

STATE OF CONNECTICUT



*AUDITORS' REPORT
CONNECTICUT LOTTERY CORPORATION
FOR THE FISCAL YEARS ENDED JUNE 30, 2016 AND 2017*

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT J. KANE

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April 2, 2020

EXECUTIVE SUMMARY

In accordance with the provisions of Section 2-90 of the Connecticut General Statutes we have audited certain operations of the Connecticut Lottery Corporation. The objectives of this review were to evaluate the corporation’s internal controls, compliance with policies and procedures, as well as certain legal provisions, and management practices and operations for the fiscal years ended June 30, 2016 and 2017.

The key findings are presented below:

Page 16	A former board member attended two board meetings after they had resigned from the board. The Connecticut Lottery Corporation should prevent non-board members from participating in board activities. CLC should ensure it receives formal reappointment letters to maintain the legitimacy of board proceedings.
Page 17	We reviewed the CLC management and sales incentive compensation program for the 2016 fiscal year. Our audit revealed that the board of directors did not formally approve the 2016 incentive program paid to 55 employees (total of \$361,698) for the 2016 fiscal year. The Connecticut Lottery Corporation should continue to obtain and document that its board of directors approve its annual incentive compensation program.
Page 17	Our review noted that CLC did not document the suspension in an employee’s personnel file. The Connecticut Lottery Corporation should document all matters affecting an employee’s work history in their personnel file.
Page 18	We compared the job descriptions and résumés for 13 employees hired during the audited period. We identified one employee who did not have the required supervisory or relevant experience for their position. The Connecticut Lottery Corporation should only hire candidates who meet the requirements in the job description. If CLC hires an applicant who does not possess the minimum experience requirements for a position, it should document the specific reason for the hiring and have a policy to address this situation.

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April 2, 2020

INTRODUCTION AUDITORS' REPORT CONNECTICUT LOTTERY CORPORATION FOR THE FISCAL YEARS ENDED JUNE 30, 2016 AND 2017

We have audited certain operations of the Connecticut Lottery Corporation (CLC) in fulfillment of our duties under Sections 1-122, 2-90, and 12-800 through 12-834 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the years ended June 30, 2016 and 2017. The objectives of our audit were to:

1. Evaluate the corporation's internal controls over significant management and financial functions;
2. Evaluate the corporation's compliance with policies and procedures internal to the authority or promulgated by other state agencies, as well as certain legal provisions, including but not limited to whether the Connecticut Lottery Corporation has complied with its regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds and the distribution of loans, grants and other financial assistance, as applicable; and
3. Evaluate the effectiveness, economy, and efficiency of certain management practices and operations, including certain financial transactions.

Our methodology included reviewing written policies and procedures, financial records, minutes of meetings, and other pertinent documents; interviewing various personnel of the authority, as well as certain external parties; and testing selected transactions. We obtained an understanding of internal controls that we deemed significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We tested certain of those controls to obtain evidence regarding the effectiveness of their design and operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contracts, grant agreements, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Résumé of Operations is presented for informational purposes. This information was obtained from various available sources including, but not limited to, the department's management and the state's information systems, and was not subjected to the procedures applied in our audit of the authority. For the areas audited, we identified:

1. Deficiencies in internal controls;
2. Apparent noncompliance with legal provisions; and
3. Need for improvement in management practices and procedures that we deemed to be reportable.

The State Auditors' Findings and Recommendations in the accompanying report presents any findings arising from our audit of the Connecticut Lottery Corporation.

COMMENTS

FOREWORD

The Connecticut Lottery Corporation operates primarily under Chapter 229a, Sections 12-800 through 12-834 of the General Statutes. Pursuant to Section 12-802 of the statutes, it is a public instrumentality and political subdivision of the state. The CLC is classified as a quasi-public agency subject to various statutory requirements related to those agencies. As a quasi-public agency, the CLC financial information is included as an enterprise fund in the State of Connecticut's Comprehensive Annual Financial Report (CAFR) as a blended component unit of the state.

Sections 12-800 through 12-834 of the General Statutes established the Connecticut Lottery Corporation to take over the operation of the state lottery from the former Division of Special Revenue. The central purpose of CLC is to provide increased revenue to the state. As such, CLC was set up to operate and manage the lottery in an "entrepreneurial and business-like manner" as a quasi-public agency. The enabling legislation intended to establish an environment relatively free from the budgetary and other constraints of traditional state agencies, which could be more responsive to the marketplace.

By law, the Connecticut Lottery Corporation is not allowed to sell the lottery or to modify lottery games that would violate any agreement the state has with the Mashantucket Pequot, Mohegan, or any other federally recognized Native American Tribe. Also, Section 12-818 of the General Statutes requires CLC to transfer, in fiscal years ended June 30, 2016 and June 30, 2017, \$2,300,000 from the sale of lottery tickets to the chronic gamblers treatment and rehabilitation account pursuant to Section 17a-713.

CLC provides two categories of game products: instant scratch tickets and terminal games. During the audited period, CLC offered the following games within these categories.

- **Scratch Games** are played by scratching off the latex covering of the play area on the ticket. A number of different instant games are in circulation during a given period, each with a determinate payout. Instant tickets were introduced to the market in September of 1975 and have become the largest contributor to total sales and resulting contributions to

the State of Connecticut's General Fund. A total of 45 and 40 new games were introduced during fiscal years ended June 30, 2016 and June 30, 2017, respectively.

- **Play3 Night** is an on-line game that is available to consumers on a daily basis. Players pick 3 numbers from a range and choose among different play options. This game has been in existence in similar form since 1977. Prizes range from \$25 to \$25,000 per day.
- **Play4 Night** is an on-line game that was introduced in 1980. Players select 4 numbers from a range and choose from different play options. Prizes range from \$25 to \$25,000 per day.
- **Lotto** is the original on-line jackpot game that was introduced in 1983. Two drawings are held each week. Players pick 6 numbers from a range of numbers. The minimum jackpot is \$1 million.
- **Cash 5** is an on-line game with a top prize of \$100,000 that was introduced in 1992 and is played seven days a week. Players pick 5 numbers ranging from 1 to 35.
- **Powerball** is a multi-state, multi-jurisdictional lottery game that is played twice each week. Players select 6 numbers from a range of numbers. The game was introduced to Connecticut players in 1995.
- **Play3 Day** and **Play4 Day** on-line games were introduced in February 1998. These games are played on a daily basis at mid-day. They are played in a similar manner as the Play3 Night and Play4 Night games.
- **CT Super Draw** is an online game that was introduced in October 2010. Drawings are held periodically at various times throughout the year. Ticket price has been set at either \$5 or \$10; sales are limited to a specific period of time, approximately three months. Each ticket is sold with a unique six-digit number. The winning numbers consist of the unique six-digit numbers randomly selected at each drawing.
- **Lucky for Life – The Game of a Lifetime** is an online game that began on January 27, 2015 and offers a top prize of \$1,000 a day for life and a 2nd prize of \$25,000 a year for life. Players pick from two separate pools of numbers: five numbers from a pool of 48 balls and one lucky ball from a pool of 18 balls.
- **Mega Millions** is a multi-state lottery game that is played twice each week. Players select 5 numbers from a range of numbers and may also select a “Megaplier,” which can increase the potential payout. This game was introduced to Connecticut players in January 2010.
- **5 Card Cash** was a terminal lottery game in which a player received a \$2 game ticket identifying 5 playing cards associated with a standard deck. Each ticket purchased for the base price featured 2 ways to win: an instant win and a draw. A player could win instantly, in the drawing, or both. The player could win up to \$5,555 instantly and then

could win up to \$255,555 in the daily drawing on the same ticket. There was an optional feature in which a player could win an additional prize. CLC discontinued this game in November of 2015 after discovering fraud by some lottery retailers.

- **Lucky Links Day and Lucky Links Night** are terminal lottery games that were introduced on April 26, 2015, with a base price of \$2 for which a player receives a game ticket featuring 8 randomly selected numbers and a free spot. The player of each game can win a prize of \$5 to \$50,000. For an additional dollar, the player can purchase an optional add-on that doubles certain prizes. The drawings for Lucky Links Day game are separate from the Lucky Links Night game.
- **Keno** is a terminal game that began in April 2016. The game can be played at more than 3,000 restaurants, bars, and retailers in the state. There are 80 numbers; a customer chooses up to 10, and 20 are ultimately drawn. The more numbers or "spots" matched, the greater the prize. Tickets start at \$1 and the results are shown live on monitors in the establishments. Winning numbers are picked every four minutes.

Organizationally, the Connecticut Lottery Corporation is composed of 7 major divisions:

Administration and Operations: Responsible for lottery claims, purchasing, and receipt, control, and disbursement of game products.

Marketing and Sales: Responsible for designing and promoting game products and the monitoring of retailers for compliance with sales and game requirements.

Information Technology and Retailer Relations: Provides information systems services, vendor compliance, and internet development.

Finance and Collections: Responsible for disbursements, accounts payable, collections, and revenue accountability.

Legal: Responsible for providing legal advice.

Human Resources: Responsible for payroll and human resources.

Security: Responsible for fraud prevention, investigations, and enforcement of lottery policies governing retail sales agents, as well as security related to lottery buildings, assets, games and personnel.

Board of Directors and Administrative Officials

Pursuant to Section 12-802 (b) of the General Statutes, the Connecticut Lottery Corporation is governed by a 13-member board of directors consisting of 11 appointees of various elected officials and two state office holders. The State Treasurer and the Secretary of the Office of Policy and Management serve as ex-officio members on the board.

Of the 11 appointed members, five are appointed by, and serve at the pleasure of, the Governor. The Governor is required to appoint directors who have the skill, knowledge, and experience in the fields of management, finance, or operations in the private sector. The six remaining appointees are chosen by various legislative leaders. Appointed members serve at the pleasure of the appointing authority. Board members receive no compensation, but are entitled to reimbursement for expenses incurred in the performance of their duties.

As of June 30, 2017, the members of the board of directors were as follows:

Ex Officio:

Robert S. Dakers, designee of the Secretary of the Office of Policy and Management,
Benjamin Barnes
Robert Morgan, designee of State Treasurer Denise L. Nappier

Governor's Appointments:

Margaret L. Morton
Michael P. Thompson
Michael Janusko

Legislative Appointments:

Patrick Birney - Vice-Chairperson
Diane Winston
Natasha M. Pierre
James Heckman

Steven A. Bafundo, Meghan Culmo, James N. Farrell, Kia D. Floyd, and Jennifer J. Hamilton also served on the board during the audited period. There were 4 vacancies on the board as of June 30, 2017. Three board member positions remained vacant as of September 1, 2019.

Subsection (c) of Section 12-802 of the General Statutes provides that the chairperson of the board shall be appointed by the Governor with the advice and consent of the legislature. In May 2011, Frank A. Farricker was appointed chairperson. On August 30, 2016, he also assumed the duties of the president and chief executive officer of the Connecticut Lottery Corporation when Anne M. Noble resigned from that position. Mr. Farricker resigned from the board in May 2017. On August 24, 2017, Donald DeFronzo was appointed chairperson and remained chairperson until his resignation on November 15, 2018. As of February 1, 2020, a new chairperson has yet to be appointed.

On February 29, 2008, Anne M. Noble was appointed president and chief executive officer of the Connecticut Lottery Corporation, and resigned on September 22, 2016. Frank A. Farricker was appointed interim president and chief executive officer on August 30, 2016, and resigned in May 2017. Chelsea Turner was appointed interim president and chief executive officer from May

16, 2017, until July 20, 2018, when she returned to her previous position as Vice President of Strategy and Governmental and Operational Affairs. On July 20, 2018, Gregory Smith was appointed president and chief executive officer and continues to serve in that capacity.

Other Audit Examinations

An independent certified public accountant audited the books and accounts of the CLC for the fiscal years ended June 30, 2016 and 2017. Those reports expressed unqualified opinions on the financial statements and reported no material weaknesses in internal control.

Section 1-122 of the Connecticut General Statutes requires that quasi-public agencies such as the Connecticut Lottery Corporation have a compliance audit performed biennially. These audits should determine whether agencies comply with their own regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds, and the distribution of loans, grants and other financial assistance. In accordance with this statute, we performed a compliance audit of CLC for the fiscal years ended June 30, 2016 and 2017. We noted certain weaknesses in compliance and internal control, as indicated in the State Auditors' Findings and Recommendations section of this report.

RÉSUMÉ OF OPERATIONS

The Connecticut Lottery Corporation has contracted with approximately 2,900 licensed retailers throughout the state to offer lottery games to the public. Only retailers who satisfy CLC's established criteria are recommended for licensure to the state Department of Consumer Protection. The Division of Special Revenue retained regulatory authority for such matters following the creation of the Connecticut Lottery Corporation. With the passage of Public Act 11-51, effective July 1, 2011, that authority was transferred to the Department of Consumer Protection.

On an ongoing basis, retailers deposit revenues generated from the sale of lottery games into fiduciary type bank accounts. Once a week, those revenues (less canceled tickets, prize payouts, and retailer commissions) are transferred into the CLC Operating Account held by a major bank. The Operating Account, along with other CLC bank accounts (Claims Account, Advance Account, Annuities Account, and Accounts Payable), is combined into a concentrator account for overnight investment. The concentrator is the main account that feeds all other accounts. Most of CLC's cash transactions flow in and out of this account.

Section 12-806 (b)(13) and Section 12-806b of the General Statutes require CLC to pay the Office of Policy and Management (OPM) for costs incurred by the Department of Consumer Protection for regulatory oversight of the lottery. Accordingly, CLC made four quarterly payments to OPM totaling \$2,768,842 in the fiscal year ended June 30, 2016 and \$2,685,182 in the fiscal year ended June 30, 2017.

State Accounts

Section 3-27a of the General Statutes allows the Connecticut Lottery Corporation to deposit excess funds with the State Treasurer in such fund or funds of the state as is considered appropriate. Excess funds represent the amount in cash accounts not immediately needed to meet current operating requirements. The concentrator account, as described above, is evaluated daily, and available cash is invested with the Treasurer of the State of Connecticut in a short-term investment fund that provides a safe return on investment. Deposits with the State Treasurer's Short Term Investment Fund (STIF) were \$14,762,676 and \$16,245,966 as of June 30, 2016, and June 30, 2017, respectively. The average annual STIF rate of return was 0.29 percent in fiscal year ended June 30, 2016 and 0.61 percent in fiscal year June 30, 2017.

On a weekly basis, the Connecticut Lottery Corporation transfers the excess of sales revenue over the cost of game prizes, retailer commissions, and operational and administrative costs to the General Fund. Transfers to the General Fund from operations totaled \$337,500,000 in the fiscal year ended June 30, 2016, and \$330,000,000 in the fiscal year ended June 30, 2017.

The Connecticut Lottery Corporation incurs long-term liabilities as the result of game prizes that are paid out in periodic payments. To meet those future obligations, CLC purchases annuities from insurance companies. This debt represents remaining periodic payments owed to Lotto, Lucky-for-Life, and instant game winners. Annuity contracts and related liabilities are reported at their discounted present value in the CLC financial statements. Outstanding long-term annuities payable increased from \$119,397,354 at June 30, 2015, to \$122,262,516 at June 30, 2016 and decreased to \$119,049,872 at June 30, 2017. This is because CLC purchased over \$11 million of annuities in the fiscal year ended June 30, 2016, but only \$3.2 million in the fiscal year ended June 30, 2017.

The Connecticut Lottery Corporation employees are considered state employees per Section 12-802 (e) of the General Statutes, and are covered under the State Employees Retirement System. Effective July 1, 2014, the Connecticut Lottery Corporation adopted and implemented Governmental Accounting Standards Board Statement (GASB) No. 68, *Accounting and Financial Reporting for Pensions*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent To the Measurement Date*. Together, GASB 68 and 71 require cost-sharing employers to recognize liabilities, deferred outflows of resources, deferred inflows of resources and expenses for their proportionate share of the pension plan's total. The recognition of deferred inflows and outflows of resources is applicable for any pension contributions made subsequent to the measurement date of the net pension liability and the end of the government's reporting period.

The CLC audited financial statements reported pension expense of \$2,238,185, deferred outflow of resources of \$4,561,278, and deferred inflow of resources of (\$4,573,016) during the fiscal year ended June 30, 2016. The audited financial statements reported pension expense of \$4,991,096, deferred outflow of resources of \$17,674,192, and deferred inflow of resources of (\$3,990,801) during the fiscal year ended June 30, 2017.

CLC payroll is processed through a direct link with the state's automated payroll system.

That system produces reports on the amount of salaries and fringe benefit costs incurred during the previous biweekly period. CLC wire transfers an amount equal to the costs incurred for salaries and fringe benefits into a State Treasurer's account to cover those costs. The operating expenses for salaries and benefits were \$17,698,258 for the fiscal year ended June 30, 2015, \$15,635,740 for the fiscal year ended June 30, 2016, and \$20,414,333 for the fiscal year ended June 30, 2017. These fluctuations are primarily attributable to corresponding fluctuations in the CLC contributions to the State Employees Retirement System (SERS). These pension expenses are reported in the CLC financial statements as part of salaries and benefits expense. These contributions decreased from \$3,538,724 to \$2,238,185 in the fiscal year ended June 30, 2016, and increased to \$4,991,096 in the fiscal year ended June 30, 2017.

Financial Operations

The Connecticut Lottery Corporation operates as an enterprise activity and is included in the State of Connecticut's Comprehensive Annual Financial Report within that category. The accrual basis of accounting is used in accordance with generally accepted accounting principles (GAAP). CLC applies applicable pronouncements of the Financial Accounting Standards Board issued on or before November 30, 1989, unless those pronouncements conflict with or contradict the pronouncements of the Governmental Accounting Standards Board.

The following is a comparative summary of operations. This financial information was obtained from the Connecticut Lottery Corporation's audited financial statements for the fiscal years ended June 30, 2015, 2016, and 2017.

	Fiscal Year Ended June 30,		
	2017	2016	2015
Total Sales	\$ 1,216,262,021	\$ 1,230,769,399	\$ 1,143,973,444
Prize Expense	(756,288,867)	(760,268,663)	(707,735,790)
All Other Expenses	(124,137,405)	(119,025,356)	(113,740,831)
Excess of Sales Over Expenses	335,835,749	351,475,380	322,496,823
Other and Nonoperating			
Revenues	288,287	101,986	86,664
Subtotal	336,124,036	351,577,366	322,583,487
Transfers to State of			
Connecticut	(4,985,182)	(5,068,842)	(4,721,440)
Income Available	331,138,854	346,508,524	317,862,047
Transfers to General Fund	(330,000,000)	(337,500,000)	(319,700,000)
Change in Net Assets	\$ 1,138,854	\$ 9,008,524	\$ (1,837,953)

In accordance with Section 12-812 of the General Statutes, the president of the Connecticut Lottery Corporation transfers the excess balance of lottery earnings to the General Fund on a weekly basis. These transfers represent an estimate of lottery sales revenues less operating expenditures, and are summarized as follows:

	Fiscal Year Ended June 30,		
	2017	2016	2015
Total Weekly Transfers	\$ 330,000,000	\$ 337,500,000	\$ 319,700,000
Percent of Total Annual Lottery Sales	27.1 percent	27.4 percent	28 percent

Instant tickets made up approximately 59.3 percent of total sales by game for the fiscal year ended June 30, 2017, 60.3 percent for the fiscal year ended June 30, 2016, and 60.1 percent for the fiscal year ended June 30, 2015. Prize expense incurred in fiscal years ended June 30, 2017, 2016, and 2015, represents 62.2, 61.8, and 61.9 percent, respectively, of the total net Lottery sales.

As presented in its audited financial statements, the CLC Statement of Net Assets for June 30, 2015, 2016, and 2017, follows:

	June 30, 2017	June 30, 2016	June 30, 2015
ASSETS			
Current Assets			
Cash and Cash Equivalents	\$ 19,245,128	\$ 19,276,750	\$ 10,173,767
Accounts Receivable, Net of Allowance	27,354,061	27,063,324	31,108,885
Prepaid Annuities for Prizes	5,651,375	8,070,640	10,956,590
Accrued Interest Receivable	1,457,709	1,641,480	1,881,995
Ticket Inventory, Net of Allowance	3,655,199	3,211,568	3,030,828
Prepaid Expenses	990,634	1,011,722	459,310
Total Current Assets	58,354,106	60,275,484	57,611,375
Noncurrent Assets			
Investments for Prize Payments at Present Value	119,049,872	122,262,516	119,397,354
Prize Reserve Held by Multi-State Lottery Association	4,665,670	4,634,376	4,736,132
Property, Plant and Equipment, Net	864,818	870,695	1,179,717
Advances to High Tier Claim Centers	150,000	200,000	250,000

Other Assets	1,864,286	-	-
Total Noncurrent Assets	<u>126,594,646</u>	<u>127,967,587</u>	<u>125,563,203</u>
Total Assets	<u>184,948,752</u>	<u>188,243,071</u>	<u>183,174,578</u>
 DEFERRED OUTFLOW OF RESOURCES			
Deferred Amount for Pensions	\$ 17,674,192	\$ 4,561,278	\$ 2,181,341
Total Assets and Deferred Outflow of Resources	<u>\$ 202,622,944</u>	<u>\$ 192,804,349</u>	<u>\$ 185,355,919</u>
 LIABILITIES AND NET ASSETS			
Current Liabilities			
Annuities Payable	\$ 6,384,423	\$ 8,740,890	\$ 11,254,922
Prizes Payable	29,802,436	28,653,715	26,236,864
Accrued Interest Payable	1,457,709	1,641,480	1,881,995
Accounts Payable and Accrued Expenses	7,941,990	8,498,055	12,833,238
Due to Regional Games	605,911	516,867	367,293
Due to Multi-State Lottery Association	1,002,621	1,481,912	503,622
Deferred Revenue	<u>759,765</u>	<u>1,051,983</u>	<u>773,769</u>
Total Current Liabilities	<u>47,954,855</u>	<u>50,584,902</u>	<u>53,851,703</u>
 Long-Term Liabilities			
Deferred Rent Liability	465,533	504,580	543,627
Net Pension Liability	55,669,017	40,525,323	44,624,031
Long-term Annuities Payable	<u>119,049,872</u>	<u>122,262,516</u>	<u>119,397,354</u>
Total Long-Term Liabilities	<u>175,184,422</u>	<u>163,292,419</u>	<u>164,565,012</u>
 Total Liabilities	 <u>223,139,277</u>	 <u>213,877,321</u>	 <u>218,416,715</u>
 DEFERRED INFLOW OF RESOURCES			
Deferred Amount for Pensions	\$ 3,990,801	\$ 4,573,016	\$ 1,593,716
Invested in Capital Assets Restricted	864,818	870,695	1,179,717
	<u>(25,371,952)</u>	<u>(26,516,683)</u>	<u>(35,834,229)</u>
Total Net Position	<u>(24,507,134)</u>	<u>(25,645,988)</u>	<u>(34,654,512)</u>

The Connecticut Lottery Corporation's assets and deferred outflow of resources increased from \$185,355,919 for the fiscal year ended June 30, 2015, to \$192,804,349 for the fiscal year ended June 30, 2016, and increased again to \$202,622,944 for the fiscal year ended June 30, 2017. The primary reason for the increase of \$7,448,430 in the fiscal year ended June 30, 2016, was an increase in cash and cash equivalents of \$9,102,983. The increase of \$9,818,595 in the fiscal year ended June 30, 2017, was due primarily to an increase of \$13,112,914 in the deferred amount for pensions.

Total liabilities decreased by \$4,539,394 during the fiscal year ended June 30, 2016, but increased by \$9,261,956 during the fiscal year ended June 30, 2017. The decline in fiscal year 2016 was attributed primarily to a decrease in accounts payable and accrued expenses. The major factor for the increase in total liabilities during the fiscal year ended June 30, 2017, was an increase in net pension liability.

Other Matters

The Connecticut Lottery Corporation introduced the 5 Card Cash game in May 2014. On January 5, 2015, CLC offices were made aware of the 5 Card Cash issues related to wager details being exposed to retailers before tickets were printed. CLC did not notify the Department of Consumer Protection of these issues until October 29, 2015. In November 2015, the Department of Consumer Protection launched an investigation into certain criminal activity conducted by lottery retailers. DCP also began an investigation into the failure of certain CLC officials to report these matters. CLC suspended 5 Card Cash in November of 2015. The investigation of 5 Card Cash retailers resulted in 15 arrests and approximately \$363,979 in court-ordered restitution.

Because the Connecticut Lottery Corporation failed to report issues with the 5 Card Cash game for about ten months, DCP informed the CLC Board of Directors that it was investigating the CLC president and chief executive officer in relation to the operation of 5 Card Cash. In August 2016, the Connecticut Lottery Corporation entered into a transition agreement with its former president/chief executive officer. The Board of Directors subsequently advised DCP that the president would transition into a consultant role and surrender her license by operation of law effective September 22, 2016.

On January 1, 2018, there was a problem with the Super Draw game. CLC sold 214,601 tickets, but excluded 100,000 tickets from the prize drawing due to human error. CLC resolved the issue by holding a second drawing for all ticket holders on January 16, 2018. CLC estimates that the error in this drawing cost almost \$1 million.

On March 12, 2018 the Senate Minority Leader and Chair of the Public Safety Committee (legislators) wrote a letter to Department of Consumer Protection (DCP) Commissioner Michelle Seagull, raising questions about the Connecticut Lottery Corporation (CLC) and requesting that DCP investigate all aspects of the operations and management of CLC. In addition, they asked DCP to include other agencies in this review. As a result, Commissioner Seagull wrote to our office on March, 23 2018 and asked us "to determine whether an independent investigation of

the circumstances that resulted in the conclusion that Mr. Alfred Dupuis, (CLC Security Director), was guilty of ‘gross neglect in the execution of his duties,’ is warranted.” Commissioner Seagull also asked whether it appeared that Mr. Dupuis’ testimony at the Public Safety Committee had any effect on the sanction against him.

On April 5, 2018, our office met with officials from the Department of Consumer Protection to discuss the commissioner’s request and the parameters of our investigation. In addition, the legislators informed us of several of their other concerns about the CLC and its operations.

Taking all of these requests into consideration, our office developed a clear scope of review on these matters. We issued our report in a letter to the legislators on November 2, 2018.

Our review contained the following scope and conclusions:

1) A review of Connecticut Lottery Corporation board member involvement in contracts and inquiry into any related-party business dealings

Conclusion: Our tests yielded no evidence of any unusual contractual relationships, payments, or contract awards related to CLC board members. We did determine that there was a former CLC contractor who later served on the CLC board.

2) An assessment of the Connecticut Lottery Corporation determination that Mr. Alfred Dupuis was guilty of “gross neglect in the execution of his duties” and whether it might be construed that CLC retaliated against Mr. Dupuis related to his role in the 5 Card Cash investigation and the 1/18 Super Draw

Conclusion: Through our review, we concluded that the charge of gross neglect and the associated administrative leave with pay could have resulted from arbitrary or retaliatory motives. We noted that many of these issues are the subject of a Commission on Human Rights and Opportunities (CHRO) complaint Mr. Dupuis has filed against CLC. We believe that CHRO is the appropriate independent authority to definitively determine whether the circumstances that resulted in the conclusion that Mr. Dupuis was guilty of "gross neglect in the execution of his duties," is warranted and whether CLC retaliated against Mr. Dupuis

3) A review of whether the CLC outside legal counsel fees were appropriate

Conclusion: Our review concluded that outside legal expenses did not seem exorbitant, as summarized in the following table:

FYE June 30,	Expenses
2014	\$247,501
2015	\$112,728
2016	\$150,112
2017	\$323,970

The significant increase in the fiscal year ended June 30, 2017, was partly attributable to \$68,941 in legal fees incurred in the Anne Noble transition agreement matter.

4) Assessment of whether CLC hired unqualified or marginally qualified personnel

Conclusion: We sampled 13 recent hires and found that 1 did not meet the position's minimum qualifications. In this case, CLC did not justify the hiring of a person who lacked the minimum qualifications. We included a recommendation in this audit report suggesting that CLC establish a policy and related documentation standards for those limited instances in which CLC hires persons not meeting the established minimum standards.

5) Review of retailer collection rates, bonding of retailers, and the CLC organizational structure relating to retailer collection

Conclusion: We performed tests in this area and determined that the disbursements and transfers made from these funds all looked reasonable and consistent with the General Statutes.

6) Review of unclaimed prize money in the Unclaimed Prize Fund

Conclusion: We performed tests in this area and determined that the disbursements and transfers made from these funds all looked reasonable and consistent with the General Statutes.

7) Assessment of Human Resources (HR) staff and staffing levels

Conclusion: None of our tests revealed any indication that the HR function was overstaffed, that HR personnel were not qualified for their positions, that FMLA was being used inappropriately, or that unusual reporting relationships existed.

8) Transition Agreement between Anne Noble and the Connecticut Lottery Corporation

On May 5, 2017, we wrote to the State of Connecticut Retirement Services Division inquiring as to whether Ms. Noble's transition agreement, which has characteristics of a separation agreement, qualified her for enhanced retirement benefits. Our opinion has not changed since that date, when we stated, "Based upon our review, it appears that the principal reasons for the transition agreement were to enhance Ms. Noble's retirement benefits and to not reveal the existence of a Department of Consumer Protection investigation and pending action against Ms. Noble that would have suspended or terminated her license. This type of adverse action against her license would have precluded Ms. Noble from working for the Connecticut Lottery Corporation. It appears that the creation of the arrangement in the transition agreement was an attempt to circumvent Ms. Noble's legal requirement to be licensed and to allow her to collect enhanced state benefits (lifetime healthcare and cost of living adjustments) she may not qualify for. We estimate that these benefits will cost taxpayers hundreds of thousands of dollars."

We also stated in our letter that, “Our office understands that quasi-public agencies are granted greater discretion than regular state agencies in the area of employment arrangements. However, we are very concerned that the Connecticut Lottery Corporation employed that discretion in a way that attempted to circumvent the spirit or letter of state laws and regulations. The corporation engaged in an effort to keep government officials and the public from knowing all of the facts surrounding the issues related to Ms. Noble’s employment situation and the Department of Consumer Protection’s investigation into fraud on the 5 Card Cash game and how the corporation’s management handled it. In addition, the corporation paid over \$100,000 in legal bills for the board and Ms. Noble to create this questionable separation arrangement.”

We would note that, in response to our inquiry of the Retirement Services Division, Comptroller Kevin Lembo responded in part, “...Current state statutes and regulations fail to establish or require critical oversight of such severance agreements.”

In light of that response, as well as our own concerns, we included a recommendation in our 2017 annual report that the General Assembly consider clarifying oversight of separation agreements. Our office recommended:

The General Assembly should consider restricting any payments related to non-disparagement agreements or those made by state agencies to departing state employees for the purpose of avoiding litigation unless such payment is made pursuant to (1) a settlement agreement entered into by the Attorney General on behalf of the state agency, or (2) an authorization by the Governor pursuant to section 3-7 of the General Statutes. The General Assembly should also consider restricting any language in a non-disparagement or settlement agreement that explicitly prohibits separating employees from the ability to exercise their rights under the state’s Whistleblower Act or similar federal law.

The General Assembly addressed this recommendation in Public Act 18-37 (Sections 8 and 26).

Sec. 8. (NEW) (Effective October 1, 2018) (a) For the purposes of this section, "state agency" means any department, board, council, commission, institution or other executive branch agency of state government, including, but not limited to, each constituent unit and each public institution of higher education. On and after October 1, 2018, no state agency shall make a payment in excess of fifty thousand dollars to an employee resigning or retiring from employment with such state agency for the purposes of avoiding costs associated with potential litigation or pursuant to a non-disparagement agreement unless such payment is made pursuant to (1) a settlement agreement entered into by the Attorney General on behalf of the state agency, or (2) an authorization by the Governor pursuant to section 3-7 of the general statutes.

Sec. 26. (NEW) (Effective October 1, 2018) (a) On and after October 1, 2018, no quasi-public agency, as defined in section 1-120 of the general statutes, shall make a payment in excess of fifty thousand dollars to an employee resigning or retiring from employment with such quasi-public agency for the purposes of avoiding costs associated with potential litigation or pursuant to a non-disparagement agreement.

(b) No non-disparagement agreement or settlement agreement as described in subsection (a) of this section may prohibit an employee from making a complaint or providing information in accordance with section 4-61dd of the general statutes.

STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

Our review of the Connecticut Lottery Corporation for the fiscal years ended June 30, 2016 and 2017. The following recommendations resulted from that review.

Noncompliance with Board Appointment Statutory Requirements

Criteria: Section 12-802 of the Connecticut General Statutes states that the 13 Connecticut Lottery Corporation board members shall be appointed by the Governor or legislative leaders.

Condition: One former board member attended two board meetings after they had resigned from the board. The board member was subsequently reappointed, but CLC allowed the board member to participate in meetings before it received a formal reappointment letter.

Effect: A former board member participated in two board meetings.

Cause: The cause is unknown.

Recommendation: The Connecticut Lottery Corporation should prevent non-board members from participating in board activities. CLC should ensure it receives formal reappointment letters to maintain the legitimacy of board proceedings. (See Recommendation 1.)

Agency Response: The Connecticut Lottery Corporation (CLC) agrees that formal documentation should be obtained in advance of incoming Board member's participation in CLC Board activities. The CLC will work with appointing authorities to ensure receipt of official appointment letters after initial email notification of appointment.

Board Approval of Incentive Compensation Plans

Criteria: Section 12-804 (a) of the General Statutes states, "The powers of the Corporation shall be vested in and exercised by the board of directors."

A review of the board meeting minutes for the 2012 to 2015 fiscal years revealed that the board formally approved incentive plans in each of those years.

Condition: We reviewed the CLC management and sales incentive compensation program for the 2016 fiscal year. Our audit revealed that the board of directors did not formally approve the 2016 incentive program. In September 2016, CLC paid 55 employees a total of \$361,698 for the 2016 fiscal year.

- Effect:* The lack of documented board approval decreases the assurance that the board reviewed and approved the 2016 incentive compensation program.
- Cause:* The cause is unknown.
- Recommendation:* The Connecticut Lottery Corporation should continue to obtain and document that its board of directors approved its annual incentive compensation program. (See Recommendation 2.)
- Agency Response:* The CLC agrees with the recommendation. CLC staff will discuss with the Board of Directors modifying the CLC's incentive compensation program to expressly include review and action by the Board of Directors.

Lack of Documentation in Personnel Files

- Criteria:* The Human Resources Department maintains personnel files as the primary repository for all documents related to an employee's work history.
- Condition:* The Connecticut Lottery Corporation initiated disciplinary action against an employee in a suspension letter charging him with "gross neglect" in the execution of his duties. Our review noted that CLC did not document the suspension in the employee's personnel file.
- Effect:* CLC initiated disciplinary action against an employee without documenting it in his personnel file.
- Cause:* The cause is unknown.
- Recommendation:* The Connecticut Lottery Corporation should document all matters affecting an employee's work history in their personnel file. (See Recommendation 3.)
- Agency Response:* The CLC agrees that disciplinary matters should be documented in the files that the CLC's Human Resources Department maintains for each employee. In the instance that this finding references, however, the CLC did not discipline the employee, nor did the CLC suspend the employee. The CLC placed the employee on non-disciplinary paid administrative leave. The employee went on medical leave immediately thereafter, which continued until the employee retired several months later.

Qualifications of Hired Employees

- Criteria:* Job descriptions include the general and special experience requirements necessary to perform the duties for a specific job. In limited cases in which an employer hires an applicant who does not meet the job's minimum requirements, the employer must document the reason for hiring someone without the requisite experience.
- Condition:* We compared the job descriptions and résumés for 13 employees hired during the audited period. We identified one employee who did not have the required one year of supervisory experience for their position. This employee also had at least one year less than the required 8 years of other relevant experience for their position. CLC did not document the reason it hired this person and does not have a policy in place to address this rare situation.
- Effect:* CLC hired an employee who did not meet the requirements in the job description.
- Cause:* The cause is unknown.
- Recommendation:* The Connecticut Lottery Corporation should only hire candidates who meet the requirements in the job description. If CLC hires an applicant who does not possess the minimum experience requirements for a position, it should document the specific reason for the hiring and have a policy to address the situation. (See Recommendation 4.)
- .
- Agency Response:* The CLC agrees with this finding. The CLC notes that the employee left the CLC voluntarily in 2018. The CLC will ensure strict compliance with its hiring requirements in the future.

RECOMMENDATIONS

Our prior audit report contained no recommendations.

Current Audit Recommendations:

- 1. The Connecticut Lottery Corporation should prevent non-board members from participating in board activities. CLC should ensure it receives formal reappointment letters to maintain the legitimacy of board proceedings.**

One former board member attended two board meetings after they had resigned from the board. The board member was subsequently reappointed, but CLC allowed the board member to participate in meetings before it received a formal reappointment letter.

- 2. The Connecticut Lottery Corporation should continue to obtain and document that its board of directors approved its annual incentive compensation program.**

We reviewed the CLC management and sales incentive compensation program for the 2016 fiscal year. We revealed that the board of directors did not formally approve the 2016 incentive program. In September 2016, CLC paid 55 employees a total of \$361,698 for the 2016 fiscal year.

- 3. The Connecticut Lottery Corporation should document all matters affecting an employee's work history in their personnel file.**

Our review noted that CLC did not document an employee's suspension in their personnel file.

- 4. The Connecticut Lottery Corporation should only hire candidates who meet the requirements in the job description.**

Our review revealed that a recently hired employee did not meet the required qualifications in either supervisory experience or other relevant experience for their CLC position. If CLC hires an applicant who does not possess the minimum experience requirements for a position, it should document the specific reason for the hiring and have a policy to address the situation.

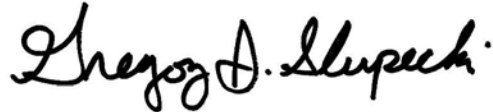
ACKNOWLEDGEMENT

The Auditors of Public Accounts would like to recognize the auditors who contributed to this report:

Timothy M. LePore
David S. Paradie
Michael R. Stemmler

CONCLUSION

We wish to express our appreciation for the courtesies and cooperation extended to our representatives by the officials and employees of the Connecticut Lottery Corporation during our examination.



Gregory J. Slupecki
Administrative Auditor

Approved:



John C. Geragosian
State Auditor



Robert J. Kane
State Auditor