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**RHODE ISLAND LOTTERY**

**MANAGEMENT COMMENTS**

**JUNE 30, 1998 AUDIT**

Ernest A. Almonte, CPA, CFE  
Auditor General

State of Rhode Island and Providence Plantations  
General Assembly

Office of the Auditor General



State of Rhode Island and Providence Plantations

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March 18, 1999

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

Members of the Rhode Island Lottery Commission:

We audited the financial statements of the Rhode Island Lottery (the "Lottery") for the year ended June 30, 1998 and have issued our report thereon dated December 11, 1998. In accordance with *Government Auditing Standards*, we have also issued a report dated December 11, 1998 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 compliance and internal control over financial reporting indicated no matters that we considered to be reportable conditions or no material instances of noncompliance. However, during our audit, we noted certain matters involving compliance, internal controls, and other operational matters that are presented for your consideration. These comments and recommendations are intended to enhance compliance with laws, regulations and contracts, improve internal control, or result in other operational efficiencies.

This report is intended for the information of the Joint Committee on Legislative Services, the Rhode Island Lottery Commission and Lottery management. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Ernest A. Almonte, CPA, CFE  
Auditor General

**RHODE ISLAND LOTTERY  
MANAGEMENT LETTER  
JUNE 30, 1998 AUDIT**

**TABLE OF CONTENTS**

	<b><u>Page</u></b>
<b><u>FINDINGS AND RECOMMENDATIONS</u></b> .....	1
PRIZE WITHHOLDING FOR CHILD SUPPORT OBLIGATIONS .....	1
PRIZE PAYOUT PERCENTAGES .....	1
COLLECTION OF VIDEO LOTTERY PROCEEDS .....	2
MONITORING.....	3
CONTRACT MONITORING.....	4
INSTANT TICKET INVENTORY INSPECTIONS.....	4
INSTANT TICKET VALIDATION CONTROLS .....	5
LOTTERY AGENT LICENSES .....	5
INSTANT TICKET PRIZE OBLIGATIONS .....	6
LOT-O-BUCKS INVESTMENT RECONCILIATION.....	9

## **FINDINGS AND RECOMMENDATIONS**

### **PRIZE WITHHOLDING FOR CHILD SUPPORT OBLIGATIONS**

RI General Law Section 42-61-7.1 requires that outstanding child support obligations (greater than \$500) be deducted from Lottery prizes in excess of \$600. Such amounts are then remitted by the Lottery to Rhode Island Family Court. Information is periodically provided by Rhode Island Child Support Services (RICSS) which identifies individuals with outstanding child support obligations. For all prizes validated at Lottery headquarters, the Lottery's prize payment system compares the winner's name and social security number with the data provided by RICSS and the appropriate withholding is made.

For video lottery games, the video lottery facilities are responsible for validation and payment of video prize awards. No procedure is in place, however, to withhold child support obligations from video lottery prizes paid at its video facilities. The Lottery should direct the video lottery facilities to withhold child support from prizes when required.

### **RECOMMENDATION**

1. Implement procedures to allow for withholding of child support from video lottery prizes.

#### **Auditee Views:**

*The Lottery concurs with this recommendation, however, it believes the law is not clear as to whether the required withholding of child support applies to video lottery prizes. Further evaluation of the intent of the law and its effect on video lottery operations is needed before any procedures can be implemented.*

### **PRIZE PAYOUT PERCENTAGES**

Section 42-61-15 of the Rhode Island General Laws (General Laws) states that "the amount of prize awards to holders of winning lottery tickets shall be determined by the commission, but shall not be less than forty-five percent (45%) nor more than fifty-five percent (55%) of the total revenue accruing from the sale of lottery tickets." The General Laws also state that "for the lottery game commonly known as "Keno", the amount of prize awards to holders of winning Keno tickets shall be determined by the commission, but shall not be less than forty-five percent (45%) nor more than sixty-five percent (65%) of the total revenue accruing from the sale of Keno tickets."

The Lottery increased the prize structure for Keno on November 5, 1995. From November 5, 1995 through June 30, 1998, Keno's prize payout has been 65.47% of total game revenue over this period. As reported in prior audits, this percentage has exceeded the 65% stipulated in the law and has

resulted in excess prize awards of \$554,066 based on total sales for this period.

### RECOMMENDATION

2. Reevaluate the designed payout percentages for Keno to ensure compliance with the General Laws.

#### Auditee Views:

*The Lottery concurs with this recommendation and is seeking amendment of the General Laws to raise the maximum Keno payout percentage to 68%.*

### COLLECTION OF VIDEO LOTTERY PROCEEDS

The Video Lottery Terminal (VLT) procedures manual developed by the Lottery in October 1995 established the responsibilities of all video lottery participants. These procedures require video lottery facilities to make daily deposits of net terminal income (less authorized working capital banks retained for the payment of prizes).

The Lottery's daily deposit requirement is important since it minimizes the amount of net terminal income due the Lottery and held by the facilities, and also improves the Lottery's (and the State's) cash flow and investment opportunities by providing access to these funds more quickly. The Lottery authorized working capital banks and began requiring the facilities to make daily deposits in August 1996.

Our prior audits noted delays in the availability of video lottery proceeds to the Lottery (and the State) due to issues surrounding the collection, counting and physical movement of cash as well as the need to retain sufficient cash for prizes. In response, we previously recommended that the Lottery consider amending its VLT procedures manual to be more specific by requiring a deposit in available funds by a certain time each day. This recommendation was not implemented during the current fiscal year and the Lottery has not performed any further analysis of the lag time relating to the availability of funds deposited by the facilities during the year.

We also recommended that the Lottery explore having the facilities electronically transfer amounts due the Lottery to facilitate the daily transfer process. Electronic transfer of funds may alleviate some of the delay associated with the logistics of collecting, counting, and moving cash for deposit to the Lottery's account. Additionally, a complete evaluation of the facilities' cash management and transfer procedures should be performed to ensure that net terminal income is available to the Lottery as soon as possible.

### RECOMMENDATIONS

3. Amend the VLT procedures manual to require a deposit in available funds by a certain time each day.

4. Consider utilizing electronic funds transfer to deposit video lottery net terminal income due the Lottery.
5. Monitor the timeliness of facility deposits based upon the availability of video proceeds in the Lottery's account.

Auditee Views:

*The Lottery concurs with these recommendations and will review cash management issues at the facilities and the feasibility of utilizing electronic funds transfer to improve the timely transfer of video lottery proceeds.*

## **MONITORING**

Lottery revenues have grown considerably over the past few years and the complexity of operations has also increased with the implementation of video lottery games. Due to the fact that a significant portion of Lottery operations are performed by others (i.e., on-line games contractor, central communications provider, and video lottery facilities) it is important that the Lottery have the resources to evaluate and monitor critical controls to ensure the integrity of lottery games and safeguard amounts due the Lottery.

As noted in prior audits, we believe the Lottery should improve its monitoring of all lottery operations. In response to our prior recommendations, the Lottery has developed a monitoring plan specific to video lottery operations and has improved its enforcement of the VLT procedures manual at the video lottery facilities.

However, during our audit, we noted weaknesses relating to financial statement account reconciliations and the monitoring of access to the Lottery's gaming systems. Also, the Lottery's video lottery monitoring plan only summarized the Lottery's present control procedures and did not include additional monitoring procedures such as analyzing deposit lag time and gaming system access. Comprehensive monitoring requires that these types of key financial and computer control procedures are in place and operating effectively over all Lottery operations.

### **RECOMMENDATION**

6. Develop and implement a comprehensive monitoring plan focusing on key financial and operating controls for Lottery activities conducted by others.

Auditee Views:

*The Lottery concurs with this recommendation.*

## **CONTRACT MONITORING**

The Lottery contracts with various vendors for various types of services relating to gaming operations. Services and products contracted for include the operation of all gaming systems, related hardware such as video terminals and instant ticket vending machines, instant ticket inventory, etc. Most contracts include provisions governing fees to be paid and charges to be recovered by the Lottery, as well as the various responsibilities to be fulfilled by the various vendors.

We noted two instances where the Lottery did not recover charges as permitted by contract provisions. Additionally, two contracts expired and were not immediately renewed despite the continuation of services. Although appropriate action was taken by the Lottery when notified of these findings, overall contract-monitoring procedures could be improved.

The Lottery should improve its contract-monitoring procedures by (1) assigning specific responsibility for contract monitoring, (2) summarizing key contract terms and expiration dates and (3) periodically assessing compliance with contract provisions.

### **RECOMMENDATION**

7. Develop contract-monitoring procedures to ensure that contract provisions are properly enforced by the Lottery.

#### **Auditee Views:**

*The Lottery concurs with this recommendation and intends to adopt procedures to improve overall contract monitoring.*

## **INSTANT TICKET INVENTORY INSPECTIONS**

A new instant ticket validation system was placed into operation in October 1997. Instant tickets are now distributed in four stages. Tickets are first assigned to the production manager in an inactive status (tickets cannot be validated). When the tickets are ready for distribution to retailers, the tickets are assigned to district sales representatives who deliver tickets to retailers on their route. Upon delivering tickets to retailers, the sales representative assigns, using the retailers' terminal, tickets to the retailers' inventory ("received status" or inactive). When retailers begin selling instant tickets, they must first change (via their terminal) the ticket status from "received" to "active". If the retailers need the tickets upon delivery, the sales representatives can also activate the tickets at that time.

The Lottery requires only District Sales Representatives to reconcile and verify their assigned inventory. Based on a representative's capability to activate tickets, it would provide improved control

if someone independent of the instant ticket distribution function periodically verified inventory as reported by the instant ticket validation system.

#### RECOMMENDATION

8. Conduct periodic inventory inspections to verify instant ticket inventory reported by the instant ticket validation system.

#### Auditee Views:

*The Lottery concurs with this recommendation.*

### INSTANT TICKET VALIDATION CONTROLS

The instant ticket validation system has a control which only allows validation of an instant ticket if the ticket has been recorded as “active” within the system. However, if a ticket presented for validation is within the retailer’s inventory but is listed as inactive or “received status”, the system will automatically activate the book and allow the ticket to be validated. By the system automatically activating the book of tickets, no warning or prompt is given to the retailer to warn them that the ticket is presently inactive. If an “inactive” ticket were attempted to be validated at another retailer, the system would prevent validation. This control is in place to prevent payment of prizes for stolen tickets.

System controls should be enhanced by either eliminating the automatic activation of a book of tickets or prompting the retailer in all instances that the ticket being presented for validation is from the “inactive” inventory. In the event that the retailer simply neglected to activate the book, they can quickly do so with little inconvenience to the customer.

#### RECOMMENDATION

9. Request that the system provider either eliminate the automatic activation feature or prompt the retailer in all instances where a ticket from the “inactive inventory” is presented for validation.

#### Auditee Views:

*The Lottery concurs with this recommendation.*

### LOTTERY AGENT LICENSES

R.I. General Law Section 42-61-5(f) states that “every holder of a license as a lottery sales

agent shall renew such license annually pursuant to the rules and regulations of the commission. Licensees shall pay to the commission a fee to be determined by the commission upon receipt or renewal of a license.” In practice, once the Lottery licenses a sales agent they remain licensed until the Lottery terminates the license. The Lottery should comply with State law and begin requiring retailers to renew licenses annually. This renewal would allow the Lottery an opportunity to update retailer information and reaffirm important Lottery regulations with retailers.

#### RECOMMENDATION

10. Require lottery sales agents to renew their licenses annually.

#### Auditee Views:

*The Lottery concurs with this recommendation*

#### INSTANT TICKET PRIZE OBLIGATIONS

The Lottery typically sells instant tickets for multiple games simultaneously with new products being introduced continuously. Prize obligations are recorded as tickets are sold based on the designed prize payout for the game. Prize obligations are reduced as prizes are paid.

Upon the implementation of the instant ticket validation system, the Lottery began recording the prize obligation for all instant games into a single account instead of maintaining a separate account for each game as was previously done. By recording all instant ticket obligations into one account, the Lottery can no longer accurately account for the prize obligations of individual games. It is important to accurately account for prize obligations for each game to ensure that the proper amounts of unclaimed prizes are recovered once the various games have ended. Further, control is enhanced when the prize obligation can be separately monitored and analyzed for each game.

The instant ticket validation system already provides the information required to account for instant ticket prize obligations by individual game. The Lottery would simply need to modify its accounting practices for recording these obligations in its general ledger.

#### RECOMMENDATION

11. Account for prize obligations relating to each instant ticket game separately using information provided by the instant ticket validation system.

#### Auditee Views:

*The Lottery concurs with this recommendation.*

## LOT-O-BUCKS INVESTMENT RECONCILIATION

The Lottery owns investments which, at maturity, are intended to coincide with the scheduled payments for Lot-O-Bucks jackpot winners. As reported in prior audits, the Lottery does not maintain its accounting records for investments held to demonstrate that scheduled Lot-O-Bucks prize payments will be satisfied by proceeds of investments. A report should be maintained which lists each required prize payment by date and matches the specific investments that will be used to satisfy the prize liability.

### RECOMMENDATION

12. Maintain accounting records to match scheduled future prize obligations with investment maturities.

#### Auditee Views:

*The Lottery concurs with this recommendation.*

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