

**STATE OF NEW HAMPSHIRE
LOTTERY COMMISSION**

**MANAGEMENT LETTER
FOR THE FISCAL YEAR ENDED JUNE 30, 2017**



MICHAEL W. KANE, MPA
Legislative Budget Assistant
(603) 271-3161

CHRISTOPHER M. SHEA, MPA
Deputy Legislative Budget Assistant
(603) 271-3161

State of New Hampshire

OFFICE OF LEGISLATIVE BUDGET ASSISTANT
State House, Room 102
Concord, New Hampshire 03301

STEPHEN C. SMITH, CPA
Director, Audit Division
(603) 271-2785

To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Lottery Commission (Lottery) as of and for the fiscal year ended June 30, 2017 and have issued our report thereon dated December 19, 2017.

This management letter, a byproduct of the audit of the New Hampshire Lottery Commission for the fiscal year ended June 30, 2017, 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 7, provides a summary of the status of observations presented in the fiscal year 2016 Lottery Commission management letter.

Subsequent to June 30, 2017, the Lottery's chief financial officer position became vacant. Continuity in this position has been important to the Lottery's successful financial reporting. While the Lottery had filled this position prior to the date of this report, the Lottery should recognize and plan for the impact of this transition on its fiscal year 2018 financial reporting efforts.

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 2016 CAFR, and it is believed that the 2017 CAFR also conforms to the certificate of achievement program requirements. A copy of the Lottery's 2017 CAFR can be obtained from the New Hampshire Lottery Commission, 14 Integra Drive, Concord, NH 03301. The Lottery CAFR can also be accessed online at:

http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/Lottery_2017_CAFR.pdf

Office of Legislative Budget Assistant

Office Of Legislative Budget Assistant

December 19, 2017

STATE OF NEW HAMPSHIRE
LOTTERY COMMISSION
2017 MANAGEMENT LETTER

TABLE OF CONTENTS

	<u>PAGE</u>
Letter Of Transmittal.....	i
Independent Auditor’s Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With <i>Government Auditing Standards</i>	1
<i>Internal Control Comments</i> *	
<i>Significant Deficiencies</i>	
1. Monitor Performance Of Reconciliation Controls.....	3
2. Improve Game Draw Controls	4
3. Mitigate ICS System Risks	5
APPENDIX - Current Status Of Prior Audit Findings	7

* No comments suggest legislative action may be required.

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



MICHAEL W. KANE, MPA
Legislative Budget Assistant
(603) 271-3161

CHRISTOPHER M. SHEA, MPA
Deputy Legislative Budget Assistant
(603) 271-3161

State of New Hampshire

OFFICE OF LEGISLATIVE BUDGET ASSISTANT
State House, Room 102
Concord, New Hampshire 03301

STEPHEN C. SMITH, CPA
Director, Audit Division
(603) 271-2785

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, 2017 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 19, 2017.

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. 3 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

December 19, 2017

Internal Control Comments
Significant Deficiencies

Observation No. 1: Monitor Performance Of Reconciliation Controls

Observation:

Lottery's control monitoring efforts during fiscal year 2017 were not sufficient to detect that certain reconciliation controls were not consistently operating as intended during portions of fiscal year 2017. Unperformed reconciliation controls increase the risk that errors or irregularities could occur in the accounts and not be detected timely.

- The June 2017 reconciliation of Tri-State Lottery activity was not completed timely, as a variance identified by the reconciliation remained unresolved until late October 2017.
- During the six month period January through June 2017, monthly bank account reconciliations were not evidenced as having been reviewed and approved, contrary to Lottery policy.
- Management was reportedly unaware that reconciliations of Lucky 7 Deal Bag Fees for paper tickets were not performed for two quarters of fiscal year 2017.

There was no evidence that management's monitoring controls timely identified and reacted to the noted problems with the Lottery's reconciliation controls.

Recommendation:

The Lottery should review and reestablish, as necessary, its reconciliation monitoring controls to reasonably ensure that it remains aware of the status of the reconciliations, including steps taken to remedy noncompliance and other problems identified by the reconciliations.

Auditee Response:

We concur.

The Lottery's chief financial officer will review and sign off monthly on the reconciliation for Tri-State and the bank accounts. In regards to Lucky 7, the reconciliations have been brought up to date and are now scheduled quarterly with a report going directly to the Lottery's chief compliance officer for review and sign off.

Observation No. 2: Improve Game Draw Controls

Observation:

Auditors noted Lottery staff dropped game balls onto the floor in two of the three game draw videos reviewed during fiscal year 2017. The fiscal year 2016 management letter also reported that staff dropped game balls in two of three game draw videos reviewed. The fiscal year 2016 management letter recommended the Lottery establish policies and procedures for an appropriate process to ensure the security and integrity of the game when game balls are dropped during the draw process.

Subsequent to the fiscal year 2016 comment, the Lottery established a policy whereby the independent draw observer is to visually inspect a dropped ball prior to proceeding with draw activities.

In light of the Lottery's continuing difficulty in performing game draws without incident, it is apparent that weaknesses remain in the Lottery's current game draw process.

Recommendation:

The Lottery should strengthen the control environment over all game draw activities. The importance of secure, uneventful game draws should be clearly communicated to staff to ensure that their responsibilities are performed in an atmosphere and manner that will lessen the risk of draw incidents.

The Lottery should establish policies and procedures to ensure the draw process is sufficiently designed, and performed in a manner to maintain the reputation of the games. Draw participants must be suitably trained to respond to management's directives, and customers' expectations, for secure and reliable game draws.

Lottery's management should evaluate whether the dropping of game balls during a draw constitutes a procedural risk requiring subsequent documentation and management notification. If deemed to be a significant risk, management should design, document, and implement further policies and procedures that mitigate the identified risk to future draws.

Appropriate monitoring controls should be established to allow management to have confidence that controls are in place and operating as intended, and to provide Lottery management with information necessary to manage game-draw incidents and to implement improvements to game draw procedures as needed.

Auditee Response:

We concur.

We will ask the Tri-State Group to review equipment options and best practices.

Observation No. 3: Mitigate ICS System Risks

Observation:

A 2011 review of the Lottery's general information technology (IT) controls, identified the lack of independence of the Lottery's ICS system as a risk. The lack of independence in the Lottery's ICS system continued during fiscal year 2017.

The ICS system is an IT system that runs parallel to the Lottery's gaming system which is used to prove the accuracy of the gaming system. The Lottery, like all other lotteries, is required to have an ICS system to participate in multijurisdictional games, including Powerball. Lottery's contract with its gaming system vendor makes the gaming system vendor responsible for contracting with another vendor to provide the Lottery's ICS system. The 2011 recommendation was for the Lottery to establish an independent ICS system by directly contracting for ICS services. (The ICS system vendor would have no direct or apparent allegiance to the gaming system vendor).

At the time of the 2011 comment, the Lottery responded that its contract with the gaming system vendor provided for the gaming vendor to hire the ICS vendor. During fiscal year 2017, the Lottery reported the respective provision of the gaming system contract had not been revisited.

Recommendation:

The Lottery should address the risk resulting from the lack of independence in its current ICS system. At its next opportunity, the Lottery should contract for an ICS system that is independent of the Lottery's gaming system vendor. Pending the establishment of an independent ICS, the Lottery should implement procedures to mitigate the risks posed by the contractual relationship between the gaming system and ICS vendors.

A mitigating control could include obtaining a service organization controls (SOC) report relative to the controls in place and in operation at the ICS system vendor. A SOC report would assist the Lottery in gaining an understanding of the scope and effectiveness of the ICS system controls which the Lottery relies upon. While a SOC report would not fully resolve the independence risk, it would allow the Lottery to better understand and manage the risks associated with the operation of its ICS system.

Auditee Response:

We concur.

We will look into available options by researching the current standards of the gaming industry.

THIS PAGE INTENTIONALLY LEFT BLANK

APPENDIX

Current Status Of Prior Audit Findings

The following is a summary of the status, as of December 19, 2017, of the observations contained in the New Hampshire Lottery Commission Management Letter for the fiscal year ended June 30, 2016. That report can be accessed at, and printed from, the Office of Legislative Budget Assistant website: www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/Lottery_2016_ML.pdf

Status

Internal Control Comments

Significant Deficiencies

1. Expand Scope Of Service Auditor's Report	●	●	●
2. Lottery Funds On Deposit With Treasury Should Be Credited With Interest	●	●	●
3. Improve Operation Of Controls To Ensure Ineligible Players Are Not Awarded Prizes	●	●	●
4. Improve Due Care Over Game Draw Activities (<i>See Current Observation No. 2</i>)	●	○	○
5. Review Employer/Employee Status Of Workers Performing Tri-State Duties	●	○	○
6. Review Communication Controls	●	●	○
7. Establish Controls Over Unclaimed Wager Revenue	●	●	●
8. Implement Controls For Timely Submission Of Distributor Fees	●	●	○
9. Perform Lucky 7 Game Controls (<i>See Current Observation No. 1</i>)	●	○	○
10. Accrue Accounts Receivable As Appropriate	●	●	●

State Compliance Comment

11. Adopt Administrative Rules As Required By Statute	●	●	○
---	---	---	---

Status Key

Count

Fully Resolved	●	●	●	5
Substantially Resolved	●	●	○	3
Partially Resolved	●	○	○	3
Unresolved	○	○	○	0

THIS PAGE INTENTIONALLY LEFT BLANK