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INDEPENDENT STATE AUDITOR'S INTERIM TRANSITION REPORT  
ON CERTAIN ACTIVITIES  
OF THE  
MASSACHUSETTS STATE LOTTERY COMMISSION

AS OF JANUARY 20, 1999

**OFFICIAL AUDIT  
REPORT  
JULY 15, 1999**

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## INTRODUCTION

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The Massachusetts State Lottery Commission (MSLC) is authorized by Chapter 10, Sections 22 through 35, of the Massachusetts General Laws to raise revenues for cities and towns by conducting various lottery games. On September 27, 1971, legislation was enacted to create a state lottery that would provide a source of revenue for the 351 cities and towns of the Commonwealth. This legislation created MSLC, which is composed of the State Treasurer, who serves as chairman; the Secretary of Public Safety; the State Comptroller; and two members appointed by the Governor for terms coterminous with that of the Governor. These members have the responsibility of approving rules and regulations, contracts, and overall policy decisions for MSLC. MSLC's Executive Director is appointed by the State Treasurer, subject to the approval of the Governor, and is responsible for MSLC's day-to-day operation.

In fiscal year 1998, MSLC collected over \$3.2 billion in revenues and incurred \$2.446 billion in expenditures, consisting of \$2.2 billion in prizes awarded; \$182 million in commissions and bonuses paid to approximately 7,600 sales agents; and \$64 million for administrative costs. The remaining revenue of approximately \$775 million was made available for distribution to cities and towns according to statute.

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws and in consideration of the most recent state election, whereby a new State Treasurer and Receiver-General was elected who serves as the chairman of MSLC, we conducted a transition audit of the financial activities, accounts, functions and related systems and control environment of MSLC through the date of transition, January 20, 1999; however, our review also included an examination of a subsequent event, a reported cash shortage. The purpose of our review was to inform the new Treasurer of the status of MSLC's fiscal and administrative operations and the related systems and control environment to enhance the transition from the prior administration to the new administration. Our report identifies certain operations of the prior administration that lacked adequate fiscal, administrative, and accounting internal controls. The recommendations in this report are to assist the new administration in implementing its internal control structure and enhancing its fiscal and administrative operations in order to safeguard its assets and revenues and ensure that they are adequate to minimize the occurrence of errors, mistakes, or illegal acts and that the office is operating in an economical, effective, and efficient manner and in compliance with all applicable rules, regulations, and laws.

We thank and commend the Treasurer and her new staff for their attention and cooperation during this audit and their commitment to working with us and the Office of the State Comptroller in implementing the necessary corrective measures to improve the operation of MSLC functions. We are issuing this report in order to assist management's expeditious implementation of corrective action, and we will follow-up on these and other issues to determine the status of corrective actions taken and will report accordingly. These reviews are intended to determine the adequacy and legal compliance of systems that have a material impact on the integrity of MSLC's control environment. We will continue to work with the new Treasurer and MSLC management to assist them in developing and implementing a new and

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improved control environment and security measures that will effect renewed confidence in MSLC's operations.

## AUDIT RESULTS

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1. Inadequate Winner Identification Security and Internal Controls Revealed Many Instances of False Representations and Potential Tax Evasion in the Payment of \$2.2 Million in Prizes at MSLC: MSLC did not have an adequate internal control system to properly verify names, Social Security numbers, and other pertinent data for prize winners cashing tickets at MSLC offices. Prize claimants gave false information to MSLC to potentially avoid state and federal tax liabilities and child support payment obligations, hide the fact that prize winners may be receiving public assistance, or for a number of other reasons. Because of a pervasive "who cares," "it's not my job or responsibility," or "it's a trivial amount or issue" attitude, there is little or no consistent effort to minimize the potential for tax evasion, nonpayment of child support, welfare fraud, or identity theft. As a result MSLC prize winners were allowed to use false identification documents, names, addresses, Social Security numbers and to file incomplete and erroneous claim forms, which resulted in numerous questionable conditions and situations that a reasonable person would believe are indicative of control and security problems that should be pursued further and eliminated, especially in an environment such as MSLC, where security and controls are critical. During our audit tests, we found many instances totaling \$2.2 million in which a number of claimants used (a) Social Security numbers of a deceased person, (b) Social Security numbers that were used by more than one person, (c) Social Security numbers, that could not be found using commercial person identification services and (d) Social Security numbers that differed in two successive years. Moreover, we found (a) the Social Security number given by a claimant belonged to a person other than the person on record at MSLC, (b) claimants used the same Social Security number for two years but a different name each year, and (c) a claimant's street address was listed in multiple municipalities. We also found a number of claimants who had an extraordinary amount of winnings. For example, one individual had 319 claims for \$412,482. This individual would have had to visit an MSLC office almost daily as a result of the 319 claims. Another individual had 149 claims for \$237,858, which would indicate the claimant had to visit MSLC offices almost three days per week.

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In addition, we found many instances of claimants having names that appeared unusual or suspicious. Further examination revealed that many of these claimants used Social Security numbers that were not found by a commercial person identification service had their Internal Revenue Service (IRS) W2-G income information forms returned to the MSLC as undeliverable by the United States Postal Service, gave telephone numbers that were not listed, and listed nonexistent post office boxes as mailing addresses.

Our review also revealed that almost 1,800 IRS W2-G income information forms amounting to almost \$7 million were returned as undeliverable by the United States Postal Service. These returned W2-G forms indicate a very high

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probability that these gambling winnings were unreported and resulted in tax and other forms of evasion. We also reviewed multiple prize winners and found that nine multiple-prize-winning individuals received 130 W2-G forms totaling \$239,674. Of these issued W2-G forms, 101 forms totaling \$191,474 were undeliverable and returned to MSLC.

Moreover, our review of the W2-G data revealed instances of improper data interpretation by MSLC's computer system. As a result, we found that 52 checks for an incorrect prize amount were initially generated. In order to correct these errors, MSLC had to generate 104 more checks before it was able to present proper checks for the correct amount, including income tax withholdings, to the prize winners.

2. Inadequate Procedures for the Collection of \$15.1 Million in MSLC Cash Receipts Held by Its Sales Agents: Our review disclosed that MSLC's settlement process for collecting its cash receipts from its sales agents was too lengthy and resulted in untimely collections, shortages, and loss of unremitted cash. As a result, there was \$15.1 million in undeposited cash sales held and owed by sales agents as of January 26, 1999, of which \$12.8 million may be uncollectible because of poor collection policies and practices that allow improper use, shortages, or thefts by MSLC sales agents. We sampled 76 outstanding accounts totaling \$3,269,860, or 22% of the total outstanding balance of \$15.1 million. Only seven agents responded; 46 did not respond at all, and 23 confirmations, totaling \$1,407,007, were returned by the U.S. Postal Service as undeliverable. 23
3. Inadequate and Inconsistent Internal Controls, Security, Oversight, and Monitoring Practices over MSLC's Sales Offices Exposed Millions of Dollars in Revenue to Loss or Theft 33
  - a. Inadequate Internal Controls over Cash Receipts at the Braintree Sales Office Resulted in a Possible Theft of Funds Exceeding \$129,000: MSLC reported a theft of sales revenue of \$597 in accordance with Chapter 647 of the Acts of 1989. The theft occurred because an employee was allowed to have control over cash receipts in MSLC's Braintree Headquarters without proper monitoring and checks and balances in place to prevent the likelihood of thefts and shortages. Moreover, a subsequent review revealed that there were numerous other variances exceeding \$129,000 between the daily transaction sheets, primary deposit slips, and the actual deposits prepared by MSLC employees and made at the Braintree office. Because MSLC failed to institute proper control and security, it remained vulnerable and experienced another theft. (see Audit Result 3b). 33
  - b. Continued Cash Control Deficiencies Contributed to and Allowed for the Shortage of at Least Another \$24,000 in MSLC Funds: Our review of the cash management controls over MSLC's Home Office and Regional Sales Bank Account activity and site visits at five regional sales offices and Braintree Headquarters as part of our follow-up to the Braintree shortage (described in Audit Result 3a, above) disclosed that the Boston Game Room 38

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was allowed to operate in an inadequate internal control environment. Specifically, control weaknesses, poor oversight, and inadequate support from Braintree Headquarters allowed for a shortage of another \$24,061. We also discovered \$39,259 of sales revenue deposits, in the form of electronic fund transfers, were not transferred to the Office of the State Treasurer in a timely manner. Further, we discovered \$309,681 in outstanding checks in the MSLC Prize Account that included items that were more than one year old and should have been investigated and resolved. Additionally, we discovered that certain bank accounts upon which handwritten checks are drawn required only one authorized signature, which represents an obvious and serious cash control weakness.

4. Poor Management of Hundreds of Millions of Instant Game Tickets Rendered Them Vulnerable to Theft and Misuse: We conducted various tests of 500,000 books having approximately 150 million tickets to determine whether systems were in place to ensure that, in all claims for prizes, the winning tickets were purchased from an authorized sales agent and was from a book that had been activated and settled by an authorized sales agent. We found that book numbers for over 29,000 winning instant game tickets with a value of \$600 or greater were not listed, and therefore the winning tickets could not be traced to the authorized agent who sold the ticket nor the book from which it came. This represents 76% of the winning instant game tickets cashed during 1998. After we brought this to the attention of MSLC officials, they responded that it was the vendor's responsibility to capture, update, and maintain this data. However, we subsequently learned that this problem was being addressed. We also determined that there were inadequate inventory controls over unsold portions of books returned to MSLC (i.e., live activated tickets). We observed partial and full ticket books being returned to MSLC in plastic grocery bags or simply wrapped with elastic bands. Also, we observed these tickets processed in unsecured areas. Since these tickets have been activated, they could be submitted for a cash prize without detection. 46
5. Contractor Overbilling of \$279,851 on Instant Game Ticket Printing: Our prior audit report determined that MSLC was being overbilled at least \$317,000 for the printing of instant game tickets. This overpricing resulted from a violation of MSLC's "most favored customer" contract status. Our follow-up review determined that, after much correspondence between MSLC and Scientific Games, Inc., (SGI), the ticket printing contractor, MSLC hired a private accounting firm to determine whether it was being overcharged. The firm confirmed that MSLC was overcharged, and SGI has credited MSLC \$225,822. In addition, on December 16, 1998 SGI notified MSLC that a new contract affected its "most favored customer" status and that MSLC was due another credit of \$54,029. 55
6. Extension of Instant Game Printing Contract: On October 21, 1993 MSLC and SGI entered into a two-year contract, not to exceed \$21.3 million, with three one-year option periods for the design and printing of instant game tickets, and related marketing services. This contract was extended for three years through October 21, 1998, not to exceed \$48 million, MSLC and SGI agreed to a second 57

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contract extension on October 21, 1998. This extension ends on June 30, 1999, and all original terms and conditions remain in force, not to exceed \$12.7 million. Former MSLC officials recommended extending the contract because the lengthy bid process would extend through the new administration's first six months in office as a transition period. The new administration has entered into a third extension through August 31, 1999.

7. Written Internal Control Procedures and System Descriptions Need Improvement: Prior audit reports have noted that MSLC had not fully and adequately documented its internal administrative and accounting control system as required by Chapter 647 of the Acts of 1989. To achieve a strong administrative and accounting control environment and to safeguard Commonwealth assets and revenues, it is essential and a statutory requirement that all state agencies and departments, including MSLC, fulfill their responsibilities and comply with the law to document and implement such a system. Chapter 647 of the Acts of 1989 defines the minimum level of quality acceptable for internal controls to be in operation throughout the various state agencies and constitutes the criteria against which such internal controls will be evaluated. We determined that internal control weaknesses continued to exist. Specifically, MSLC's internal control plan lacked required critical elements, such as the identification and clear communication of all operating cycles; identification of duties and responsibilities of staff and management at key internal control points; identification of management directives, policies, and procedures; description of continuous supervision; identification of individuals who have access to records; full documentation; and practices consistent with the documented plan. 58
8. Certain Questionable Payroll Practices: We reviewed MSLC's payroll and personnel records and found that (a) favored employees were allowed to carry over vacation time in a manner contrary to their contract while other employees forfeited vacation days; (b) one employee took approximately four months of vacation immediately before resigning, and as a result was paid for an additional six holidays, four more accrued vacation days and two skeleton days totaling \$4,569 in additional pay; and (c) there was no personnel policy and procedures manual for non-union and union employees. 59
9. Other Areas That Need Improvement and Require Review by the Present MSLC Administration: Prior year audits of the Commonwealth's Comprehensive Annual Financial Report identified the following observations and recommendations on current or future accounting, administrative, operating, and financial reporting matters at MSLC, some of which have been repeatedly disclosed, such as (a) weaknesses in the electronic fund transfer system, (b) lack of an automated general ledger system, (c) reclassification of MSLC to an enterprise fund, (d) inadequate support for unremitted cash and accounts payable balances, (e) inadequate review of investment ratings of investment custodians, and (f) understatement of prizes payable. 62

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 Our prior audit disclosed that inadequate contract compliance procedures resulted in pricing errors contained in billings for instant game ticket printing not being identified and deceptive billing for advertising services. Our follow-up review determined that MSLC has not updated its control procedures over contract compliance and that all vouchers for contracted services should be thoroughly monitored to ensure that vendor billings comply with contract terms and conditions. MSLC exceeded the maximum contract obligations on its legal service contract and improperly paid for certain legal services performed in fiscal year 1998 with fiscal year 1999 funds.

The prior administration spent thousands of dollars in funds at \$350 per hour to review and discuss our audit report rather than implementing our recommendations and taking corrective action on the deceptive practices outlined in our report. (See item (a) above and Appendices Va and Vb).

## SUMMATION OF AUDIT RESULTS

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The Office of the State Auditor provides the Executive Office, the Legislature, the Judiciary, oversight agencies, and the general public with independent and objective evaluations of various agencies, activities, and programs operated by the Commonwealth. The authority to audit these agencies comes directly from the Legislature. In the course of meeting this statutory mandate, the Office of the State Auditor issues various reports and makes recommendations to assist agencies and program administrators in correcting areas where administrative, accounting, and program controls need to be improved. The recommendations enhance the ability of agencies to protect the assets and revenue of the Commonwealth, ensure that taxpayer dollars are protected, and make certain that programs are both efficient and effective. This report identifies what happens when these recommendations are ignored.

Accounting and management systems are designed to promote the consistent and controlled treatment of transactions. In order to ensure that transactions are handled properly, organizations, institutions, and agencies must implement a sound system of internal controls. These controls, when properly developed, implemented, and enforced, virtually eliminate the possibility of incorrect accounting, internal theft, or deviation from acceptable procedures. When these controls are ignored or routinely bypassed, they cease to provide the protection for which they were designed. We found numerous instances in which MSLC bypassed, overrode, or ignored its own policies, resulting in significant internal control breakdowns and needless losses to the Commonwealth and its taxpayers.

Our audit report documents numerous questionable conditions, including inadequate monitoring of prizewinners, system failures in instant game controls, faulty collection practices and policies, the bypassing of regulations requiring the shutting down of MSLC sales terminals, thefts in its own sales rooms, and the reclassification of thefts to "borrowing" and "loans." In each instance, the condition evident resulted in an unnecessary loss of income or a needless expense to the Commonwealth. This loss or reduction in income directly impacts the amount of money available for distribution to



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the Commonwealth's cities and towns. Some have tried to minimize the importance of these problems by simply measuring their dollar impact against MSLC's total revenues. This is a mistake. The sum of these problems, the recurring nature of some of the issues, and the recalcitrant nature of former MSLC management combine to present an image of an agency that has assumed the authority that is not theirs while avoiding responsibilities that clearly are.

It is easy to pretend that the volume of dollars that flow through MSLC somehow excuses MSLC's pervasively poor attitude, whereby officials were so caught up in maintaining and increasing sales that they overlooked the basic controls needed to protect what they already had. Furthermore, they developed a level of secrecy about their operations, which is unhealthy and dangerous. In fact, this furtive behavior contradicts openness sought by the Commonwealth in its activities as articulated in the internal control guide issued by the State Comptroller.

Sales drive MSLC and appear to have played an inordinate role in every decision made by MSLC management. There appears to have been a view within MSLC that any weakness or problem that becomes evident within the lottery system must not be made public. Moreover, there is an obvious belief within MSLC that any public disclosure of these issues will reduce public confidence. The internal focus to promote and increase ticket sales led to the unhealthy practice of allowing agents with poor collection histories to remain open. This determination to post increasing sales numbers is surely a factor in the inadequate practices used to identify MSLC prize claimants. Most importantly, it is this attitude that most likely led to management's intentional withholding of information integral to the investigation of a theft.

Time and time again we found instances where troublesome agents did not have their terminals shut down and were allowed to maintain ticket sales. The obvious problem with this is that these individuals increase the amount of cash they are withholding from the Commonwealth. By allowing its sales agents to maintain a troubled operation, MSLC made the problem larger rather than smaller. The concept MSLC does not seem to grasp is that these amounts due from agents are cash sales and public dollars, and therefore must be treated with exceptional care. There should be no tolerance for misuse, misappropriation, or theft. The funds collected by agents are not gross revenues that can be applied to any business expenses that the agent chooses. Rather, they represent funds that belong to the Commonwealth. For example, when an individual pays the Registry of Motor Vehicles for sales taxes, a license, or a fee, these amounts are not be considered receivables. They are income to the Commonwealth as soon as they are received. Moreover, if they are missing and not turned over to the Treasurer, it is a shortage or a theft not a "loan" or "borrowing." So too with MSLC funds. Individuals apply for a license to represent MSLC. This right of representation carries with it the obligation to collect, protect, and turn over to the Commonwealth the funds collected on its behalf.

The Legislature, recognizing the danger of agencies policing themselves, enacted Chapter 647 of the Acts of 1989 and empowered the Office of the State Auditor to review the internal controls within agencies and instruct them about what needs to be corrected to prevent a repeat occurrence, since such a review could not be accomplished in an unbiased manner by an agency itself. The Legislature also recognized that an individual agency should not investigate thefts or shortages within its own operation and

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charged the Office of the State Auditor with that additional responsibility. The following indicates what can happen when an agency assumes the role of auditor.

There appeared to be a theft of \$597 at MSLC, and as a result the Office of the State Auditor began a Chapter 647 review of this matter. During our review we were told that MSLC had conducted its own internal review. When we attempted to continue our review for the purposes of providing corrective measures, we were obstructed by former MSLC officials. Our attempts to access the outside auditor's workpapers were denied on the grounds of "attorney client privilege." This is in total contrast to the cooperation of current MSLC officials regarding the Boston office shortage. MSLC blatantly ignored its responsibility under Chapter 647 in the first instance. Had they not done so, the second theft could have been prevented.

This course of action by former MSLC officials combined with their refusal to have the results of its investigation released to our auditors represent an intent to circumvent Chapter 647 and hide the results from the general public. This institutional arrogance exhibited by former MSLC officials resulted in management's failure to comply with the law and correct their problems rather than deny them. Thus, these officials share in the blame for the repeated cash shortages in Boston. MSLC's tactic of denial is also evident in the inconsistent manner in which it responds to theft. When a sales employee "kites" or "borrows" funds, there is an immediate termination of that individual. However, when there is kiting or borrowing of Commonwealth funds by MSLC sales agents, they are allowed to continue selling tickets while entering a payment plan.

It is important to note that when an agency of the Commonwealth is audited that the Office of the State Auditor is reviewing an agency's stewardship of taxpayer funds. As a result, government management and its employees are held to an higher standard, and government auditors who represent the Legislature, taxpayers, and the public have a higher authority (statutory) than hired firms. Moreover, government auditors' presence and efforts should be unencumbered by a management that is filtering and controlling access to records and employees.

Our audit revealed that MSLC had lax oversight and inadequate internal controls and security. In an environment that processes in excess of \$3.2 billion annually, strict financial oversight and internal controls are an absolute necessity in order for the public and Legislature to have confidence in the integrity of MSLC operations. In a situation where over \$2 billion of instant game tickets are given to 7,600 MSLC sales agents on a consignment-type basis, it is critical that MSLC institute timely settlement practices and ticket inventory controls in order to prevent sales agents from illegally withholding and misusing tens of millions of dollars from MSLC. This lack of periodic inventories and timely settlements allowed sales agents custody of cash receipts belonging to MSLC for an unacceptable period of time. This practice is in essence an interest-free state-subsidized line of credit for MSLC sales agents. MSLC's sales-driven vision cannot be allowed to imperil the revenue cycle through inadequate cash receipt and ticket inventory controls, since these funds and tickets are the property of the Commonwealth, as well as the cities and towns that are the ultimate recipients of \$775 million of these cash receipts.

The aforementioned deficiencies, lax controls, and inadequate security found at MSLC

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has perpetuated an environment that allowed the following conditions to occur:

- Inadequate prize winner identification system that does not guard against deadbeat parents, welfare fraud, income tax evasion, or identity theft. We identified \$2.2 million paid to prize claimants who made false representations.
- \$15.1 million in undeposited cash sales held by sales agents that is due MSLC. Of the \$15.1 million, \$12.8 million is probably uncollectible because of the poor settlement and collection practices of MSLC. These funds would have been ultimately disbursed to the Commonwealth's cities and towns if proper monitoring and collection practices were in place.
- Two instances of possible theft of MSLC funds by employees totaling over \$129,000 and \$24,061, respectively.
- Poor controls over electronic fund transfers resulting in \$39,259 not being transferred in a timely manner as well as \$309,681 in outstanding checks over one year old.
- Weak controls over hundreds of millions of dollars, and lack of full tracking of instant game tickets at (1) MSLC and (2) between MSLC and the system's vendor. Instant game tickets revenues are approximately \$2.1 billion and constitute 65% of MSLC cash receipts.
- Overcharges on the printer's billing of \$279,851 for instant game tickets, of which MSLC management was unaware until it was brought to its attention by our audit.
- A lack of fully documented and implemented administrative and accounting control procedures as required by Chapter 647 of the Acts of 1989. The neglect and failure of MSLC management to document and implement such control procedures and fulfill its responsibilities under the law provides fertile ground for the irregularities and illegal acts, that have occurred at MSLC.
- Questionable payroll practices that do not treat all employees equitably or in conformance with the provisions of the union contract.
- Other matters that need improvement as identified in the prior audits of the Commonwealth's Comprehensive Annual Financial Report, including:
  - a. Weaknesses in the documentation, reconciliation, reporting and recording of sales agents in electronic fund transfers resulted in \$22 million rejected transfers. Sales agents revenue should be adequately documented, reconciled, reported, and recorded, to ensure that revenue is properly and timely transmitted and accounted for to MSLC.
  - b. Lack of an automated general ledger system which would aid in the development of monthly financial reports in order to inform management of the status of financial activities so that there is proper management

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oversight.

- c. Reclassification of MSLC to an enterprise fund which would reflect the full cost of MSLC's operation and would be the same accounting model used by most other state-operated lotteries.
- d. Inadequate support for unremitted cash and accounts payable balances. Proper support for unremitted cash and accounts payable would ensure that cash is deposited, recorded, reported timely, and less susceptible to shortages or thefts, and that bills are paid in a timely manner.
- e. Inadequate reviews of investment custodian annuity firms. Investment custodian annuities firms should be reviewed on a continuous basis to determine whether the firm is a going concern in order to minimize defaults on annuities.
- f. Understatement of approximately \$9 million of annuity prizes payable. Procedures should be implemented to match the prizes payable to the annuity contract to ensure that the correct prize amount is paid.

MSLC must comply with Chapter 647 and develop effective internal controls that must be implemented and maintained at MSLC. The new administration should use its authority to correct the serious financial and programmatic issues that exist at MSLC to curtail and minimize their reoccurrence.

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## INTRODUCTION

### Background

The Massachusetts State Lottery Commission (MSLC) is authorized by Chapter 10, Sections 22 through 35, of the Massachusetts General Laws to raise revenues for cities and towns by conducting various lottery games. MSLC may establish, and from time to time revise, such rules and regulations for these activities as it deems necessary or desirable.

On September 27, 1971, legislation was enacted to create a state lottery that would provide a source of revenue for the 351 cities and towns of the Commonwealth. This legislation created MSLC, whose membership is composed of the State Treasurer, who serves as chairman; the Secretary of Public Safety; the State Comptroller; and two members appointed by the Governor for terms coterminous with the Governor. These commission members have the responsibility of approving rules and regulations, contracts, and overall policy decisions for MSLC. Specifically, Chapter 10, Section 24, of the General Laws states that MSLC shall have the following powers and duties:

The commission is hereby authorized to conduct a state lottery and shall determine the types of lottery or lotteries . . . and such other matters necessary or desirable for the efficient and economical operations and administration of the lottery and for the convenience of the purchaser of tickets or shares and the holders of winning tickets or shares . . . .The commission shall advise and make recommendations to the director regarding the operation and administration of the lottery. The commission shall report monthly to the governor, the attorney general and the general court, the total lottery revenues, prize disbursements and other expenses for the preceding month, and shall make an annual report to the same which shall include a full and complete statement of lottery revenues, prize disbursements and other expenses, including such recommendations as it may deem necessary or advisable . . . .

The commission is authorized to carry on a continuous study and investigation of said lottery throughout the commonwealth in order... to ascertain any defects in the state lottery law or in the rules and regulations issued thereunder whereby any abuse in the administration and operation of the lottery or any evasion of said law or said rules and regulations may arise or be practiced . . . .

The commission shall make a continuous study and investigation of the operation and administration of similar laws in other states or countries, of any literature on the subject which from time to time may be published or available on any federal laws which may affect the operation of the lottery, and of the reaction of citizens of the commonwealth to existing and potential features of the lottery with a view to recommending or effecting changes that will tend to better serve and implement the purposes of the state lottery law.

The commission shall have the power to issue subpoenas to compel the attendance of witnesses and the production of documents, papers, books, records and other evidence before it in any matter over which it has jurisdiction, control or supervision. The commission shall have the power to administer oaths and affirmations to persons whose testimony is required.

The Executive Director is appointed by the State Treasurer, subject to the approval of the Governor, and is responsible for the day-to-day operation of MSLC. The following highlights specific powers and duties of the Executive Director as authorized by Chapter 10, Section 26, of the General Laws:

He shall act as secretary and executive officer of the commission and shall license as agents to sell lottery tickets such persons as in his opinion will best serve the public convenience and promote the sale of tickets or shares, provided, however, that no person shall be assigned more than one license to sell lottery tickets or shares....The director shall confer regularly as necessary or desirable and not less than once every month with the commission on the operation and administration of the lottery, shall make available for inspection by the commission, upon request, all books, records, files, and other information and documents of the commission, shall advise the commission and recommend such matters as he deems necessary and advisable to improve the operation and administration of the lottery. He shall suspend or revoke any license for violation of the state lottery law or of the rules and regulations made thereunder. He shall, subject to the approval of the commission and the applicable laws relating to public contracts, enter into contracts for the operation of the lottery, or any part thereof, and into contracts for the promotion of the lottery. No contract awarded or entered into by the director shall be assigned by the holder thereof except with the specific approval of the commission. He shall certify monthly to the state treasurer and the commission a full and complete statement of lottery revenues, prize disbursements and other expenses for the preceding month.

The administrative office of MSLC is located at 60 Columbian Street, Braintree, Massachusetts. MSLC also has four regional offices, which are located in Fairhaven, West Springfield, Woburn, and Worcester. In addition, there is a Canton warehouse, a Norwell back-up computer facility, and a Boston Game Room located in the John W. McCormack State Office Building. MSLC has the authority to collect revenues incidental to running various games. It also has the authority to disburse prizes, pay commissions to agents, and to cover certain expenses. Operating expenses, such as salaries and administrative expenses, must be appropriated by the Legislature. In addition, MSLC's Charitable Gaming Division may grant "beano" licenses to fraternal, religious, veterans, nonprofit, and charitable organizations. The division may also license beano organizations to sell charitable gaming tickets in conjunction with the game of beano.

In fiscal year 1998, MSLC collected over \$3.2 billion in revenues and incurred \$2.446 billion in expenditures, consisting of \$2.2 billion in prizes awarded, \$182 million for commissions and bonuses paid to the approximately 7,600 sales agents, and \$64 million for administrative costs. The remaining revenue totaling \$775 million was made available for distribution according to statute.

The following is an analysis of MSLC revenue by source:

	Fiscal Year Ended <u>June 30, 1998</u> (000 omitted)	
Revenues		
Instant Games	\$2,085,330	64.7%
The Big Game	55,233	1.7%
Numbers Game	385,018	11.9%
Mass Cash	59,758	1.9%
Keno	470,213	14.6%
Charity Game Tickets	5,514	0.2%
Beano Tax (2/5)	2,390	0.1%
Pull Tabs	3,342	0.1%
Megabucks	74,752	2.3%
Mass Millions	65,694	2.0%
Interest	10,850	0.3%
Miscellaneous Income	<u>7,227</u>	<u>0.2%</u>
Total Revenues	<u>\$3,225,321</u>	<u>100%</u>

#### Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws and in consideration of the most recent state election of a new State Treasurer and Receiver-General, who serves as the chairman of MSLC, we conducted a transition audit of the financial activities, accounts, and functions of MSLC through the date of transition, January 20, 1999; however, our review also included an examination of a subsequent shortage reported on June 9, 1999.

Our audit was conducted in accordance with applicable generally accepted government auditing standards and, accordingly, included such audit procedures and tests as we considered necessary under the circumstances.

The objectives of our review were to determine whether:



- (1) (a) The level of actual versus projected spending and revenue were in agreement, (b) revenues and expenses were timely recorded, (c) required inventory controls over property and equipment existed, and (d) MSLC's internal control structures were adequate.
- (2) Management had adequate controls for measuring, reporting, and monitoring MSLC's effectiveness and compliance with applicable laws, rules, and regulations.
- (3) Management's recording, reporting, and monitoring of financial activity and its inventory controls were adequate to ensure that resources were safeguarded and were being used economically and efficiently.
- (4) Management had adequate controls and procedures in place for prize winner identification so as to insure the validity of the data for compliance with applicable state and federal laws governing (a) income tax withholding and reporting, (b) child-support withholding, and (c) public assistance regulations.
- (5) Management had taken corrective action on prior audit results.

Our methodology included reviewing applicable laws, rules, and regulations; interviewing selected MSLC personnel; testing and reviewing accounting records and transactions; and analyzing administrative documents and minutes of MSLC board meetings. Our audit methodology also included the following:

Actual Versus Projected Spending: We compared the level of actual expenditures and encumbrances for the audit period to projected spending plans. Comparisons were developed for each of MSLC appropriation (see Appendix II). We also conducted special-scope testing of various expenditures and encumbrances to confirm both the validity of the expenses and that the correct appropriation was charged.

Revenue: We reviewed the collection procedures regarding the sale of lottery tickets by MSLC sales agents and employees to the actual receipt of funds by the office. We visited and observed the daily financial activities at all the regional offices (Boston, Fairhaven, West Springfield, Woburn, and Worcester) and the Braintree headquarters.

Property and Equipment: We obtained a copy of the office's perpetual property inventory and a certification that an annual physical inventory of its property and equipment had been conducted within the past year. In addition, we conducted interviews with appropriate staff and conducted special-scope testing and observation of the listed assets.

Internal Control Structures: In planning and performing our review, we considered MSLC's internal control structures for the purpose of reporting on the review objectives mentioned above and not to provide assurance on the internal control structures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and are recorded properly.

Personnel and Payroll: We reviewed personnel procedures and records and performed special-scope testing on payroll. In addition, we conducted interviews with appropriate staff. With the change in administration, we verified payroll payments to terminated, newly hired, and transferred employees.

Prize Winner Identification: We reviewed the current procedures used to validate prize winner identification data. As part of our testing, we reviewed the listing of prizes of \$600 or more paid at MSLC locations. We performed testing to determine the reasonableness and validity of prize winner identification data as well as MSLC's procedures and efforts to obtain reliable information. In order to accomplish our audit objectives, we tested available MSLC records and used independent third-party information sources to confirm, deny, or question the validity of the data given to MSLC by prize winners.

Inventory of Instant Game Tickets: We requested that MSLC have its field representatives, as part of their scheduled site visits, inventory all tickets on-hand with each sales agent. The Assistant Director of Finance offered to make available an inventory being performed at 140 sales agents whom MSLC has labeled as problematic. The inventory was made available to us near the completion of our audit.

Instant Game Ticket Internal Controls: For the period January to May 1999, we examined over 500,000 books that contained 150 million instant game tickets. The tickets contained in these books could generate revenue of between \$60 to \$150 million, depending on the price of the ticket. In our sample, there were 53,000 winners of prizes of over \$600 who received approximately \$145 million. We ran a series of tests to examine the instant game processes for possible internal control weaknesses, misuse, and deviations from stated MSLC policies.

Chapter 647 Review: MSLC, in accordance with Chapter 647 of the Acts of 1989, reported two thefts of sales revenue at its Braintree and Boston offices. Chapter 647 requires state agencies to report any losses, shortages, thefts or unaccounted-for variances to the Office of the State Auditor (OSA). The law further requires the OSA to determine whether there was a loss, the amount of such loss, the control weaknesses that contributed to or caused the loss, and to recommend improvements. We reviewed the cash receipt process for sales revenue to determine how the thefts occurred and whether any control weaknesses contributed to the theft. (See Appendix III).

Allegations: During our audit we received from various sources numerous allegations of improper MSLC activities, such as MSLC filing incorrect bonuses and commissions to the IRS, DOR, and sales agents, MSLC altering records, sales agents being charged for tickets they had not received or sold, missing tickets from several sales agent locations, problematic sales agents having their licenses reinstated under unusual circumstances, lottery tickets being distributed to certain vendors free of charge, and coupons for free MSLC tickets and games being produced and distributed.

During our audit engagement MSLC's prior and interim management conducted various activities that limited and impeded our ability to perform our audit testing procedures. A scope limitation occurs during an audit engagement when an auditee places restrictions on the scope of the auditor's work. These restrictions result in a disruption in the timing of the audit work performed, including the necessity to apply all the audit procedures considered necessary by the auditor in the circumstances of the engagement. Such restrictions were imposed by MSLC upon the staff during our audit engagement.

Specifically, the OSA is authorized by its enabling legislation, Chapter 11, Section 12, of the General Laws, to perform audits of state agencies. This statute further mandates that “the state auditor shall have access to such records at reasonable times and said department [OSA] may require the production of books, documents, vouchers, reports and other records relating to any matter within the scope of such audit.” Also, in accordance with Chapter 647 of the Acts of 1989, there should be “an official equivalent in title or rank to an assistant or deputy to the department head, whose responsibility, in addition to his regular assigned duties, shall be to ensure that the agency has written documentation of its internal accounting and administrative control system on file. Said official shall in the performance of his duties ensure that: (1) the documentation of all internal control systems is readily available for examination by the . . . state auditor” (see Appendix III).

In addition, the State Comptroller has issued an internal control guidelines as required by Chapter 647 of the General Laws that describe the need for program accountability, as follows:

Our system of government today rests on an elaborate structure of interlocking relationships among all levels of government for managing public programs. Officials and employees who manage these programs must render a full account of their activities to the public. Frequently specified by law, this accountability concept is inherent in the governing process of this state.

The requirement for accountability has caused a demand for more information about government programs and services. Public officials, legislators, and private citizens want and need to know whether government funds are handled properly and in compliance with laws and regulations, and also whether government organizations, programs, and services are achieving the purposes for which they were authorized and funded.

Despite these statutory requirements, MSLC did not make all requested records available to the audit staff at reasonable times as required by statute. Several items were not readily turned over to the audit staff for review, and others were never made available, including:

- Documented internal controls policies and procedures (5 month response time)
- Fixed asset inventory records (5 month response time)
- Private accounting firm documentation relating to its providing project management and quality assurance services in support of MSLC’s application and technical information replacement project (never received)

- Inventory of tickets on hand at problematic agent locations (3 ¾ months response time)
- Cancelled bank checks (never received)
- Narrative and/or flowchart detailing lifecycle of instant tickets (never received)
- Complete 1998 Internal Revenue Service W 2-G Gaming Winning Income listing (5 ½ week response time)
- Original winning ticket claim forms (6 ½ week response time)
- Bank account information, such as the number of accounts, account numbers, source and use of funds, bank reconciliations, and other pertinent information (2 ½ month response time)
- Invoices, contracts, and audit reports submitted by private auditors hired by a law firm that reviewed the theft of funds by an MSLC employee (never received because of a claim of “attorney-client privilege”)
- Invoices, contract, and other documentation supporting the private auditors’ preparation of new internal control procedures (never received)
- Documentation of the procurement process for MSLC’s new on-line gaming system (never received)

In addition, the audit staff was given photocopies of (as opposed to original) source documents obtained from sales agent files that were being tested, which make it easy to conceal and difficult to detect altered documents. No central files existed for each sales agent; rather, information was dispersed in various locations throughout the collections department. For example, sale agent information, such as various Massachusetts Management Accounting and Reporting System (MMARS) reports, collection agency data, sales agent applications, correspondence between sales agents and MSLC, promissory notes, legal documents, and copies of checks made out to MSLC in payment for arrearages, were not kept in a central file.

On many occasions MSLC personnel were unable to answer any of our questions regarding MSLC operations or gave conflicting information regarding the same MSLC policies, procedures, processes, and operations. Since many of MSLC’s policies, procedures, processes, and operating processes were not in writing, it could not be clearly demonstrated which of them should actually be in place and whether they were implemented in accordance with management’s directives.

Moreover, access to MSLC's personnel who directly performed transactions or activities was limited. For example, on several occasions we requested to meet with certain staff members who were involved with (e.g., initiated) MSLC transactions that we were testing. In some instances, MSLC did not bring the individuals involved in these transactions to these meetings.

Finally, the OSA is required by its enabling legislation to perform its audits in accordance with Generally Accepted Government Auditing Standards. These standards place requirements on auditors on the type of information that must be obtained during an audit. Obtaining and reviewing original records is necessary for assessing the validity of documentation as true, sufficient, competent, and relevant evidence. Examination of these original documents is necessary to afford a reasonable basis for auditors' judgments regarding the transaction, organization, program, activity, or function specifically under audit. We were also informed that a former Executive Director, upon his resignation, removed all files from his office at MSLC headquarters. MSLC staff explained that many original documents we sought were in those files and that copies did not exist. However, during the course of our audit, MSLC officials in many instances, particularly in those instances involving records relative to certain MSLC activities, provided only photocopies or faxes of agency records. Such behavior to limit and obstruct access is often indicative of an agency attempting to conceal evidence of improper activities, functions, or directives. Also, during the course of our review we received several allegations that records were being altered or destroyed, which may also explain why some records were not provided. This limited our ability to review sufficient, competent, and evidential matter when performing our audit tests. In addition, this raises serious questions as to whether original documents may have been altered or whether state laws were violated if such documents were processed by MSLC and other agencies. It is a violation of state finance and record retention laws and regulations to destroy or falsify records.

Therefore, had we had proper access to records and personnel as necessary during the course of the audit we would have issued our report sooner and other reportable conditions that might have come to our attention would also have been disclosed. Because the audit team was not afforded timely and reasonable

access to MSLC's records and, equally important, the personnel who have direct knowledge and involvement in preparing the records, the issues discussed in our report are based solely on the limited information we were able to obtain and review at MSLC. Also, given the serious and significant scope limitations we encountered, MSLC's failure to comply with state regulations relative to the timely provision of this information, and the significant and serious issues identified during the conduct of our audit work, we will be forwarding a copy of this report to the appropriate state and federal regulatory, law enforcement, and oversight agencies for their review.

Nevertheless, as a result of our transition audit of the status of the financial activities, accounts, and functions of MSLC, we have identified certain functions or processes that lacked adequate fiscal, accounting, and administrative internal controls to ensure that MSLC is operated in an economical, effective, and efficient manner and that MSLC assets and revenues are safeguarded and in compliance with all applicable rules, regulations, and laws. The recommendations in this report will assist the new administration in developing and implementing its internal control structure and financial and administrative operations to ensure they are adequate to minimize the occurrence of errors, mistakes, or illegal acts and that the office is operated in an economical, efficient, and effective manner in which assets and revenues are safeguarded and in compliance with all applicable rules, regulations, and laws.

We thank and commend the Treasurer and her new staff for their attention and cooperation during this audit and for their commitment to working with us and the Office of the State Comptroller in implementing the necessary corrective measures to improve the operation of MSLC functions. We are issuing this report to assist management's expeditious implementation of corrective action, and will follow-up on these and other issues to determine the status of recommended corrective measures that MSLC is required to immediately implement under Chapter 647 and will report accordingly in the future. These reviews are intended to determine the adequacy of systems and legal compliance that have a material impact on the integrity of MSLC's control environment. We will continue to work with the new Treasurer and MSLC management in order to assist them in their development and implementation of a

new and improved control environment and security measures to bring restored confidence in the integrity of MSLC operations.

## AUDIT RESULTS

1. Inadequate Winner Identification Security and Internal Controls Revealed Many Instances of False Representations and Potential Income Tax Evasion in the Payment of \$2.2 Million in Prizes at MSLC

As part of our audit we reviewed the winner identification security controls over the payoff for winning game tickets by the Massachusetts State Lottery Commission's (MSLC) offices. Winning game tickets whose prizes exceed \$600 cannot be paid by MSLC sales agents but must be presented for claim and payment at one of the six MSLC offices located throughout the Commonwealth. We found that MSLC did not have an adequate internal control system to verify names, Social Security numbers, and other pertinent data for lottery winners cashing tickets at MSLC offices. As a result, MSLC made payments to some prize winners who used false identification documents, names, addresses, and Social Security numbers and who filed incomplete and erroneous claim forms. In addition, MSLC lacked adequate procedures to follow-up on undeliverable Internal Revenue Service (IRS) form W2-G's (Gambling Winnings) returned by the U.S. Postal Service.

When we initially began our audit at the Braintree headquarters, we noticed that there were no signs posted in the Customer Services area to inform prize claimants of the personal identification data needed in order to process a claim form for a winning prize of \$600 or more. We did, however, note during our site visits to the other MSLC offices that signs were posted explaining the methods of prize claiming as well as the personal identification data necessary to be presented to MSLC for a prize claim. Additionally, we received conflicting information about the baseline personal identification data requirements necessary to process a prize claim. According to personnel at MSLC regional offices, directions had come from the Braintree Headquarters stating that if the prize claimant did not have adequate personal identification, no prize check was to be given to the claimant. However, the Customer Service Manager at the Braintree Headquarters informed us that MSLC cannot require a prize claimant to produce appropriate identification documentation and that, if the claimant was in possession of a winning ticket, MSLC would simply pay the prize to the claimant. We found this position to be strange, given



existing tax laws, etc.. We then asked the Chief of Security at the Braintree Headquarters about his understanding of prize claimant identification practices. He stated that, if a prize claimant did not have acceptable personal identification documents, no prize would be paid. Clearly, these conflicting policies, understandings, communications, and practices within MSLC demonstrate the need for revised policies and practices regarding prize claimant notifications and that personal identification requirements be clearly and uniformly communicated to ensure proper compliance with applicable state and federal tax laws.

MSLC claims and payment procedures requirements for winning tickets are now posted in the claims lobby at each of its six locations. The procedures that are posted in MSLC offices for winners to claim prizes read as follows:

1. Complete an MSLC claim form which requires the following information:
  - Name
  - Address
  - City or Town and Zip Code
  - Social Security Number
  - Phone Number
2. Sign both the claim form and the back of the prize winning ticket
3. Present a form of Social Security Identification when presenting the winning ticket at the Customer Service Claims area.

The claims department staff is then supposed to verify that the signature on the back of the winning ticket matches the signature on the claim form and that a Social Security number identification has been presented. This was the extent of the verification procedures in place at the claims department.

The 961 Code of Massachusetts Regulations (CMR) 2.38 requires the following procedures for claiming prizes and lottery verification:

- (3) Claim Forms. Each prize ticket owner, other than those paid in cash, or his/her representative is required to complete the claim form which is available free of charge at each Sales Agent or Lottery office and sign the winning ticket. If the prize ticket owner is a minor or other person(s) unable to complete the claim form, then said minor or person shall have his/her guardian, conservator, parent, adult member of his/her household, or his/her next friend or other proper representative complete the claim form

in his/her stead. If the Director determines that the person who completed the claim form on behalf of an owner is not the proper person to claim the prize on behalf of the owner, the Director may demand a new claim form completed by a person who is acceptable to the Director as the proper person so to claim the true owner's prize. The claim form incorporates the following provisions. . . .

(c) Indemnification of the Commission for any loss occasioned by an untruth or misrepresentation by the ticket owner or the person claiming the prize in his/her behalf.

(d) All information requested by the Commission which may include but not be limited to the prize ticket owner's (and any person signing in his/her behalf) name, address, and social security number or taxpayer's identification number. The claim form may contain any other provision which the Director may, from time to time, deem necessary and proper to protect the Commission and the public welfare. Each claim form must have attached thereto the original Lottery ticket.

Lottery Verification. The Sales Agent or claim center reviews the claim form and the ticket and must be assured that the ticket is a winner and that the back of the ticket and the claim are properly filled out and signed by the claimant. Upon validation, the prize money will be forwarded to the claimant in check form except that the winner of the prize of \$50,000 or more must present him/herself in person at the Office of the Director to receive his/her prize unless he/she is physically or mentally incapable of so doing.

In addition to the above-mentioned procedures, if a winning ticket with a prize of \$50,000 or more is presented to the claims department, the ticket is given to the Director of Security, who, using a computerized security control system, ensures that the winning ticket is a valid MSLC ticket and not a counterfeit or invalid ticket.

At no point in this control system do MSLC claims representatives use any third-party verification, such as commercial person identification system services, to verify the validity of the name, address, and Social Security number presented. The system currently in place relies entirely on visual observation by MSLC employees of the data presented by the prize claimant. This lack of independent verification of data is an internal control weakness in this system, the effects of which are described subsequently in this audit result.

MSLC's responsibilities regarding the payment of prizes to lottery winners are addressed in both federal and state law. These laws identify income tax withholding requirements and the need for MSLC to determine that the winners are not delinquent on child support payments or are not currently receiving public assistance, as described in the following paragraphs.

The Internal Revenue Tax Code governing state-conducted lotteries (26 Sec. 3402) states, in part:

Winnings which are subject to withholdings [include] . . . Proceeds of more than \$5,000 from a wager placed in a lottery conducted by an agency of a State.

In all cases of single winnings of \$600 or more, MSLC is required to issue a W2-G form for income tax purposes.

Additionally, MSLC's claim payment procedure revision of June 4, 1998 underscores the income tax withholding requirements by stating that, when MSLC system generates a prize check in excess of \$5,000, a 33% tax deduction (28% federal and 5% state) is automatically withheld.

MSLC must also comply with Chapter 10, Sections 28A and 28B, of the General Laws, which state, in part:

Prior to disbursement of a prize in excess of six hundred dollars, the commission shall review information . . . to ascertain whether the holder of a winning ticket owes past-due child support to the commonwealth or to an individual . . . . If the holder owes past-due child support, the commission shall . . . disburse to the holder only that portion of the prize, if any, remaining after the holder's past-due child support obligation has been satisfied. . . .

The commission shall, on a monthly basis, transmit to the department of transitional assistance . . . a list of all persons who were the holders of any winning ticket in excess of six hundred dollars in the prior month. The information shall be provided . . . to ensure the immediate identification of persons who may be receiving public assistance benefits.

MSLC's routinely accepting taxpayer information without independent verification results in an inadequate prize winner identification system that does not guard against payments being made to deadbeat parents, welfare fraud, or tax evasion from failure to report income or file tax returns. We developed various audit procedures to test the effectiveness of the current system. As a basis for our testing, we used MSLC's records for individuals who had received prizes in excess of \$600 and for whom IRS W2-G Gambling Winnings income information forms had been issued. The W2-G form records such pertinent information as gross winnings, federal and state taxes withheld, type of wager, date won, and taxpayer identification number. The W2-G form is sent to the taxpayer identified on the form, and the information is electronically transferred to the IRS and the Massachusetts Department of Revenue (DOR).

To determine the effects of MSLC's lax winner claimant identification procedures, we reviewed the records (a) for possible fictitious names and other data that appeared unusual or suspicious (b) to determine the validity of names and Social Security numbers for multiple prize winners, and (c) for noncompliance with income tax withholding regulations. As part of our audit procedures we used national commercial person identification services to research the validity of Social Security numbers and names and locations of MSLC prize winners. The results of the tests are as follows:

a. Possibly Fictitious Names: We found that many names of MSLC prize winners appeared unusual or suspicious. Our further investigation of MSLC data revealed that some of the Social Security numbers and related information provided by these claimants did not match their names. Additionally, some of the corresponding W2-G forms were sent back to MSLC as undeliverable, and the phone numbers for some of those individuals were not provided. Of the 20 suspicious names we identified in our sample, seven Social Security numbers could not be located by commercial person identification services, five had their W2-G forms returned to MSLC by the U.S. Postal Service as undeliverable, and eleven listed phone numbers that could not be located using the name and/or address on file at MSLC.

b. Multiple Prize Winners: We selected the names of 182 individuals who had been paid seven or more prizes in excess of \$600 per prize. The range of claims began at a low of seven prizes per individual to a high of 319 prizes paid to one individual and ranged from a total of \$6,194 and \$412,482, respectively. The total value of the prizes awarded to these individuals was approximately \$7,300,000.

The results of our testing indicated that numerous identification deficiencies existed, as follows:

<u>Number of Instances</u>	<u>Dollar Amount of Prizes</u>	<u>Description of the Deficiency</u>
3	\$ 52,825	The claimant provided a Social Security number that was issued to a person who was reported as deceased.
47	1,445,064	The claimant provided a Social Security number that was being used by more than one person (ranging from two to four people).
14	441,554	No record of the Social Security number given by the

claimant to MSLC could be located using commercial person identification services.

3	47,567	The claimant used a Social Security number that belonged to a person other than the individual listed on MSLC's W2-G.
5	141,085	The claimant was listed at the same street address but in multiple municipalities.
2	26,360	The claimant used a different Social Security in two successive years. Moreover, the Social Security numbers used could not be located.
<u>1</u>	<u>13,500</u>	The claimant used the same Social Security number for two years but a different name each year.
<u>75</u>	<u>\$2,167,955</u>	

As shown above, we determined that, for the 182 multiple winners sampled, at least 75 identification deficiencies existed. This further demonstrates the ineffectiveness of MSLC's efforts, policies, and procedures for obtaining adequate evidence of the identity of claimants.

Also, in this sample of 182 multiple winners, we determined that nine claimants had some or all of their W2-G forms returned by the U.S. Postal Service as undeliverable. MSLC issues a separate W2-G form for amounts over \$600 for each prize won. Thus, if an individual has won multiple times, MSLC will issue a separate W2-G form for each of the prizes. For the nine individual winners, 130 W2-G forms totaling \$239,674 were issued. Of that total, 101, or 78% of the W2-G forms totaling \$191,474 were returned to MSLC by the U. S. Postal Service as undeliverable. In two of the nine cases, the prize winners contacted MSLC and requested a reissuance of their W2-G forms. In one of those two instances of requested reissuance, the individual's reissued W2-G forms were once again returned to MSLC. The following schedule details the specifics of these returned W2-G forms:

<u>Prize Winner</u>	<u>Number of W2-G Forms</u>		<u>Dollar Value of W2-G Forms Prizes</u>	
	<u>Issued</u>	<u>Returned</u>	<u>Issued</u>	<u>Returned</u>
a	23	20	\$21,067	\$17,360
b	10	2	6,860	1,372
c*	8	8	17,575	17,575
d	33	33	65,226	65,226
e	13	1	9,208	1,000

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f**	7	7	8,000	8,000
g	19	13	71,110	40,313
h	9	9	31,128	31,128
i	<u>8</u>	<u>8</u>	<u>9,500</u>	<u>9,500</u>
Total	<u>130</u>	<u>101</u>	<u>\$239,674</u>	<u>\$191,474</u>

\* Prize winner requested reissue of W2-G

\*\* Prize winner requested reissue of W2-G; however, reissued W2-G's were also returned to MSLC

This further demonstrates weaknesses in the winner identification control systems in place at MSLC.

In addition, our search for telephone numbers did not turn up 94 of the 182 individuals in our sample. Although, this may be due to the fact that some individuals may have unlisted phone numbers, it is our understanding that approximately 18% of Massachusetts telephone customers have unlisted phone numbers versus the 51% of the individuals in MSLC records in our sample. Of the 94 people in question, we could not locate a name, address, phone number or date of birth for 19 of these individuals. This group of 19 individuals included the highest frequency winner, who claimed 319 prizes valued at \$412,482 for the year ended December 31, 1998.

We also reviewed the sample of 182 prize winners for reasonableness and determined that only two of the 10 highest frequency prize winners had any income tax withheld. A prudent person would question the odds of some of the top 10 winners being as fortunate as is indicated on the W2-G records. For instance, the No. 1 prize winner would have had to visit an MSLC office almost daily as a result of his 319 wins totaling \$412,482; the No. 2 prize winner with 149 wins won at the rate of three days per week for a total of \$237,858. The results of our tests for calendar year 1998 were as follows:

Individuals Who Won Multiple Prizes	Number of Times Won	Dollar Value of Winnings	Dollar Value of Prizes in Excess of \$5,000	Taxes Withheld
a	319	\$412,482	0	None
b	149	237,858	0	None
c	85	627,949	\$340,220	None on \$287,729
d	68	131,245	0	None
e	46	79,048	0	None
f	42	58,798	0	None
g	36	110,984	\$75,000	None on \$35,984
h	34	52,806	0	None
i*	33	65,226	0	None

j	<u>30</u>	<u>33,574</u>	0	None
	<u>842</u>	<u>\$1,809,970</u>		

\*W2-G's were returned by the United States Postal Service.

This group of 10 high-frequency winners is not only very fortunate to have won their respective prizes, but even more fortunate to have won 81% of their prizes without having any income tax withheld on their winnings. Moreover, this group includes two winners for whom no Social Security records were found, two winners with two or more people using the same Social Security number, and one winner who reportedly lives at the same street address in multiple municipalities, all of whose W2-G forms were returned to MSLC by the U.S. Postal Service. Clearly, it is possible that some of these individuals may be acting as "professional cashiers" i.e., cashing tickets for a fee that would be less than the real winner's tax liability.

In order to place some perspective on the odds of multiple winners for instant games, see Appendix IX. The data detailed on this Appendix show that, for the four instant games analyzed, a total of 171,360,000 tickets were available to be sold. However, only 10,510 of the total fell within the range of \$1,000 to \$5,000 prizes (i.e., prizes that are large enough to be significant but do not require any income tax to be withheld.) In simpler terms, approximately only six out of every 100,000 tickets to be purchased would yield a \$1,000 to \$5,000 prize. Statistically, these multiple winners would have had to purchase hundreds of thousands to millions of tickets in order for them to win so many prizes and "beat the odds."

c. Income Tax Withholdings: Our review of the calendar year 1998 W2-Gs revealed that approximately 1,800 W2-Gs totaling approximately \$7 million were returned to MSLC by the U.S. Postal Service as undeliverable. IRS regulations require that withholdings be made for those winning events where the prize exceeds \$5,000. The MSLC Claims Department Internal Control Procedure (Revised June 4, 1998) requires the following for the payment of a claim:

If the ticket is found to have a prize payment due, the Manager must enter the name, address and social security number of the winner. The system generates a prize check. If the winning is in excess of \$5,000, a 33% tax deduction is automatically withheld (28% Federal and 5% State). The check number and date are written on the claim form, as well as the word "paid." The check

is placed in an envelope and mailed to the prize winner. A "Notice" form (copy attached) detailing the prize total, tax amounts, and net paid amount is also entered in the envelope.

During our review of the electronic instant game data, we matched the gross proceeds (total amount of prize winning) against net proceeds (total amount of prize winning less federal and state withholding taxes). We found 139 instances totaling \$1,179,000 where the gross proceeds equaled the net proceeds. The first indication was that the federal and state taxes were not withheld. However, our further review of MSLC's 1998 W2-Gs electronic files disclosed that 87 of 139 W-2Gs were for Keno prizes greater than \$5,000, which require no taxes to be withheld. We also determined that 52 W2-Gs involved computer errors. We traced the W2-Gs to the prize check register and determined that two checks were issued for each of these W2-Gs: one check was for the gross win and a second check was net of withholding. Fortunately, MSLC staff detected these errors, voided both checks, and issued a third new check, net of proper tax withholding.

A review of claims documentation revealed that for the 52 W2-Gs initially generated without withholding, either a probate court order (for those instances which a person who has winnings spread over a number of years dies and his/her estate is in probate) or a change in a claimant filing status resulted in MSLC staff entering new data into the W2-Gs file, causing the error. Our review of the W2-Gs issued during the period January 1, 1999 through April 30, 1999 revealed that these weaknesses still exist. MSLC staff is aware of the system weaknesses but has not taken corrective action.

Also, we performed sampling of one-time winners with prizes in excess of \$5,000 who had both state and federal income taxes withheld to determine the validity of the identification data given by these one-time winners to MSLC. The results of our test revealed three instances in which no record of the Social Security numbers given to MSLC could be found. These three winners consisted of two \$10,000 prize winners and one \$50,000 prize winner. Therefore, it is evident that potential false identity issues were not limited to multiple winners nor to winners who had no income tax withholdings taken from their prize.

The results of our overall testing in the prize winner identification control system indicated that some portion of MSLC's prize winners used false identification documents, names, addresses, and Social



Security numbers. This type of activity (i.e., using false or other people's identification) could represent what is commonly referred to as "identity theft." According to the Federal Bureau of Investigation, identity theft is one of the fastest-growing crimes in the nation. The identity theft problem has become so large that the federal government enacted Title 18, United States Code – Section 1028 entitled "Fraud and Related Activity in Connection With Identification Documents and Information." This law, which became effective October 30, 1998, makes identity theft a federal crime for any party that (1) produces or uses a false identification document or (2) knowingly uses, without lawful authority a means of identification of another person with the intent to commit any unlawful activity. Likewise, the Commonwealth passed into law on December 3, 1998, Chapter 397, An Act Relative to False Impersonation and Identity Fraud, imposing large fines or imprisonment for such fraud.

Under the current system of security controls, MSLC cannot be assured of the validity of the identification data presented by prize claimants for those prizes that must be claimed at an MSLC office. There are numerous potential reasons why a prize claimant would give incorrect data to MSLC, including:

- Evasion of state and federal tax liability.
- Underpayment of taxes by using false identification if the prize winner is in a tax bracket higher than MSLC's withholding rates.
- Lessening of the amount of state and federal taxes by using a person (a professional cashier) to cash a winning ticket for a fee that is less than the winner's tax liability.
- Avoidance of paying past-due child support.
- Avoidance of lessening public assistance payments by the amount of prize winnings (welfare fraud).
- Combination of the above-mentioned tax avoidance/lessening situation with the past-due child support or public assistance.
- Evasion of law enforcement agencies for any number of reasons.

Since the misrepresentation of prize claimant identities to MSLC would generally lead to a loss of tax revenue for the Commonwealth and the U.S. Treasury, MSLC as a government agency has a greater

responsibility to strengthen its policies and procedures in this area. Furthermore, the use of false information may represent an attempt to avoid personal responsibility such as child support or hide the fact that a winner may be receiving public assistance. It is evident therefore that there is a sufficient incentive on the part of false claimants to attempt to compromise or corrupt MSLC's system to perform inadequate scrutiny of phony identification data. Although it may be impossible to completely correct this situation, it is obvious that MSLC management needs to dramatically improve its internal controls and security measures in this area. For example, MSLC's requiring claimants to provide a second piece of identification, a picture ID, or a check book or bank book with an address could dramatically reduce the number of false names and addresses.

Under both IRS and DOR regulations, MSLC has the responsibility to take reasonable and prudent steps to validate taxpayer information. As a government agency running a lottery operation, it is even more incumbent upon MSLC to be more diligent in its claimant identification efforts and to work with the IRS, DOR's Tax Department, DOR's Child Support Enforcement Division, the Department of Transitional Assistance, and other federal and state agencies to address these deficiencies. Although MSLC has an internal audit function, it is apparent that it has not been able to ensure that claimants are properly identified, taxpayer income is properly reported, taxes are not evaded, and welfare fraud and child support fraud is avoided.

Recommendation: MSLC should, at a minimum, implement the following internal control measures within its claims department:

- Institute the use of the commercially available people identification information services. These services would allow for the validation of prize claimant names, addresses, and Social Security numbers.
- Enter into an interagency cooperation agreement with the Registry of Motor Vehicles for on-line access to driver's license data and any other identification data.
- Provide the claims department with on-line access to stored W2-G information per winner in order to review multiple prize winners for potential irregularities.

- Institute measures to preclude or minimize the corruption of the security and control systems, such as separating duties so that the individual verifying a claimant's identification is different than the person processing a prize being claimed, having a supervisor or manager review and approve a suspicious or unusual claim, etc..

When the above-mentioned information systems are in place in the claims department, MSLC should establish appropriate policies and procedures that require increasingly more stringent identification steps to be taken under such circumstances such as:

- Large prize winners (a dollar base line should be determined by MSLC)
- Multiple prize winners
- Suspicious sounding names and/or addresses as well as suspicious circumstances when prize claimants present themselves
- Prize claimants presenting inadequate or marginal identification documents

In addition, MSLC should develop specific identification criteria, documentation, policies, and procedures that would be acceptable before the claims department issues a payment for winning tickets. Key internal control activities should be identified and included in any policies and procedures as well as the criteria of documentation that is developed. Also, MSLC needs to:

- Recognize its role with a broader view and coordinate with other federal and state agencies to obtain assistance in order to understand and develop clear policies and practices to fulfill its obligations as a lottery to comply with applicable laws and to minimize having its system compromised by professional cashiers or others who seek to evade identification.
- Consider mailing prizes in order to minimize evasion of identity and its obvious benefits.
- Consider accumulating total of winnings on one W2-G per year for multiple winners.
- Work with other agencies to amend regulations and laws to collect taxes from multiple prize winners, which would also cut into the business of professional cashiers who are not only helping others evade taxes but are evading taxes themselves, since it is unlikely they perform these services for free.
- Ensure that its internal audit function improves its procedures for addressing the issues noted in this audit result.

Finally, MSLC management should take and provide training to understand, develop and implement policies and practices to comply with applicable laws and regulations, as required.

2. Inadequate Procedures for the Collection of \$15.1 Million in MSLC Cash Receipts Held by Its Sales Agents

MSLC's settlement process for collecting cash receipts from sales agents was too lengthy and resulted in untimely collection of its revenues; loss of unremitted revenue; and, in certain cases, sales agents having illegally and/or improperly withheld funds. As a result, approximately \$15.1 million of cash receipts were not transferred to MSLC from its sales agents as of January 26, 1999. Moreover, this has been a longstanding issue, as our prior audit also reported outstanding amounts owed by sales agents representing cash sales receipts that they had not remitted through the established settlement process.

The new administration should consider the attitudes of the prior administration toward these cash sales and develop a new uniform philosophy that minimizes theft and loss of this revenue that is consistent with the way it treats its own sales employees when they behave like sales agents. The sale of lottery tickets is a transaction resulting in the receipt of cash by the agent, not a receivable. Just as when a sales clerk in a department store receives cash for the sale of a product, the money belongs to the company, not the clerk. If the clerk keeps any money that belongs to the company, it is considered a theft, larceny, or embezzlement, not an interest-free-loan. It is not a receivable from the clerk. Similarly, when an employer withholds income taxes from an employee, it is acting as a fiduciary agent for this employee and is responsible and liable for turning over all withheld taxes to the IRS and DOR. Failure to do so in a prescribed manner or using the funds for other purposes results in severe fines, penalties, and sanctions because it is a theft of someone else's money, not a loan to the employee.

MSLC's settlement process was impaired because MSLC's central bank could not sweep (collect funds) from a sales agent's bank account if the balance is less than the exact amount due. This situation was further compromised by MSLC's ineffective rules that do not close down a sales agent early enough in the process before the amount of unremitted MSLC revenue grows beyond control, is deemed lost and uncollectible, and is written off. Furthermore, there were no procedures in place to prohibit the sales agents from selling existing activated instant game tickets within their inventory after their sales authority

has been revoked. The lengthy process and other deficiencies demonstrate a severe lack of internal controls over the safeguarding of MSLC assets and revenues.

MSLC offers a variety of games of chance that are collected by sales agents who have been licensed to represent MSLC as well as its own sales offices staffed by MSLC employees. Currently, there are seven types of games being offered to the general public (i.e., daily numbers, instant game tickets, Keno, Megabucks, the Big Game, Mass Millions, and Mass Cash). Throughout the Commonwealth there are approximately 7,600 sales agents that sell tickets and collect cash for MSLC.

The settlement process for all on-line games begins at the end of the first week, when agents have one week's sales receipts on hand. The settlement process for the instant games scratch tickets is a biweekly process whereby the agents have funds on hand that are included in the Sunday settlement reports for the books of tickets considered sold through the automated settlement process or a sales agent settling with a field representative.

In fiscal year 1998, MSLC collected over \$3.2 billion in revenues and incurred \$2.446 billion in expenditures, consisting of \$2.2 billion for prizes awarded; \$182 million for commissions and bonuses paid to the sales agents; and \$64 million for administrative costs. The remaining revenue of approximately \$775 million was made available for distribution to cities and towns according to statute. As shown in the following table, our review indicated that, as of January 26, 1999, \$13.8 million of the \$15.1 million unremitted cash due from sales agents was more than 90 days overdue.

Aging of Unremitted Revenue  
As of January 26, 1999

<u>1-30 Days</u>	<u>31-60 Days</u>	<u>61-90 Days</u>	<u>Over 90 Days</u>	<u>Total</u>
\$488,311	\$389,872	\$426,746	\$13,761,851	\$15,066,780

Moreover, the balance of funds owed by sales agents increased from \$13.2 million as of June 30, 1996 to over \$15 million as of January 26, 1999. MSLC officials stated that the unremitted receipts increase by approximately \$4 million per year and that this amount is offset by collections received.

MSLC's prior administration wrote off \$332,090 in unremitted receipts during the period July 1, 1998 to December 31, 1998. Additionally, as of December 31, 1998 there were pending write-offs of \$1,037,009. Write-offs are determined only after MSLC and its collection agents have exhausted all possible avenues to collect the money owed and have submitted proper documentation to the Office of the State Comptroller for review.

The settlement process for game revenues collected by sales agents begins on a Sunday for the previous week's receipts and should conclude at the earliest five days later (the fifth day of the collection process), but for some agents this process often extends two, three, or more weeks before MSLC is able to transfer all revenues to the Commonwealth's accounts. Sound business practices, however, advocate that this process be shortened and not be allowed to extend to beyond one week, or in the case of instant game tickets two weeks, of settlement without some assurance that MSLC revenues are fully deposited, fully reported, available for transfer, and not in the sole control of the sales agent.

The online settlement report is transmitted to the sales agent notifying them of the amount due to MSLC. On the following day, the agent is required to deposit this amount into a special bank account controlled by the sales agent and MSLC. After review by MSLC staff, an online report is sent on Monday to MSLC's host bank. During the week, the host bank notifies the sales agents' member banks that funds identified in the report will be withdrawn on that Friday. Should the account's balance be below the identified amount by as little as one dollar, the transfer does not take place. In such cases, the collection process begins again on Monday (the eighth day of the collection process), with the host bank notifying the member bank that no transfer occurred. On Thursday (the 11<sup>th</sup> day of the collection process), the member bank once again attempts to withdraw identified funds from the agent's account. At this time the sales agent has had possession of MSLC revenue for up to 18 days for online games. In the case of instant game tickets where the Guaranteed Low-End Prize Structure (GLEPS) has not been reached, the sales agent could have possession of MSLC's funds for up to 180 days. The GLEPS process is described by a MSLC memorandum as follows:

Since tickets are not scanned at the time of sale, the relevant interaction with our system is at the time winning tickets are scanned for verification by the agent. Since the ticket books are printed with a guaranteed low-end prize structure (GLEPS), the system can determine the percentage of a book sold based on the amount of cash of GLEPS tickets. Using these percentages, certain parameters were established defining a “sold” book. Every two weeks, the system captures all of the “sold” books of a particular agent and bills that agent, net of prizes paid, commissions, bonuses and other various credits via a summary report (detailed information is mailed to the agent) and automatically triggers an EFT [Electronic Fund Transfer] transaction from the agent’s bank to the Commonwealth’s bank.

The automated settlement system recognizes revenue in three categories:

- Upon the sale of 85% of prize money between one to 120 days of activation, the total sale is recorded.
- Upon the sale of 80% of prize money between 121 to 180 days of activation the total sales is recorded.
- After 181 days of activation, the total book of tickets is recorded as a sale.

Should there still be no transfer, the host bank notifies the member bank, which in turn notifies MSLC on Monday (the 15<sup>th</sup> day of the collection process) that there is a problem in sweeping the sales agent’s bank account. At this point the following collection procedures are supposed to occur:

- The agent’s terminal is shut off until payment is received.
- The agent is contacted and notified of the amount due and any applicable fines. A fine of \$75 per offense is assessed. An agent hearing is automatic after the third offense within a 12-month period, and the agent’s terminal will remain off until the hearing is completed.
- The receivable amount is entered into the Commonwealth’s Billing and Accounts Receivable Subsystem (BARS), and payment is due within 15 days.
- Reminder notices are sent at 16, 31, and 46 days. Collection notices begin at 60 days.
- At 31 days, hearing papers are filed with MSLC’s Legal Department with the intent to revoke the agent’s license.
- Assessment is made regarding the collectibility of the receivable. If collection in a lump sum is not probable, a payment plan may be considered if the business is viable.
- Final telephone calls are made to the agent to try to resolve the outstanding receivable.

Sound business practices advocate that MSLC sales receipts be processed and deposited immediately into bank accounts to secure the funds and limit access to them, thereby protecting them from misuse,

theft, or unintentional loss. However, MSLC's settlement process does not adhere to these basic business principles or its own policies and procedures (e.g., shutting down sales terminals after three violations within one year, imposing a \$75 fine).

The following examples demonstrate that MSLC's policies and procedures do not minimize unremitted receipts by sales agents, some of which ultimately results in thefts and losses to the Commonwealth. This information was difficult to obtain and verify due to MSLC's lack of a central filing system within the collection department. MSLC officials cited the confidentiality of certain information (e.g., credit reports) and therefore provided us with copies of certain documents only, which prevented us from verifying the authenticity of original documents and transactions.

In the first example, MSLC's Revenue Recovery Unit (RRU) reviewed the "Agent 90 Day Instant Game Report" and discovered that one sales agent had ticket sales from multiple ticket books of the same game. By having multiple ticket books open (i.e., "ticket shelving") the GLEPS would be delayed and the agent would have access to MSLC funds for a longer period of time without funds being reported, transferred to, and recorded by MSLC. This prompted a visit by the RRU, which discovered that not all the books were on the premises of the sales agent. The RRU immediately settled all the open books, and it was determined that the agent owed \$234,500. The amount was calculated by comparing open sales books with those that had been delivered to the agent. As a result of a hearing two days later, the sales agent, through his attorney, paid \$234,500 to MSLC. This debt should have been apparent through the report of open books that the RRU examined. However, MSLC management did not inform the field representative and regional supervisor that the sales agent owed the \$234,500.

The second example involves a sales agent who was initially denied (in May 1993) a license to sell tickets because of poor credit but was subsequently granted the license. Two years later (July 1995) the agent was notified of a hearing because of revenues not remitted to MSLC. As a result of the hearing, the agent was placed on probation again as of July 25, 1995 but was still allowed to sell tickets. While on probation, the agent paid off the debt over the ensuing months. A year-and-a-half later (December 1996)



the agent was given a second hearing because of unremitted deposits, which resulted in the agent's again being placed on probation. On July 23, 1997 this agent was notified that his license was being revoked. After negotiations with this agent, which resulted in a payment of \$20,500 and a promissory note for \$17,486, the agent was again allowed to sell lottery tickets. As of February 11, 1998 this sales agent was no longer licensed to sell lottery products and owed MSLC \$48,813. We attempted to confirm this balance by mailing a confirmation letter to this agent. However, the letter was returned by the U.S. Postal Service with the message, "Moved and left no forwarding address."

A third situation demonstrates again that an agent can have multiple infractions (i.e., lack of deposits) but still be able to continue selling tickets. The agent in question was granted a license in July 1994. A year later the agent was denied a license for a second store because of bad credit but was ultimately granted a second license. In December 1996, MSLC held a hearing and placed the agent on probation due to unremitted funds. The agent again fell behind in remitting revenue in early 1998 and was notified that his license was being revoked as of July 6, 1998. In August 1998, the agent was no longer in business. MSLC did monitor this agent in early 1998, but by the time of revocation, the undeposited cash had already accumulated to \$45,626.

Another situation involved an agent who was granted a license in June 1997. He had signed a license agreement indicating that he was the sole owner of the business. One month later there was a change of ownership to a partnership, but the owners did not notify MSLC. In March 1998 MSLC records indicated that, although the agent owed revenues of \$145,804 he had remitted only \$65,000, leaving a balance still owed of \$80,804. MSLC does not know the whereabouts of this agent, who is no longer in business, and the agent's account is currently with a collection agency. This situation is particularly troublesome since the partner mentioned above, cashed a winning lottery ticket for \$50,000 while the partnership still owed MSLC nearly \$100,000.

Part of the solution to this problem could be better utilization of district managers and field representatives as monitors of sales agent activity. The primary focus of the field representative's duties

throughout the job description is sales maximization. Those duties requiring analysis, comparison, and monitoring of sales activity also focus on maximization of sales. Under the direction of the regional supervisor, the field representative is responsible for implementing marketing plans, meeting sales goals for a specific geographic area, and servicing a large number of accounts (sales agents). The field representative performs sales, public relations, and problem-solving duties. He or she also takes actions, primarily at the point of sale, to maximize sales of the entire MSLC product line.

These responsibilities could be utilized to assist MSLC and to make quick identifications of problem accounts, even while focusing on maximizing sales revenues. This additional emphasis and action could help minimize write-offs of thefts or shortages and maximize collection of unremitted revenue due the Commonwealth.

Similarly, the regional supervisor's job summary emphasizes sales maximization, as follows:

Regional Supervisor Job Summary

Under the direction of the Assistant Director for Marketing, the Regional Supervisor for Lottery is responsible for implementing marketing plans that help to meet district goals and in managing the activities of several Field Representatives and in-house personnel, in such a manner as to maximize sales in each geographical sales area. This Regional Supervisor, through field activities, confers and performs reviews, provides controls, guidance, direction and leadership for the achievement of sales goals in accordance with sound marketing practices. The Regional Supervisor also manages MSLC marketing activities of several hundred Sales Agents.

As a result of its lengthy and inadequate collection process, MSLC has not collected over \$15 million from its sales agents. Moreover, the collection and monitoring process contributes to the ability of sales agents to illegally and/or improperly keep and use MSLC revenue, with the ultimate effect of lost local aid to communities. Furthermore, MSLC estimates that \$12.8 million of the \$15 million owed by sales agents is potentially uncollectible. Prior MSLC officials have stated that the total outstanding and uncollectible amount is "immaterial" when measured against the annual total sales revenue. This is reflective of a pervasive attitude held by the prior administration that these uncollectible revenues (write-offs) are an acceptable sort of subsidy to keep marginal agents afloat because MSLC needs them to help maximize lottery sales. However, these amounts are not immaterial, considering that these losses were

cash sales and could have been minimized or eliminated with proper internal controls, more timely collection procedures, improved monitoring procedures, and a better attitude and understanding that these losses represent cash shortages or thefts to MSLC that should be dealt with accordingly, not as a loan which should be tolerated, unlike when a similar situation occurs with its own sale employees as shown in its own analysis (see Appendix VI).

In addition, MSLC officials should keep in mind that sales agents applied for the privilege to be agents fully aware of MSLC rules because they benefit from additional sales through increased traffic in their place of business plus the commission and bonus income they receive from selling lottery tickets. Therefore, MSLC should collect its revenue on a timely basis without allowing unremitted funds to get out of hand. Being an MSLC sales agent is a privilege, not a right.

No analysis of the additional cost of controls verses the benefits received (e.g., eliminating a potential \$12.8 million dollar write-off) has been presented to us. There are some state agencies and municipalities that could function more effectively on the amount of funds that MSLC cavalierly dismisses as immaterial and proposes to write off. Some increases in payroll costs for a strengthened field presence with a much more rapid identification and response process to problem sales agents could preclude these types of sizeable write-offs in the future so that more funds could be distributed according to statute to the Commonwealth's cities and towns.

We selected a sample of 76 outstanding accounts with balances of \$25,000 or more and mailed written balance confirmations to these sales agents. These accounts totaled \$3,269,860, or 22%, of the total outstanding balance of \$15.1 million. Only seven agents, or 9%, responded in some form. Forty-six did not respond, and 23 confirmations, totaling \$1,407,007 were returned by the U.S. Postal Service as undeliverable. The confirmations were sent to agents who owed the following amounts to the Commonwealth.

<u>No. of Agents</u>	<u>Amount Owed</u>
39	\$25,000 to \$49,999
25	\$50,000 to \$74,999

6	\$75,000 to \$99,999
4	\$100,000 to \$124,999
<u>2</u>	\$125,000 to \$175,000
<u>76</u>	

All of these accounts had been outstanding more than 180 days, which is indicative of poor monitoring and oversight on behalf of MSLC.

After we brought settlement weaknesses to the attention of MSLC officials, MSLC made some changes in the settlement process regarding its inability to sweep a sales agent's account if funds are less than the amount that should be in the account. However, we were informed by MSLC officials that the new settlement process, which became effective as of January 1999, only applies to new sales agents. Most sales agents still operate under the old system, and their funds cannot be swept unless the exact amount owed is on deposit. We were also informed that MSLC currently does not have a plan in place to convert old agents to the new settlement process.

Also, all MSLC sales agents still have the ability to withdraw funds from their accounts. MSLC indicated that agents need funds on hand to cover winning prizes. While we understand that prizes are to be paid out, it is not prudent that agents should control more revenues than necessary for such purposes for between 90 and 181 days. Rather, agents should deposit MSLC revenues in a timely manner. MSLC's contention that sales agents must have unlimited access to sales revenue is unsupported and unwise, particularly since MSLC is unable to track daily sales revenue by sales agents.

As demonstrated by the numerous examples and conditions of poor policies, practices, and attitudes exhibited in this audit result and further detailed in Appendix VI, where MSLC allows agents who hold hundred of thousands of dollars to continue to operate without "termination" or "collection" for "no reason needed" or where "theft" has been detected and a payment plan has been arranged, it is evident that MSLC has some revisions to make in its policies and practices. Although MSLC does have an internal audit function, as evidenced by our audit it has not been able to minimize losses or the opportunities and incentives on the part of sales agents to compromise MSLC's system.

Recommendation: MSLC should, at a minimum:

- Establish a better process to ensure that potential sales agents are viable and responsible businesses that will be able to remit revenue to MSLC in a timely basis.
- Revise the settlement process to allow MSLC's central bank to sweep all sales agent bank accounts for partial and full payments of amounts owed.
- Establish a dedicated account for all sales agents whereby the only transaction will be the depositing of MSLC revenues.
- Require agents to make timely deposits to the dedicated account.
- Shorten the collection process by the host bank, which is currently 15 days, to a maximum of four days to ensure the timeliness of revenue collection to the Commonwealth.
- Expand field representatives and/or regional supervisors duties or a newly formed collections group to visit all defaulted sales agents within one working day of notification by the host bank that funds cannot be swept.
- Develop controls and procedures to prohibit agents from selling tickets after their authority has been revoked.
- Consider requiring sales agents to carry sufficient bond to cover potential shortages and thefts, especially for agents with recurring problems.
- Develop inventory procedures and controls to confirm whether ticket books are on the agent's premises.
- Discontinue the policy that allows sales agents to take their sales commission prior to depositing MSLC funds. Commissions should only be paid upon verification of transmitted sales revenues.
- Review its policies with regard to fines and all other actions taken against defaulted agents, as its current procedures do not appear to be a deterrent to untimely sales agent deposits. MSLC should consider implementing finance charges on past due amounts.
- Require sales agents to prepare and file a weekly online inventory of tickets on hand.
- Require sales agents to make full payment of amounts owed before a revoked license is re-enstated.
- Institute a central filing system to access sales agent revenue information in a timely manner.
- Ensure that agents notify MSLC when there is a change in ownership status by instituting penalties and fines for noncompliance or making them individually responsible for not giving notice.
- Enforce existing policies regarding imposing fines, shutting down terminals, and revoking licenses.

- Make periodic counts of tickets on hand at sales agents, particularly of those with delinquency problems.
  - Take and provide training to all MSLC personnel to reeducate them on the importance of proper controls and security and to remind them that they work for the taxpayers and citizens of the Commonwealth and should develop better attitudes towards collecting all revenues due the Commonwealth.
  - Ensure that its internal audit function improves its procedures for addressing the issues noted in this audit result.
3. Inadequate and Inconsistent Internal Controls, Security, Oversight and Monitoring Practices over MSLC's Sales Offices Exposed Millions of Dollars in Revenue to Loss or Theft

a. Inadequate Internal Controls over Cash Receipts at the Braintree Sales Office Resulted in a Possible Theft of Funds Exceeding \$129,000: In accordance with Chapter 647 of the Acts of 1989, MSLC notified the OSA of a theft of \$597 by an employee who admitted to "borrowing" the funds. Based on our review of the reported theft, we determined that on April 2, 1997 an employee (performing the function of another employee who was absent from work) brought a cash deposit envelope to the bank. The teller notified the employee making the deposit that the amount noted on the deposit was not correct. Upon returning to work, that employee notified his supervisor, who in turn notified the Controller. When confronted by MSLC officials, the employee, who was absent but normally performs this function, admitted that he had "borrowed" the \$597 and claimed that he was going to repay the funds. This amount was returned, and the employee resigned.

This employee, an accounting supervisor, was responsible for four employees and reported directly to the Controller. One of the functions of the employee was to collect the revenue from season ticket renewals and applications (received at the Finance Department) and the sale of instant game tickets and on-line games by the Claims Center/Customer Service Department (in MSLC's Braintree Headquarters) and to ensure that these deposits were delivered to the bank. However, due to MSLC's lack of a cash receipt journal, no deposits were ever recorded. Although copies of the bank deposit receipts were filed,

they were never traced to the bank statement by this individual or any other employee to ensure that all funds received were deposited.

The State Comptroller's Internal Control Guide requires that proper internal controls exist for the receipt, reporting, recording, depositing, and reconciling of cash receipts. Chapter 8, Revenue Controls, outlines the critical internal controls needed for revenue, as follows:

1. Control Objectives

- All revenue received should be recorded accurately, efficiently (with documentation), accounted to appropriate revenue sources, deposited with the appropriate depository and credited as a cash receipt on the books of the Commonwealth. Gross receipts are to be deposited on a daily basis; no amounts should be deducted from the deposit of gross receipts in order to process a refund....
- Cancellations, remissions, adjustments, refunds, abatements or credit memoranda should be properly authorized and transacted on MMARS [the Massachusetts Management Accounting and Reporting System] . . . .
- Monthly reconciliations should be performed with the State Treasurer's records, bank statements, department records, and MMARS reports. This should be done at least on a monthly basis.

2. Control Activities

- Deposit all receipts with the appropriate depository within one business day of receipt, for sweep by the Office of the State Treasurer. Large volumes of cash or checks should be deposited more frequently than once a day . . . .
- Have all checks and credit card payments made payable to the Commonwealth of Massachusetts, Department (Name).
- Have all checks endorsed "for deposit only" to the appropriate bank, "to be credited to the account of the Commonwealth of Massachusetts."
- When dealing with cash over the counter, issue a pre-numbered receipt to the person making the cash payment, with one copy filed for review by an independent person.
- When dealing with cash over the counter use mechanical devices such as a cash register.
- Ensure that revenue received by mail is:
  - date stamped with date of receipt.

- recorded to a department maintained log, listing the employee opening the mail, the date the monies were received, the amount of monies received, the name of the person or firm from which the monies were received, and the purpose for which the monies were received.
- Maintain a proper segregation of duties. Keep separate the employee functions of opening the mail from the employee who is authorized to record receipt of money and the employee who maintains accounts receivable records. In circumstance where segregation of duties is not possible, ensure that transactions are properly recorded by implementing compensatory controls (such as supervisory review).
- Individuals receiving cash or negotiable securities or making deposits should not be involved in reconciling bank accounts.
- Secure receipts in an appropriate manner (e.g. cash drawer, vault, lock box).
- Establish clear accountability when receipts are transferred from one individual to another or from one entity to another. All information should be documented, logged and periodically reconciled.
- Deposit receipts in the Designated Sweep Accounts, by the State Treasurer's Office unless specifically directed by statute to deposit in a different fund.
- Account for receipts in MMARS through a CD/CT transaction within three days of receipt.
- Ensure that all pertinent documentation related to receipts is maintained. This may include deposit tickets, customer receipts, remittance advices or other memoranda supporting the transaction.
- Document nonsufficient fund checks through the appropriate MMARS transaction (NF).
- Reconcile receipt records as follows using MMARS reports:
  - reconcile records of cash/revenue received against deposit records and bank book balances for the period;
  - compare receipts against receivables and determine if the receipt is being properly credited;
  - compare refunds against revenues to ensure that refunds have been recorded;
  - compare detailed accounts receivable record to summary accounts receivables records for the period.
- Ensure that reconciliations are reviewed and approved in writing by the appropriate departmental official. Any discrepancies should be resolved by an authorized departmental official within a reasonable time period after the discrepancies have



been noted. Chronic reconciliation problems may prompt a review of record keeping practices, and the methods used to reconcile cash balances to the Treasurer's cash records.

- Carefully code receipts at year end in order to record and deposit receipts in the proper fiscal year.

MSLC began an internal review that covered the period of January 1993 through April 1997. An MSLC employee examined Daily Settlement Reports (a recap of daily sales activity) as well as deposit slips and compared them to MSLC's bank account, noting significant discrepancies exceeding \$90,000. On June 17, 1997 an MSLC employee was appointed a special security officer and along with representatives from a private accounting firm inventoried all records, forms, checks, and cash from the prior employee's work desk and file cabinet, which had been confiscated by MSLC. The inventory included undeposited funds on hand amounting to \$101,324.46. This amount consisted of \$950.91 in cash and \$100,373.55 in checks, thus indicating a far greater potential shortage. The funds were for season ticket sales and daily sales of lottery games.

Our review of the bank statements and deposit slips from the Claims Center/Customer Service Department (CC/CSD) indicated that funds were received by the Finance Department but were never deposited. In some cases, the deposit slip received from the CC/CSD was not used for the actual deposit. The deposit slip indicated the amount of cash, coins, and checks that accompanied the deposit slip. We traced the CC/CSD-prepared deposit slips on hand to the bank statements and determined that not all the funds transmitted from the CC/CSD were deposited by the Finance Unit. Specifically, our analysis indicated that \$129,344 was not deposited and was unaccounted for. Examples of our analysis follow:

<u>Deposit Slip Received from CC/CSD</u>				<u>Deposit Per Bank Statement</u>		
<u>Date</u>	<u>Total</u>	<u>Currency</u>	<u>Checks</u>	<u>Deposit Per Bank Statement</u>	<u>Comment</u>	<u>Unaccounted for Shortage</u>
10/13/93	\$1,358.75	\$1,308.75	\$ 50.00	\$ 50.00	Currency Not Deposited	\$1,308.75
12/14/93	\$3,100.00	\$3,100.00	-	-	No Deposit	\$3,100.00
12/02/94	\$ 865.00	\$ 731.00	\$134.00	\$134.00	Currency Not Deposited	\$ 731.00
12/29/94	\$2,205.50	\$1,510.50	\$695.00	-	No Deposit	\$2,205.50
01/02/97	\$1,048.25	\$ 663.25	\$385.00	\$385.00	Currency Not Deposited	\$ 663.25
01/14/97	\$3,377.50	\$2,767.50	\$610.00	-	No Deposit	\$3,377.50

MSLC notified the Attorney General's Office regarding the theft of funds. According to MSLC officials, a law firm was retained to review this situation. MSLC indicated to us that the Attorney General's Office had closed this matter. We requested access to the private auditors' working papers as well as a copy of their report. However we were denied access because of the claim of "attorney-client privilege," and supposedly a report was never issued. The former Executive Director indicated that the law firm hired to look into this matter in turn hired the private auditors. The OSA is an independent constitutional office of the Commonwealth representing the Legislature, taxpayers and the public interest and by statute should have been allowed access to the outside auditor's working papers because the client was the Commonwealth. In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the OSA is authorized to:

Inspect, review, or audit, in conformity with generally accepted government auditing standards [GAGAS], the accounts, books, records and activities of vendors contracting . . . or agreeing to provide services. . . pursuant to any and all contracts or agreements between the Commonwealth [and] its departments and said vendors to the extent necessary to determine compliance with the provisions and requirements of such contract or agreement and the laws of the Commonwealth. Any contract entered into between an entity, including vendors, and a state agency shall include a clause providing the state auditors with access as intended by this section.

Apparently, MSLC officials failed to require access to workpapers, contrary to its obligation under the above law. Also, as required by Chapter 647, the OSA is specifically required to determine the amount of any loss and the internal control weaknesses that contributed to such loss, for which the affected agency is required to implement immediate corrective action to prevent the recurrence of the problems identified.

As stated above, MSLC obtained the services of a private accounting firm (via an attorney) to perform a review of internal controls over cash receipts and reconciliations and to document internal controls and segregation of duties. Upon completion, recommendations were submitted in the above areas, including the recommendation that an accounts receivable journal be implemented and reconciliations be performed. The former administration should have cooperated with the OSA to

conduct a review of this theft as required under Chapter 647. Instead it spent money on an outside firm, even though MSLC was not a defendant. However, as evidenced throughout the report and specifically Audit Result 3b, the result of the costs and efforts of former MSLC officials to obstruct Chapter 647 reviews by the OSA left itself vulnerable to further thefts. It is important for MSLC officials to fully understand that (token) restitution, employee dismissal, plea bargains, or convictions, as a result of investigations either internally or by other outside investigators or law enforcement and prosecution agencies are in no way a substitute for or an exemption from their statutory obligations under Chapter 647, which is to immediately implement the corrections to internal control weaknesses and conditions that contributed to or caused the problems after the notification and review by the OSA. Therefore, having failed in their duty, MSLC officials, management, and employees created and perpetuated an atmosphere and environment where controls and security were inadequate, allowing further theft and shortages to occur, and thus share some responsibility.

b. Continued Cash Control Deficiencies Contributed to and Allowed for the Possible Shortage of at Least Another \$24,000 in MSLC Funds: In conjunction with our review of the theft noted in Audit Result 3a, and in regard to these reported shortages, we reviewed MSLC's procedures for reconciling its seven bank account. We found that procedures for reconciling and monitoring two of MSLC's major bank accounts--the Home Office and Regional Sales Bank Account and the Prize Account--were deficient. We also noted that the Prize Account and the Indirect Agent Bonus Account required only one authorized signature when handwritten checks were issued. Specifically, we found a continuing environment of inadequate internal control deficiencies that contributed to a possible theft of \$24,061; other deposits in transit (outstanding electronic fund transfers) totaling \$39,259 that had not been electronically transferred in a timely manner as they should have been (the oldest of these reconciling transfers was deposited in December 1997); and, stale dated prize checks totaling \$309,681 presented as a reconciling item.

(1) A Continuing Environment of Inadequate Internal Controls and Security Measures over Revenue at the Boston Sales Office Resulted in a Shortage of \$24,061: Our review of the cash management

controls over MSLC's Home Office and Regional Sales Bank Account disclosed that the Boston Game Room office did not have an adequate internal control environment and received poor oversight and support from MSLC's Braintree Headquarters. Their overall internal control weaknesses allowed for a possible theft of at least \$24,061.

The Boston Game Room, located in the McCormack State Building, has only two employees who are responsible for sales of lottery tickets and the payment of prizes. These two employees are supposed to begin each day with a cash drawer of \$500. At the close of each day all funds (i.e., sales, prizes paid, and cash on hand) are totaled and reconciled on a form entitled "Daily In-House Sales Report." In addition, the two employees are required to complete (1) a Teller Daily Recap form, which describes the net bank deposit to be made and (2) a form entitled "Inventory Control Sheet – Instant Games," which is a daily reconciliation of the inventory and sales of instant game tickets. Funds for deposit are periodically picked up by an armored car service for deposit in the Regional and Home Office Sales Bank Account. The armored car service also provides a log of funds received from the Boston Game Room. This log lists the date of pickups, the bank, amount of funds, bag and seal number, number of items, and the signature of the armored car service employee that received the deposit.

At MSLC Headquarters, the accounting department is supposed to reconcile the Regional and Home Office Sales Bank Account monthly. The accounting department should review for outstanding checks, deposits in transit, and any other reconciling items in order to balance the bank statements' cash balance with the cash balance according to MSLC accounting records. Reconciling items are to be noted and traced to the subsequent month's bank statement in order to ensure the validity of these items and that they clear through the following month's bank statement.

During our site visit to the Boston Game Room, we observed that because there were only two employees and no other staff was periodically assigned, there was inadequate segregation of employee duties. We also observed that on occasion only one employee was working in the room. More importantly, we determined that the accounting office did not provide proper or adequate oversight or

monitoring of the cash activities of the Boston Game Room. We also understand that a larger number of unscratched instant tickets could be scanned in order to find winners. Unlike sales agents, whose terminals shut down after scanning three losing tickets, the regional office employees' terminals do not shut down and can scan tickets continuously.

The Boston Game Room had the largest calendar year 1998 sales volume, totaling \$347,733, of all of the regional offices. In fact, according to MSLC sales data, only the Braintree Headquarters sold more than the Boston Game Room during 1998, with total sales of \$352,864. The additional sales at Braintree exceeded Boston Game Room sales by only \$5,131.

During our field visits to the regional MSLC offices, we determined that MSLC staffing at some locations was disproportionate to sales volume. The Boston Game Room, which has virtually the same sales volume as Braintree Headquarters, was staffed by only two people who received minimal and inadequate management direction or oversight as there was no on-site manager or scheduled support from Braintree to ensure quality control. However, other regional offices with considerably smaller sales volumes appeared to have more clerical/customer service staff as well as on-site management.

In fact, in one of the regional offices visited, an MSLC employee kept an independent ledger, not a required MSLC form, in order to be able to verify the funds transacted and deposited for their own protection. A wise move considering the existing environment.

Our initial testing of the February 1999 bank reconciliation for this account reflected that deposits in transit for the Boston Game Room totaled \$30,313. A portion of these deposits in transit had been used as reconciling items for as long as three months. Our review disclosed that numerous deposits that should have been deposited in the bank account had not been processed by the bank. Upon noting deposit-in-transit irregularities and variances, we asked Braintree accounting personnel responsible for reconciling this bank account why no investigative action had been taken by MSLC to determine why these deposits-in-transit had not been properly deposited in the bank account in a timely manner. We were told that the armored car service that collected these deposits had been robbed and that this service was no longer

picking up deposits. We requested both (1) written documentation of the alleged robbery and termination of deposit pickup services as well as (2) the bank statement for March 1999. However, no written documentation was provided to us concerning the armored car status. We were also informed that MSLC had engaged a private accounting firm to perform certain auditing services and that the March bank statements were in the possession of the firm. Because of the lack of data provided to us, we were precluded from completely analyzing the nature, causes, and appropriate action that should have been taken to resolve these deposit-in-transit questions and irregularities, which in effect reflected a variance or shortage.

On June 9, 1999, after having informed the appropriate MSLC accounting employees of the lack of adequate monitoring of the Boston Game Room funds and the irregularities that we had discovered, we were subsequently informed by MSLC, via a Chapter 647 of the Acts of 1989 notice that the accounting firm had started work in this area and that a possible “kiting or borrowing of money” in the amount of \$24,060.50 had occurred (see Appendix X). At this point, unlike prior MSLC actions described in Audit Result 3a, we were given access to all documentation, including copies of the private accounting firm’s workpapers in compliance with Chapter 647. It was determined that two books of instant game tickets were missing; 16 books of tickets listed in MSLC’s master inventory as delivered to the Game Room were still in MSLC’s Braintree warehouse, four weeks after their supposed delivery; and three books of tickets were in inventory for at least three months prior to being activated. The possible misuse or loss of state funds is of concern, and there are no legal provisions available for MSLC sales agents or employees to “borrow” funds. There is an inconsistent practice and a different set of “rules” in the way MSLC deals with sales agents and lottery employees selling games and tickets. When a sales agent does not remit cash in accordance with MSLC policies and procedures (which could be viewed as a theft) they are placed on payment plans; fines are not imposed, licenses are not revoked, lottery terminals are not shut off, and the agents are afforded every opportunity to keep on selling tickets and collect their bonuses and commissions. However, when MSLC employees do not remit cash, the employees are discharged or

suspended until there is an investigation. This is an unfair and discriminatory practice that MSLC should review. Employees should be treated equally, fairly, and with the same courtesies and benefits provided to MSLC's sales agents. It is also important to discontinue these inconsistent holdover attitudes and euphemisms and to reeducate MSLC staff so that they perform their duties properly.

Our comparison of the dollar amounts to be deposited according to the Boston Game Room's "Daily In-House Sales Report" with the deposit dates recorded on the monthly bank statements revealed deficiencies that should have been detected by the accounting department in the Braintree Headquarters had appropriate internal control practices been exercised by MSLC. We compared the collection dates of the Boston Game Room reports with the deposit dates per the bank reconciliations and determined that an average of five to six weeks elapsed between the collection of funds at the Game Room and their date of deposit in the bank. For example, the \$2,125 collected on January 5, 1999 was not deposited in the bank until February 22, 1999. A more pointed example is that in February 1999, \$14,662 was collected and should have been deposited. However, no February deposits were shown on the February bank statement or on the bank statements for March and April. Additionally, the armored car logs were incomplete, were missing dates of pick-up, showed evidence of numerous pick-ups of deposits on weekend dates when the Game Room was closed, and were, for all practical auditing purposes, useless. These conditions should have alerted Braintree management of the need to review and investigate the matter.

The following table describes dates and amounts of deposits that were outstanding and comprise the \$24,061 in question.

<u>Date</u>	<u>Amount</u>
11/30/98	\$ 1,289
1/28/99	1,260
1/29/99	1,140
2/1 to 2/28/99	14,662
3/1 to 3/10/99	<u>5,710</u>
Total	<u>\$24,061</u>

The following internal control weaknesses at the Boston Game Room were noted:

- No on-site segregation of duties existed. Two employees operated the Boston Game Room. Their duties included sales terminal activity, claim verification, cashing and processing winning tickets, daily cash draw closings, preparation of bank deposit slips, maintenance of the physical inventory of tickets available for sale, replenishment of inventory, and other clerical and financial activities.
- No evidence of periodic management on-site review of activities or oversight monitoring support from Braintree was noted.
- Finance department personnel at MSLC's Braintree Headquarters were unable to provide control document summaries of the Boston Game Room activity for our review.

The Internal Control Guide for Departments issued by the Office of the State Comptroller, Section III, states, in part:

Duties Should Be Segregated

A primary principle in any internal control system or plan is segregation of duties. In an automated environment the principle of segregation of duties is critical because it ensures the separation of different functions such as data preparation, input, and review, and it defines authority and responsibility over transactions and use of the Commonwealth's resources.

The key is that no individual or small group of individuals should be in a position to control all aspects of a transaction. Incompatible duties are:

- Operational responsibilities and record keeping;
- Custody of assets and accounting for those assets;
- Authorization of transactions and custody or disposal of the related assets or records.

For example, different personnel should perform the different functions of data entry, authorizing, custody, and report review. If this control principle is properly planned, implemented and adhered to, funds are safeguarded against a single individual's "irregularity."

Segregation of duties is especially challenging for departments with small numbers of employees. Managers of such departments must consider this principle when designing and defining job duties, and they must build control procedures to assure some degree of segregation.

Management's review and approval of transactions, reports and reconciliations are useful techniques in small departments with limited numbers of personnel.

- Individuals responsible for monitoring inventories should not have the authority to authorize withdrawals of items maintained in inventory.

For both large and small departments, their internal control system should ensure that, at minimum, the following activities are properly segregated:



- Individuals receiving cash into the office should not be involved in making deposits.
- Individuals taking physical inventories should not be involved in maintaining inventory records.
  - Systemically review each staff member's work.
  - Provide documentation of supervision.

Adequate and timely supervision is especially important in small departments, where small numbers of personnel may inhibit a thorough segregation of duties. An adequate system of internal controls should contain procedures to restrict access to resources, including funds, equipment, supplies, inventory, and the information that accounts for these assets.

As part of our review, in regard to the shortage discussed in Audit Result 3a, we visited and observed the daily financial activities not only at the Boston Game Room, but also at MSLC's regional offices in Fairhaven, West Springfield, Woburn, and Worcester as well as the Braintree Headquarters. We witnessed ticket sales activity, winning prize claim verification, the processing of winning tickets, daily cash draw closings, preparation of daily deposit slips, and other related activities.

Our review revealed that MSLC had insufficient physical security measures in place at its offices. We observed a large opened window in the "secured" computer room at the Braintree Headquarters. A person could easily climb through this opening. In addition, the back doorway into the computer room was propped open by a chair during breaktimes so that employees could enter in and out of it at their convenience. Moreover, at regional offices the bulletproof glass at front windows does not go all the way up to the ceilings, leaving employees susceptible to harm and theft. The Braintree office has no bulletproof glass whatsoever in place. These observations reflect the lack of adequate physical security controls at MSLC locations.

(2) Inadequate Monitoring of Electronic Fund Transfers: Our review of the Regional and Home Office Sales Bank Account reconciliations revealed \$39,259 in deposits that were not transferred to the Office of the State Treasurer. The Treasurer's Office would normally sweep (i.e., automatically transfer funds) funds from this account on a weekly basis. However, because the \$39,259 did not meet the

standard electronic funds transfer (EFT) criteria, the funds were never transferred. These funds were undeposited for over two months. When we brought this to the attention of MSLC officials, corrective action was taken, and the funds were transferred to the Treasurer's Office on June 7, 1999, two days before we received the Chapter 647 notice of the suspected "kiting" or "borrowing" of MSLC funds.

(3) Stale Dated Prize Checks Totaling \$309,681 and Other Issues: During our review of the Prize Account reconciliations for February 1999, we were informed that there were outstanding checks over one year old totaling \$309,681. We request detailed information regarding these outstanding checks, but due to the ongoing investigation of the State Treasurer's Unclaimed Check Fund by the Office of the Attorney General we did not receive access to any detailed information regarding these checks. We also noted that a number of handwritten checks were issued from this account on a monthly basis. These checks currently require only one authorized signature. The same holds true for the Indirect Agent Bonus Account, through which a number of handwritten checks were also issued on a monthly basis and also required only one authorized signature. Again, this is evidence of an environment of poor controls that was allowed to continue by MSLC's Braintree management.

Chapter 8, Section B, of the Office of the Comptroller's Internal Control Guide requires that bank reconciliation discrepancies be resolved in a reasonable manner, as follows:

Ensure that reconciliations are reviewed and approved in writing by the appropriate departmental official. Any discrepancies should be resolved by an authorized departmental official within a reasonable time period after the discrepancies have been noted.

Although MSLC does have an internal audit function, it is evident that it has been unable to minimize or prevent the misuse, theft, and shortages of Commonwealth funds revealed in this audit result.

Recommendation: MSLC management should refer to Chapter 647 to clearly and fully understand their statutory responsibilities and implement all requirements of the law as well as the State Comptroller's guidelines to establish and effectuate all critical revenue control objectives and activities in order to establish internal control procedures and practices that would provide for appropriate controls over the total flow of cash. Particular emphasis in these controls should be given to the deficient

situations explained in this Audit Result. The control system should include, but not be limited to, the following provisions:

- Documentation should appear in management directives, administrative policies, and accounting policies, procedures, and manuals. Documentation should include internal control procedures and accountability systems and identification of all operating cycles.
  - Ensure that there is an adequate segregation of duties and responsibilities to ensure checks and balances. Key duties and responsibilities should be assigned to a number of individuals to prevent one person from having complete control over any single cash function.
  - Ensure that qualified and continuous supervision, oversight, and monitoring is provided to all staff. This should include clearly communicating duties, responsibilities, and accountability to each staff member and reviewing each staff member's work.
  - Change EFT criteria to allow for timely fund transfers.
  - Ensure that transactions are recorded, reported, and deposited promptly.
  - Ensure limited access to all cash resources.
  - Develop improved inventory controls over tickets that include periodic counts of cash and tickets on hand in sales offices.
  - Develop and implement monthly reconciliation procedures (or as often as necessary) that would compare bank statements to MMARS and cash records. Any variances in the reconciliation should be investigated and reported to management.
  - Implement policies and procedures to ensure that old outstanding checks and funds not swept by the Treasurer's Office are handled in a proper and timely manner.
  - Require that all handwritten checks from the Prize Account and the Indirect Agent Bonus Account have two signatures.
  - Ensure that its internal audit function improves its procedures for addressing the issues noted in this audit result.
4. Poor Management of Hundreds of Millions of Instant Game Tickets Rendered Them Vulnerable to Theft and Misuse

MSLC has a sophisticated system of controls in place over instant game tickets. These controls, for the most part, have been developed and implemented by the vendor chosen by MSLC in 1996. At that time the vendor developed a new information infrastructure for MSLC, including new applications and new controls to accommodate the growth in the number and scope of MSLC games being offered to the

public. The sheer volume of the transactions that take place in a single day is so great that MSLC must have total confidence in the systems in place, since it would be both impractical and irresponsible for MSLC to operate without such systems. During our audit we requested the internal control plan for the instant game revenue cycle in order to determine the existence of adequate internal controls and to verify that the system was accurately recording tax reporting and other data. However, we found that the entire instant game revenue cycle worth in excess of \$2 billion in revenue, did not have written policies and procedures. In fact, the instant game revenue cycle was not even a part of MSLC's internal control plan.

The integrity of instant game tickets is safeguarded through a number of controls. Security, designed within the tickets, consists of two sets of data: the game and book number and the Void If Removed Number (VIRN). The book number is the index for the Master Ticket Inventory File, while the VIRN is used to verify the validity of winning tickets. Appendices VII and VIII illustrate an example of a winning ticket, an MSLC claim form, and a file claim produced by the sales agent's on-line machine. In addition, MSLC's Management Information System (MIS) has established elaborate security protocols to protect the flow of data between the sales agents and MSLC's main computer. For example, telephone lines between MSLC computers and remote machines require specially encoded digital passwords, and the special phone lines can only be installed at the request of MSLC. This allows for extremely secure transmissions.

We divided the instant game revenue cycle into 11 components. As explained above, each game is a unique product and is safeguarded by two master inventory files. The components are as follows: (a) ordering with printer, (b) receiving the two digital (tape) master inventories of tickets, (c) receiving and warehousing of the printed tickets, (d) distribution to sales agents (stores), (e) activation of tickets, (f) tracking GLEPS, (g) sales settlements, (h) prizes paid, (i) returning tickets to MSLC, (j) settling returned tickets and (k) the redistribution of returned tickets. We divided these components into four processes, as follows:

a. Inventory Tracking: The system allows MSLC to track the location and status of tickets from the time they are received by MSLC until the winning tickets are cashed. All tickets are shipped to MSLC agents in books containing 300 instant game tickets. The computer system records a book as being either in inventory, shipped to an MSLC sales agent, active, stolen, settled, or destroyed. Each instant game uses an identical numbering scheme for the books of instant game tickets; however, the combination of the game number and the book number allows MSLC to isolate any single book and identify the sales agent and the status of the book.

b. Billing and Collection: Book numbers are also integral in the billing and collection process. Built into each game and each book is a guaranteed low-end prize structure (GLEPS), which include small cash prizes (see Appendix IX). These prizes are distributed throughout the inventory of game books in a random but equitable manner. When MSLC receives a shipment of instant game tickets, it also receives a computer inventory tape that validates winning tickets. It is important to note that one of the master inventory tapes validates winning tickets via the VIRN. However, access to the VIRN Master Inventory File is protected by a three-step security process. As GLEPS are cashed the system keeps track of low-end prizes per book that have been cashed. An MSLC agent is billed for individual books of instant game tickets when the GLEPS reach 80% within a book (between 121 to 180 days of activation), or 85% within a book (between 1 to 120 days of activation), when the book has not reached the 80% mark but the sales agent has had the book for six months, or when a game is taken off the market.

c. Activation: A winning ticket with a prize of more than \$19 cannot be validated by the system unless the book containing it was activated on an authorized MSLC terminal. Activation is accomplished when the sales agent scans a bar-coded activation card included in each new book of tickets. Once a book has been activated, all of the winning tickets contained within it are eligible to be cashed. Once a ticket is activated it cannot be deactivated; it is live until it is destroyed. Validation is the process by which MSLC agents verify the authenticity of tickets by scanning the VIRN on a terminal. Furthermore, any

book activated by an agent other than the agent of record is flagged and investigated. Until a book is activated, the system will not validate (verify) any winning ticket with a prize of over \$19. However, MSLC's system allows tickets with a prize under \$19 that have not been activated to be cashed. For example, if a book is stolen and all 300 tickets are scratched, all prizes under \$19 can be cashed. Subsequent to our inquiries regarding this issue, MSLC lowered the prize limit to \$14. MSLC investigates all unactivated tickets presented for payment and takes corrective action. Although the activation process protects MSLC against prize claims from agents having unauthorized books, (e.g., books that were delivered to the wrong agent or books that were swapped between agents) it does not protect the billing process from "ticket shelving", a scheme whereby an agent sells tickets from multiple activated books at the same time rather than completely selling tickets from one book before opening another new book. This delays the billing and settlement process and allows the agent to retain custody of MSLC funds for a longer period of time.

Because book numbers play such a significant role in MSLC controls, we used them in developing our testing procedures. It was our objective to confirm that MSLC's system accurately tracked tickets from warehousing to their final disposition. We requested data from several of the data repositories maintained by MSLC and we applied our audit queries against this data. The primary goals of our audit queries were to establish that:

- Winning tickets could be traced to the actual claim form to the sales agent who sold them.
- That a winning ticket of \$600 or more had been cashed and could be traced to both the winning individual and the sales agent who activated the book from which it came.
- When required by law, taxpayer information (name, address, Social Security number) was collected by MSLC and forwarded to the proper taxing authorities.
- When necessary, the proper amounts were withheld from prizes and those amounts were forwarded to the IRS and DOR.

We obtained data for the instant games "Holiday Cash," "Jubilee 25," "Sparkling Gold," "Set for Life," and "Wild 25." We specifically requested a mix of games that would give two games that had completed

their life cycle, two games in mid-cycle, and one that was just at its beginning. This game data provided us with information up to the date that the request was processed by MSLC, including the total range of books within a game, the current status of each book, and the dates that the books were validated and/or settled. MSLC also provided, at our request, a listing of all winners during 1998 who had claimed a prize of \$600 or more. This information was given to us in electronic form, allowing us to trace winning tickets to the individual winners and the MSLC sales agent who sold the ticket. Additionally, the data provided us with information on gross prizes and net pay-outs, from which we could determine whether withholding taxes were deducted for proper tax reporting to the IRS and DOR.

The nature of instant game tickets is such that controls over ticket distribution, validation, prize authorization, and ticket destruction is of paramount importance. Unplayed tickets are like cash and require similar care and protection. The first layer of protection over instant game tickets is the activation process. However, once activated these tickets have both a face value and a winning potential and are a target for theft and misuse.

To determine whether controls were in place to ensure that all claim for prizes were legitimate (i.e., the winning ticket was purchased from an authorized sales agent and the ticket was from a book that had been activated and settled by an authorized agent), we performed the following tests:

- A match between destroyed books and winners of \$600 or more
- A match between unshipped books and winners of \$600 or more
- A match between winners of \$600 or more and any book with a status other than settled

We estimate that this test involved over half a million books and 150 million tickets.

Our testing found several control weaknesses. We attempted to confirm that winning instant game tickets were sold from books that had been properly activated and settled by sales agents. To conduct this test we attempted to compare the book numbers included in the game histories (e.g., activated books, settled books, the agent who sold the book, the agent who cashed the ticket, game and ticket numbers) against the book numbers included in the listing of winners of \$600 or more. We found that book

numbers for over 29,000 of the winning instant game tickets were not listed. In fact, no tickets paying a prize of \$600 or more had book numbers available before mid-October 1998. Therefore, a winning ticket could not be traced to the authorized agent who sold the ticket or to the book from which it came. This represents 76% of the winning instant game tickets cashed during that year. When we brought this matter to the attention of MSLC officials, they indicated that the vendor hired in 1996 was responsible for providing this information. According to the MSLC Lottery Computer System contract issued in 1996, the vendor should have provided MSLC with a computer administrative management system, including the development and implementation of an internal control system as well as ad hoc reporting on demand. Additionally, the vendor was required to but did not provide MSLC with a customer support system that includes, at a minimum the following functionalities in complete form in each area:

- Sales information by agent by game (e.g., daily, weekly, clerk) calendar or fiscal year.
- Prize information
- Settlement of instant games
- Inventory information
- Electronic fund transfer account information
- Invoicing capabilities

The vendor should have also provided a financial accounting package that includes, at a minimum, the following functionalities:

- Ability to generate comprehensive audit trails
- Access to winning number information
- Prize information

d. Ticket Returns: According to MSLC officials, when unsold portions of books are returned to a MSLC office, they are supposed to be locked in security bags and transported to MSLC headquarters, where they are processed by Return Room employees. Our review revealed that return forms enclosed with returned tickets, were not always signed by MSLC employees and sales agents, which could lead to



billing disputes over the amount of tickets that were actually returned. Full ticket books are returned to the master ticket inventory for redistribution to other sales agents. However, Return Room employees do not have the ability to verify their daily input of ticket quantities returned. Therefore, transposition errors, omissions, etc., cannot be detected and corrected, leaving MSLC vulnerable to billing errors (in cases where sales agents' accounts were not properly credited). Further, this return system is flawed because the total number of tickets returned is entered into the system as opposed to the actual ticket numbers themselves. As a result, all returned tickets are active, even at the moment they are being destroyed. Returned tickets are locked in the security holding areas and, approximately once a month, are destroyed under the supervision of MSLC security personnel. Because MSLC does not have an inventory control system over a tickets entire life cycle or a system in place to deactivate these tickets, they are live and can be cashed until they are destroyed.

While conducting the audit, we observed partial and full ticket books being returned to MSLC headquarters in plastic grocery bags or simply wrapped with elastic bands. Moreover, Return Room employees who receive these tickets from security work in unsecured, scattered areas in the claims/validation department. These include partitioned work areas as well as tables exposed in a common passageway from the Claims/Validation Department to the Collection and Finance Departments. These areas are in close vicinity to the second-floor elevator.

During our audit we checked for any winning prize paid on a ticket from an unauthorized or destroyed book. This test encompassed over 500,000 books and 150,000,000 tickets. However, tickets could have been cashed prior to MSLC's recording the books as being destroyed. The transportation and processing of live, activated tickets in such a casual and unsecured manner indicates that it cannot be demonstrated with confidence that such activities did not occur, and that the weak control environment renders the system vulnerable to theft or abuse, such as the so-called illicit activities recently alleged in the media.

The lapse in process, combined with lack of book numbers in the payment summary provided by MSLC, makes it impossible for MSLC to demonstrate that no tickets were cashed from books that were listed as destroyed, stolen, or returned. This gap in the internal controls for instant game tickets is one that should be addressed immediately by MSLC. Information provided by MSLC for transactions beyond mid-October 1998 indicate that book numbers are now being captured. However, additional steps, including the shredding or defacing of tickets, should be added to the procedures governing the return of activated tickets.

During our review, we were given an inventory report of instant game tickets at certain sales agents. However, the sales agent inventory report that MSLC provided to us was inadequate and was not completed in the manner it was originally represented. Specifically, we were given an inventory spreadsheet and cover letter that contained an incomplete explanation of the methodology used to inventory instant game tickets at 234 locations. The spreadsheet contained a significant number of variances which MSLC should resolve; for example the spreadsheet contained 30 instances of potential ticket shelving and 225 locations with books that were listed on the MSLC master inventory list but were not found in the store.

During our audit, it became obvious that a number of systemic breakdowns have occurred at MSLC. These breakdowns range from insecure transportation of returned tickets to the failure of the system to record book numbers of the returned tickets. As stated earlier, MSLC has established a sophisticated information system with elaborate controls. Many of the controls are built into the computer applications used by MSLC. The difficulty with these types of controls is that breakdowns are not always readily apparent or that employees become complacent and do not utilize or practice all available security measures, and thus the chain of inventory controls over activated tickets is broken or compromised, rendering it vulnerable to theft and abuse. MSLC should develop a series of reports so that it is constantly monitoring the system for breakdowns and weaknesses. An internal audit function exists at MSLC, but it is obvious from our audit that system issues such as inadequate ticket inventory control,

inadequately secured returned tickets, and the failure to record such critical information as book numbers are not a priority.

MSLC's Management Information System (MIS) consists of three parts: the on-line gaming system, the sales agent reporting and billing system and MSLC financial reporting system. When a problem within the management information system is identified, a technician's incident report is prepared so corrective action can be initiated. This is how the aforementioned prizes-paid file was changed so it is now capable of collecting data for all fields.

We have identified several other MIS weaknesses that require corrective action, including:

- Sales Agent Licensing: A sales agent who owed \$67,000 had his license revoked but received a renewed license in the mail. We determined that the sales agent's original license was revoked in the on-line gaming system but not in the sales agent reporting system. The license was automatically renewed in the sales agent reporting system. The sales agent had his sales settled manually rather than settled on-line, thereby avoiding detection.
- Sales Agent 1099's: A sales agent who received a \$25,000 commission for selling a large Megabucks winning ticket had the commission rescinded following an MSLC hearing. The sales commission was deleted from MSLC's 1099 file. As a result of inadequate communication, MIS staff added the commission back into MSLC's 1099 file. MSLC management did not detect this error. We also determined that the MIS prepared 1099's of eight active sales agents which were returned because of federal identification number (FID) errors and that two 1099's were returned because of errors in bonuses earned. The 1099 errors occurred because changes in sales agent licenses and federal identification numbers resulting from changes in corporate ownership were not added to MSLC data files.
- Sales Agent Addresses: Using data from MMARS reports, we mailed 76 confirmations to sales agents with amounts due MSLC. We had 23 confirmations returned by the U.S. Postal Service as undeliverable because MSLC does not know the correct address of its sales agents.

MSLC needs to monitor and analyze sales patterns, prepare comparison and trend analysis and identify potential warning signs. Surprise inventories of agent stocks would also serve to reduce the likelihood of shelving and other inappropriate activities.

Recommendation: MSLC should, at a minimum:

- Improve its controls and security operations by developing tests for its systems.
- Develop and practice improved inventory controls, including surprise counts of tickets held by sales agents, through all points of the life cycle from receipt to distribution, sales, claims for prizes, to tickets returned as unsold, to destruction.

- Develop written policies and procedures for the instant game ticket revenue cycle, incorporate them into internal control plans, and clearly communicate these controls to MSLC staff.
- Track and analyze agent sales patterns to identify potential problems and create safeguards and strategies to address and resolve them.
- Ensure that returned instant game tickets are controlled and placed within a secure area.
- Establish a secured process for deactivating returned instant game tickets.
- Ensure that its internal audit function improves its procedures for addressing the issues noted in this audit result.

5. Contractor Overbilling of \$279,851 on Instant Game Ticket Printing

Our prior audit determined that MSLC was being overbilled for the printing of instant game tickets. The report established that MSLC had been overbilled at least \$317,685, contrary to the instant game printing contract's "most favored customer" clause, which states that printing prices are calculated as follows:

MOST FAVORED CUSTOMER

During the life of this contract all prices charged by the Contractor shall be computed using the lower of:

- (a) the Contractor's proposed Cost Table prices; or
- (b) the lowest price charged by the Contractor, for the same or lower volume, under any contract entered into with any of its customers for similar products.

The Agency shall consider factors such as inflation in making price comparison.

According to the terms of the contract, Scientific Games, Inc., (SGI) is responsible for monitoring price changes resulting from new contracts with any of its customers. During the prior audit we raised our concerns to MSLC officials that SGI was overbilling because new contracts were violating MSLC's "most favored customer" status. Based on this discussion, MSLC staff contacted SGI, and in a letter dated September 18, 1996, SGI confirmed that its recent production prices were not in compliance with MSLC's "most favored customer" clause. SGI explained that, because certain provisions of a new

contract with the State of California that did not conform with MSLC “most favored customer” status, MSLC was due a credit of at least \$317,685.

Our follow-up review determined that MSLC hired a private accounting firm to assess whether SGI had complied with MSLC’s “most favored customer” contract clause. In a letter dated May 21, 1997, the firm confirmed our concerns and stated that SGI’s pricing was not in compliance with MSLC’s “most favored customer” clause and that MSLC should receive a credit of \$225,822.

The firm’s review focused on the cost of accelerated delivery of instant game tickets because it was the only price component on which SGI and MSLC could not agree. (The two parties agreed on the pricing of such items as ticket quality, ticket size, paper quality, and production requirements.) The firm based its finding on the following factors:

- Under the Massachusetts contract, the standard schedule for delivery is 70 days, while the California schedule is seven weeks (49 days). Both SGI and MSLC agree the “average” delivery schedule for Massachusetts is 19 days. Thus, the pricing difference between SGI and MSLC is being driven by the 21-day difference in the standard schedule.
- At a standard daily delivery rate of \$1,800 per day, this 21-day difference has a price impact of between seven cents and \$1.30, depending on the game. It appears that the use of the seven-week schedule complies with the intent of the “most favored customer” clause of the contract, and SGI’s price should be reduced to reflect this provision.
- Based on these prices and the quantity of tickets ordered and expected to be delivered to MSLC under the existing contract, the credit due to MSLC from SGI in order to satisfy the “most favored customer” clause is \$225,822.

In a letter of agreement dated July 8, 1997, MSLC agreed to accept a credit of \$225,822, and SGI agreed to reinvoice any current payable and to use the new prices in all future billings. SGI also agreed to notify MSLC of any new contracts affecting MSLC’s “most favored customer” clause. MSLC received a purchase voucher on July 13, 1997 that reflected this credit.

On December 16, 1998 SGI notified MSLC that it had entered into a new contract with the State of Indiana. SGI stated that the price structure of the Indiana contract affected the MSLC’s “most favored customer” clause and, as a result, MSLC was due another credit of \$54,029. These new prices affect only one of MSLC’s current games.

Recommendation: MSLC should continue its diligence in reviewing any new contracts SGI may enter into and monitor the “most favored customer” clause to ensure that it receives the proper credit when due.

6. Extension of Instant Game Printing Contract

On October 21, 1993 the Commonwealth of Massachusetts, Department of Procurement and General Services, on behalf of MSLC and SGI, entered into a contract with a maximum obligation of \$21,330,113 for the purchase of instant game tickets, designs, and related marketing services. The terms of this contract stipulated that the contract shall be for 24 months, with an option to extend the contract up to three additional one-year periods at the same terms and conditions. Prices for each option year were to be stated through a revised cost table attachment.

On October 21, 1995 MSLC and SGI renewed their existing contract for an additional three-year period with a maximum obligation of \$48 million for the purchase of instant game tickets, designs, and related marketing services. All other terms and conditions as set forth in the contract dated October 21, 1993 were retained in full force and effect through October 21, 1998.

MSLC and SGI agreed to another contract extension on October 21, 1998 that was for a period of eight months to June 30, 1999. The contract was extended based upon the recommendation of former MSLC officials, who considered the size, scope, duration, and lengthy bid process for a new contract as well as the upcoming change of MSLC administration. The contract extension set a maximum obligation of \$12,685,400. The extension was made on the condition that MSLC should not incur any additional expenses for the tickets or services than it is currently paying. MSLC and SGI have agreed to a third contract extension through August 31, 1999. All contract terms remain the same.

Recommendation: MSLC should expeditiously complete the Requests for Proposals (RFP) process so that a new favorable instant game printing contract can be awarded before its current contract expires.

#### 7. Written Internal Control Procedures and System Descriptions Need Improvement

Prior audit reports have noted that MSLC had not fully documented its internal administrative and accounting control system as required by Chapter 647 of the Acts of 1989. To achieve a strong administrative and accounting control environment and to safeguard their assets, it is essential and a statutory requirement for agencies to document such a system in written form. Chapter 647 of the Acts of 1989 defines the minimum level of quality acceptable for internal controls in operations throughout the various state agencies and departments and constitutes the criteria against which such internal controls will be evaluated. Chapter 647 specifically outlines the following requirements:

- Internal control systems of the agency are to be clearly documented and readily available for examination. The documentation should include: internal control procedures, internal control accountability system, and identification of all operating cycles;
- All transactions and other significant events are to be promptly recorded, clearly documented, and properly classified;
- Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority;
- Key duties and responsibilities are to be assigned in a manner to ensure that proper checks and balances exist and assure that one person does not have control over a complete operating cycle; and
- Access to resources is to be limited.

During our audit, we reviewed MSLC's internal control structure and determined that the following internal control weaknesses existed:

- Inadequate control over the sale of instant game tickets, including lax monitoring of sales agent activity, deposit of sales revenue, and lack of procedures for the weekly inventory of instant game tickets with sales agents.
- Inadequate procedures for recording, reporting, collecting, and depositing season renewals and application and sale of lottery game and tickets at MSLC headquarters, including inadequate documentation and supervisory oversight.
- Inadequate control over union contract provisions regarding vacation leave carryovers, and lack of personnel policies and procedures for union and nonunion employees.
- Lack of monitoring and inadequate oversight control procedures over vendor billings regarding contract terms and conditions.

- Inadequate prize claimant identification security and internal controls.

The elements of the plan that are lacking in the critical elements of an internal control structure and should be included in a written internal control plan are as follows:

- Identification of all operating cycles, which would include an explanation of the cycle and flow of transactions through the critical internal control points. This should include the initiation or authorization of the transactions or events, all aspects of the transaction while in process, and the final classification summary record.
- The identification of the duties and responsibilities of staff and management positions at key internal control points.
- Identification of management directives, administrative policies, and accounting policies and procedures.
- Identification of key duties and responsibilities where segregation of duties are employed to ensure that effective checks and balances exist. This would include at a minimum authorizing, approving, and recording transactions.
- A description of the continuous supervision that is provided to ensure that internal control objectives exist. The descriptions at a minimum should include the duties, responsibilities, and accountabilities assigned to each staff member, and critical points at which work is approved and where the staff members work is reviewed systematically to ensure that work flows as intended.
- Identification of individuals who have access to resources and records. Restrictions on access to resources will depend upon the vulnerability of the resource and the perceived risk of loss, both of which shall be periodically assessed.

Recommendation: MSLC should continue to strengthen and improve its internal control system by implementing additional policy plans, practices, and enhanced control and security procedures listed above to provide an appropriate environment of adequate safeguards in compliance with statutes including Chapter 647 and the State Comptroller's prescribed guidelines and the mission, roles, and responsibilities of MSLC.

#### 8. Certain Questionable Payroll Practices

We reviewed payroll and personnel records and determined that (a) favored employees were allowed to carry over vacation time contrary to their union contract, (b) an employee took approximately four months vacation and then immediately resigned and was thereby paid for two skeleton days, six holidays,



and four more accrued vacation days, and (c) there was no personnel policy and procedures handbook for non-union and union employees.

a. Vacation Time Carryover Policy Exceeded: Two management employees were allowed to exceed their union contract regarding vacation time carryover. The union contract allows employees, with the approval of the Executive Director, to carry over vacation leave to subsequent years up to three years of allowable time earned each year. For example, if an employee earned 25 days vacation each year and did not take any vacation leave for three years, the maximum vacation time that could be carried over at the end of the third year would be 75 days of vacation (25 days per year for three years). However, the two employees in question were allowed to carry over 104 and 115 days, respectively. These employees earned 25 days of vacation each year, and their maximum amount of vacation leave carryover would be 75 days. These employees therefore exceeded the carryover limit by 29 and 40 days, respectively, contrary to the provisions of the contract. Moreover, at the same time these two employees were allowed to carry over unused vacation, other employees were required to forfeit their unused vacation time.

The Executive Director approved the carryover of the excess unused vacation days for one of the employees because he was responsible for the implementation and monitoring of the information technology operation at the new MSLC facility in Braintree. The same individual was responsible for the instant game ticket automatic settlement system and procurement of a new computer system. As important as this employee was to certain operations of MSLC, it is a questionable practice because it is inconsistent with a sound internal control environment for an employee not to take vacation leave during the year and not delegate responsibilities to other employees.

The other employee, in May 1997, requested to carry over unused vacation because he felt his workload was so great that he could not “in good conscience” take a vacation. The Executive Director also approved this request for the vacation carryover. However, we determined that from July 1, 1997 to December 31, 1998 this employee took 76 vacation days out of 126 workdays. Apparently, this

employee's workload seems to have diminished rather quickly. One would have to ask if this represents a "favored employee situation" for management contrary to the terms of the union contract.

b. Questionable Vacation Payments: The Assistant Director, a non-union employee, took over three months vacation from October 6, 1998 through January 25, 1999. On January 26, 1999, this employee resigned and received \$4,569 for the six holidays, four vacation days, and two skeleton days earned while on vacation prior to the resignation date. Considering the high level and responsible position of Assistant Director, it is unreasonable that this person would be allowed and able to take four months off. It appears that the actual date of resignation was October 6, 1998, and by being allowed to stretch out his vacation rather than take a lump-sum payment, he received an additional 12 days pay totaling \$4,569.

c. Lack of Personnel Handbook: MSLC has approximately 390 employees, two of whom are non-union employees (the Executive Director and the Assistant Director), and the remaining employees belong to the union. The union contract has specific elements with regard to vacation leave, sick leave, holidays, and compensation time. However, MSLC does not have a personnel handbook that outlines management policies and procedures with regard to personnel and human resource matters for the union and non-union employees. Even though there are only two non-union employees, and union employees have a contract, there still should be personnel policies, procedures, and directives that are formalized and communicated to all employees.

Chapter 647 of the Acts of 1989, an act relative to improving internal control within state agencies, (see Appendix III) requires that significant events are authorized and executed only by persons acting within the scope of their authority. Authorization should be clearly communicated to managers and employees and should include the specific conditions and terms in which authorization is to be made.

Recommendation: MSLC should develop a comprehensive personnel policy and procedures manual that incorporates union contract provisions so that management directives and scope of authority are communicated to all employees. Also, MSLC should review its vacation carryover policy to ensure that it

(1) is communicated to all employees, (2) is fair and equitable to all employees, (3) meets the needs of MSLC and does not hamper MSLC operations and (4) complies with the union contract.

9. Other Areas That Need Improvement and Require Review by the Present MSLC Administration

Prior year audits of the Commonwealth's Comprehensive Annual Financial Report identified the following observations and recommendations on other current or future accounting, administrative, operating, and financial reporting matters at MSLC.

- (1) Electronic Funds Transfers: Sales revenue collected by sales agents are deposited and electronically transferred each week into a bank account controlled by the State Treasurer.
  - a. Support for Expenditures: MSLC personnel indicated that documents supporting all electronic fund transfers [EFT] transactions are maintained on file for two to six months and then are destroyed. If the information is needed after it is destroyed, it must be recreated from EFT tapes. The Commonwealth's common rule for record retention is a minimum of three years after the close of the related transaction. Since the majority of documents used by MSLC relates to winnings and payments and their related investments that span over a long period of time, documents supporting these activities should be maintained for a minimum of three years after the close of the life of the winning, payment, and investments.
  - b. Reconcile Electronic Funds Transferred: MSLC does not provide EFT information to the Treasury on a timely basis. Information for certain EFT transactions were not provided to the Treasury for as long as three months after the transactions took place. EFT letters are necessary to provide the Treasury with a weekly breakdown of revenues and expenditures by game and the amount of cash received by the bank account. EFTs are to be faxed to the Treasury weekly so that MMARS may be updated and wire transfers reconciled.
  - c. Reporting and Recording of EFT Rejects: EFT rejects are posted against instant game revenue rather than to the specific games affected. MSLC provides the Treasury with the total amount of rejects per the daily bank link statement but does not provide a detail of rejects by the related games. As a result, instant game revenue is understated in MMARS and other game revenues are overstated. MSLC classifies revenues by game type using an Excel spreadsheet for its internal use; the information is not always posted to MMARS. As of June 30, 1998, rejects totaling approximately \$22 million were posted against instant game revenue.
- (2) Need for an Automated General Ledger System

MSLC financial statements are developed using Excel spreadsheets. In addition, MSLC did not perform timely reconciliations of its financial information to MMARS. Failure to perform such reconciliations may lead to errors going unnoticed for prolonged periods of time, making subsequent correction more difficult. These errors may also not be discovered in time to make adjustments to the financial statements that could result in material misstatements. It also may result in a potential failure to identify manual errors in spreadsheet entries and calculations. Excel spreadsheets do not normally have imbedded controls that are used in a system of internal controls, such as requiring balanced journal entries to make changes to the financial information.

MSLC should adopt a general ledger system. This system could either be based on MMARS downloads or could be an off-the-shelf system which should have requisite imbedded controls. The general ledger system would then aid in the development of monthly financial statements that could be easily reconciled to MMARS.

(3) Lottery Commission as an Enterprise Fund

MSLC is not accounted for or controlled in the same manner as other state lotteries. Current accounting literature recommends that lotteries be accounted for as enterprise funds so that the full cost of operations are reflected prior to determining the “profits” available for prizes and other uses. Most states follow this accounting model. In addition, because lotteries are separately reported as enterprise funds, most states subject them to a separate audit of operations and separate evaluations of the internal control structures.

MSLC is one of the few departments that have significant transactions and activities occurring on a daily basis. Currently, MSLC is reported as part of the major special revenue funds in the financial statements of the Commonwealth. Because of the volume of its activity, as well as the significant dollar prizes being awarded, MSLC is constantly under scrutiny by the public and may require a more detailed audit.

(4) Inadequate Support for Unremitted Cash and Accounts Payable Balances

MSLC personnel were not able to provide information necessary for the audit of MSLC’s unremitted receipts held by sales agents and accounts payable as of June 30, 1998. MSLC had experienced significant personnel turnover during fiscal year 1998 and 1997, and new employees were not familiar with MMARS in order to provide auditable information. As of June 30, 1998, gross accounts receivable totaled approximately \$19 million, the related uncollectible accounts totaled approximately \$5 million, and accounts payable totaled \$33 million. These amounts were not auditable, as the information was not available.

(5) Investment Rating

While testing prizes payable and insurance annuities, we noted one insurance company that maintains certain annuities for MSLC was in financial difficulty as of June 30, 1998. This insurance company holds approximately \$1.5 million, which represents 0.10% of total prizes payable balance at year-end. This amount is not material to the financial statements of the Commonwealth; however, MSLC does not record an allowance for defaulted annuities and does not have policies and procedures in place to provide alternative payment sources in the case of defaults.

(6) Understatement of Prizes Payable

Prizes payable was understated as of June 30, 1998. From a sample of 34 annuities selected for testing, five accounts were understated. The total amount of the known understatements was approximately \$11 million, and an additional likely understatement of approximately \$9 million was projected.

Recommendation: MSLC should:

- Become familiar with record retention requirements and maintain its documents accordingly.

- Ensure that all EFT information is provided to the Treasury weekly so that cash and wire transfers can be reconciled on a timely basis.
- Set up clearing accounts on MMARS and track EFT rejects by game type so that revenue by game type is more accurately reflected.
- Perform reconciliations to MMARS monthly.
- Consider accounting for MSLC as an enterprise fund. This would allow the Commonwealth to evaluate the true cost and benefit of its operations while providing additional assurance to the public. Such accounting would require that the MSLC accounting systems be evaluated and possibly upgraded so that operations could be reported on a full accrual basis.
- Ensure that employees are cross-trained so that extended absences or turnover would not cause a break in financial operations. In addition, we recommend that adequate training on MMARS is provided to accounting and financial reporting personnel so that financial information can be reviewed and reconciled on a timely basis and is therefore auditable.
- Establish a reserve to reflect annuities at their net estimated realizable value in case of market fluctuation and review the investment ratings for all of its investment custodians at least on an annual basis. In addition, we recommend MSLC identify alternative investment vehicles as backups to ensure that it will be able to meet all prizes payments as they become due in case one or more annuity custodians become insolvent.
- Improve its procedures for reconciling prizes payable and annuity contracts to ensure that the related liabilities are properly stated.

#### 10. Status of Prior Audit Results

a. Deceptive Lottery/Advertising Agency Billing Arrangement: Our prior review of MSLC's payments of its advertising agency's monthly billings revealed a practice of deception and circumvention of state laws, rules, and regulations. Specifically, MSLC forwarded to its advertising agency various invoices addressed to and received by MSLC for services and goods incurred by and received by MSLC. After the advertising agency paid these bills for MSLC, the agency would then bill MSLC for reimbursement under the "Miscellaneous Billing" category. Participants involved referred to and grouped the invoices related to this scheme, under the code name "Donut Fund." As a result, invoices and costs for goods and services that originated with and were incurred and received directly by MSLC were channeled through and paid by an intermediary instead of MSLC directly in order to conceal the true name of the original source provider of the services (vendor) and the nature and extent of the costs.

During our prior audit, MSLC officials informed us that MSLC had discontinued its practice of claiming questionable, in-house charges as promotional expenses paid through its advertising agency. These officials also indicated that, for fiscal year 1996, many of these expenditures formerly classified as advertising costs, if incurred, would be reclassified to different expenditure classifications and paid directly against MSLC's general appropriation. Our follow-up review determined that MSLC has properly classified and presented its advertising expenses.

Also, during our follow-up review we determined that a law firm was hired for various legal services. We reviewed a June 13, 1997 invoice for legal services for April and May of 1997 totaling \$9,758 (see Appendices Va and Vb). Many of the expenses itemized on the invoice were for telephone conversations with the Deputy State Treasurer and MSLC officials. Two of the telephone conversations that involved a review of the OSA audit report that was issued on May 22, 1997 are itemized as follows:

<u>Date of Service</u>	<u>Description of Service</u>	<u>Number Of Hours</u>	<u>Amount</u>
5/23/97	Telephone conference with Beth T. Miner Myers, Review audit report	1.10	\$385
5/27/97	Telephone conferences with Mary Zarilli, Telephone conference with J Grossman. Draft M. Zarilli debriefing memo. Review audit report. Draft memo to R. Popeo.	6.80	\$2,380

The prior administration spent thousands of dollars at a rate of \$350 per hour to review and discuss our prior audit disclosing questionable and improper practices conducted by MSLC that it claimed were appropriate rather than simply concentrating on implementing our recommendations for corrective actions for these deceptive and irregular activities.

b. Free Coupons Used to Circumvent the Statutory Mandate to Reduce Advertising Costs and to Conceal and Distort Total Operating Costs and Activities: Our prior audit disclosed that minutes of a December 11, 1995 MSLC meeting, attended by all but one of MSLC's commissioners, noted that

advertising efforts were being aimed at developing a cooperative advertising program with corporate sponsors due to statutory reductions in the advertising budget. This strategy was accomplished by exchanging free lottery coupons for advertising services which were paid for by corporate sponsors. Various sources have indicated that as much as \$100 million in free coupons were used, exchanged, or distributed in this program for corporate-funded advertising during calendar year 1996.

Our prior audit disclosed that MSLC designed the cooperative advertising program to circumvent and exceed the statutorily imposed advertising expenditure limits of \$2.8 million for fiscal year 1995 and \$400,000 for fiscal year 1996. Moreover, the advertising program, through its printing of coupons (in effect money), not only circumvented the legislative appropriation process without the knowledge and consent of the Legislature, but also distorted and concealed MSLC's true operating revenues and expenses, because the value of the coupons was not documented or recorded on MSLC's financial statements. However, at the same time, revenues to the Commonwealth's cities and towns were reduced because of increased prize money pay-outs associated with these free lottery coupons. Our follow-up review revealed that MSLC has discontinued this practice. Our follow-up review determined that MSLC has terminated its cooperative advertising program.

c. Late Penalties for Inadequately Monitored and Untimely Lease Payments: Our prior audit report disclosed that MSLC had accrued late charges totaling \$122,877 during fiscal year 1995 and 1996 that resulted from untimely payments on its leased equipment. MSLC had contacted the lessors and negotiated settlements of these late charges totaling \$41,047.

Our follow-up review determined that all leases were entered into the State Comptroller's recurring payment system, and MSLC's controller reviewed lease payments each month. Moreover, MSLC was current with all of its lease payments, and no late charges were paid during fiscal year 1998 or fiscal year 1999 to date.

d. Inadequate Facility Management Procurement Controls: The prior report noted that deficiencies in MSLC's management controls over the relocation of its office and warehouse space in Braintree, which

resulted in the payment for construction modifications and services that were executed contrary to the Commonwealth's open competitive-bid requirements. These noncompetitive expenditures consisted of \$469,653 to MSLC's landlord for a combination of lease change orders and service contracts and \$78,000 of amendments for moving costs to initial contracts of \$50,296. Furthermore, our review disclosed \$8,546 of MSLC overpayments for the landlord's service contract charges.

MSLC responded that the move undertaken to relocate MSLC Headquarters was a very complex series of individual tasks that had to be executed precisely in order to maintain MSLC operations and the flow of revenue to the Commonwealth without disruption. The primary objective was to accomplish the move without an interruption in service and the resulting loss of revenue to the cities and towns of the Commonwealth.

While we recognize that the prior management at MSLC was concerned with the possibility that a disruption would affect the operation of MSLC, it failed to effectively manage the timeliness of the move. Additionally, the use of an outdated Request for Proposals, which caused numerous change orders, clearly demonstrates a lack of management skills by the prior MSLC administration.

e. Inadequate Monitoring of Lease Compliance: Our prior audit noted that MSLC had expended \$36,000 to pay for traffic details that exceeded contractual terms with the landlord. A further review has indicated that, due to a late change in federal regulations for uninstalled traffic signal lights, the application for a permit to install traffic lights was delayed. In order to continue to provide public safety to MSLC employees and customers these conditions continued. While we recognize that changes in federal regulations cannot be predicted, the costs associated with change need to be absorbed. According to MSLC officials, the landlord incurred the substantial additional costs, with the remaining being charged to MSLC.

f. Inadequate Internal Controls over Contract Compliance Administration: Our prior audit disclosed that inadequate contract compliance procedures resulted in pricing errors contained in billings for instant game ticket printing not being identified and deceptive billing for advertising services being processed.



Our follow-up review determined that MSLC had not updated its control procedures over contract compliance and that all vouchers for contracted services were not being thoroughly monitored to ensure that vendor billings comply with contract terms and conditions. MSLC exceeded the maximum contract obligation on its legal service contract. Also, MSLC paid for certain legal services performed in fiscal year 1998 with fiscal year 1999 funds.

Further, MSLC entered into a contract for legal services for an amount not to exceed \$100,000 in fiscal year 1998. The contract had an option to renew in fiscal year 1999 for an amount not to exceed \$100,000. This option was exercised. On January 5, 1998 MSLC received an invoice for legal services totaling \$173,619.32 (see Appendix XIb). MSLC submitted to the State Comptroller a payment voucher (PV) (see Appendix XIa) on January 15, 1998 for \$100,000 the maximum contract obligation. This PV has been processed and paid.

Our review of the billing's documentation showed that services totaling \$108,832.50 were for services delivered during fiscal year 1998, a prior fiscal period. The balance of the services, \$64,776.82, were delivered during the current fiscal year 1999. State finance law requires that goods and services received in a given fiscal year must be paid for from funds appropriated for that fiscal year. In addition, the PV, completed by an MSLC employee, had false dates of services and the wrong budgeted fiscal year indicating that all of the services were provided in fiscal year 1999 when in fact services were provided in 1998. The Date of Service Box on the PV (see Appendix XIa) requires a period of time when the services were performed. The PV only indicated a date of December 24, 1998, which had no relationship to any date submitted on the law firm's invoice that services were performed from May 20, 1998 through November 24, 1998 (spanning two separate fiscal years). The PV was signed and approved by the former controller, who was subsequently transferred to the internal audit unit as manager (see Appendix XIa). In addition, the MSLC employee who prepared the PV gave misleading information in the voucher's budgeted fiscal year space.

MMARS Memorandum 279 requires that a prior year deficiency be filed with the State Comptroller for payment of expenses relating to a prior year, as follows:

- Departments are requested to submit all prior fiscal year bills with a cover letter. Prior Year Deficiency Request Form and a COMPLETED Batch Transmittal & PV (Payment Voucher) form with back up documentation. The Comptroller's Office will execute payments accordingly.
- All prior year deficiencies submitted to the Office of the Comptroller for payment will be charged back to the submitting departments current FY appropriation. The Office of the Comptroller is required to chargeback to the appropriation from which the deficiency payment would have been made. If that appropriation does not exist or is invalid in the current FY, charges can be made to the current FY appropriation for the general administration of the department.

When the new administration discovered this situation, it took corrective action by submitting a prior year deficiency request (see Appendix XII) of \$108,832.50 to the State Comptroller in order to correct this matter.

Recommendation: MSLC should, at a minimum:

- Ensure that it improves its internal control environment by fulfilling its obligation to establish and adhere to written accounting controls and procedures in compliance with Chapter 647 of the Acts of 1989.
- Establish monitoring and oversight control procedures to ensure that vendor billings comply with contract control terms and conditions.
- Adopt procedures for monitoring its contracts to ensure that services are billed and paid in a timely manner and in accordance with the rules and regulations adopted by the OSC.
- Request assistance from the OSC to obtain and participate in training on the Commonwealth's finance laws and regulations including all the OSC accounting and reporting systems.

## SUMMATION OF AUDIT RESULTS

The Office of the State Auditor provides the Executive Office, the Legislature, the Judiciary, oversight agencies, and the general public with independent and objective evaluations of various agencies, activities, and programs operated by the Commonwealth. The authority to audit these agencies comes directly from the Legislature. In the course of meeting this statutory mandate, the Office of the State Auditor issues various reports and makes recommendations to assist agencies and program administrators in correcting areas where administrative, accounting, and program controls need to be improved. The recommendations enhance the ability of agencies to protect the assets and revenue of the Commonwealth, ensure that taxpayer dollars are protected, and make certain that programs are both efficient and effective. This report identifies what happens when these recommendations are ignored.

Accounting and management systems are designed to promote the consistent and controlled treatment of transactions. In order to ensure that transactions are handled properly, organizations, institutions, and agencies must implement a sound system of internal controls. These controls, when properly developed, implemented, and enforced, virtually eliminate the possibility of incorrect accounting, internal theft, or deviation from acceptable procedures. When these controls are ignored or routinely bypassed, they cease to provide the protection for which they were designed. We found numerous instances in which MSLC bypassed, overrode, or ignored its own policies, resulting in significant internal control breakdowns and needless losses to the Commonwealth and its taxpayers.

Our audit report documents numerous questionable conditions, including inadequate monitoring of prizewinners, system failures in instant game controls, faulty collection practices and policies, the bypassing of regulations requiring the shutting down of MSLC sales terminals, thefts in its own sales rooms, and the reclassification of thefts to “borrowing” and “loans.” In each instance, the condition evident resulted in an unnecessary loss of income or a needless expense to the Commonwealth. This loss or reduction in income directly impacts the amount of money available for distribution to the Commonwealth’s cities and towns. Some have tried to minimize the importance of these problems by

simply measuring their dollar impact against MSLC's total revenues. This is a mistake. The sum of these problems, the recurring nature of some of the issues, and the recalcitrant nature of former MSLC management combine to present an image of an agency that has assumed the authority that is not theirs while avoiding responsibilities that clearly are.

It is easy to pretend that the volume of dollars that flow through MSLC somehow excuses MSLC's pervasively poor attitude, whereby officials were so caught up in maintaining and increasing sales that they overlooked the basic controls needed to protect what they already had. Furthermore, they developed a level of secrecy about their operations, which is unhealthy and dangerous. In fact, this furtive behavior contradicts openness sought by the Commonwealth in its activities as articulated in the internal control guide issued by the State Comptroller.

Sales drive MSLC and appear to have played an inordinate role in every decision made by MSLC management. There appears to have been a view within MSLC that any weakness or problem that becomes evident within the lottery system must not be made public. Moreover, there is an obvious belief within MSLC that any public disclosure of these issues will reduce public confidence. The internal focus to promote and increase ticket sales led to the unhealthy practice of allowing agents with poor collection histories to remain open. This determination to post increasing sales numbers is surely a factor in the inadequate practices used to identify MSLC prize claimants. Most importantly, it is this attitude that most likely led to management's intentional withholding of information integral to the investigation of a theft.

Time and time again we found instances where troublesome agents did not have their terminals shut down and were allowed to maintain ticket sales. The obvious problem with this is that these individuals increase the amount of cash they are withholding from the Commonwealth. By allowing its sales agents to maintain a troubled operation, MSLC made the problem larger rather than smaller. The concept MSLC does not seem to grasp is that these amounts due from agents are cash sales and public dollars, and therefore must be treated with exceptional care. There should be no tolerance for misuse, misappropriation, or theft. The funds collected by agents are not gross revenues that can be applied to

any business expenses that the agent chooses. Rather, they represent funds that belong to the Commonwealth. For example, when an individual pays the Registry of Motor Vehicles for sales taxes, a license, or a fee, these amounts are not be considered receivables. They are income to the Commonwealth as soon as they are received. Moreover, if they are missing and not turned over to the Treasurer, it is a shortage or a theft not a “loan” or “borrowing.” So too with MSLC funds. Individuals apply for a license to represent MSLC. This right of representation carries with it the obligation to collect, protect, and turn over to the Commonwealth the funds collected on its behalf.

The Legislature, recognizing the danger of agencies policing themselves, enacted Chapter 647 of the Acts of 1989 and empowered the Office of the State Auditor to review the internal controls within agencies and instruct them about what needs to be corrected to prevent a repeat occurrence, since such a review could not be accomplished in an unbiased manner by an agency itself. The Legislature also recognized that an individual agency should not investigate thefts or shortages within its own operation and charged the Office of the State Auditor with that additional responsibility. The following indicates what can happen when an agency assumes the role of auditor.

There appeared to be a theft of \$597 at MSLC, and as a result the Office of the State Auditor began a Chapter 647 review of this matter. During our review we were told that MSLC had conducted its own internal review. When we attempted to continue our review for the purposes of providing corrective measures, we were obstructed by former MSLC officials. Our attempts to access the outside auditor’s workpapers were denied on the grounds of “attorney client privilege.” This is in total contrast to the cooperation of current MSLC officials regarding the Boston office shortage. MSLC blatantly ignored its responsibility under Chapter 647 in the first instance. Had they not done so, the second theft could have been prevented.

This course of action by former MSLC officials combined with their refusal to have the results of its investigation released to our auditors represent an intent to circumvent Chapter 647 and hide the results from the general public. This institutional arrogance exhibited by former MSLC officials resulted in

management's failure to comply with the law and correct their problems rather than deny them. Thus, these officials share in the blame for the repeated cash shortages in Boston. MSLC's tactic of denial is also evident in the inconsistent manner in which it responds to theft. When a sales employee "kites" or "borrows" funds, there is an immediate termination of that individual. However, when there is kiting or borrowing of Commonwealth funds by MSLC sales agents, they are allowed to continue selling tickets while entering a payment plan.

It is important to note that when an agency of the Commonwealth is audited that the Office of the State Auditor is reviewing an agency's stewardship of taxpayer funds. As a result, government management and its employees are held to an higher standard, and government auditors who represent the Legislature, taxpayers, and the public have a higher authority (statutory) than hired firms. Moreover, government auditors' presence and efforts should be unencumbered by a management that is filtering and controlling access to records and employees.

Our audit revealed that MSLC had lax oversight and inadequate internal controls and security. In an environment that processes in excess of \$3.2 billion annually, strict financial oversight and internal controls are an absolute necessity in order for the public and Legislature to have confidence in the integrity of MSLC operations. In a situation where over \$2 billion of instant game tickets are given to 7,600 MSLC sales agents on a consignment-type basis, it is critical that MSLC institute timely settlement practices and ticket inventory controls in order to prevent sales agents from illegally withholding and misusing tens of millions of dollars from MSLC. This lack of periodic inventories and timely settlements allowed sales agents custody of cash receipts belonging to MSLC for an unacceptable period of time. This practice is in essence an interest-free state-subsidized line of credit for MSLC sales agents. MSLC's sales-driven vision cannot be allowed to imperil the revenue cycle through inadequate cash receipt and ticket inventory controls, since these funds and tickets are the property of the Commonwealth, as well as the cities and towns that are the ultimate recipients of \$775 million of these cash receipts.

The aforementioned deficiencies, lax controls, and inadequate security found at MSLC has perpetuated an environment that allowed the following conditions to occur:

- Inadequate prize winner identification system that does not guard against deadbeat parents, welfare fraud, income tax evasion, or identity theft. We identified \$2.2 million paid to prize claimants who made false representations.
- \$15.1 million in undeposited cash sales held by sales agents that is due MSLC. Of the \$15.1 million, \$12.8 million is probably uncollectible because of the poor settlement and collection practices of MSLC. These funds would have been ultimately disbursed to the Commonwealth's cities and towns if proper monitoring and collection practices were in place.
- Two instances of possible theft of MSLC funds by employees totaling over \$129,000 and \$24,061, respectively.
- Poor controls over electronic fund transfers resulting in \$39,259 not being transferred in a timely manner as well as \$309,681 in outstanding checks over one year old.
- Weak controls over hundreds of millions of dollars, and lack of full tracking of instant game tickets at (1) MSLC and (2) between MSLC and the system's vendor. Instant game tickets revenues are approximately \$2.1 billion and constitute 65% of MSLC cash receipts.
- Overcharges on the printer's billing of \$279,851 for instant game tickets, of which MSLC management was unaware until it was brought to its attention by our audit.
- A lack of fully documented and implemented administrative and accounting control procedures as required by Chapter 647 of the Acts of 1989. The neglect and failure of MSLC management to document and implement such control procedures and fulfill its responsibilities under the law provides fertile ground for the irregularities and illegal acts, that have occurred at MSLC.
- Questionable payroll practices that do not treat all employees equitably or in conformance with the provisions of the union contract.
- Other matters that need improvement as identified in the prior audits of the Commonwealth's Comprehensive Annual Financial Report, including:
  - a. Weaknesses in the documentation, reconciliation, reporting and recording of sales agents in electronic fund transfers resulted in \$22 million rejected transfers. Sales agents revenue should be adequately documented, reconciled, reported, and recorded, to ensure that revenue is properly and timely transmitted and accounted for to MSLC.
  - b. Lack of an automated general ledger system which would aid in the development of monthly financial reports in order to inform management of the status of financial activities so that there is proper management oversight.
  - c. Reclassification of MSLC to an enterprise fund which would reflect the full cost of MSLC's operation and would be the same accounting model used by most other state-operated lotteries.

- d. Inadequate support for unremitted cash and accounts payable balances. Proper support for unremitted cash and accounts payable would ensure that cash is deposited, recorded, reported timely, and less susceptible to shortages or thefts, and that bills are paid in a timely manner.
- e. Inadequate reviews of investment custodian annuity firms. Investment custodian annuities firms should be reviewed on a continuous basis to determine whether the firm is a going concern in order to minimize defaults on annuities.
- f. Understatement of approximately \$9 million of annuity prizes payable. Procedures should be implemented to match the prizes payable to the annuity contract to ensure that the correct prize amount is paid.

MSLC must comply with Chapter 647 and develop effective internal controls that must be implemented and maintained at MSLC. The new administration should use its authority to correct the serious financial and programmatic issues that exist at MSLC to curtail and minimize their reoccurrence.



## APPENDIX I

Summary of Accounts

January 20, 1999

Account

0640-0000	Lottery Commission Administration and Expenses	\$34,889,191
0640-0005	Keno Implementation & Associated Costs	1,360,141
0640-0010	Lottery Advertising	400,000
0640-0045	Computer System Replacement Telecommunication Lease Costs	8,085,917
0640-0096	Lottery Health	280,410
0640-0103	Lottery & Arts Lottery Spending	27,032,847
0640-5799	State Arts Lottery	173,814,475
0640-7001	Balance, July 1 Annuities	1,697,434,064
0640-7743	Disputed Prize Escrow	1,081,924
0640-8940	Lottery Mainframe	44,430,000
	Total	<u><u>\$1,988,808,969</u></u>

## APPENDIX II

Comparison of Fiscal Year 1999 Appropriated Versus Actual Expenditures by Subsidiary

January 20, 1999

<u>Account</u>	<u>Account Name</u>	<u>Appropriation</u>	<u>Encumbrance</u>	<u>Expenditure</u>	<u>Balance</u>	<u>Expenditures % of Obligation Ceiling</u>
0640-0000	Lottery Commission Administration and Expenses					
	Regular Employee Compensation	\$ 19,599,708	\$ -	\$ 9,443,139	\$ 10,156,569	48.180
	Employee Expenses	307,000	128,942	155,739	22,319	50.729
	Employee Benefits	2,541,680	887,610	736,600	917,470	28.981
	Administrative Expenses	-	-	-	-	-
	Facilities Operational Expenses	190,150	10,543	25,096	154,511	13.198
	Energy Costs & Space Rental Expenses	2,487,821	908,987	1,396,224	182,610	56.122
	Professional Services - Consultants	1,371,507	886,828	203,716	280,963	14.853
	Operational Services	2,256,862	1,092,806	998,186	165,870	44.229
	Equipment Purchases	223,144	28,572	43,184	151,388	19.353
	Equipment Lease	5,871,319	2,579,011	2,470,983	821,325	42.086
	Client Services-Coop Fund	40,000	20,000	-	20,000	50.000
	Total	<u>\$ 34,889,191</u>	<u>\$ 6,543,299</u>	<u>\$ 15,472,867</u>	<u>\$ 12,873,025</u>	

## APPENDIX II (Continued)

Comparison of Fiscal Year 1999 Appropriated Versus Actual Expenditures by Subsidiary

January 20, 1999

<u>Account</u>	<u>Account Name</u>	<u>Appropriation</u>	<u>Encumbrance</u>	<u>Expenditure</u>	<u>Balance</u>	<u>Expenditures % of Obligation Ceiling</u>
0640-0005	Keno Implementation & Associated Costs					
	Administrative Expenses	\$ 1,180,518	535,267	\$ 190,289	\$ 454,962	16.119
	Professional Services - Consultants	50,000	-	-	50,000	-
	Equipment Lease	129,623	54,173	22,827	52,623	17.610
	Total	<u>\$ 1,360,141</u>	<u>\$ 589,440</u>	<u>\$ 213,116</u>	<u>\$ 557,585</u>	15.669
0640-0010	Lottery Advertising					
	Administrative Expenses	\$ 350,000	\$ 67,482	\$ 34,226	\$ 248,292	9.779
	Professional Services - Consultants	50,000	9,650	5,350	35,000	10.700
	Total	<u>\$ 400,000</u>	<u>\$ 77,132</u>	<u>\$ 39,576</u>	<u>\$ 283,292</u>	9.894
0640-0045	Computer System Replacement Telecommunication Lease Costs	\$ 8,085,917	\$ 3,649,980	\$ 3,613,679	\$ 822,258	44.691
0640-0096	Lottery Health Employee Benefits	\$ 280,410	\$ -	-	\$ 280,410	-

## APPENDIX II (Continued)

Comparison of Fiscal Year 1999 Appropriated Versus Actual Expenditures by Subsidiary

January 20, 1999

<u>Account</u>	<u>Account Name</u>	<u>Appropriation</u>	<u>Encumbrance</u>	<u>Expenditure</u>	<u>Balance</u>	<u>Expenditures % of Obligation Ceiling</u>
0640-0103	Lottery & Arts Lottery Spending Administrative Expenses	\$ 27,032,847	\$ 11,989,734	\$ 13,129,482	\$ 1,913,631	48.569
0640-5799	State Arts Lottery	173,814,475	11,130,842	126,397,934	36,285,699	72.720
0640-7001	Balance July 1 Annuities	1,697,434,064	24,153,584	1,604,473,533	68,806,947	94.523
0640-7743	Disputed Prize Escrow	1,081,924	-	-	1,081,924	-
0640-8940	Lottery Mainframe	44,430,000	-	-	44,430,000	-
	Total	<u>\$ 1,988,808,969</u>	<u>\$ 58,134,011</u>	<u>\$ 1,763,340,187</u>	<u>\$ 167,334,771</u>	

## APPENDIX III

Chapter 647, Acts of 1989  
An Act Relative to Improving the Internal Controls within State Agencies

H 5

Chapter 647

THE COMMONWEALTH OF MASSACHUSETTS

*In the Year One Thousand Nine Hundred and Eighty-nine*

AN ACT RELATIVE TO IMPROVING THE INTERNAL CONTROLS WITHIN STATE AGENCIES.

*Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:*

Notwithstanding any general or special law to the contrary, the following internal control standards shall define the minimum level of quality acceptable for internal control systems in operation throughout the various state agencies and departments and shall constitute the criteria against which such internal control systems will be evaluated. Internal control systems for the various state agencies and departments of the commonwealth shall be developed in accordance with internal control guidelines established by the office of the comptroller.

(A) Internal control systems of the agency are to be clearly documented and readily available for examination. Objectives for each of these standards are to be identified or developed for each agency activity and are to be logical, applicable and complete. Documentation of the agency's internal control systems should include (1) internal control procedures, (2) internal control accountability systems and (3), identification of the operating cycles. Documentation of the agency's internal control systems should appear in management directives, administrative policy, and accounting policies, procedures and manuals.

(B) All transactions and other significant events are to be promptly recorded, clearly documented and properly classified. Documentation of a transaction or event should include the entire process or life cycle of the transaction or event, including (1) the initiation or authorization of the transaction or event, (2) all aspects of the transaction while in process and (3), the final classification in summary records.

(C) Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority. Authorizations should be clearly communicated to managers and employees and should

## APPENDIX III (Continued)

Chapter 647, Acts of 1989An Act Relative to Improving the Internal Controls within State Agencies

H 5

include the specific conditions and terms under which authorizations are to be made.

(D) Key duties and responsibilities including (1) authorizing, approving, and recording transactions, (2) issuing and receiving assets, (3) making payments and (4), reviewing or auditing transactions, should be assigned systematically to a number of individuals to ensure that effective checks and balances exist.

(E) Qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved. The duties of the supervisor in carrying out this responsibility shall include (1) clearly communicating the duties, responsibilities and accountabilities assigned to each staff member, (2) systematically reviewing each member's work to the extent necessary and (3), approving work at critical points to ensure that work flows as intended.

(F) Access to resources and records is to be limited to authorized individuals as determined by the agency head. Restrictions on access to resources will depend upon the vulnerability of the resource and the perceived risk of loss, both of which shall be periodically assessed. The agency head shall be responsible for maintaining accountability for the custody and use of resources and shall assign qualified individuals for that purpose. Periodic comparison shall be made between the resources and the recorded accountability of the resources to reduce the risk of unauthorized use or loss and protect against waste and wrongful acts. The vulnerability and value of the agency resources shall determine the frequency of this comparison.

Within each agency there shall be an official, equivalent in title or rank to an assistant or deputy to the department head, whose responsibility, in addition to his regularly assigned duties, shall be to ensure that the agency has written documentation of its internal accounting and administrative control system on file. Said official shall, annually, or more often as conditions warrant, evaluate the effectiveness of the agency's internal control system and establish and implement changes necessary to ensure the continued integrity of the system. Said official shall in the performance of his duties ensure that: (1) the documentation of all internal control systems is readily available for examination by the comptroller, the secretary of administration and finance and the state auditor, (2) the results of audits and recommendations to improve departmental internal controls are promptly evaluated by the agency management, (3) timely and appropriate corrective actions are effected

## APPENDIX III (Continued)

Chapter 647, Acts of 1989An Act Relative to Improving the Internal Controls within State Agencies

H. 5

by the agency management in response to an audit and (4), all actions determined by the agency management as necessary to correct or otherwise resolve matters will be addressed by the agency in their budgetary request to the general court.

All unaccounted for variances, losses, shortages or thefts of funds or property shall be immediately reported to the state auditor's office, who shall review the matter to determine the amount involved which shall be reported to appropriate management and law enforcement officials. Said auditor shall also determine the internal control weaknesses that contributed to or caused the condition. Said auditor shall then make recommendations to the agency official overseeing the internal control system and other appropriate management officials. The recommendations of said auditor shall address the correction of the conditions found and the necessary internal control policies and procedures that must be modified. The agency oversight official and the appropriate management officials shall immediately implement policies and procedures necessary to prevent a recurrence of the problems identified.

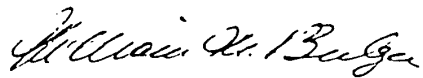
House of Representatives, December 21, 1989.

Passed to be enacted,

 , Speaker.

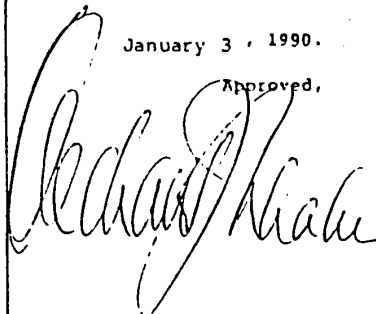
In Senate, December 22, 1989.

Passed to be enacted,

 , President.

January 3, 1990.

Approved,

 Governor.

## APPENDIX IV

Chapter 647 Awareness LetterFrom the State Auditor and the State Comptroller

## The Commonwealth of Massachusetts

Office of the State Auditor  
State House  
Boston, MA 02133

Office of the Comptroller  
One Ashburton Place  
Boston, MA 02108

June 9, 1999

Legislative Leadership  
Judicial Branch Administrators  
Elected Officials  
Secretariats  
Department Heads

The Office of the State Auditor and the Office of the State Comptroller, as with past fiscal years, will continue our efforts regarding internal controls. Chapter 647 of the Acts of 1989, An Act Relative To Improving Internal Controls Within State Agencies, establishes the minimum level of quality acceptable for Internal Control Systems in operation throughout state departments and constitutes the criteria against which Internal Control Structures will be evaluated. With the passage of this law, we began an Internal Control Campaign to educate and make all departments aware of the significant role Internal Controls have on its financial and administrative operations. A good system of Internal Controls coordinates a department's policies and procedures to safeguard its assets, checks the accuracy and reliability of the department's accounting data, promotes operational efficiency, and encourages adherence to prescribed managerial policies.

Departments have made significant progress in the area of Internal Controls. Every department has certified to the existence of documented controls in the form of an Internal Control Plan. In Fiscal Year 1999, we will be broadening the Internal Control Campaign focus. We will be reviewing and testing plans in a broader context that includes all aspects of a Department's business, programmatic operations as well as financial.

The American Institute of Certified Public Accountants defines Internal Controls as a process designed to provide reasonable assurance regarding the achievement of objectives in the reliability of financial reporting, effectiveness, and efficiency of operations and compliance with applicable laws and regulations. Internal Controls consist of the following five interrelated components.

**Control Environment** sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of Internal Control, providing discipline and structure.

**Risk Assessment** is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.



## APPENDIX IV (Continued)

Chapter 647 Awareness Letter

**Control Activities** are the policies and procedures that help ensure that management directives are carried out.

**Information and Communication** are the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.

**Monitoring** is a process that assesses the quality of internal control performance over time

Chapter 647 requires that an official, equivalent in title or rank to an assistant or deputy to the department head shall be responsible for the evaluation of the effectiveness of the departments internal controls and establish and implement changes necessary to ensure the continued integrity of the system. This should be done annually or more often as conditions warrant. Department officials responsible for internal controls should evaluate whether their departments' Internal Control Plans include the above components.

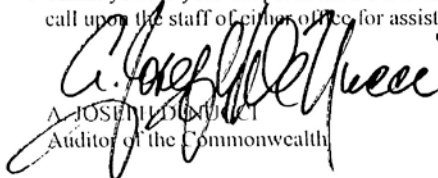
To assist Departments with this effort, we provide the following support activities:

- ♦ The Office of the Comptroller offers departments both ongoing and special internal control training upon request.
- ♦ An Internal Control Guide (due to be updated in early Fiscal Year 2000) is available on the Office of the Comptroller's Web page: <http://www.osc.state.ma.us/>.
- ♦ Upon request, the Office of the Comptroller provides assistance to departments in the process of redefining or reviewing their Internal Control Plans.
- ♦ As part of the Statewide Single Audit, auditors will review and comment upon the Internal Control Plan of any department with audit coverage.
- ♦ Single Audit testing will include increased work: test the transaction compliance with the Internal Control Plan; go beyond the plans to assess and test the plans' implementation within departments.

Chapter 647 requires that all unaccounted for variances, losses, shortages or thefts of funds or property be immediately reported to the Office of the State Auditor (OSA). The OSA is required to determine the amount involved and the internal control weaknesses that contributed to or caused the condition, make recommendations for corrective action, and make referrals to appropriate law enforcement officials. In order to comply with this law instances must be reported on the Report on Unaccounted for Variances, Losses, Shortages, or Thefts of Funds or Property and be submitted to the OSA. Reporting forms can be obtained by contacting the Auditor's office, Room 1819, McCormack State Office Building or Web Site: <http://www.magent.state.ma.us/sao/>.

The Offices of the State Comptroller and the State Auditor are committed to the goal of improving the Internal Control structure of the Commonwealth, department by department.

Thank you for your cooperation and attention on this worthwhile task. Please do not hesitate to call upon the staff of either office for assistance.

  
A. JOSEPH RICCI  
Auditor of the Commonwealth

  
MARTIN J. BENISON  
State Comptroller

## APPENDIX Va

Commonwealth of Massachusetts Payment Voucher (PV)  
for Legal Services of \$9,758.05

[illegible]

## APPENDIX Vb

Invoice for Legal Services of \$9,758.05

Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.  
One Financial Center  
Boston, Massachusetts 02111

Massachusetts State Lottery Commission  
60 Columbian Street  
Braintree, MA 02184-7342

June 12, 1997

---

Re: State Investigation

FOR PROFESSIONAL SERVICES RENDERED  
through May 31, 1997

\$9,730.00

Disbursements:

--- 28.05

Total:

\$9,758.05

N62

177120 1

RECEIVED  
JUN 18 1997  
PURCHASING

## APPENDIX Vb (Continued)

## Invoice for Legal Services of \$9,758.05

MINTZ, LEVIN, COHN, FERRIS, GLOVSKY and POPEO, P.C.  
One Financial Center  
Boston, Massachusetts 02111

MASSACHUSETTS STATE LOTTERY COMMISSION  
60 COLUMBIAN STREET  
BRAINTREE, MA 02184-7342

June 13, 1997  
17167-001  
Invoice # 8057889

FOR PROFESSIONAL SERVICES RENDERED THROUGH MAY 31, 1997

RE: STATE INVESTIGATION

04/10/97 Telephone call with Tom Trimarco.	R R POPEO	.50	175.00
04/11/97 Telephone call with Tom Trimarco.	R R POPEO	.20	70.00
04/14/97 Telephone call with Tom Trimarco; conference with T. Trimarco, Mary Zarilli, Jim Driscoll and TMiner.	R R POPEO	1.60	560.00
04/14/97 Conference with R. Popeo. Conference with Lottery personnel. Telephone conference with T. Trimarco.	T MINER	2.10	735.00
04/15/97 Telephone call with Tom Trimarco.	R R POPEO	.40	140.00
04/22/97 Telephone conference with Mary Zarilli. Telephone conference with T. Trimarco/Beth Myers. Conference with R. Popeo.	T MINER	.80	280.00
04/28/97 Review documents regarding investigation.	T MINER	2.50	875.00
04/29/97 Telephone conferences with John Grossman. Telephone conferences with Mary Zarilli. Telephone conferences with Beth Myers. Review invoices.	T MINER	1.80	630.00

## APPENDIX Vb (Continued)

Invoice for Legal Services of \$9,758.05

MASSACHUSETTS STATE LOTTERY COMMISSION		June 13, 1997	PAGE 2
FILE NUMBER: 17167-001			
INVOICE NO.: 8057589			
05/06/97	Preparation of Mary Zarilli for interview. Outline issues.	T MINER	2.40 840.00
05/07/97	Review materials in preparation for M. Zarilli interview. Attend M. Zarilli interview. Conference with R. Popeo regarding interview.	T MINER	3.00 1050.00
05/08/97	Telephone conference with Beth Myers.	T MINER	.30 105.00
05/09/97	Telephone conferences with M. Zarilli. Telephone conference with Beth Myers.	T MINER	.70 245.00
05/14/97	Telephone TTrimarco.	R R POPEO	.20 70.00
05/20/97	Telephone conference with John Grossman. Telephone conference with Mary Zarilli.	T MINER	.80 280.00
05/22/97	Telephone conference with Beth Myers, draft response to Attorney General's Office.	T MINER	.80 280.00
05/23/97	Telephone conference with Beth Myers. Review audit report.	T MINER	1.10 385.00
05/27/97	Telephone conferences with Mary Zarilli. Telephone conference with J. Grossman. Draft M. Zarilli debriefing memo. Review audit report. Draft memo to R. Popeo.	T MINER	6.80 2380.00
05/28/97	Telephone conference with J. Grossman. Telephone conference with M. Zarilli. Edit Zarilli debriefing memo. Draft memo to R. Popeo regarding status, strategy.	T MINER	1.80 630.00
TOTAL FOR SERVICES:			\$ 9,730.00
EXPENSES			
	Reprographics		28.05

## APPENDIX Vb (Continued)

Invoice for Legal Services of \$9,758.05

MASSACHUSETTS STATE LOTTERY COMMISSION  
FILE NUMBER: 17167 001  
INVOICE NO.: 8057889

June 13, 1997

PAGE 3

TOTAL EXPENSES: \$ 28.05

TOTAL THIS STATEMENT: \$ 9,758.05

## APPENDIX VI

Massachusetts State Lottery Commission  
Unremitted Balances over \$25,000 Due From Sales Agents

Receivable Detail bal over 25k							
Customer Name	Receivable Open	Probable	Terminated	Collection	Town	Reason	DEA Name
TFS Franchise Corp	\$ 229,326.16		no	no	Many locations	no reason needed	redesigned
D & G Vending Inc	\$ 187,651.15	yes	yes	no	Norton	Revoked / Kitinn / Criminal Investigation	Kelly's Package & Variety
Bud & Jim Inc	\$ 175,125.22	yes	yes	yes	Brockton	Conversion to Auto Settle	Bud & Jim's
Visco, Stephen P	\$ 167,855.83		yes	yes	Winthrop	Revoked	4 C's Sub Shop
Stone Brothers, LLC	\$ 124,360.10		yes	yes	Northboro	Revoked / Internal theft	Grille al Solomon Pond
Carnabuci, Santo	\$ 116,300.31		yes	no	Holbrook	Revoked / New owner assuming liability	Santo's Market
Roberts Food Mart	\$ 115,737.07	yes	yes	yes	Hanover	Conversion to Auto Settle / Agent in jail	Roberts Food Mart
Carl's Variety	\$ 105,309.63	yes	yes	yes	Belmont	Revoked / Failure to pay	Carl's Variety
Chisholm, John S	\$ 100,103.38	yes	yes	yes	Worcester	Revoked / Conversion to Auto Settle	Chandler St. Mobile
SPG Service	\$ 96,074.66	yes	yes	yes	Brockton	Conversion to Auto Settle	Village Market
Abbasi, Hafsa	\$ 88,431.27	yes	yes	no	Auburn	Revoked / Kitinn / Criminal Investigation	One Stop Foods
Abbasi, Hafsa	\$ 81,758.26	yes	yes	no	Chicopee	Revoked / Criminal case / Kitinn	Hank's Variety
Boutillier, Francis	\$ 78,616.14		yes	yes	Brockton	Conversion to Auto Settle	Frank's Market
Whabi, Fayez	\$ 78,381.25	yes	yes	yes	Needham	Agent fled state	Lil Peach
Chaudry, Muhammed	\$ 78,121.38		yes	no	Cape Cod	Revoked	Chaudry's Market
Sunset Restaurant	\$ 71,959.32	yes	yes	yes	New Bedford	Failure to pay	Sunset Café
Butt, Amjad	\$ 70,762.08	yes	yes	yes	Attleboro	Refusal to pay	Shop N Save
ABC Discount	\$ 68,774.06	yes	yes	yes	Revere	Revoked / Kitinn	ABC Discount
Convenience Depot	\$ 65,375.42	yes	yes	yes	Dighton	Conversion to Auto Settle	Convenience Depot
Hillside Cleaning Service Inc	\$ 64,634.87	yes	yes	yes	Worcester	Conversion to Auto Settle	Hillside Spa
A.L. Johnson Associates	\$ 63,674.36	yes	yes	yes	Roxbury	Conversion to Auto Settle	Blue Hill Liquor
Rahman, Khaista	\$ 63,652.38	yes	yes	yes	Brockton	Conversion to Auto Settle	Brockton Citgo
Abu Sami's Food Service	\$ 61,476.19	yes	yes	yes	Boston	Conversion to Auto Settle	Vandabil Café
Klam Co., Inc	\$ 60,466.22	yes	yes	yes	Brookline	Failure to pay	Rose's Mkt
Orient Height News	\$ 58,632.79	yes	yes	yes	E. Boston	Revoked	Orient Heights News
Lane, Dennis	\$ 56,874.00		no	no	Quincy	Internal theft / Payment Plan	7-Eleven
Michos Toth	\$ 52,541.58	yes	yes	yes	Framingham	Conversion to Auto Settle / Filed for B	Milk N More 2
Chalabouni, Michel J	\$ 51,447.39	yes	yes	yes	Milford	Unable to pay	Sunoco Mini Mart
Shelly's Variety	\$ 48,708.49	yes	yes	yes	Grafton	Failure/refusal to pay	Shelly's Variety
Cam Donuts	\$ 48,526.70	yes	yes	no	New Bedford	Failure to pay	Golden Donuts
Lausana, Elza M	\$ 48,286.02	yes	yes	no	Chelsea	Revoked / Kitinn	Joe's Fish Market
Mark's Variety	\$ 44,523.66	yes	yes	yes	Ludlow	Conversion to Auto Settle	Mark's Variety
JW Country Store	\$ 44,237.25	yes	yes	yes	Wareham	Unable to pay	PJ's Bakery and General Store
Nguyen, Son Doc	\$ 43,703.00	yes	yes	no	Salem	Revoked / AFT Criminal Investigation	V & S Market
Elwell, Scott	\$ 42,818.05	yes	yes	yes	Marlboro	Conversion to Auto Settle	Convenience Food Mart
Trieu, Chung K	\$ 42,738.90	yes	yes	yes	Dedham	Failure to pay final settlement	High Street Variety
One Stop Convenience	\$ 39,848.39		yes	yes	Gloucester	Conversion to Auto Settle	Rudy's One Stop
Depasquale, Joseph	\$ 38,252.97	yes	yes	no	Newton	Death	Biscone's
Island Caterers, Inc	\$ 37,472.44	yes	yes	no	No Reading	Failure to pay	The Bull Pen
Doris, Ann M	\$ 35,569.09	yes	yes	no	Charlestown	Final settlement unpaid	Mama Maria's
McBride, Timothy	\$ 35,281.65		yes	no	Braintree	Payment Plan	White Hen
Ali, Sayed A	\$ 34,954.51	yes	yes	no	Gardner	Failure to pay / Revoked	E-Z Mart
Pimental, Ruben	\$ 34,862.55	yes	yes	no	Jamaica Plain	Failure to pay	La Pimental Market

## APPENDIX VI (Continued)

Massachusetts State Lottery Commission  
Unremitted Balances over \$25,000 Due from Sales Agents

Receivable Detail bal over 25k							
Customer Name	Receivable Open	Probable	Terminated	Collection	Town	Reason	DBA Name
Fazio Enterprises	\$ 31,560.25	yes	yes	no	Malden	Failure to pay	Fazio Enterprises
Alfakyani, Zil	\$ 30,710.88		yes	no	Lynn	Disputed Final Balance	Lil Peach
Southland Corp	\$ 30,265.95		no	no	Many locations	no reason needed	7-11 Franchisee
Smith, Ineria	\$ 28,183.44	yes	no	no	Weston	Payment Plan	Weston Center Grocery
Greene, John	\$ 26,437.40	yes	yes	yes	Rehoboth	Failure to pay	Dairyland Farms
Total:	\$ 3,398,264.55						
B. Pelton							
3/8/89							
Probable Write Off Total	\$ 2,410,703.78						

TOTAL P. 04

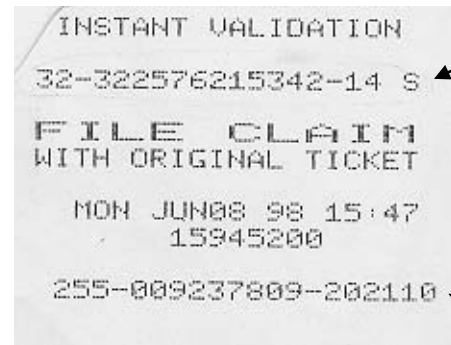


## APPENDIX VII

Massachusetts State Lottery Commission  
Example of Winning Ticket and Support for Claim Form

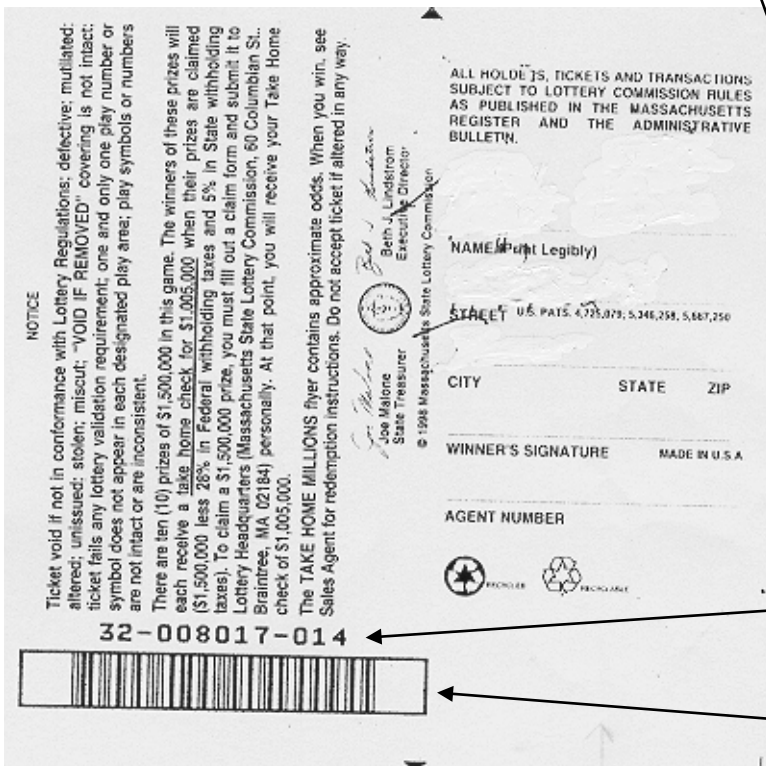


VIRN (Void If Removed Number)



Online Ticket Serial Number

VIRN (Void If Removed Number)



I. Instant Game Ticket  
Identification

VIRN (Void If Removed Number)

## APPENDIX VIII

## Massachusetts State Lottery Commission

### Example of Claim Form

4416-0914-7306 ©1997, Moore Document Solutions. All rights reserved. - 2028


**INSTRUCTIONS** (This Form is for ALL Lottery Tickets)

- Complete the Claim Form by following those steps:  
1) Carefully print either the 18-digit serial number or the 11-digit instant ticket number in the space provided. Complete the remainder of the Claim Form by printing your name, address, social security number and telephone number.
- Sign the Claim Form and your ticket. Separate the Lottery copy from your receipt copy. Put the Lottery copy of Claim Form and your ticket into the envelope provided and take it to the nearest Lottery office or mail it to Lottery Headquarters.

**KEEP YOUR COPY OF THE CLAIM FORM. IT IS YOUR RECEIPT.**

Winners agree to Abide by Massachusetts State Lottery Rules.

---

<b>MASSACHUSETTS STATE LOTTERY COMMISSION CLAIM FORM</b>											
 <b>THE LOTTERY</b>				<i>Samuel D. Phillips</i> Executive Director				<i>Joe Malone</i> STATE TREASURER			
ON LINE TICKET SERIAL NUMBER											
INSTANT GAME TICKET IDENTIFICATION				PREFIX		BOOK NUMBER				TICKET NO.	
<b>PLEASE PRINT CAREFULLY</b>											
WINNER'S NAME (First, Middle Initial, Last)											
STREET											
CITY								STATE		ZIP CODE	
SOCIAL SECURITY NO.						TELEPHONE NUMBER					

---

Agent's Signature _____  Agent Signature certifies that the above named person is making a claim on enclosed ticket.	Player's Signature _____  I certify, under penalties of perjury that the information contained herein is correct and true. I declare that I am eighteen years of age or older and that to the best of my knowledge and belief the name, address and taxpayer identifying number identifies me as the sole recipient of this payment.	Date _____
--	--	------------

LOTTERY COPY

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## APPENDIX IX

Massachusetts State Lottery Commission  
Prize Distribution of “Break the Bank,” “High Stakes,” “Quick Silver,” and “\$200,000 Jackpot”

Prize Value	\$200,000 Jackpot - \$5 Ticket Winners Per Game	High Stakes - \$5 Ticket Winners	Break the Bank - \$2 Ticket Winners	Quick Silver - \$1 Ticket Winners
\$ 200,000	50			
\$ 50,000		60		
\$ 20,000			50	
\$ 10,000	250		50	
\$ 5,000	510		100	
\$ 4,000		1,260		
\$ 1,000		7,560		1,080
\$ 500	38,220			
\$ 400	201,600		14,700	
\$ 200		14,700	25,200	
\$ 100		51,450	80,500	50,400
\$ 50	100,800		52,500	26,040
\$ 40	100,800	201,600	168,000	75,600
\$ 30		100,800		
\$ 20	604,800	302,400	336,000	201,600
\$ 15		201,600		
\$ 10	2,419,200	504,000	840,000	604,800
\$ 6		2,016,000		
\$ 5	2,822,400	403,200	840,000	403,200
\$ 4			3,696,000	1,411,200
\$ 3		2,520,000		
\$ 2			4,536,000	4,435,200
\$ 1				5,241,600
Total Winners	6,288,630	6,324,630	10,589,100	12,450,720
Total Tickets	30,240,000	30,240,000	50,400,000	60,480,000

## APPENDIX X

## Chapter 647 Report on Shortages, Losses, Thefts of Funds or Property

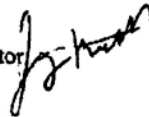
*Massachusetts State Lottery Commission*  
*60 Columbian Street*  
*Braintree, Massachusetts 02184-1738*

TEL: (781) 849-5555

TTY: (781) 849-5079

FAX: (781) 849-5546

SHANNON P. O'BRIEN  
CHAIREDWARD LASHMAN  
ACTING EXECUTIVE DIRECTOR

TO: Office of the State Auditor  
FROM: Jay Mitchell, Executive Director   
DATE: June 8, 1999  
Agency: Massachusetts State Lottery Commission  
Address: 60 Columbian Street, Braintree, MA 02184

Agency Contact Person: Jeanette Maillet, Assistant Director/Finance, 781-849-5522

Date Detected: June 2, 1999

Explanation of Condition: During the course of a Lottery requested review conducted by KPMG, LLP; a review of the reconciliation reports of our Regional Office bank account resulted in an outstanding balance of deposits that has not been located.

Cause of Condition: Suspected "kiting" or borrowing of money.

Amount of Funds Involved: \$24,060.50

Checking Account Involved: 9363587198

Agency Division or Section Involved: Boston Gaming Room, McCormick Building

Individuals Aware of Incident: Shannon O'Brien, Treasurer; Michael Travaglini, First Deputy Treasurer; Edward Lashman, Acting Executive Director/Lottery; Jeanette Maillet, Assistant Director/Finance/Lottery; James Driscoll, General Counsel/Lottery; Shawn Warren and Karen Gershman, KPMG.

No. of Individuals Having Access to Accounts/Funds Affected: 2

Other Pertinent Information:

Report Completed By: Jeanette Maillet, Assistant Director/Finance, 781-849-5522


Visit our Web Site: [www.masslottery.com](http://www.masslottery.com)

## APPENDIX XIa

Payment Voucher (PV)  
For Legal Services of \$100,000

# The Commonwealth of Massachusetts

## PAYMENT VOUCHER INPUT FORM

Department/Organization Name MSLC		Document ID		PV Date 01 15 99		Acctg Fnd 99		BFY 99	
Trans PV	Dept LOT	R/Org 1000	Number 9075019	PV Date 01 15 99		Acctg Fnd 99		BFY 99	
Action: (E) Sch Pay Date Off Liab Act		<b>VENDOR'S CERTIFICATION</b> I certify that the goods were shipped or the service rendered as set forth below.							
Ref Doc ID		(Please Sign In Ink)							
Document Total		100,000.00		Sext		Payment Ref Number		Vendor Code	
Referenced Order		Line		Quantity		Description		Unit Price	
Amount		100,000.00		1		INV # 8092866		042 718 459 000 3	
Emp									
Vendor Name and Address		MINTZ LEVIN COHN FERRIS GLOVSKY							
Office of the Comptroller									
Reference Order		LN Tran Dept R/Org Number Line Dept Approp Sub Org Obj S Obj Prog Ty Q1 SC LOT 1000 9342001 01 LOT 0640 0000 HH 1000 H03 Proj/CI/Grc Actv Rptg Fund BS Acct MSA# Line # Disc Date of Service Quantity Line Amount 12 24 98 To 1 100,000.00 I hereby certify under the penalties of perjury that all laws of the Commonwealth governing disbursements of public funds and the regulations thereof have been complied with and observed.							
Prepared By: L. Abbondandolo		Title: Admin Clerk		Date: 1 15 99		Page 1		Of 1	
Entered By: [Signature]		Title: [Signature]		Date: [Signature]		Page [Signature]		Of [Signature]	
Approved By: [Signature]		Title: Controller		Date: 1-15-99		Phone: [Signature]		[Signature]	

## APPENDIX XIb

Invoice for Legal Services of \$173,619.32

MINTZ, LEVIN, COHN, FERRIS, GLOVSKY and POPEO, P.C.  
 One Financial Center  
 Boston, Massachusetts 02111

MASSACHUSETTS STATE LOTTERY COMMISSION  
 60 COLUMBIAN STREET  
 BRAINTREE, MA 02184-7342

December 30, 1998  
 17167-001  
 Invoice # 8092866

*OK'd, [Signature]*  
 3/12/99

FOR PROFESSIONAL SERVICES RENDERED THROUGH NOVEMBER 30, 1998

RE: GENERAL

05/20/98	Conference with P. Sacks, P. Cray, D. Wilkins and K. O'Toole.	R R POPEO	1.00	350.00
05/29/98	Attend deposition of Mrs. Kantges. Conference with RRPopeo regarding same. Conference with CHernandez-Malaby regarding brief.	T MINER	.80	280.00
06/01/98	Edit opposition brief. Review correspondence - exhibits. Telephone conference with J. Driscoll. Telephone conference with P. Cray. Conference with RRPopeo.	T MINER	6.80	2380.00
06/01/98	Finalizing and filing opposition to N. Havan's motion to stay administrative hearing; telephone conference with TAMiner regarding interview of computer expert at lottery.	C D HERNANDEZ-MALA	5.00	1250.00

## APPENDIX XIb (Continued)

Invoice for Legal Services of \$173,619.32

MASSACHUSETTS STATE LOTTERY COMMISSION  
 FILE NUMBER: 17167-001  
 INVOICE NO.: 8092866

December 30, 1998 PAGE 2

06/02/98	Review Brief of Attorney General. Conferences with CHernandez-Malaby regarding meeting with computer person. Telephone conference with B. Lindstrom. Telephone conference with P. Cray.	T MINER	2.40	840.00
06/02/98	Meeting with G. Calabrese and counsel of record regarding Lottery computer system and discovery issues; meeting with TMiner regarding meeting with G. Calabrese and N. Havan document requests; review of discovery and hearing issues.	C D HERNANDEZ-MALA	4.80	1200.00
06/03/98	Telephone conferences with B. Lindstrom. Telephone conference with J. Driscoll. Review Kantges' briefs. Review correspondence from L. Johnson.	T MINER	2.00	700.00
06/04/98	Review pleadings. Telephone conference with CHernandez-Malaby. Telephone conference with J. Merberg.	T MINER	2.60	910.00
06/05/98	Attend Havan's deposition. Conference with J. Merberg. Conference with RRPopeo.	T MINER	7.20	2520.00
06/05/98	Meeting with TMiner regarding N. Havan's request for administrative hearing documents; drafting letter to K. Callahan regarding N. Havan's request for administrative hearing documents; review of administrative hearing issues.	C D HERNANDEZ-MALA	1.20	300.00
06/09/98	Telephone conferences with J. Merberg. Review correspondence. Telephone conference with S. DePhillippo.	T MINER	1.40	490.00
06/10/98	Telephone conference with J. Merberg. Review correspondence.	T MINER	1.30	455.00

## APPENDIX XIb (Continued)

## Invoice for Legal Services of \$173,619.32

MASSACHUSETTS STATE LOTTERY COMMISSION  
 FILE NUMBER: 17167-001  
 INVOICE NO.: 8092866

December 30, 1998 PAGE 3

06/11/98	Review materials from J. Merberg. Telephone conference with J. Merberg. Telephone conference with S. DePhillippo.	T MINER	1.20	420.00
06/11/98	Research regarding cases for CHernandez-Malaby.	S P LIEBERTHAL	.50	37.50
06/15/98	Prepare for hearing on motion to stay. Conferences with CHernandez-Malaby regarding hearing preparation.	T MINER	4.00	1400.00
06/15/98	Meeting with TAMiner regarding preparation for administrative hearing, research projects, and case status; drafting letter to L. Johnson regarding production of administrative hearing documents; review of administrative hearing documents.	C D HERNANDEZ-MALA	1.40	350.00
06/16/98	Telephone conference with TAMiner.	R R POPEO	.80	280.00
06/16/98	Review correspondence. Prepare for Day 2 of Havan's deposition. Conferences with CHernandez-Malaby.	T MINER	4.00	1400.00
06/16/98	Prepare for hearing. Attend hearing on recusal issue.	T MINER	4.20	1470.00
06/16/98	Hearing at Superior Court regarding motion to stay adjudicatory hearing at Lottery Commission.	C D HERNANDEZ-MALA	2.00	500.00
06/16/98	Meetings with TAMiner regarding preparations for adjudicatory hearing; drafting letter to L. Johnson regarding other administrative proceedings conducted by lottery; drafting notice of appearance in Superior Court case.	C D HERNANDEZ-MALA	5.40	1350.00

80000

YVJ 10:01 RR/RO/CO



## APPENDIX XIb (Continued)

Invoice for Legal Services of \$173,619.32

MASSACHUSETTS STATE LOTTERY COMMISSION		December 30, 1998	PAGE	4
FILE NUMBER: 17167-001				
INVOICE NO.: 8092866				
06/16/98	Westlaw research and text research on Rule 32(a) (3) and Rule 45 and compliance with a subpoena.	E D SANDERS	5.30	662.50
06/17/98	Attend continued deposition of Havan. Attend deposition of Agop Basmajian. Review additional Commission decisions.	T MINER	10.50	3675.00
06/17/98	Drafting letter to L. Johnson regarding other lottery administrative proceedings; review of transcripts from administrative hearings; meeting with TMiner regarding adjudicatory/superior court hearing.	C D HERNANDEZ-MALA	1.60	400.00
06/17/98	Writing a memo on Rules 32 and Rules 45.	E D SANDERS	4.50	562.50
06/18/98	Conference with TMiner.	R R POPEO	.70	245.00
06/18/98	Conference with RRPopeo regarding strategy. Draft letter to J. Driscoll. Attend deposition of Abrahamian. Conference with CHernandez-Malaby regarding status/strategy.	T MINER	8.50	2975.00
06/18/98	Phone conference with TMiner regarding issues for adjudicatory hearing.	C D HERNANDEZ-MALA	.40	100.00
06/18/98	Writing and revising memo on Rule 32 and Rule 45.	E D SANDERS	3.50	437.50
06/19/98	Conference call with J. Merberg, L. Johnson regarding procedural issues regarding administrative hearing.	T MINER	3.50	1225.00
06/19/98	Prepare for hearing before Judge Ball. Argue motion to stay issue before Judge Ball.	T MINER	4.50	1575.00

0100

TVF L0:CT RR/RO/CO

## APPENDIX XIb (Continued)

Invoice for Legal Services of \$173,619.32

MASSACHUSETTS STATE LOTTERY COMMISSION  
 FILE NUMBER: 17167-001  
 INVOICE NO.: 8092866

December 30, 1998 PAGE 5

06/19/98	Meeting with TMiner regarding preparations for adjudicatory hearing.	C D HERNANDEZ-MALA	.90	225.00
06/19/98	Hearing at Superior Court regarding motion to stay adjudicatory hearing before Lottery Commission.	C D HERNANDEZ-MALA	3.60	900.00
06/20/98	Review of materials for N. Havan examination; reviewing deposition transcripts for N. Havan.	C D HERNANDEZ-MALA	1.30	325.00
06/21/98	Draft opening statement for RRPopeo. Conferences with CHernandez-Malaby regarding action items for administrative hearing.	T MINER	7.00	2450.00
06/21/98	Meeting with TMiner regarding strategy for administrative hearing; review of Havan examination; revising witness list and exhibit list.	C D HERNANDEZ-MALA	2.50	625.00
06/22/98	Telephone conferences with CHernandez-Malaby regarding status.	T MINER	.50	175.00
06/22/98	Hearing regarding objections to deposition questions to P. Kantges.	C D HERNANDEZ-MALA	1.00	250.00
06/22/98	Telephone conference with J. Driscoll regarding computer expert and hearing issues; attendance at court ordered deposition of P. Kantges; telephone conference with J. Merberg, L. Johnson and J. Steadman regarding disclosure and pre-hearing issue; finalizing and filing witness and exhibit lists; preparing cross examination of N. Havan; telephone conference with JFinkelstein regarding N. Havan examination; meetings with DRottenberg regarding burden of proof research.	C D HERNANDEZ-MALA	7.60	1900.00

## APPENDIX XIb (Continued)

Invoice for Legal Services of \$173,619.32

1

MASSACHUSETTS STATE LOTTERY COMMISSION  
 FILE NUMBER: 17167-001  
 INVOICE NO.: 8092866

December 30, 1998 PAGE 6

06/22/98	Researching burden of proof in administrative proceeding for CHMalaby.	D E ROTTENBERG	3.00	375.00
06/23/98	Edit opening statement. Draft cross-examination outline for Barber. Telephone conferences with J. Merberg, P. Cray, court clerk.	T MINER	7.20	2520.00
06/23/98	Meetings with TMiner regarding preparation for adjudicatory hearing; drafting and revising cross-examination of N. Havan and P. Kantges; preparation and review of exhibits and superior court pleadings for adjudicatory hearing; research regarding potential discovery disputes in adjudicatory hearing; meeting with JFinkelstein and DKSpiller regarding PowerPoint presentation for hearing.	C D HERNANDEZ-MALA	8.30	2075.00
06/23/98	Meeting with CHernandez-Malaby and DKSpiller regarding preparations for hearing; preparations of slides regarding same.	J E FINKELSTEIN	1.90	218.50
06/23/98	Shepardizing "Burden of Proof" cases.	D E ROTTENBERG	.60	75.00
06/23/98	Meeting regarding Lottery hearing and brainstorming for PowerPoint.	D K SPILLER	1.90	180.50
06/24/98	Attend continued deposition of Mrs. Kantges. Attend character witness depositions. Conference with RRPopeo. Review decision of Judge Ball. Telephone conference with J. Merberg. Conferences with CHernandez-Malaby regarding hearing preparation.	T MINER	9.50	3325.00

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## APPENDIX XIb (Continued)

Invoice for Legal Services of \$173,619.32

MASSACHUSETTS STATE LOTTERY COMMISSION  
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06/24/98 Meetings with TAmner regarding hearing preparation; drafting examination of N. Havan; telephone conferences with J. Driscoll regarding hearing; telephone conference with G. Calabrese regarding hearing; drafting pre-hearing submission regarding Barber testimony; hearing preparation.	C D HERNANDEZ-MALA	8.50	2125.00
06/24/98 Preparation of exhibits, slides for appeal hearing; coordinating technology preparation for hearing; communication with D. DeVillis, CHernandez-Malaby, DKSpiller regarding same.	J E FINKELSTEIN	1.90	218.50
06/24/98 Meeting with JEFinkelstein and CHernandez-Mallaby regarding appeal hearing; Created templates for PowerPoint presentation.	D K. SPILLER	1.70	161.50
06/25/98 Conference with TAmner and CHernandez-Malaby in preparation for trial.	R R POPEO	3.50	1225.00
06/25/98 Draft Havan outline. Prepare for pretrial conference. Attend pretrial conference with J. Steadman. Telephone conferences with B. Corcoran, C. Hinckley.	T MINER	10.50	3675.00
06/25/98 Meetings with TAmner regarding hearing preparation; drafting examinations for hearing; pre-hearing conference with Judge Steadman; meeting with RRPopeo regarding hearing preparations; drafting submissions regarding Bardakjian and Barber testimony; hearing preparation.	C D HERNANDEZ-MALA	13.20	3300.00

## APPENDIX XIb (Continued)

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06/25/98	Preparing presentation for cross-examination of N. Havan; communications with CHMalaby, TAMiner, DKSpiller regarding same.	J E FINKELSTEIN	11.80	1357.00
06/25/98	Prepared PowerPoint presentation for appeal hearing.	D K SPILLER	11.90	1130.50
06/26/98	Draft Havan outline. To Watertown to view store - attempt to interview Hagopian. Review PowerPoint presentation. Meeting with J. Merberg.	T MINER	10.00	3500.00
06/26/98	Meetings with TAMiner regarding preparation for hearing; drafting examinations; meetings with DKSpiller and JFinkelstein regarding PowerPoint presentation; meeting at J. Merberg regarding hearing; review of discovery telephone conferences with G. Calabrese; hearing preparation.	C D HERNANDEZ-MALA	8.90	2225.00
06/26/98	Preparation of exhibits, slides for cross-examination of N. Havan; various communications/meetings with CHMalaby, TAMiner, DKSpiller.	J E FINKELSTEIN	10.20	1173.00
06/26/98	Prepared and edited PowerPoint presentation for appeal hearing.	D K SPILLER	10.00	950.00
06/27/98	Preparation for Lottery hearing; prepare witness testimony.	R R POPEO	4.10	1435.00
06/27/98	Draft outline of Havan examination. Draft outline of Abrahamian examination. To Watertown to interview Chris Hagopian. Draft outline of Hagopian outline.	T MINER	9.00	3150.00

## APPENDIX XIb (Continued)

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06/27/98	Meetings with TMiner regarding preparations for adjudicatory hearing; preparing examination and presentation for N. Havan cross-examination; drafting chronology of events surrounding February 5, 1998 Mass Millions drawing; meetings with JFinkelstein and DKSpiller regarding PowerPoint presentation for N. Havan and R. Abrahamian cross-examinations.	C D HERNANDEZ-MALA	5.70	1425.00
06/28/98	Preparation for Lottery hearing, opening statement; review materials.	R R POPEO	4.00	1400.00
06/28/98	Draft outlines for Hinckley, Harney, Mrs. Kantges. Edit jurisdictional.	T MINER	4.50	1575.00
06/28/98	Meetings with TMiner regarding preparations for adjudicatory hearing; meetings with JFinkelstein and DKSpiller regarding examination of R. Abrahamian and N. Havan; drafting and finalizing submission on jurisdictional issues; preparation and review of exhibits for adjudicatory hearing.	C D HERNANDEZ-MALA	7.60	1900.00
06/28/98	Preparation for cross-examination of N. Havan, R. Abrahamian; communications with CHernandez-Malaby and DKSpiller regarding same.	J E FINKELSTEIN	8.10	931.50
06/28/98	Prepared and edited PowerPoint presentation for appeal hearing.	D K SPILLER	4.20	399.00
06/29/98	Attendance at Lottery hearing; preparation for next day hearing.	R R POPEO	10.20	3570.00
06/29/98	Attend day one of hearing. Prepare for day 2 of hearing.	T MINER	14.00	4900.00

## APPENDIX XIb (Continued)

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06/29/98	Participation in adjudicatory hearing at lottery commission; meeting with TMiner regarding adjudicatory hearing; researching and drafting bench memorandum regarding burden of proof in adjudicatory proceeding; preparation and review of exhibits for hearing.	C D HERNANDEZ-MALA	15.60	3900.00
06/29/98	Assisting RRPopeo, TMiner, and CHernandez-Malaby at Adjudicatory Hearing at Mass State Lottery; preparations regarding same.	J E FINKELSTEIN	10.00	1150.00
06/29/98	Researching and writing memo on attorney-client privilege.	D E ROTTENBERG	2.60	325.00
06/29/98	Lottery Adjudicatory hearing.	D K SPILLER	10.90	1035.50
06/30/98	Attendance at Lottery hearing; prepare for next day hearing.	R R POPEO	10.80	3780.00
06/30/98	Day two of trial and prepare for day three.	T MINER	12.00	4200.00
06/30/98	Participating in adjudicatory hearing at lottery commission; drafting examination of G. Calabrese; review of bets and computer print-out for February 5, 1998; researching whether past statements of P. Kantres to lottery admissible as prior act; preparation and review of exhibits for hearing.	C D HERNANDEZ-MALA	12.90	3225.00
06/30/98	Assisting RRPopeo, TMiner, CHernandez-Malaby at adjudicatory hearing; preparations regarding same; assisting TMiner with preparations for cross-examination of R. Abrahamian; communications with TMiner, CHernandez-Malaby, DKSpiller regarding same.	J E FINKELSTEIN	14.40	1656.00

## APPENDIX XIb (Continued)

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06/30/98	Lottery adjudicatory hearing.	D K SPILLER	10.80	1026.00
07/01/98	Preparation for and attendance at Lottery hearing.	R R POPEO	10.50	3675.00
07/01/98	Prepare for and participate in adjudicatory hearing.	T MINER	12.50	4375.00
07/01/98	Preparing and participating in adjudicatory hearing at Lottery Commission; preparation and review of exhibits for hearing.	C D HERNANDEZ-MALA	11.70	2925.00
07/01/98	Communications with DKSpiller regarding preparations for continuation of adjudicatory hearing.	J E FINKELSTEIN	.30	34.50
07/01/98	Lottery adjudicatory hearing.	D K SPILLER	10.90	1035.50
07/02/98	Attendance at Lottery hearing; prepare for closing.	R R POPEO	13.50	4725.00
07/02/98	Prepare for and participate in adjudicatory hearing.	T MINER	12.00	4200.00
07/02/98	Preparing and participating in adjudicatory hearing at Lottery Commission.	C D HERNANDEZ-MALA	11.30	2825.00
07/02/98	Attended Mass Lottery Adjudicatory Hearing.	D K SPILLER	10.30	978.50
07/03/98	Lottery hearing; conference with Judge Steadman, L. Johnson and J. Merberg.	R R POPEO	4.00	1400.00
07/03/98	Preparing and participating in adjudicatory hearing at Lottery Commission.	C D HERNANDEZ-MALA	4.80	1200.00
07/03/98	Attended Mass Lottery Adjudicatory Hearing.	D K SPILLER	3.80	361.00
07/06/98	Organizing documents from hearing; telephone conference with TMiner regarding hearing and closing arguments.	C D HERNANDEZ-MALA	.60	150.00



## APPENDIX XIb (Continued)

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07/07/98 Telephone conference with L. Johnson.	R R POPEO	.30	105.00
07/07/98 Conference with CHernandez-Malaby regarding status. Telephone conference with J. Merberg regarding settlement. Conference with RRPopeo. Organize trial documents.	T MINER	2.30	805.00
07/08/98 Telephone conference with L. Johnson.	R R POPEO	.30	105.00
07/08/98 Telephone conferences with J. Merberg.	T MINER	.50	175.00
07/09/98 Conference call with J. Merberg and TAMiner; telephone conferences with L. Johnson; conference with TAMiner.	R R POPEO	1.50	525.00
07/09/98 Conference with RRPopeo. Telephone conferences with J. Merberg.	T MINER	1.50	525.00
07/13/98 Telephone conference with J. Merberg.	T MINER	.20	70.00
07/14/98 Telephone conference with J. Merberg. Conference with CHernandez-Malaby.	T MINER	.40	140.00
07/22/98 Telephone J. Merberg.	R R POPEO	.30	105.00
07/22/98 Telephone conference with B. Lindstrom.	T MINER	.20	70.00
07/23/98 Conference with TAMiner.	R R POPEO	.70	245.00
07/23/98 Telephone conference with B. Lindstrom. Conference with RRPopeo regarding status. Telephone conference with P Stewart regarding Kevin Sullivan investigation.	T MINER	1.50	525.00
07/28/98 Telephone conference Merberg; conference call L. Johnson, TAMiner; conference TAMiner; telephone T. Trimarco, Herald reporter.	R R POPEO	2.10	735.00

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07/28/98	Telephone conference with J. Merberg, RRPopeo, L. Johnson. Conference with RRPopeo regarding strategy. Review regulations regarding procedure for withdrawal of claim.	T MINER	2.80	980.00
07/30/98	Telephone conference with J. Driscoll. Review correspondence from J. Merberg.	T MINER	.70	245.00
08/03/98	Telephone conferences with L. Johnson and J. Merberg regarding settlement. Telephone conference with T. Trimarco. Telephone conference with B. Lindstrom.	T MINER	2.50	875.00
08/04/98	Telephone conferences with J. Merberg, L. Johnson. Telephone conference with B. Lindstrom. Telephone conference with B. Barnett. Telephone conference with P. Cray.	T MINER	3.20	1120.00
08/05/98	Telephone conferences with T. Trimarco. Telephone conference with B. Lindstrom. Attend conference with Judge Steadman. Telephone conferences with J. Merberg.	T MINER	3.60	1260.00
08/06/98	Telephone conferences with J. Merberg, L. Johnson regarding settlement. Telephone conference with T. Trimarco. Telephone conference with B. Lindstrom. Draft letter to B. Lindstrom.	T MINER	2.10	735.00
08/07/98	Telephone conferences with J. Merberg, L. Johnson. Telephone conference with J. Steadman.	T MINER	2.80	980.00
08/11/98	Conference with TMiner.	R R POPEO	.20	70.00

## APPENDIX XIb (Continued)

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08/11/98	Telephone conference with B. Lindstrom, T. Trimarco. Conference with RRPopeo regarding status.	T MINER	.80	280.00
08/12/98	Telephone conference with T. Trimarco.	T MINER	.30	105.00
08/17/98	Telephone T. Trimarco; conference with TMiner.	R R POPEO	.70	245.00
08/17/98	Review Steadman's decision. Telephone conferences with B. Lindstrom, T. Trimarco. Conference with RRPopeo. Review draft press release. Telephone conference with J. Driscoll.	T MINER	3.10	1085.00
08/18/98	Conference with B. Lindstrom, attend Commission meeting and press conference. Follow up telephone calls with J. Merberg, L. Johnson.	T MINER	3.80	1330.00
08/18/98	Review of J. Steadman's decision.	C D HERNANDEZ-MALA	.10	25.00
08/19/98	Telephone T. Trimarco.	R R POPEO	.30	105.00
08/19/98	Telephone conference with J. Merberg. Telephone conference with B. Lindstrom.	T MINER	.60	210.00
08/20/98	Telephone conferences with J. Merberg, L. Johnson, T. Trimarco, J. Driscoll, P. Cray. Review stipulations of dismissal.	T MINER	2.20	770.00
08/21/98	Telephone conferences with J. Merberg. Telephone conference with T. Trimarco. Telephone conference with J. Driscoll.	T MINER	1.20	420.00
08/24/98	Telephone T. Trimarco; telephone calls with J. Merberg; telephone L. Johnson.	R R POPEO	1.30	455.00

## APPENDIX XIb (Continued)

## Invoice for Legal Services of \$173,619.32

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08/25/98 Telephone conference with P. Cray regarding license issues.	C D HERNANDEZ-MALA	.20	50.00
08/27/98 Telephone conference with P. Cray regarding lottery resolution.	C D HERNANDEZ-MALA	.20	50.00
09/08/98 Review correspondence with L. Johnson.	T MINER	.30	105.00
09/09/98 Telephone L. Johnson; conference with TMiner.	R R POPEO	.50	175.00
09/09/98 Conference with RRPopeo.	T MINER	.30	105.00
09/28/98 Telephone L. Johnson; conference with TMiner.	R R POPEO	.60	210.00
09/28/98 Conference with RRPopeo regarding issues; phone call J. Driscoll; phone call CHernandez-Malaby regarding transcripts.	T MINER	.60	210.00
09/28/98 Review of transcripts; sending transcripts to J. Driscoll.	C D HERNANDEZ-MALA	.20	50.00
09/29/98 Review of hearing transcripts.	C D HERNANDEZ-MALA	.30	75.00
10/19/98 Review enabling statute; phone call Beth Lindstrom	T MINER	.50	175.00
11/16/98 Telephone TMiner.	R R POPEO	.20	70.00
11/16/98 Telephone conference with RRPopeo.	T MINER	.20	70.00
11/17/98 Telephone L. Johnson.	R R POPEO	.20	70.00
11/17/98 Phone call Larry Johnson.	T MINER	.30	105.00
11/24/98 Phone Call Beth Lindstrom; phone call Larry Johnson	T MINER	.80	280.00

TOTAL FOR SERVICES: \$153,492.00

## APPENDIX XIb (Continued)

## Invoice for Legal Services of \$173,619.32

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## EXPENSES

Telecopy	107.00
Reprographics	1636.95
Secretarial Overtime	373.50
Postage	4.20
Telephone	1.06
Messenger	42.00
Transcript and Steno Fees	4974.57
Air Freight	151.54
→ Air Travel	225.00
→ Auto Travel	337.55
→ Taxi and ground transportation	604.65
Westlaw	569.62
Outside Messenger	153.25
Meal Expense	424.55
Courtlink Usage	2.19
Opus Video & Photography	603.75
Opus Video & Photography	9915.94
TOTAL EXPENSES:	\$ 20,127.32

## \*-----TIMEKEEPER SUMMARY-----\*

TIMEKEEPER		RATE	TIME	FEE\$
R POPEO	MEMBER	350.00	72.30	25,305.00
T MINER	MEMBER	350.00	212.90	74,515.00
C HERNANDEZ-MAL	NON-MEMBER	250.00	148.80	37,200.00
J FINKELSTEIN	ANALYST	115.00	58.60	6,739.00
D ROTTENBERG	LAW CLERK	125.00	6.20	775.00
D SPILLER	ANALYST	95.00	76.40	7,258.00
S LIEBERTHAL	OFFICE SERVICE	75.00	.50	37.50
E SANDERS	LAW CLERK	125.00	13.30	1,662.50
	TOTALS		589.00	153,492.00

TOTAL THIS STATEMENT: \$173,619.32

## APPENDIX XII

Request for a Prior Year Deficiency Payment  
For Legal Services*Massachusetts State Lottery Commission**60 Columbian Street**Braintree, Massachusetts 02184 - 1738*

TEL: (781) 849-5555

TTY: (781) 849-5679

FAX: (781) 849-5546

SHANNON P. O'BRIEN  
CHAIREDWARD LASHMAN  
ACTING EXECUTIVE DIRECTOR

TO: Martin Benison, Comptroller

FROM: Jeanette Maillet, Assistant Director/Finance *JM*

DATE: March 15, 1999

RE: PRIOR YEAR DEFICIENCY PAYMENT

The Massachusetts State Lottery Commission (MSLC) is submitting for payment a bill from Mintz Levin Cohn Ferris Glovsky and Popeo PC in the amount of \$108,832.50. This represents billing from May through June 30 of 1998 and is therefore a prior year bill. Unfortunately, Mintz Levin did not submit the bill on time nor would the Lottery have been able to pay the bill if it was submitted on time as it did not have enough money encumbered in the FY98 contract to cover the full amount of the final bill.

Ed Lashman and I have come into this situation after the fact and cannot explain why Mintz Levin was allowed to continue to work without an increase to their FY98 contract. We do, however, know that the Lottery has a continuing relationship with Mintz Levin that is positive and it is our desire to clean up this situation by paying Mintz Levin what is owed. We will also make sure that any future work provided by the law firm is in fact covered by a valid contract.

Therefore, I ask that you approve this prior year submission for payment. For your information, I did consult with Sue Patts-Nagy regarding this problem and she agreed that submitting this as a prior year deficiency would be the best way to resolve the problem. Please let me know if you have any questions. Hopefully, I'll see you at the Commission meeting on Friday! Please give me a call at 781-849-5522, if you have any questions or wish to discuss this issue any further. Thanks so much!

*Thanks Marty!*  
*J.*