
RHODE ISLAND LOTTERY

Independent Auditor's Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards*

and

MANAGEMENT COMMENTS

JUNE 30, 2009 AUDIT

Ernest A. Almonte, CPA, CFF
Auditor General

State of Rhode Island and Providence Plantations
General Assembly
Office of the Auditor General



STATE of RHODE ISLAND and PROVIDENCE PLANTATIONS
GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

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October 6, 2009

Joint Committee on Legislative Services, General Assembly
State of Rhode Island and Providence Plantations:

We have audited the financial statements of the Rhode Island Lottery (the “Lottery”) for the year ended June 30, 2009 and have issued our report thereon dated September 23, 2009. Our audit report, which includes the Lottery’s financial statements and our Independent Auditor’s Report thereon, was issued under separate cover.

In accordance with *Government Auditing Standards*, we have also prepared a report, dated September 23, 2009 and included herein, on our consideration of the Lottery’s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts. Our report on the Lottery’s internal control over financial reporting and on compliance and other matters did not include any significant deficiencies in internal control over financial reporting. Our report did identify a matter relating to a potential fraud at one of the video lottery facilities that was required to be reported under *Government Auditing Standards*.

We also reported two matters which are intended to improve internal control and provide other operating efficiencies which we have presented for your consideration.

Sincerely,

Ernest A. Almonte, CPA, CFF
Auditor General

RHODE ISLAND LOTTERY

JUNE 30, 2009 AUDIT

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STATE of RHODE ISLAND and PROVIDENCE PLANTATIONS
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**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Joint Committee on Legislative Services, General Assembly
State of Rhode Island and Providence Plantations:

We have audited the financial statements of the Rhode Island Lottery (Lottery), an enterprise fund of the State of Rhode Island and Providence Plantations, as of and for the year ended June 30, 2009 and have issued our report thereon dated September 23, 2009. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control over financial reporting.

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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Joint Committee on Legislative Services, General Assembly
State of Rhode Island and Providence Plantations:

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, 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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as item 2009-1.

We also noted certain matters that we reported to management of the Lottery which are included with the Schedule of Findings and Responses as Findings 2009-2 and 2009-3.

This report is intended solely for the information and use of the Joint Committee on Legislative Services and the Lottery and the State's management, and is not intended to be and should not be used by anyone other than these specified parties.



Ernest A. Almonte, CPA, CFF
Auditor General

September 23, 2009

SCHEDULE OF FINDINGS AND RESPONSES

Finding 2009-1

OTHER MATTER REQUIRED TO BE REPORTED UNDER GOVERNMENT AUDITING STANDARDS

Subsequent to June 30, 2009, the Lottery became aware of a potential fraud involving the operation of the bonus play rewards program (“bonus play program”) at Twin River, a licensed video lottery facility. The bonus play program at Twin River became operational in June 2008 and was authorized by the Lottery. Due to weaknesses in controls over Twin River’s administration of the bonus play program including a lack of segregation of duties, inappropriate access rights, and system design weaknesses, a Twin River employee responsible for the administration of the program was able to create invalid player reward accounts and unauthorized free play credits. The free play credits resulted in video lottery prize awards being paid. Note 13 (c) to the Lottery’s June 30, 2009 financial statements contains an estimate of the amount of potential loss to the Lottery. The Lottery plans to seek reimbursement from Twin River for the amount of any loss attributable to this unauthorized activity.

This incident has been investigated by Twin River management, Lottery management and the Rhode Island State Police. Corrective action is planned by Twin River to improve controls over the administration of the bonus play program. Finding 2009-2 includes recommendations to the Lottery to improve its oversight of the bonus play programs at each of its licensed video lottery facilities.

Finding 2009-2

CONTROL REVIEWS FOR SIGNIFICANT CHANGES IN GAMING OPERATIONS

The Lottery has developed formal comprehensive policies and procedures designed to ensure that adequate internal controls are in place over video lottery operations. The Lottery also devotes significant resources annually to the monitoring of contractor compliance with these policies and procedures. Operations at the video lottery facilities are subject to change for a variety of reasons -- one of the more recent changes is the implementation of direct player reward marketing efforts (i.e., bonus play program) to increase sales at the facilities.

Prior to the implementation of the bonus play program at Twin River, the Lottery considered the impact of the program on the gaming systems already utilized to operate video lottery. The Lottery also developed and implemented monitoring policies and procedures to consider this new facet of video lottery operations.

During fiscal 2009, upon discovery of the issue discussed in Finding 2009-1, it was determined that Twin River had not implemented proper internal controls to effectively safeguard the integrity of its bonus play program. Although certain of these activities are clearly within the responsibility and control of the video lottery facility, the facility's control procedures must be considered due to the direct impact on video lottery sales and prize awards. In this specific instance, a certification by the facility of its policies and procedures relating to the bonus play program would have provided additional assurance that the facility had given adequate consideration to proper controls over its operation and administration. Additionally, onsite review of controls over its operation either by Lottery personnel or a contractor engaged to perform the review would have ensured that controls, as certified by the facility, were in place and operating effectively.

Upon discovery of the control deficiency indicated above, the Lottery began a review of the facility's controls over its bonus play program and has made appropriate recommendations to resolve the known deficiencies. Once implemented by the facility, the Lottery should engage a contractor knowledgeable about these types of specific gaming operations to validate that the facility's controls are in place and operating effectively to safeguard video lottery operations.

RECOMMENDATIONS

- 2009-2a Obtain a certification of controls employed by the video lottery facilities in relation to significant operational changes made within video lottery operations prior to their implementation.
- 2009-2b Obtain an examination of policies and procedures relating to the operation of bonus play programs at the two video lottery facilities to ensure that each facility has controls in place to effectively safeguard video lottery operations.

Auditee Views:

2009-2a

The Lottery will obtain certifications of internal controls for all significant operational changes from the two video lottery facilities prior to implementation of approved changes. The Lottery has formal policies and procedures requiring licensed Video Lottery Facilities have adequate internal controls to safeguard, to the highest degree possible, Lottery assets provided in the operation. The Lottery, as part of its regulatory and oversight responsibilities, will also require internal and external evaluations of required controls over approved operations.

2009-2b

The Lottery has required Twin River to engage the services of an investigative and computer forensics firm regarding the control issue over the bonus play program. The Lottery is in the process of defining the requirements for examinations of the bonus play

operations and player tracking systems and developing proposals for external firms to bid and perform the examinations. The Lottery has also required both video lottery facilities to implement various controls to ensure IT systems are adequately secured, restricted, controlled and monitored. The Lottery will require future routine examinations of the bonus play and tracking systems.

Finding 2009-3

UTILIZATION OF THE STATE'S ACCOUNTING SYSTEM FOR FINANCIAL REPORTING

The Lottery's internal general ledger accounting system is used for financial reporting; however, the Lottery utilizes the State's accounting system known as the Rhode Island Financial and Accounting Network System (RIFANS) for all disbursements relating to Lottery operations, except for prize disbursements. The Lottery records all payment transactions in both their internal accounting system and RIFANS for payments to vendors. Revenue and cash receipt transactions are also recorded in both systems although more detail is recorded in the Lottery's accounting system. The activity recorded in RIFANS is basically cash receipts and disbursements whereas the Lottery's accounting system records all activity on an accrual basis to prepare financial statements in accordance with generally accepted accounting principles.

For certain centralized billing processes used by the State (e.g., payroll, purchase cards, office supplies, etc.), payments are initiated through the State's Office of Accounts and Control and individual agencies are charged for their pro-rata share of monthly activity. In these instances, the Lottery does not initiate payment and must review reports from RIFANS to identify and record this activity in their internal accounting system.

The Lottery performs reconciliations of cash and certain expenditure categories between their internal general ledger and RIFANS, however, changes in the fiscal closing processes conducted by the State and the Lottery can still lead to variances between the financial activity reported by the two systems. In addition, the Lottery's current process includes a duplication of effort for the recording of disbursements and cash receipts within both systems. Further, because RIFANS does not include all financial statement activity required for the preparation of accrual basis financial statements, the State can not adopt a comprehensive budget for Lottery operations as part of their annual budget process.

We believe that accounting and financial reporting of the Lottery's operations through RIFANS would provide the most efficient and effective means of internal control over financial reporting. RIFANS, as currently utilized to meet the State's financial reporting needs, could not accommodate the Lottery's financial reporting needs. The State, in conjunction with the Lottery, should adopt a plan to facilitate the use of RIFANS to meet the accounting and financial reporting needs of the Lottery. Such a plan will require careful consideration of the Lottery's chart of accounts, their monthly fiscal closing process, and other needs to allow for the timely

preparation of monthly and annual financial statements as required by Rhode Island General Laws.

RECOMMENDATION

2009-3 Explore using RIFANS for Lottery financial reporting thereby eliminating the redundancy of recording Lottery activity in two accounting systems.

Auditee Views:

The Lottery will continue to explore opportunities to utilize the State's RIFANS financial reporting system in order to eliminate recording accounting activity in both the Lottery's and State's accounting systems. During the prior fiscal year, the Lottery has met with the State personnel regarding the requirements necessary to utilize the RIFANS system. The Lottery will continue to meet with the appropriate personnel to plan and determine when and how the State's system can accommodate the Lottery's financial reporting needs and regulatory requirements which include issuance of monthly financial statements and transfers of estimated revenues to the State's General Fund.