

STATE OF CONNECTICUT



*AUDITORS' REPORT
DIVISION OF SPECIAL REVENUE
FOR THE FISCAL YEARS ENDED
JUNE 30, 2003, 2004 AND 2005*

AUDITORS OF PUBLIC ACCOUNTS

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Table of Contents

INTRODUCTION.....	1
COMMENTS.....	1
FOREWORD.....	1
Gaming Policy Board.....	2
Legislative Changes	2
RÉSUMÉ OF OPERATIONS:	3
Receipts	3
Expenditures.....	4
Betting Taxes Fund	5
CONDITION OF RECORDS	6
Password access to the Division's LAN.....	6
Other Matters	7
RECOMMENDATIONS.....	8
INDEPENDENT AUDITORS' CERTIFICATION.....	9
CONCLUSION	11

September 12, 2007

**AUDITORS' REPORT
DIVISION OF SPECIAL REVENUE
FOR THE FISCAL YEARS ENDED JUNE 30, 2003, 2004 AND 2005**

We have made an examination of the financial records of the Division of Special Revenue, for the fiscal years ended June 30, 2003, 2004 and 2005. This report on that examination consists of the Comments, Condition of Records, Recommendations and Certification, which follow. Financial statements pertaining to the operations and activities of the Division of Special Revenue, are presented on a Statewide Single Audit basis to include all State Agencies. This examination has been limited to assessing the Division's compliance with certain provisions of laws and regulations, contracts and grants and evaluating the Division's internal control structure, policies, and procedures established to ensure such compliance.

COMMENTS

FOREWORD:

The Division of Special Revenue is responsible for the administration and regulation of legal gaming activities in the State under the provisions of Title 12, Chapters 226 and 226b, and Title 7, Chapter 98, Sections 7-169 through 7-186q, of the General Statutes. Pursuant to Section 12-557c, subsection (a) the Division is within the Department of Revenue Services (DRS) for "administrative purposes only" as defined in Section 4-38f of the General Statutes. In all other respects the Division is independent of DRS.

In accordance with Section 12-557c, subsection (b), of the General Statutes, the Division is under the direction and control of an Executive Director. Susan G. Townsley served as the Executive Director of the Division of Special Revenue from July 6th, 2001, until July 31st, 2004. Daniel Marchitello served as Acting Executive Director from August 1st, 2004, until November 23rd, 2004. Paul A. Young was appointed as Executive Director effective November 24th, 2004, and continues to serve in that capacity.

Gaming Policy Board:

In accordance with Sections 12-557e, Section 7-169, subsection (c), and Section 7-185 of the General Statutes, the Gaming Policy Board assists the Division of Special Revenue in overseeing legalized gambling within the State of Connecticut. Among its duties and powers, the Gaming Policy Board is responsible for advising the Governor on Statewide plans and goals for legal gambling and for assisting in the development and approval of regulations for gaming activities.

For the period July 2002 through May 2005, the Board was made up of the following members:

Nelson C.L. Brown - Chair	-	reappointed September 15, 2004
Richard Antonetti -		reappointed October 20, 2004
William Farrell -		reappointed December 2, 2004
William LaVelle -		reappointed October 24, 2001
Gilbert Lebovitz -		reappointed February 6, 2002

Gilbert Lebovitz resigned, effective June 15, 2006, and was succeeded by Paul F. Pendergast, effective June 16, 2006.

William LaVelle resigned, effective July 21, 2005, and was succeeded by Gregory R Shettle, effective November 11, 2005. Mr Shettle resigned, effective March 8, 2006, and was succeeded by Gayle A. Russell, effective January 22, 2007.

Legislative Changes:

Several Public Acts that directly affected the Agency took effect during the audited period. The most notable were as follows:

- Public Act 03-1 - An act repealing Las Vegas night games.
- Public Act 03-60 - An act concerning raffle ticket sales and the prohibition of interactive on-line lottery games.
- Public Act 03-178 - An act concerning charitable bingo and sealed ticket sales.
- Public Act 04-7 - An act concerning municipal bingo payments.
- Public Act 04-79 - An act revising various permits.
- Public Act 05-11 - An act increasing the value of prizes awarded at recreational bingo games for senior citizens.
- Public Act 05-82 - An act allowing the conduct of a frog-race raffle in the town of Windham.

None of these Public Acts materially affected the operation of the Division.

RÉSUMÉ OF OPERATIONS:

Receipts:

General Fund receipts totaled \$9,110,142, \$9,146,920 and \$8,386,770 during the fiscal years ended June 30th, 2003, 2004 and 2005, respectively. A comparative summary of General Fund receipts for the audited years is presented below:

	Fiscal Year		
	2002-2003	2003-2004	2004-2005
Gaming Receipts			
Taxes on Off Track Betting (OTB)	\$5,783,231	\$5,783,041	\$5,275,183
Charitable Games Receipts	1,230,391	1,401,955	1,426,800
Taxes on Dog Racing	181,965	153,013	104,299
Total from Gaming	<u>7,195,587</u>	<u>7,338,009</u>	<u>6,806,282</u>
Other Receipts			
Registration and permit fees	67,755	66,405	64,335
License and Registration fees	59,030	53,960	50,660
Miscellaneous	61,952	392,444	253,152
Total Other Receipts	<u>188,737</u>	<u>512,809</u>	<u>368,147</u>
Reimbursements			
Reimbursements (mainly CT Lottery Commission)	1,725,818	1,296,102	1,212,341
Total Reimbursements	<u>1,725,818</u>	<u>1,296,102</u>	<u>1,212,341</u>
Total General Fund Receipts	<u>\$9,110,142</u>	<u>\$9,146,920</u>	<u>\$8,386,770</u>

Revenues from dog racing fell noticeably during the audited period. Dog racing operations in Connecticut ceased before the end of the 2004-2005 Fiscal Year. The major portion of betting taxes revenue is received from OTB operations. OTB revenue was negatively impacted by the growing popularity of casino gaming. Charitable games receipts included payments for sealed tickets sold by charities, fees to hold bingo games, and payments for permits to hold other games of chance. Receipts from the recovery of regulatory costs from the Connecticut Lottery Corporation are authorized by Section 12-806, subsection (b), part (13), of the General Statutes.

Expenditures:

A Comparative Summary of the Division's Expenditures is presented below:

	Fiscal Year		
	2002-2003	2003-2004	2004-2005
Personnel Services	\$6,241,299	\$4,820,390	\$5,116,360
Greyhound Sample Testing	463,000	84,060	0
Other Contractual Services	1,185,102	960,606	921,921
Commodities	158,586	122,901	146,704
Equipment	0	100	99
General Fund Expenditures	<u>8,047,987</u>	<u>5,988,057</u>	<u>6,185,084</u>
Betting Fund	10,715,163	10,676,048	9,711,206
Indian Gaming-Mashantucket	1,594,225	1,559,011	1,862,211
Indian Gaming-Mohegan	1,365,713	1,408,202	1,450,062
Capital Equipment Purchase Fund	31,027	43,169	40,560
Restricted Fund Expenditures	<u>13,706,128</u>	<u>13,686,430</u>	<u>13,064,039</u>
DSR Total Expenditures	<u>\$21,754,115</u>	<u>\$19,674,487</u>	<u>\$19,249,123</u>
Gaming Policy Board	<u>\$2,383</u>	<u>\$2,025</u>	<u>\$1,484</u>
(General Fund Expenditures)			

The decrease in Greyhound Sample Testing costs over the three year period, from \$463,000 to zero, reflects in part, decreased greyhound activity in reaction to a Division policy change concerning the cost of greyhound drug testing. Prior to this policy change, the Division bore the cost of greyhound drug testing. Under the new policy, the greyhound facilities had to pay for the cost of sample testing. The decrease also reflected in part the slow-down and final complete discontinuation of that sector of the gaming industry in Connecticut, in response to the growing popularity of casino gaming.

Only minor expenditures were incurred by the General Fund and by the Capital Equipment Purchase Fund for the purchase of Capital Equipment Items.

The marked decrease in the Division's Personnel Services costs reflects lay-offs and early retirements during the second half of the 2002-2003 Fiscal Year. As can be seen above, Personal Services expenditures represent the largest category of expenditures from budgeted appropriations. The following summary presents the average number of filled full-time and part-time positions during the audited period.

	Fiscal Year		
	<u>2002-2003</u>	<u>2003-2004</u>	<u>2004-2005</u>
Full-time filled positions	158	132	129
Part-time filled positions	9	8	9
Temporary filled positions	4	4	5
Total	<u>171</u>	<u>144</u>	<u>143</u>

Betting Taxes Fund:

This agency fund was used throughout the audited period to account for the deposit of taxes and other moneys paid by pari-mutuel licensees such as Off Track Betting Facilities. Betting Taxes Fund activity during the audited fiscal years is summarized below.

	Fiscal Year		
	<u>2002-2003</u>	<u>2003-2004</u>	<u>2004-2005</u>
Beginning Balance	\$284,507	\$286,306	\$352,667
Receipts:			
Betting Taxes	<u>10,716,962</u>	<u>10,742,409</u>	<u>9,658,346</u>
Total Available Cash	<u>11,001,469</u>	<u>11,028,715</u>	<u>10,011,013</u>
Disbursements:			
Payments to Towns	4,773,508	4,740,497	4,331,724
Transfers to the General Fund	<u>5,941,655</u>	<u>5,935,551</u>	<u>5,379,482</u>
Total Transfers and Expenditures	<u>10,715,163</u>	<u>10,676,048</u>	<u>9,711,206</u>
Ending Balance	<u>\$286,306</u>	<u>\$352,667</u>	<u>\$299,807</u>

Betting Taxes Fund receipts decreased during the audited period, in large part because of the decrease and eventual cessation of activities at the Plainfield Greyhound Track. A corresponding proportional decrease was also reflected in Payments to Towns, and Transfers to the General Fund.

CONDITION OF RECORDS

Our review of the financial records of the Division of Special Revenue disclosed the following matter of concern requiring Agency attention.

Password Access to the Division's Local Area Network (LAN):

- Criteria:* The State Department of Information Technology (DOIT), quoting from the Multi-State Information Sharing and Analysis Center (MS-ISAC) publication "Cyber Security Awareness" gives details of "best practices" relating to the use of User IDs and Passwords in Information Technology. These "best practices" include the following guidance – "Your password should be changed periodically."
- Condition:* Passwords are required to access the Division's Local Area Network (LAN.) However, the Division does not require users to regularly change their passwords. Furthermore, we were informed that only 29 of the current 155 LAN users have the type of system configuration that would allow them to change their passwords.
- Effect:* Unless passwords are regularly changed there is a heightened risk that unauthorized parties might learn the passwords and be able to access the Division's LAN system, obtain access to confidential data, and alter, erase or corrupt records and files.
- Cause:* According to the Division, manpower and fiscal limitations have prevented them from addressing this problem.
- Recommendation:* The Division should give a higher priority to the need for enabling LAN users to periodically change their passwords.
- Agency Response:* "The Division agrees with the Auditors findings. The Division of Special Revenue is in the process of upgrading its network and when the new network is in place, which is currently scheduled for the end of the calendar year, Division employees will be able to change their network passwords. In the interim the Division will create a policy for changing network passwords starting in June 2007, that takes into account its limited resources and multiple platforms, this will allow password changes on our existing platforms and network. The new policy will be phased in, with the conversion first of those PCs that are most easily modified and lastly of those that require the most work. This will allow us to test for problems that might occur, especially for those with multiple platforms. Phasing in the policy is also necessary because such a change will be labor intensive. The new procedure will

require training for all employees. We anticipate all existing passwords will be changed by Fall 2007 and the new system in place by January 2008. The Division will work with DOIT to insure our policy conforms to State of Connecticut standards on frequency of changing passwords and degree of difficulty of passwords.”

Other Matters:

Gaming Policy Board Meetings:

Section 12-558 of the General Statutes, which deals with the Gaming Policy Board, mandates in part that “Four members of the board shall constitute a quorum,...” Our review of the minutes of the Board meetings noted two instances where Board meetings appear to have been held in the absence of a quorum. Furthermore, the minutes of these meetings were read and approved at the next Board meeting. The minutes noted the absence of a quorum and that “...therefore no formal action may be taken at this time.” However, the minutes also recorded that “The Board will receive the monthly reports....” Members of the Division’s staff reviewed the reports with the board members that were present. Such action gives the impression that a Board meeting was held despite there being no quorum.

Regarding the minutes of these meetings, under such circumstances it is generally accepted practice that the minutes should be limited to noting the names of the members present, the names of the members absent, the names of any staff present, and noting that there being no quorum present, no actions were taken and that the meeting was adjourned at a given time.

RECOMMENDATIONS

Our prior report on the fiscal years ended June 30, 2001, and 2002, contained four recommendations. The status of each recommendation within the prior report is presented below.

Prior Audit Recommendations:

- The Division should implement procedures to effectively monitor travel advances and ensure compliance with the State Comptroller's petty cash employee travel advance requirements. The Division established new procedures that appear to be effective. This recommendation is not being repeated.
- The Division should fully implement its disaster recovery plan by storing information offsite to ensure timely successful retrieval of back up information in the event of an emergency. Our current audit noted that the Division routinely stores back-up tapes offsite. This recommendation is not being repeated.
- The Division should review State Comptroller fiscal year end instructions and file all required GAAP forms in a timely manner. Our current audit noted that the Division filed the required GAAP forms in a timely manner. This recommendation is not being repeated.
- The Division should improve controls over the procurement/payment process to ensure that commitments and expenditures are processed in accordance with established requirements. Our current audit did not note any instance in which procurement/payment was not processed in accordance with established requirements. This recommendation is not being repeated.

Current Audit Recommendations:

- 1. The Division should give a higher priority to the need for enabling LAN users to periodically change their passwords.**

Comments:

We noted that passwords are required to access the Division's LAN. However, the Division does not require users to regularly change their passwords. Furthermore, we were informed that only 29 of the current 155 LAN users have the type of system configuration that would allow them to change their passwords.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes, we have audited the books and accounts of the Division of Special Revenue, for the fiscal years ended June 30, 2003, 2004 and 2005. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations, contracts and grants and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grants applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement audits of the Division of Special Revenue for the fiscal years ended June 30, 2003, 2004 and 2005, are included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Division of Special Revenue complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of the internal controls 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 Division of Special Revenue is the responsibility of the Division of Special Revenue's management.

As part of obtaining reasonable assurance about whether the Agency 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 Agency's financial operations for the fiscal years ended June 30, 2003, 2004 and 2005, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants. However, providing an opinion on compliance with these 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*. However, we noted a certain immaterial or less than significant instance of noncompliance, which is described in the accompanying "Condition of Records" and "Recommendations" sections of this report

Internal Controls over Financial Operations, Safeguarding of Assets and Compliance:

The management of the Division of Special Revenue is responsible for establishing and maintaining effective internal controls over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts and grants applicable to the Agency. In planning and performing our audit, we considered the Agency's internal controls over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Agency's financial operations in order to determine our auditing procedures for the purpose of evaluating the Division of Special Revenue's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal controls over those control objectives.

Our consideration of the internal controls over the Agency's financial operations and over compliance would not necessarily disclose all matters in the internal controls 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 or failure to safeguard assets that would be material in relation to the Agency's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions by the Agency 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 controls that we consider to be material or significant weaknesses.

However, we noted a certain matter involving the internal controls over the Agency's financial operations, safeguarding of assets, and/or compliance, which is 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.

CONCLUSION

We wish to express our appreciation for the cooperation and courtesies extended to our representatives by the officials and staff of the Division of Special Revenue during the examination.

Michael H. Hamilton
Associate Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts