

**STATE OF NEW HAMPSHIRE
SWEEPSTAKES COMMISSION**

**MANAGEMENT LETTER
FOR THE YEAR ENDED JUNE 30, 2003**

To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Sweepstakes Commission, a department of the State of New Hampshire, as of and for the year ended June 30, 2003 and have issued our report thereon dated November 21, 2003.

This management letter, a byproduct of the audit of the New Hampshire Sweepstakes Commission for the year ended June 30, 2003, contains an auditor's report on compliance and on internal control over financial reporting and an auditor's report on management issues. The appendix, included as an attachment to the management letter, provides a summary of the status of observations presented in the fiscal year 2002 management letter of the Sweepstakes Commission.

The Commission is again submitting its comprehensive annual financial report (CAFR) to the molly 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 Commission received GFOA certification for its 2002 CAFR, and it is believed that the 2003 CAFR also conforms to the certificate of achievement program requirements. A copy of the Commission's 2003 CAFR can be obtained from the New Hampshire Sweepstakes Commission, 14 Integra Drive, Concord, NH 03301.

Office Of Legislative Budget Assistant
Office Of Legislative Budget Assistant

November 21, 2003

**STATE OF NEW HAMPSHIRE
SWEEPSTAKES COMMISSION**

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

Auditor's Report On Compliance And On Internal Control Over Financial Reporting

To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Sweepstakes Commission as of and for the year ended June 30, 2003 and have issued our report thereon dated November 21, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the New Hampshire Sweepstakes 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the New Hampshire Sweepstakes 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 assurance 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 Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in Observations No. 1 through No. 5 of this report.

A material weakness is a 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 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 referred to on page one are material weaknesses.

This auditor's report on compliance and on internal control over financial reporting is intended solely for the information of the management of the New Hampshire Sweepstakes 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
Office Of Legislative Budget Assistant

November 21, 2003

Internal Control Comments
Reportable Conditions

Observation No. 1 - Investment Account Should Be Reconciled

Observation:

The Sweepstakes Commission (Commission) did not reconcile its general ledger investment account to Treasury records, resulting in an overstatement of investments at June 30, 2003. The Commission maintains two accounts in its general ledger to track Treasury investment and cash activity.

Treasury invests excess funds in a Fidelity account at the direction of the Commission. Funds needed to cover current operating expenses remain in a cash account with Treasury. The Commission reconciles the total of the cash and investments with Treasury to the total of the two accounts within the general ledger and to the State accounting system on a monthly basis. However, they do not reconcile the investment or cash accounts separately.

In December 2002, Treasury redeemed \$1.3 million from the investment account and transferred the funds to the cash account to cover expenses. This transaction was not communicated to the Commission. As a result, the Commission's general ledger investment account did not agree with the Fidelity statement. The Commission was unaware of the transfer because it does not routinely request nor receive the monthly Fidelity statements detailing account activity. It only receives a summary from Treasury, from which the Commission records any interest earned.

The \$1.3 million discrepancy created a second error in June 2003 when the Commission requested that Treasury redeem investments of \$10.8 million for transfer to the Education Trust Fund. Treasury was only able to redeem \$10.7 million because the investment balance was still \$1.3 million less than the Commission was aware of. The shortage was transferred from the cash account.

Since the monies only shifted between the cash and investment accounts, and the Commission only reconciles the total of cash and investments, the error went undetected until identified by the audit. The net effect of the errors at June 30, 2003 was an overstatement of investments and an understatement of cash in the amount of \$1,142,419 in the general ledger. While there is no effect to the financial statements, since cash and investments are reported as a single amount on the Statement of Net Assets, the notes to the financial statements were misstated. The Commission has corrected the error in the notes to the fiscal year 2003 Comprehensive Annual Financial Report. Because the monies were in the cash account and not the investment account for several months, the Commission lost approximately \$7,800 in interest on the funds.

Recommendation:

The Commission should request more detailed information from Treasury for the Fidelity investment account to facilitate a periodic reconciliation of the account to their general ledger investment account. Any discrepancies should be investigated with Treasury.

Auditee Response:

We concur and will request the Treasurer's office make a detailed monthly investment statement available to the Commission. The transfer to the Education Trust Fund was not affected by this transaction.

Observation No. 2 - Consistently Account For Accruals Due To/Due From Tri-State Lotto Commission

Observation:

The Sweepstakes Commission (Commission) accounts for accruals due to/due from the Tri-State Lotto Commission (Tri-State) in an inconsistent manner. When Tri-State owes the Commission funds, a check is written to the Commission. However, when the Commission owes Tri-State funds, the payable is carried forward and netted against future receivables.

The Commission generally records a receivable from Tri-State at fiscal year-end, for which they receive a check in the following year and properly reverse the receivable. However at June 30, 2002, a payable of \$183,370 to Tri-State was recorded and was not reversed in fiscal year 2003, resulting in an overstatement of accounts payable of \$183,370 at June 30, 2003. The error was identified by the audit and corrected in fiscal year 2004.

While this error may be corrected simply by posting a reversing entry at the beginning of the following fiscal year, the Commission should periodically settle the amounts due to Tri-State. This would enable the Commission to avoid carrying forward a liability for extended periods.

Recommendation:

The Commission should review its accounting practices, and develop procedures for periodic review and payment of accruals due Tri-State.

Auditee Response:

We concur, the Commission will settle the amounts due to Tri-State Commission on a quarterly basis. This review will also be part of the year-end process.

Observation No. 3 - Management Should Monitor Adherence To Contract Provisions

Observation:

The Commission did not monitor the insurance provisions of its contract with Creative Games International (CGI). The Commission contracts with CGI for the printing of instant gaming tickets. A requirement of that contract is that CGI provide proof of certain insurances as outlined in the request for proposal. While CGI did provide proof of insurance, the amounts and types of insurance provided did not meet contract requirements. Management was unaware of the deficiencies, which may be considered a default on the contract.

The table below summarizes the deficiencies in the CGI insurance coverage.

Type of Insurance	Minimum Requirement	Amount Provided by CGI*	Amount of Deficiency
General Liability	\$250,000/claim \$2,000,000/incident	\$1,000,000/occurrence <i>and</i> in the aggregate	\$1,000,000
Errors and Omissions	\$1,000,000	\$15,000,000	\$0
Business Interruption	\$5,000,000	\$0	\$5,000,000
Fidelity (Crime)	\$1,000,000	\$1,000,000, subject to \$50,000 deductible	\$50,000

* The General Liability and Fidelity (Crime) insurances were increased during the fiscal year, and therefore met or exceeded the minimum requirement as of December 2002.
Source: LBA review of contract provisions

In addition to the deficiencies noted above, the dollar amounts on the proof of insurance are listed in Canadian dollars. Therefore, while the minimum requirements may seem to be met, the amount of coverage in Canadian dollars may not meet the requirement.

The task of receiving and reviewing the proof of insurance was assigned to Commission staff. Management was not involved in reviewing or monitoring these contract provisions.

Recommendation:

The Commission should better monitor adherence to the provisions of the contract to reduce the risk of loss. While it is reasonable to assign monitoring to Commission staff, management should periodically review the work of the staff to ensure they are aware of the major contract provisions in order to properly assess contractual compliance.

Auditee Response:

We concur, management should have reviewed this contract for the continuing insurance requirement. The amount of deficiency for General Liability is listed as \$1,000,000. However, Marsh Canada LTD, the insurance company for Creative Games International, actually insured

the company for \$1,000,000 Canadian (CDN) funds for General Liability and \$15,000,000 (CDN) for Umbrella Liability for the period of December 1, 2002 through December 1, 2003. Translating this to United States dollars would be estimated at \$11,800,000, or more than the amount required by contract.

Business interruption insurance has been a very difficult product to purchase due to the September 11th terrorist act. The vendor will continue to work with insurance companies to obtain coverage. The New Hampshire Sweepstakes Commission will address this issue in future Requests for Proposals.

The Fidelity insurance has a \$50,000 deductible, Creative Games has agreed to be responsible for payment of this deductible.

Observation No. 4 - Policies And Procedures Should Be Established For Information Technology Change Management And Key Distribution

Observation:

The Commission does not have formal policies and procedures for information technology change management, or for accounting for and controlling the distribution of keys to the testing room at the Commission. These issues were noted in our audit of the Commission's financial statements for the year ended June 30, 2001, based on an information technology security review done by KPMG, LLP for the Audit Division of the Office of the Legislative Budget Assistant.

Formal change management policies and procedures should be in place to document application development, testing and implementation of updates and changes to applications, and system configuration changes. Per discussion with Commission personnel, it was thought that policies and procedures were included in the Information Technology Manual of Policies and Procedures (ITMPP). However, we noted no change management policies and procedures in the ITMPP. Without formal, written change management policies and procedures, the Commission's information technology systems are susceptible to possible employee abuse or misuse.

Formal policies and procedures for accounting for and controlling the distribution of keys to the testing room should also be in place. The testing room is used to test new games and changes to current games using terminals with a live connection to the test server. We noted in 2001 that the keys to the testing room had not been routinely safeguarded, and no log had been maintained to control distribution of keys. Management reported that an Accountant III was subsequently assigned the responsibility of maintaining and performing a periodic review of the distribution of all keys. However, the Accountant III was not aware of this responsibility. The Executive Director has informed us that the Accountant III has since been made aware of this responsibility, and the Commission is currently developing a written policy. The testing room must be sufficiently safeguarded and distribution of keys must be inventoried and tightly controlled to ensure the integrity of the games.

Recommendation:

The Commission should develop formal change management policies and procedures to document application development, testing and implementation of updates and changes to applications, and system configuration changes. Once developed, the policies and procedures should be periodically reviewed and updated to include any changes noted in the review.

The Commission should develop written policies and procedures regarding the distribution of keys to the testing room. These policies and procedures must also be communicated to the person responsible for maintenance of the keys and the log.

Auditee Response:

We concur, the Commission will develop formal change management policies and procedures and update the ITMPP. Also, the policies and procedures for maintenance of the keys and the log was communicated to the Accountant III responsible for this process.

Observation No. 5 - Information Security Issues Identified By Fiscal Year 2001 Security Review Should Be Resolved

Observation:

The Commission still has outstanding information security issues that were identified two years ago. The audit firm of KPMG, LLP performed a security review of the Commission's computer systems in connection with our audit of the Commission's financial statements for the year ended June 30, 2001. Of the 33 issues noted, seven remain less than substantially resolved. Two of those issues are discussed in Observation No. 4. According to the Commission, the remaining five security-related issues require approval from the State's Information Technology (IT) Director before they may be resolved, as they involve hardware and software purchases or other significant expenditures.

The Commission is in the process of reviewing software that will help resolve the outstanding security issues. The Commission also requested and received funding for an outside firm to perform additional testing on its computer systems and help the Commission develop a security assessment plan for its network. Once approval is granted from the IT Director, the Commission should be able to proceed and fully resolve the issues.

Recommendation:

The Sweepstakes Commission should continue to work with the State's IT Director regarding the security issues to resolve the outstanding issues.

Auditee Response:

We concur, the Commission has been in discussion with the Office of Information Technology concerning this project. We have not received an approval as of this date.

Auditor's Report On Management Issues

To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Sweepstakes Commission as of and for the year ended June 30, 2003 and have issued our report thereon dated November 21, 2003.

We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of the New Hampshire Sweepstakes Commission as of and for the year ended June 30, 2003, we noted an issue related to the operation of the Commission that merits management consideration but does not meet the definition of a reportable condition as defined by the American Institute of Certified Public Accountants, and was not an issue of noncompliance with laws, rules, regulations or contracts.

The issue that we believe is worthy of management consideration but does not meet the criteria of a reportable condition or noncompliance is described in Observation No. 6 of this report.

This auditor's report on management issues is intended solely for the information of the management of the New Hampshire Sweepstakes 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
Office Of Legislative Budget Assistant

November 21, 2003

Management Issues Comment

Observation No. 6 - Performance Measures Should Be Implemented For Advertising Campaigns

Observation:

The Commission still has not developed an effective cost/benefit (performance measurement) analysis system for its advertising campaigns. During fiscal year 2003, the Commission spent \$2.7 million on advertising without having performance measures in place to determine if there was a correlation between those advertising dollars and increased sales. While we recognize that advertising is essential to lottery sales, without performance measures in place, management cannot determine whether appropriate advertising decisions are made, including whether the proper amount is allocated to individual games or to advertising in total. This issue was noted in our 1999 and 2002 audits of the Commission.

As a result of our 2002 audit comment, the Commission and its advertising agency performed a review of its advertising expenditures. The results indicated an inability to directly match dollars spent advertising a game with increases in sales for that game because a game's performance is based on a wide variety of factors. The Commission has since requested quarterly reports from its advertising agency, comparing sales and advertising dollars spent. The first quarterly report for fiscal year 2004 has not yet been submitted.

While we do not dispute the results of the review of advertising expenses, we do question whether the Commission had sufficient information to conclude that there are too many variables to meaningfully measure the effectiveness of its advertising efforts. There are several ways to measure advertising effectiveness, such as collecting customer impression/reaction information through surveys or other data collection means. The Commission has not considered performance measures other than data compiled from information already on hand.

While advertising is not the most significant cost category for the Commission, accounting for less than 2% of total fiscal year 2003 expenditures, it is one of the few areas the Commission has great discretion in how the dollars are spent. The decisions directly impact revenue flows, and as such the impact of those expenditures should be better understood.

Recommendation:

The Sweepstakes Commission should continue working on developing performance measurement tools to better assess the effectiveness of its advertising program. The Commission should also consider collecting data other than sales and expense figures to use as performance measurement tools. The assessment of advertising effectiveness should allow the Commission to make better informed decisions, such as when to advertise, how much to advertise, which games to advertise, etc. The Commission may consider enlisting the services of the University of New Hampshire to assist in developing effectiveness indicators.

Auditee Response:

We concur. The Commission has been working with the advertising agency in developing performance measurement tools. Quarterly reports were presented to the Commission, but at this time we are working to refine these reports to better our assessment process in spending on advertising. We are going to be using our advertising of the Powerball jackpots to track sales data versus not advertising for the same jackpot amounts as one of the measurement tools.

The Commission is also in the process of collecting data from other lotteries in the tools they use for measuring the effectiveness of their advertising. There have been discussions with the University of New Hampshire about developing effectiveness indicators.

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APPENDIX

Current Status Of Prior Audit Findings

The following is a summary of the status, as of November 21, 2003 of the observations contained in the management letter of the Sweepstakes Commission for the year ended June 30, 2002. A copy of the prior report can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House, Room 102, Concord, NH 03301-4906.

Internal Control	Status
<i>Reportable Conditions</i>	
1. Accounting Transactions Should Be Thoroughly Reviewed To Ensure Recognition In The Proper Accounting Period	● ● ○
2. Disaster Recovery Plan Should Be Thoroughly Updated And Tested	● ● ●
3. Bingo Enforcement Vehicle Costs Should Be Reviewed For Reasonableness	● ● ○
4. Formal Fraud Deterrence And Detection Program And Fraud Reporting Policy Should Be Established	● ● ●
Management Issues	
5. Formal Business Plan Should Be Updated	● ● ●
6. Advertising Effectiveness Should Be Measured <i>(See Current Observation No. 6)</i>	● ○ ○
7. Purchase Of A Test File Server Should Be Reviewed	● ● ●
8. Sweepstakes Commission Should Consider Formally Changing Its Name To “New Hampshire Lottery”	● ● ●
9. Criminal Background And Motor Vehicle Record Checks Should Be Performed On All Prospective Employees	● ● ●

Status Key

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

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