the reconciliation process.

Observation No. 10: Accrue Accounts Receivable As Appropriate

Observation:

The Lottery did not report Racing and Charitable Gaming Division revenues on the accrual basis during fiscal year 2016, due to the Lottery's consideration that the year-end accruals of accounts receivable and their effect on period revenue would be insignificant.

Generally accepted accounting principles (GAAP) and State accounting policies direct that enterprise funds, including the Lottery report on the full accrual basis of accounting and thereby record and report accounts receivable and revenue on the accrual basis.

As a result of the Lottery not reporting Racing and Charitable Gaming Division revenues on the full accrual basis, at June 30, 2016 the Lottery's accounts receivable were understated by approximately \$204,000, and the Lottery's fiscal year 2016 revenues were understated by approximately \$31,000.

Recommendation:

The Lottery should report all of its financial activity on the appropriate full-accrual basis. While GAAP does not need to be applied to immaterial amounts, to improve its consistency and accuracy in reporting, the Lottery should include the Racing and Charitable Gaming revenue accounts in its year end accruals.

Auditee Response:

We concur.

The former Racing and Charitable Gaming Commission did not prepare standalone Comprehensive Annual Financial Reports (CAFR). Accordingly, in years prior to the merger with the Lottery Commission, the financial statements submitted to the Department of Administrative Services were prepared on a cash basis. However, going forward as a Division of the Lottery Commission all Racing and Charitable Gaming financial activities will be captured on an accrual basis to be included in the Lottery CAFR.

State Compliance Comment

Observation No. 11: Adopt Administrative Rules As Required By Statute

Observation:

Certain of the Lottery's statutorily required administrative rules had not been adopted or had expired prior to June 30, 2016.

- Administrative rules required by RSA 284:12 pertaining to live racing expired during or prior to fiscal year 2016.
- Administrative rules required by RSA 287-D:3 (XVI) pertaining to gambling machine investigation and enforcement have not been adopted by the Lottery.

Recommendation:

The Lottery should adopt administrative rules as required by statute. If the Lottery determines that statutorily required administrative rules are no longer necessary, the Lottery should request that statutes be appropriately amended.

Auditee Response:

We concur.

Live racing has not taken place in the State since 2009, and is not expected to return. Although simulcast racing continues to be offered at two locations in New Hampshire, its future is also uncertain. Given the continuous decline in racing activities, and the increased need for rulemaking in other areas, the adoption of rules relative to live horse racing was given low priority.

In 2015, the legislature granted the agency the authority to investigate and enforce the laws relative to unlawful gambling machines without the funding needed to perform these activities. As a result, the agency has been unable to dedicate resources toward this endeavor. Since the agency is not currently engaging in investigation of unlawful gambling machines and enforcement functions, rulemaking relative to these activities was given low priority.

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APPENDIX

Current Status Of Prior Audit Findings

The following is a summary of the status, as of December 30, 2016, of the observations contained in the New Hampshire Lottery Commission Management Letter for the fiscal year ended June 30, 2015. That report can be accessed at, and printed from, the Office of Legislative Budget Assistant website:

http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/Lottery_2015_ML.pdf

Status

Internal Control Comments

Significant Deficiencies

- | | | | | |
|----|---|---|---|---|
| 1. | Resolve Recognized Weaknesses In Security Systems | ● | ● | ○ |
| 2. | Establish Policies And Procedures For Tracking Prize Reimbursements | ● | ● | ● |
| 3. | Lottery Funds On Deposit With Treasury Should Be Credited With Interest (<i>See Current Year Observation No. 2</i>) | ● | ● | ○ |

State Compliance Comment

- | | | | | |
|----|--|---|---|---|
| 4. | Comply With Statute Or Request Appropriate Amendment | ● | ● | ● |
|----|--|---|---|---|

Status Key

Count

Fully Resolved	●	●	●	2
Substantially Resolved	●	●	○	2
Partially Resolved	●	○	○	0
Unresolved	○	○	○	0

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