

STATE OF CONNECTICUT



*AUDITORS' REPORT
CONNECTICUT LOTTERY CORPORATION
FOR THE FISCAL YEAR ENDED JUNE 30, 2008*

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

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October 19, 2009

**AUDITORS' REPORT
CONNECTICUT LOTTERY CORPORATION
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

We have examined the books, records, and accounts of the Connecticut Lottery Corporation (hereafter referred to as the Corporation or the Lottery), as provided in Section 2-90 and Section 1-122 of the General Statutes, for the fiscal year ended June 30, 2008.

SCOPE OF AUDIT:

This audit was primarily limited to performing tests of the Corporation's compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 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 ended June 30, 2008, 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, the Lottery 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) as a blended component unit of the State.

Sections 12-800 through 12-834 of the General Statutes established the Connecticut Lottery Corporation to take over the operation of the Lottery from the Division of Special Revenue. The central 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 Pequot, the Mohegans, or any other Federally recognized Native American Tribe. Also, Section 12-818 of the General Statutes requires the Corporation to annually transfer \$1,500,000 to the chronic gamblers treatment and rehabilitation program account for the fiscal year ended June 30, 2007, and for each fiscal year thereafter. It should be noted that Public Act 07-1, enacted in the June 2007 Special Session, required an additional transfer of \$400,000 for the fiscal year ended June 30, 2008.

The Lottery provides two categories of game products: instant "scratch" tickets and computer-based on-line games. 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 payout. Instant tickets were introduced to the market in September of 1975 and have become the largest contributor to total sales and resulting contributions to the State of Connecticut's General Fund.
- **Play3 Night** is an on-line 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.
- **Play4 Night** is an on-line game that was introduced in 1980. Players select four numbers from a range and choose from different play options.

- **Classic Lotto** is the original on-line jackpot game that was introduced in 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 on-line 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.
- **Play3 Day** and **Play4 Day** on-line 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 Play3 Night and Play4 Night games.

On March 29, 2009, subsequent to the audited period, the Corporation introduced a new on-line game, "Lucky-4-Life." Drawings are held twice a week on Monday and Thursday nights. Players pick five numbers from a range of numbers. The top prize is \$2,000 a week for life.

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

Finance:

Responsible for disbursements, accounts payable, collections, and revenue accountability.

Marketing and Sales:

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

Administration and Operations:

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

Human Resources:

Responsible for payroll and human resources.

Legal:

Responsible for providing legal advice and serving as the Lottery's liaison to the Legislature.

Security:

Responsible for fraud prevention, investigations, and enforcement of Lottery policies governing retail sales agents, as well as security related to Lottery buildings, assets, games and personnel.

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 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, 2008, the members of the Board of Directors were as follows:

Ex Officio:

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

Robert Morgan, designee of State Treasurer Denise L. Nappier

Governor Appointments:

John S. Paul, Chairperson
Margaret L. Morton
Patricia Racz
Wendy B. Kingsbury
Carolyn C. Long

Legislative Appointments:

Steven A. Bafundo
Patrick M. Birney
Kenneth J. Saccente
Martin E. Stauffer

As of June 30, 2008, 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 January 25, 2007, John S. Paul was appointed Chairperson and continues to serve in that capacity. Also, Joseph DiNatale served on the Board 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. He held this position until his retirement on April 1, 2007. He was succeeded on June 1, 2007, on an interim basis, by John A. Ramadei, Chief Financial Officer. On February 29, 2008, Anne M. Noble was appointed to the position of President and Chief Executive Officer of the Connecticut Lottery Corporation and continues to serve in that capacity.

Other Audit Examinations:

An independent certified public accountant audited the books and accounts of the Lottery for the fiscal year ended June 30, 2008. That report expressed an unqualified opinion on the financial statements and reported no material weaknesses in internal control.

Section 1-122 of the Connecticut General Statutes requires that quasi-public agencies such as the Connecticut Lottery Corporation 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, 2008. We did not note any weaknesses in compliance or internal control.

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. Claims Account, Advance Account, Annuities Account, and Accounts Payable), is combined into a "Concentrator" account for overnight investment.

It should be noted that Public Act 09-2, effective April 1, 2009, provided for a reduction in the minimum retailer commission from five per cent of the retailer's lottery sales to four per cent. The Lottery held a public hearing on May 7, 2009, to discuss an amendment to Section 9 of the Lottery's Rules of Operation, which addresses the commission percentage paid to Lottery retailers. As of May 8, 2009, the Board of Directors had not yet met to discuss amending the Rules of Operation.

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 daily, 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 its bank. Deposits with the State Treasurer’s Short Term Investment Fund (STIF) were \$18,307,702, as of June 30, 2008.

The Connecticut Lottery Corporation transfers to the Connecticut General Fund on a weekly basis the excess of sales revenue over the cost of game prizes, retailer commissions, and operational and administrative costs. Transfers to the General Fund from operations totaled \$283,000,000 for the fiscal year ended June 30, 2008.

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 long-term annuities outstanding from \$223,710,396 at June 30, 2007, to \$193,958,980 at June 30, 2008.

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 \$13,873,384 for the fiscal year ended June 30, 2008.

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. This financial information was obtained from the Connecticut Lottery Corporation's audited financial statements for the fiscal years ended June 30, 2007 and 2008.

	Fiscal Year Ended June 30,	
	2007	2008
Total sales	\$ 957,026,434	\$ 998,147,892
Prize expense	(579,854,360)	(608,217,698)
All other expenses	(94,806,908)	(101,589,713)
Excess of sales over expenses	282,365,166	288,340,481
Other and nonoperating revenues	1,778,344	1,734,700
Subtotal	284,143,510	290,075,181
Transfers to State of Connecticut	(4,215,359)	(4,992,404)
Income available	279,928,151	285,082,777
Transfers to General Fund	(279,000,000)	(283,000,000)
Change in Net Assets	<u>\$ 928,151</u>	<u>\$ 2,082,777</u>

In accordance with Section 12-812 of the General Statutes, the President of the Connecticut Lottery Corporation transfers the excess balance of Lottery earnings to the General Fund on a weekly basis. These weekly transfers represent an estimate of lottery sales revenues less operating expenditures. Weekly transfers totaled \$283,000,000 for the fiscal year ended June 30, 2008, or 28.4 percent of total annual lottery sales for this fiscal year. For the fiscal year ended June 30, 2008, instant tickets made up approximately 62 percent of total sales by game.

As presented in its audited financial statements, the Corporation's Statement of Net Assets for June 30, 2007, and June 30, 2008, was as follows:

	June 30, 2007	June 30, 2008
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 21,854,156	\$ 37,035,370
Accounts receivable, net of allowance	10,103,206	12,305,072
Prepaid annuities for prizes	39,936,111	36,055,362
Accrued interest receivable	9,107,098	7,650,406
Ticket inventory, net of allowance	2,209,877	1,725,606
Prepaid expenses	142,044	151,274
Total Current Assets	<u>83,352,492</u>	<u>94,923,090</u>
Noncurrent Assets		
Investments for prize payments at present value	223,710,396	193,958,980
Prize reserve held by Multi-State Lottery	4,813,592	4,840,454

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Association		
Advances to high tier claim centers	150,000	150,000
Property, plant and equipment, net	<u>1,477,764</u>	<u>2,939,083</u>
Total Noncurrent Assets	<u>230,151,752</u>	<u>201,888,517</u>
Total Assets	<u>\$ 313,504,244</u>	<u>\$ 296,811,607</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Annuities payable	\$ 42,063,377	\$ 38,084,724
Prizes payable	24,668,392	34,282,333
Accrued interest payable	9,107,098	7,650,406
Accounts payable and accrued expenses	7,914,326	14,548,225
Due to Multi-State Lottery Association	1,447,563	1,047,771
Deferred revenue	<u>487,905</u>	<u>812,372</u>
Total Current Liabilities	<u>85,688,661</u>	<u>96,425,831</u>
Long-Term Liabilities		
Deferred rent liability		238,832
Long-term annuities payable	<u>223,710,396</u>	<u>193,958,980</u>
Total Long-Term Liabilities	<u>223,710,396</u>	<u>194,197,812</u>
Total Liabilities	<u>309,399,057</u>	<u>290,623,643</u>
Net Assets		
Invested in capital assets	1,477,764	2,939,083
Restricted for unclaimed prizes	4,105,187	6,187,964
Unrestricted	<u>(1,477,764)</u>	<u>(2,939,083)</u>
Total Net Assets	<u>4,105,187</u>	<u>6,187,964</u>
Total Liabilities and Net Assets	<u>\$ 313,504,244</u>	<u>\$ 296,811,607</u>

The Connecticut Lottery Corporation's assets decreased from \$313,504,244 for the fiscal year ended June 30, 2007, to \$296,811,607 for the fiscal year ended June 30, 2008. The primary reason for this decrease is the continuing trend of prize winners selecting the lump sum payment option over the long-term annuity option. This has resulted in a reduction in investments for prize payments at present value and a corresponding decrease in long-term annuities payable.

CONDITION OF RECORDS

There were no recommendations developed as a result of this examination.

RECOMMENDATIONS

Status of Prior Audit Recommendation:

Our prior audit report of the fiscal year ended June 30, 2007, included two recommendations. The status of each recommendation is presented below.

- *The Connecticut Lottery Corporation (CLC) should comply with the part of Section 1, subsection (h) of Public Act 07-1 (which was codified as Section 9-612 of the General Statutes) that requires that any entity that has submitted a quotation on a CLC Request for Proposal has to be included in the CLC's submissions to the State Elections Enforcement Commission. The Corporation has complied with this recommendation.*
- *The Connecticut Lottery Corporation should document compliance with the certification requirements of Section 4-252, subsection (b), of the General Statutes. The Corporation has complied with this recommendation.*

Current Audit Recommendations:

There were no recommendations developed as a result of this examination.

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, 2008. This audit was primarily limited to performing tests of the Corporation's compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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, grant agreements, 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 grant agreements 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 grant agreements 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.

Internal Control over Financial Operations and Compliance

In planning and performing our audit, we considered the Corporation's internal control over its financial operations and its compliance with requirements as a basis for designing our auditing procedures for the purpose of evaluating the Corporation's financial operations and compliance with certain provisions of laws, regulations, contracts, and grant agreements, but not for the purpose of providing assurance on the effectiveness of the Corporation's 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

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis unauthorized, illegal, or irregular transactions. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Corporation's ability to properly initiate, authorize, record, process, or report financial data reliably consistent with management's direction, and/or comply with certain provisions of laws, regulations, contracts, and grant agreements such that there is more than a remote likelihood that noncompliance with laws, regulations, contracts, and grant agreements that is more than

inconsequential will not be prevented or detected by the Corporation's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that noncompliance which could result in significant unauthorized, illegal, irregular, or unsafe transactions and/or material noncompliance with certain provisions of laws, regulations, contracts, and grant agreements that would be material in relation to the Corporation's financial operations will not be prevented or detected by the Corporation's internal control.

Our consideration of the internal control over the Corporation's financial operations, and compliance with requirements would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over the Corporation's financial operations and compliance with requirements that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Connecticut Lottery Corporation complied with laws, regulations, contracts, and grant agreements, 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, 2008, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 no instances of noncompliance.

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 grant agreements included within the scope of this audit.

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.

Cynthia A. Ostroske
Associate Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts