

# STATE OF CONNECTICUT



*AUDITORS' REPORT  
CONNECTICUT LOTTERY CORPORATION  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006*

**AUDITORS OF PUBLIC ACCOUNTS**  
KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

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March 20, 2008

**AUDITORS' REPORT  
CONNECTICUT LOTTERY CORPORATION  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

We have examined the books, records, and accounts of the Connecticut Lottery Corporation (hereafter referred to as the Lottery or the Corporation), as provided in Section 2-90 and Section 1-122 of the General Statutes, for the fiscal year ended June 30, 2006.

**SCOPE OF AUDIT:**

This audit was primarily limited to performing tests of the Corporation's compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to a determination of whether the Corporation has complied with its regulations concerning the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources

We also considered the Corporation's internal control over its financial operations and its compliance with requirements that could have a material or significant effect on its financial operations in order to determine our auditing procedures for the purpose of evaluating the Corporation's financial operations and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives. Our consideration of internal control included the five areas identified above.

Our audit included a review of a representative sample of the Corporation's activities during the audited fiscal year in the five areas identified above and a review of other such areas as we considered necessary. The financial statement audit of the Connecticut Lottery Corporation, for the fiscal year indicated above, was conducted by the Corporation's independent public accountants.

## COMMENTS

### FOREWORD:

The Connecticut Lottery Corporation operates primarily under Chapter 229a, Sections 12-800 through 12-834 of the General Statutes. Pursuant to Section 12-802 of those Statutes, it is a public instrumentality and political sub-division of the State. Also, pursuant to Chapter 12 of the General Statutes, it is classified as a quasi-public agency subject to various statutory requirements related to those agencies. As a quasi-public agency, the Corporation's financial information is included as an Enterprise Fund in the State of Connecticut's Comprehensive Annual Financial Report (CAFR) and classified as a blended component unit of the State.

As described within Sections 12-800 through 12-834 of the General Statutes, the Connecticut Lottery Corporation was established principally to take over the operation of the Lottery from the Division of Special Revenue. The purpose of the Corporation is to provide increased revenue to the State. As such, the Corporation was set up to operate and manage the Lottery in an "entrepreneurial and business-like manner" as a quasi-public agency. Such agencies, working in an environment relatively free from budgetary and other constraints compared to traditional State agencies, can be more responsive to the marketplace.

By law, the Connecticut Lottery Corporation is not allowed to sell the Lottery or to modify lottery games that would violate any agreement the State has with the Mashantucket Pequots, the Mohegans, or any other Federally recognized Native American Tribe. Also, Section 12-818 of the General Statutes requires the Corporation to annually transfer \$1,200,000 to the chronic gamblers treatment and rehabilitation program account for each of the fiscal years ended June 30, 2001, through June 30, 2006, and requires an annual transfer of \$1,500,000 to this account for the fiscal year ended June 30, 2007, and for each fiscal year thereafter. Furthermore, Section 53 of Public Act 05-251, effective July 1, 2005, required the Corporation to transfer an additional one-time payment of \$300,000 to the chronic gamblers treatment and rehabilitation program account for the fiscal year ended June 30, 2006, as well as a one-time payment of \$200,000 to the Department of Education for gambling awareness education.

The Lottery provides two categories of game products: online games and instant "scratch" tickets. During the audited period, the Corporation offered the following games within the two categories.

- **Scratch games** are played by scratching off the latex covering of the play area on the ticket. A number of different instant games are in circulation during a given period, each with a determinate pay out. Instant tickets were introduced to the market in September 1975, and have become the largest contributor to total sales and resulting contributions to the State of Connecticut's General Fund.
- **Play 3** is an online game that is available to consumers on a daily basis. Players pick

three numbers from a range and choose among different play options. This game has been in existence in similar form since 1977.

- **Play 4** is an online, nightly game that was introduced in 1980. Players select four numbers from a range and choose from different play options.
- “**Classic Lotto**,” the original lotto online game, was introduced on November 18, 1983. Two drawings are held each week. Players pick six numbers from a range of numbers. The minimum jackpot is \$1 million.
- **Cash 5** is an online game with a top prize of \$100,000 that was introduced in 1992 and is played seven days a week. Players pick five numbers from a range of numbers.
- **Powerball** is a multi-State, multi-jurisdictional Lottery game that is played twice each week. Players select six numbers from a range of numbers. The game was introduced to Connecticut players in 1995.
- **Mid-day 3** and **Mid-day 4** online games were introduced in February 1998. These games are played on a daily basis at mid-day. They are played in a similar manner as the Play 3 and Play 4 games.

Organizationally, the Connecticut Lottery Corporation is primarily divided into three major areas:

Finance and Administration:

Responsible for disbursements, accounts payable, collections, revenue accountability, payroll and human resources.

Marketing and Sales:

Responsible for designing and promoting game products and the monitoring of retailers for compliance with sales, licensing, and game requirements.

Operations:

Responsible for Lottery claims, purchasing services, information systems, receipt, control and disbursement of game products to retailers.

**Board of Directors and Administrative Officials:**

Pursuant to Section 12-802, subsection (b), of the General Statutes, the Connecticut Lottery Corporation is governed by a 13 member Board consisting of 11 appointees of various elected officials and two State office holders. The State Treasurer and the Secretary of the Office of

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Policy and Management serve as ex-officio members of the Board of Directors.

Of the 11 appointed members, five are appointed by, and serve at the pleasure of, the Governor. The Governor is required to appoint directors who have skill, knowledge, and experience in the fields of management, finance, or operations in the private sector. The six remaining appointees are chosen by various legislative leaders. Appointed members serve at the pleasure of the appointing authority. Board members receive no compensation, but are entitled to reimbursement for expenses incurred in the performance of their duties.

As of June 30, 2006, the members of the Board of Directors were as follows:

Ex Officio:

Gale A. Mattison, Vice Chairperson, designee of Secretary of the Office of Policy and Management  
Robert L. Genuario

Robert Morgan, designee of State Treasurer  
Denise L. Nappier

Governor Appointments:

Anne M. Noble, Chairperson  
Margaret L. Morton  
John Paul  
Patricia Racz

Legislative Appointments:

Steven Bafundo  
John E. Calkins, Jr.  
William A. Kiner  
Kenneth J. Saccente  
Martin E. Stauffer

As of June 30, 2006, there were two unfilled Board positions.

Subsection (c) of Section 12-802 of the General Statutes provides that the Chairperson of the Board shall be appointed by the Governor with the advice and consent of the Legislature. On December 2, 2004, Anne M. Noble was appointed Chairperson and continued to serve in that capacity during the audited period.

On March 30, 2001, James Vance was appointed to the position of President and Chief Executive Officer of the Connecticut Lottery Corporation. Mr. Vance continued to serve in this position during the audited period.

### **Other Audit Examinations:**

An independent certified public accountant audited the books and accounts of the Lottery for

the fiscal year ended June 30, 2006. The accountants' report on that examination expressed an unqualified opinion on the Lottery's financial statements, disclosed no material weaknesses in internal control, and no reportable instances of noncompliance.

Section 1-122 of the Connecticut General Statutes requires that quasi-public agencies such as the Lottery have a compliance audit performed annually. Such audits should determine whether these agencies comply with their own regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds, and the distribution of loans, grants and other financial assistance. In accordance with this statute, we performed a compliance audit of the Lottery for the fiscal year ended June 30, 2006. Our audit disclosed certain weaknesses, which are discussed in the "Condition of Records" and "Recommendations" sections of this report.

### **RÉSUMÉ OF OPERATIONS:**

The Connecticut Lottery Corporation has contracted with approximately 2,800 licensed retailers throughout the State to offer lottery games for sale to the public. Only retailers who satisfy the Corporation's established criteria are recommended for licensure to the State of Connecticut's Division of Special Revenue. The Division of Special Revenue retained regulatory authority for such matters following the creation of the Connecticut Lottery Corporation.

On an ongoing basis, retailers deposit revenues generated from the sale of lottery games to the public into fiduciary type bank accounts. Once a week, those deposits (less canceled tickets, prize payouts and retailer commissions) are "swept" into the Corporation's Operating Account held by a major bank. The Operating Account along with other Corporation bank accounts (i.e. Claim Account, Advance Account and Accounts Payable) are combined into a "Concentrator" account for overnight investment.

### **State Accounts:**

Section 3-27a of the General Statutes allows the Connecticut Lottery Corporation to deposit excess funds with the Treasurer in such fund or funds of the State as is considered appropriate. Excess funds represent the amount in cash accounts not immediately needed to meet current operating requirements. The "Concentrator" account, as described above, is evaluated weekly and available cash is invested with the Treasurer of the State of Connecticut in a short-term investment fund that offers a greater return on investment than the Corporation's bank. Deposits with the State Treasurer's Short Term Investment Fund (STIF) totaled \$13,086,110 as of June 30, 2006.

The Connecticut Lottery Corporation transfers net income to the Connecticut General Fund on a weekly basis. Such transfers are based upon sales revenue less the cost of game prizes, retailer commissions and operational and administrative costs. Transfers to the General Fund from operations totaled \$284,865,000 for the fiscal year ended June 30, 2006.

The Connecticut Lottery Corporation incurs long-term liabilities as the result of game prizes that are paid out in the form of periodic payments. In order to meet those future obligations, the

Corporation purchases annuities from insurance companies. This debt represents remaining periodic payments owed to Lotto and Instant game winners. Annuity contracts and related liabilities are reported at their discounted present value in the Financial Statements of the Corporation. Since the inception of the lump sum payout option for prize winners, in 1997, the trend among prize winners has been to choose the lump sum option instead of the annuity option. In turn, the Corporation's long-term liabilities have been decreasing as annuity payments made to winners have decreased (thus decreasing the Corporation's annuity investment purchases). This has contributed to a decrease of the annuities outstanding from \$288,893,856, for the fiscal year ended June 30, 2005, to \$256,711,694 for the fiscal year ended June 30, 2006.

Connecticut Lottery Corporation employees are considered employees of the State of Connecticut per Section 12-802, subsection (e), of the General Statutes and are covered under the State Employees Retirement System. The Corporation's payroll is processed through a direct link with the State's automated payroll system. That system produces reports on the amount of salaries and fringe benefit costs incurred during the previous biweekly period. An amount equal to the costs incurred for salaries and fringe benefits is wire transferred by the Corporation into a State of Connecticut Treasurer's Account to cover those costs. The operating expenses for salaries and benefits were \$12,640,863 for the fiscal year ended June 30, 2006.

**Financial Operations:**

The Connecticut Lottery Corporation operates as an enterprise activity and is included in the State of Connecticut's Comprehensive Annual Financial Report within that category. The accrual basis of accounting is used in accordance with generally accepted accounting principles. The Corporation applies applicable pronouncements of the Financial Accounting Standards Board issued on or before November 30, 1989, unless those pronouncements conflict with or contradict the pronouncements of the Governmental Accounting Standards Board.

The following is a comparative summary of operations obtained from the Connecticut Lottery Corporation's audited financial statements for the fiscal years ended June 30, 2005 and 2006.

	<b>Fiscal Year Ended June 30,</b>	
	<b>2005</b>	<b>2006</b>
Total sales	\$ 932,933,942	\$ 970,326,788
Prize expense	(573,000,223)	(587,388,079)
All other expenses	(88,868,441)	(95,640,800)
Excess of sales over expenses	271,065,278	287,297,909
Other and nonoperating revenues	870,905	1,687,118
Subtotal	271,936,183	288,985,027
Transfers to State of Connecticut	(3,392,614)	(4,174,283)
Income available	268,543,569	284,810,744
Transfers to the General Fund	(268,515,000)	(284,865,000)
<b>Net Income</b>	<b>\$ 28,569</b>	<b>\$ (54,256)</b>

In accordance with Section 12-812 of the General Statutes, the President of the Connecticut Lottery Corporation transfers the excess balance of the Lottery Fund to the General Fund on a weekly basis. These weekly transfers represent an estimate of lottery sales revenues less operating expenditures. Weekly transfers totaled \$284,865,000 for the fiscal year ended June 30, 2006, or roughly 29 percent of total annual lottery sales for this fiscal year. For the fiscal year ended June 30, 2006, instant tickets made up nearly 61 percent of total sales by game.

As presented in its audited financial statements, the Corporation's Statement of Net Assets as of June 30, 2005 and 2006, was as follows:

	<u>June 30, 2005</u>	<u>June 30, 2006</u>
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 26,767,171	\$ 23,650,519
Accounts receivable, net of allowance	10,184,963	11,932,311
Prepaid annuities for prizes	45,408,395	43,398,371
Due from Multi-State Lottery Association	35,129,098	
Accrued interest receivable	12,473,079	10,639,799
Ticket inventory	2,174,331	2,110,091
Prepaid expenses	157,581	444,596
<b>Total Current Assets</b>	<u>132,294,618</u>	<u>92,175,687</u>
<b>Noncurrent Assets</b>		
Investments for prize payments at present value	288,893,856	256,711,694
Prize reserve held by Multi-State Lottery Association	4,686,901	4,940,925
Advances to high tier claim centers	150,000	150,000
Property, plant and equipment, net	2,241,760	1,923,988
<b>Total Noncurrent Assets</b>	<u>295,972,517</u>	<u>263,726,607</u>
<b>Total Assets</b>	<u>\$428,267,135</u>	<u>\$355,902,294</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>Current Liabilities</b>		
Annuities payable	\$ 48,107,534	\$ 45,764,611
Prizes Payable	58,139,221	31,195,660
Accrued interest payable	12,473,079	10,639,799
Accounts payable and accrued expenses	16,833,746	6,417,274
Due to Multi-State Lottery Association		1,244,846
Deferred revenue	588,407	751,374
<b>Total Current Liabilities</b>	<u>136,141,987</u>	<u>96,013,564</u>

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<b>Long Term Liabilities</b>		
Long-term annuities payable	288,893,856	256,711,694
<b>Total Long-Term Liabilities</b>	<u>288,893,856</u>	<u>256,711,694</u>
<b>Total Liabilities</b>	<u>425,035,843</u>	<u>352,725,258</u>
<b>NET ASSETS</b>		
Invested in capital assets	2,241,760	1,923,988
Restricted for unclaimed prizes	3,231,292	3,177,036
Unrestricted	<u>(2,241,760)</u>	<u>(1,923,988)</u>
<b>Total Net Assets</b>	<u>3,231,292</u>	<u>3,177,036</u>
<b>Total Liabilities and Net Assets</b>	<u><b>\$428,267,135</b></u>	<u><b>\$355,902,294</b></u>

The Connecticut Lottery Corporation's assets decreased from \$428,267,135 for the fiscal year ended June 30, 2005, to \$355,902,294 for the fiscal year ended June 30, 2006. This decrease resulted, in part, from the disparity in amounts due from the Multi-State Lottery Association (MUSL) at year-end. As of June 30, 2005, MUSL owed the Lottery \$34,662,301 for a Powerball grand prize winner in Connecticut whose winning numbers were drawn on June 25, 2005. (MUSL operates various games, most notably the Powerball game, on behalf of participating state lotteries. Participating state lotteries, on a weekly basis, contribute a share of an estimate of the grand prize liability. The Connecticut State Lottery is a member of MUSL.) There were no Powerball winning tickets sold in Connecticut in the fiscal year ended June 30, 2006. Consequently, no receivables were due to the Lottery from MUSL as of June 30, 2006, which contributed to the decrease in Lottery assets as of June 30, 2006, relative to the prior year. Further, a reduction in investments for prize payments at present value and the corresponding decrease in long-term annuities payable also played a role in the decrease in Lottery assets. This was due, most significantly, to prize winners increasingly choosing the lump sum payment option over the long-term annuity option.

## CONDITION OF RECORDS

Our review of the financial records of the Corporation disclosed an area requiring attention, as discussed in this section of the report.

### **Purchasing of Goods and Services:**

*Criteria:* Public Act 05-287, as codified in Section 4a-81 of the General Statutes, effective July 13, 2005, provides that no State agency or quasi-public agency shall execute a contract for the purchase of goods or services valued at \$50,000 or more in any calendar or fiscal year without obtaining a written affidavit from the chief official of the contractor attesting to whether any consulting agreement was entered into in connection with the awarded contract.

*Condition:* We noted several instances during the audited period in which the Corporation entered into contracts to purchase services amounting to \$50,000 or more. However, in all but one instance, the Corporation did not obtain the consulting affidavit required by Section 4a-81 of the General Statutes.

*Effect:* In some instances, the Corporation did not fully comply with Section 4a-81 of the General Statutes. This decreased assurance that large contracts were awarded without the influence of paid consultants.

*Cause:* It appears that the Corporation misinterpreted the Public Act, believing that it only applied when State agencies or quasi-public agencies themselves enter into contracts with consultants.

*Recommendation:* The Connecticut Lottery Corporation should obtain consulting affidavits when entering into contracts amounting to \$50,000 or more, as required by Section 4a-81 of the General Statutes. (See Recommendation 1.)

*Auditee Response:* “Management of the Connecticut Lottery Corporation (CLC) agrees with the condition noted above. When Section 4a-81 was released, the management of CLC believed the “consulting affidavit” applied to consulting contracts only, and not all purchases of goods or services of \$50,000 or more. Although no instances of consultants influencing contract awards occurred, we agree that affidavits were not obtained for all large contracts during fiscal year 2006. However, since the misinterpretation of Section 4a-81 was clarified during the audit process, the CLC has implemented the procedure to obtain the required consulting

affidavits for contracts of \$50,000 or more. The CLC will continue to comply with this requirement in all future periods.”

## RECOMMENDATIONS

*Status of Prior Audit Recommendation:*

There were no recommendations presented in our prior audit report.

*Current Audit Recommendation:*

- 1. The Connecticut Lottery Corporation should obtain consulting affidavits when entering into contracts amounting to \$50,000 or more, as required by Section 4a-81 of the General Statutes.**

Comment:

We noted that the Corporation entered into several contracts, each valued at \$50,000 or more, without obtaining the required consulting affidavits.

## INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 and Section 1-122 of the General Statutes, we have conducted an audit of the Connecticut Lottery Corporation's activities for the fiscal year ended June 30, 2006. This audit was primarily limited to performing tests of the Corporation's compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to a determination of whether the Corporation has complied with its regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds and the distribution of loans, grants and other financial resources, and to understanding and evaluating the effectiveness of the Corporation's internal control policies and procedures for ensuring that the provisions of certain laws, regulations, contracts and grants applicable to the Corporation are complied with. The financial statement audit of the Connecticut Lottery Corporation, for the fiscal year indicated above, was conducted by the Corporation's independent public accountants.

We conducted our audit in accordance with the requirements of Section 2-90 and Section 1-122 of the General Statutes. In doing so, we planned and performed the audit to obtain reasonable assurance about whether the Connecticut Lottery Corporation complied in all material respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

### COMPLIANCE:

Compliance with the requirements of laws, regulations, contracts and grants applicable to the Connecticut Lottery Corporation is the responsibility of the Corporation's management.

As part of obtaining reasonable assurance about whether the Connecticut Lottery Corporation complied with laws, regulations, contracts and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Corporation's financial operations for the fiscal year ended June 30, 2006, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources

Our examination included reviewing all or a representative sample of the Corporation's activities in those areas and performing such other procedures as we considered necessary in the circumstances. The results of our tests disclosed the following instances of non-compliance, which are further described in the accompanying "Condition of Records" and

“Recommendations” sections of this report: In several instances, the Corporation entered into contracts for purchases totaling \$50,000 or more without obtaining the consulting affidavits required by Public Act 05-287.

**INTERNAL CONTROL:**

The management of the Connecticut Lottery Corporation is responsible for establishing and maintaining effective internal control over its financial operations and compliance with the requirements of laws, regulations, contracts and grants applicable to the Corporation. In planning and performing our audit, we considered the Corporation’s internal control over its financial operations and its compliance with requirements that could have a material or significant effect on the Corporation’s financial operations in order to determine our auditing procedures for the purpose of evaluating the Corporation’s financial operations and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives. Our consideration of internal control included, but was not limited to, the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources

Our consideration of the internal control over the Corporation’s financial operations and over compliance would not necessarily disclose all matters in the internal control that might be material or significant weaknesses. A material or significant 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 noncompliance with certain provisions of laws, regulations, contracts, and grants that would be material in relation to the Corporation’s financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions at the entity being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control that we consider to be material or significant weaknesses.

However, we noted certain matters involving internal control over the Connecticut Lottery Corporation’s financial operations and/or compliance, which are described in the accompanying “Condition of Records” and “Recommendations” sections of this report.

This report is intended for the information of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited. Users of this report should be aware that our audit does not provide a legal determination of the Connecticut Lottery Corporation’s compliance with the provisions of the laws, regulations, contracts and grants included within the scope of this audit.

**CONCLUSION**

In conclusion, we wish to express our appreciation for the courtesies and cooperation extended to our representatives by the officials and employees of the Connecticut Lottery Corporation during our examination.

Daniel F. Puklin  
Principal Auditor

Approved:

Kevin P. Johnston  
Auditor of Public Accounts

Robert G. Jaekle  
Auditor of Public Accounts