New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor

Department of the Treasury
Division of the State Lottery

July 1, 2005 to August 31, 2006

Richard L. Fair
State Auditor
The Honorable Jon S. Corzine  
Governor of New Jersey

The Honorable Richard J. Codey  
President of the Senate

The Honorable Joseph J. Roberts, Jr.  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of Treasury, Division of the State Lottery for the period of July 1, 2005 to August 31, 2006. If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fair  
State Auditor  
November 16, 2006
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope</td>
<td>1</td>
</tr>
<tr>
<td>Objectives</td>
<td>1</td>
</tr>
<tr>
<td>Methodology</td>
<td>1</td>
</tr>
<tr>
<td>Conclusions</td>
<td>2</td>
</tr>
<tr>
<td>Findings and Recommendations</td>
<td></td>
</tr>
<tr>
<td>Debt Recovery</td>
<td>3</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>3</td>
</tr>
<tr>
<td>Advertising Contract</td>
<td>4</td>
</tr>
<tr>
<td>Disaster Recovery and Business Continuity</td>
<td>4</td>
</tr>
<tr>
<td>Auditee's Response</td>
<td>6</td>
</tr>
</tbody>
</table>
Scope

We have completed an audit of the Department of the Treasury, Division of the State Lottery for the period July 1, 2005 to August 31, 2006. Our audit included financial activities accounted for in the state’s General Fund and the State Lottery Fund.

The prime responsibility of the Division of the State Lottery is to raise revenue for contributions to state education and institutions benefiting the citizens of New Jersey through the sale of lottery products. Sales of lottery tickets totaled $2.4 billion for fiscal year 2006 resulting in $844 million in contributions to the state. Appropriations expenditures for administration of the division were $27 million for fiscal year 2006.

Objectives

The objectives of our audit were to determine whether the financial transactions were related to the division’s programs, were reasonable, and were recorded properly in the accounting systems.

This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the agency. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed agency personnel to obtain an understanding of the
programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Some sample populations were sorted and transactions were judgmentally selected for testing.

Conclusions

We found that the financial transactions included in our testing were related to the division's programs, were reasonable, and were recorded properly in the accounting systems. In making this determination, we noted certain internal control weaknesses and matters of compliance with laws and regulations that merit management's attention.
Debt Recovery

The division can recover more debt for all state agencies.

The division processes payments for prizes exceeding $600. Before checks are processed, the division is required to match the payment file with other state records to determine if any prize winners have defaulted on student loans or child support obligations. Amounts owed to these agencies are deducted from the prize and forwarded to the respective agency before payment is made. The division could also recover amounts for other state agencies by matching the prize winners file to the Division of Taxation’s Set-off of Individual Liability (SOIL) database which contains detailed records of debt owed to the state. We noted the division paid $900,000 to prize winners during 2005 that could have been recovered.

Recommendation

We recommend the division match the prize winner file with Taxation’s SOIL records and withhold any amounts these individuals owe the state. The division should seek legislation if it is determined they do not have the authority to offset debts other than student loans and child support.

Accounts Receivable

State Treasury Circular Letter 06-03-OMB states that all accounts receivable that have not been collected in 91 days should be transferred to the Division of Revenue for collection. The division’s records showed a balance of $2.4 million due from retail agents at June 30, 2006. The division’s prior practice was to transfer older accounts receivable to the Attorney General (AG). Currently, the division transfers only receivables less than $5,000 to the Division of Revenue and transfers larger amounts to the AG. As of June 30, 2006 the division had transferred
$1.4 million to the AG and $360,000 to the Division of Revenue. The remaining amount is being actively pursued for collection by the division.

**Recommendation**

We recommend the division transfer all of their accounts receivable older than 91 days to the Division of Revenue in accordance with the circular letter.

---

**Advertising Contract**

The division has a state contract with an advertising vendor that includes procurement of printed promotional materials. A provision permits the vendor to subcontract for the printing services and requires it to solicit three bids for jobs expected to cost less than $15,000. The contract requires the division to pay the vendor an administrative fee of $1,500 each time it solicits bids. We noted five such instances where printing services ranging from $95 to $1,105 were procured by the vendor, and in each case the division paid the administrative fee. The division therefore paid more for the vendor to solicit bids than the eventual cost of the printing services. State procurement regulations do not require price competition for smaller transactions.

**Recommendation**

We recommend the division modify the existing provision which requires them to pay a bid solicitation fee for smaller printing services. This should be done when the next contract is negotiated.

---

**Disaster Recovery and Business Continuity**

The division’s disaster recovery plan includes a
The division can improve its disaster recovery. Back-up location that would provide continuity if the operations of the headquarters were disabled. A plan is in place and is regularly tested; however, the recovery of certain functions could be prolonged. Although critical functions such as the sales network and the electronic funds transfer of revenues would recover without interruption, the payment of prize winners could be delayed until the necessary equipment could be procured.

Recommendation

We recommend the division enhance their existing disaster recovery and business continuity plan so that no functions would experience prolonged interruption.
October 31, 2006

Thomas R. Meseroll  
Assistant State Auditor 
Office of the State Auditor 
125 South Warren Street 
P.O. Box 067 
Trenton, NJ 08625 

Dear Mr. Meseroll, 

Thank you for providing the opportunity for Lottery management to respond to the audit findings identified in your letter dated October 20, 2006. I have attached our direct response to these findings on the following pages.

I would also like to take this opportunity to thank you and your staff for their courtesy and professionalism, toward my staff, during the audit process.

Should you have any further questions concerning our responses, please feel free to contact either Lottery Deputy Executive Director William Jourdain or myself at your convenience.

Sincerely,

[Signature]

Michelene Davis, Esq.  
Executive Director  
Division of State Lottery

Attachment

C: Bradley I. Abelow, State Treasurer 
Robert J. D’Anton, Chairman, State Lottery Commission 
Robert Smartt, Deputy State Treasurer 
William Jourdain, Deputy Executive Director, Lottery 
Stephen Palmieri, Fiscal Manager, Lottery
Attachment – Division of Lottery Management Response

Debt Recovery

The division processes payments for prizes exceeding $600. Before checks are processed, the division is required to match the payment file with other state records to determine if any prize winners have defaulted on student loans or child support obligations. Amounts owed to these agencies are deducted from the prize and forwarded to the respective agency before payment is made. The division could also recover amounts for other state agencies by matching the prizewinner file to the Division of Taxation's Set-off of Individual Liability (SOIL) database, which contains detailed records of debt owed to the state. We noted the division paid $900,000 to prizewinners during 2005 that could have been recovered.

We recommend the division match the prize winner file with Taxation's SOIL records and withhold any amounts these individuals owe the state. The division should seek legislation if it is determined they do not have the authority to offset debts other than student loans and child support.

*The Division of Lottery concurs with the State Auditor’s recommendation to match prize awards in excess of $600 against the SOIL program. This program will mirror current legislated directives to match Division of Economic Assistance and Higher Education Student Assistance account in arrears against Lottery winnings. As noted above, the Lottery’s statute is specific on revenue disbursement and will require additional legislation. The Division will actively seek assistance to proceed with the State auditor’s recommendation through, the Department of Treasury’s legislative unit and the Office of Management and Budget.*

Accounts Receivable

State Treasury Circular Letter 06-03-OMB states that all accounts receivable that have not been collected in 91 days should be transferred to the Division of Revenue for collection. The division's records showed a balance of $2.4 million due from retail agents at June 30, 2006. The division's prior practice was to transfer older accounts receivable to the Attorney General (AG). Currently, the division transfers only receivables less than $5,000 to the Division of Revenue and transfers larger amounts to the AG. As of June 30, 2006 the division had transferred $1.4 million to the AG and $360,000 to the Division of Revenue. The remaining amount is being actively pursued for collection by the division.

We recommend the division transfer all of their accounts receivable older than 91 days to the Division of Revenue in accordance with the circular letter.

*The Division of Lottery recognizes the requirements of Circular Letter 06-03 OMB with regards to our outstanding account receivable balances. As a majority of the receivables noted as referred to the AG pre-date the circular letter, the Division of Lottery will utilize this opportunity to relieve the AG of this collection activity and will comply by transferring all outstanding accounts older that 91 days to the Division of Revenue.*
Advertising Contract

The division has a state contract with an advertising vendor that includes procurement of printed promotional materials. A provision permits the vendor to subcontract for the printing services and requires it to solicit three bids for jobs expected to cost less than $15,000. The contract requires the division to pay the vendor an administrative fee of $1,500 each time it solicits bids. We noted five such instances where printing services ranging from $95 to $1,105 were procured by the vendor, and in each case the division paid the administrative fee. The division therefore paid more for the vendor to solicit bids than the eventual cost of the printing services. State procurement regulations do not require price competition for smaller transactions.

We recommend the division modify the existing provision, which requires them to pay a bid solicitation fee for smaller printing services. This should be done when the next contract is negotiated.

The Division of Lottery acknowledges this issue with the boilerplate language contained within the contract, and will work with the Division of Purchase and Property to correct this anomaly during the next procurement process. Lottery Management will also monitor these smaller bid solicitations, during the remaining term of the current contract, to insure best value to the State.

Disaster Recovery and Business Continuity

The division's disaster recovery plan includes a back-up location that would provide continuity if the operations of the headquarters were disabled. A plan is in place and is regularly tested; however, the recovery of certain functions could be prolonged. Although critical functions such as the sales network and the electronic funds transfer of revenues would recover without interruption, the payment of prizewinners could be delayed until the necessary equipment could be procured.

We recommend the division enhance their existing disaster recovery and business continuity plan so that no functions would experience prolonged interruption.

The Lottery is currently revising our Business Continuity plan to include a full functioning Lottery administrative facility at a designated backup site. This plan is an integral component of the Lottery Gaming System procurement and will provide a scaled down facility mirroring all of the critical day-to-day business functionality of the Division. Unplanned delays in the procurement of the Gaming System contract have prevented the Division of Lottery from implementing this plan.