

STATE OF CONNECTICUT



*AUDITORS' REPORT
CONNECTICUT LOTTERY CORPORATION
FISCAL YEARS ENDED JUNE 30, 2020 AND 2021*

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ CLARK J. CHAPIN

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June 15, 2022

EXECUTIVE SUMMARY

In accordance with the provisions of Sections 1-122, 12-802(d), and 2-90 of the Connecticut General Statutes, we have audited certain operations of the Connecticut Lottery Corporation (CLC) for the fiscal years ended June 30, 2020 and 2021. Our audit did not identify any instances of noncompliance with laws, regulations, and policies; internal control deficiencies; or a need for improvement in practices and procedures that warrant the attention of management.

STATE OF CONNECTICUT



AUDITORS OF PUBLIC ACCOUNTS

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June 15, 2022

AUDITORS' REPORT CONNECTICUT LOTTERY CORPORATION FISCAL YEARS ENDED JUNE 30, 2020 AND 2021

We have audited certain operations of the Connecticut Lottery Corporation (CLC) in fulfillment of our duties under Sections 1-122, 12-802(d), and 2-90 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the fiscal years ended June 30, 2020 and 2021. The objectives of our audit were to evaluate:

1. CLC's significant internal controls over compliance and its compliance with policies and procedures internal to CLC or promulgated by other state agencies, as well as certain legal provisions, including as applicable, but not limited to whether CLC 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;
2. CLC's internal controls over certain financial and management functions; and
3. The effectiveness, economy, efficiency, and equity 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 CLC; and testing selected transactions. Our testing was not designed to project to a population unless specifically stated. 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 this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the 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 a reasonable basis for our conclusions based on our audit objectives.

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

1. Apparent non-compliance with laws, regulations, contracts and grant agreements, policies, and procedures;
2. Deficiencies in internal controls; and
3. A need for improvement in management practices and procedures that we deemed to be reportable.

COMMENTS

FOREWORD

The Connecticut Lottery Corporation (CLC) operates primarily under Chapter 229a, Sections 12-800 through 12-834 of the General Statutes. Pursuant to Section 12-802, it is a public instrumentality and political subdivision of the state. CLC is classified as a quasi-public agency subject to various statutory requirements.

Sections 12-800 through 12-834 of the General Statutes established CLC to take over the operation of the state lottery from the former Division of Special Revenue. CLC's principal purpose is to provide increased revenue to the state. As such, CLC was established 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, CLC is not allowed to sell the lottery or 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 \$2,300,000 from the sale of lottery tickets to the chronic gamblers treatment and rehabilitation account in fiscal years ended June 30, 2020 and 2021, pursuant to Section 17a-713.

CLC provides two categories of game products: instant scratch tickets and computer-based online games.

Significant Legislation

- **Public Act 19-117 (Sections 82 through 85, and 90)**, effective June 26, 2019, established the Connecticut Teachers' Retirement Fund Bonds Special Capital Reserve Fund (TRF-SCRF) to provide protection for holders of pension obligation bonds issued in 2008 to help cover the Teachers' Retirement System unfunded liability. This act authorized the redirection of CLC revenues to the TRF-SCRF if funding falls below the required minimum capital reserve.
- **Public Act 19-117 (Section 365)**, effective June 26, 2019, established a regionalization subaccount in the state's General Fund regional planning incentive account. Under this act, CLC must transfer revenue funded by its online lottery draw games that exceeds the cost of the debt-free community college program to the subaccount. If CLC does not offer an online lottery program, this act required the Governor to propose adjustments to the fiscal year 20-21 budget to provide at least \$1 million to support the task force's recommended regionalism initiatives.

Organizationally, CLC is composed of eight major divisions:

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

Marketing: Responsible for designing and promoting game products.

Sales: Responsible for assisting retailers in complying with the terms of their contracts.

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 and Transportation: 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, CLC 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, 2021, the members of the board of directors were as follows:

Ex Officio:

Patti Maroney, designee of the Secretary of the Office of Policy and Management
John R. Flores, designee of the State Treasurer

Governor's Appointments:

Robert T. Simmelkjaer, II, Chairperson
Wilfred Blanchette, Jr., Vice-Chairperson
Margaret L. Morton

Legislative Appointments:

Manny Langella
Andrew Meehan
Megan Culmo
James Heckman

Michael P. Thompson, Patrick Birney, Dawna Capps, and Natasha M. Pierre also served on the board during the audited period. There were four vacancies on the board as of June 30, 2021.

Section 12-802(c) 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 August 2017, Donald DeFronzo was appointed chairperson and served in that role until his resignation in October 2018. Robert Simmelkjaer was appointed chairperson in May 2020 and continues to serve in that capacity.

Gregory Smith was appointed president and chief executive officer on July 20, 2018 and continues to serve in that capacity.

Other Audit Examinations

An independent certified public accountant audited the books and accounts of CLC for each of the fiscal years ended June 30, 2020 and 2021. Those reports each expressed an unmodified opinion on the financial statements and reported no significant deficiencies or material weaknesses in internal control.

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 CLC. Public Act 11-51, effective July 1, 2011, transferred that authority to the Department of Consumer Protection.

Retailers deposit revenues generated from the sale of lottery games into fiduciary-type bank accounts. Each week, those deposits (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 for costs incurred by the Department of Consumer Protection for regulatory oversight of the lottery. Accordingly, CLC made quarterly payments to the Office of Policy and Management totaling \$3,206,366 and \$3,221,745 in the fiscal years ended June 30, 2020 and 2021, respectively.

State Accounts

Section 3-27a of the General Statutes allows CLC to deposit excess funds with the State Treasurer in such state fund or funds 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 \$6,014,523 and \$15,547,774 as of June 30, 2020, and June 30, 2021, respectively. The average annual STIF rate of return was 1.5% in the fiscal year ended June 30, 2020 and 0.1% in the fiscal year ended June 30, 2021.

CLC transfers the excess of sales revenue over the cost of game prizes, retailer commissions, and operational and administrative costs on a weekly basis to the General Fund. Transfers to the General Fund from operations totaled \$347,700,000 in the fiscal year ended June 30, 2020, and \$418,000,000 in the fiscal year ended June 30, 2021.

CLC incurs long-term liabilities as a 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.

Long-term payment requirements for annuities payable for the last two fiscal years are as follows:

Activity for Fiscal Year	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
2021	\$125,817,870	\$7,166,248	\$ (6,132,894)	\$126,851,224	\$4,901,063
2020	\$126,882,199	\$4,986,503	\$ (6,050,832)	\$125,817,870	\$5,325,774

CLC employees are considered state employees per Section 12-802(e) of the General Statutes and are covered under the State Employees' Retirement System.

CLC's audited financial statements reported pension expenses of \$6,839,243, deferred outflows of resources of \$17,191,401, and deferred inflows of resources of \$3,479,159 during the fiscal year ended June 30, 2020. The audited financial statements reported pension expenses of \$6,942,580, deferred outflows of resources of \$14,121,895, and deferred inflows of resources of \$4,948,767 during the fiscal year ended June 30, 2021.

CLC's audited financial statements reported Other Post-Employment Benefits (OPEB) expenses of \$6,341,942, deferred outflows of resources of \$20,284,815, and deferred inflows of resources of \$8,501,032 during the fiscal year ended June 30, 2020. The audited financial statements reported OPEB expenses of \$5,935,346, deferred outflows of resources of \$20,233,302, and deferred inflows of resources of \$12,377,730 during the fiscal year ended June 30, 2021.

CLC's payroll is processed through a direct link with the state's automated payroll system, which produces reports on the 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 pay those costs. The operating expenses for salaries and benefits were \$27,337,556 for the fiscal year ended June 30, 2020, and \$27,227,998 for the fiscal year ended June 30, 2021.

Financial Operations

The Connecticut Lottery Corporation operates using the economic resources measurement focus and the accrual basis of accounting in accordance with generally accepted accounting principles (GAAP) for governmental enterprise funds. In its accounting and financial reporting, CLC follows the pronouncements of the Governmental Accounting Standards Board. CLC is considered a component unit of the State of Connecticut and is included in the state's Annual Comprehensive Financial Report as such.

The following is a comparative summary of operations. This financial information was obtained from CLC's audited financial statements for the fiscal years ended June 30, 2021, 2020, and 2019.

	Fiscal Year Ended June 30,		
	2021	2020	2019
Total Sales	\$ 1,497,770,079	\$ 1,305,284,157	\$ 1,333,911,283
Prize Expense	(929,753,347)	(822,242,533)	(822,863,178)
All Other Expenses	(147,307,234)	(136,447,539)	(132,544,411)
Excess of Sales Over Expenses	420,709,498	346,594,085	378,503,694
Other and Nonoperating Revenues/Expenses	609,453	588,677	558,429
Subtotal	421,318,951	347,182,762	379,062,123
Transfers to State of Connecticut	(5,521,745)	(5,506,366)	(5,299,454)
Income Available	415,797,206	341,676,396	373,762,669
Transfers to General Fund	(418,000,000)	(347,700,000)	(370,000,000)
Change in Net Position	\$ (2,202,794)	\$ (6,023,604)	\$ 3,762,699

In accordance with Section 12-812 of the General Statutes, the Connecticut Lottery Corporation president 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 expenses, and are summarized as follows:

	Fiscal Year Ended June 30,		
	2021	2020	2019
Total Weekly Transfers	\$ 418,000,000	\$ 347,700,000	\$ 370,000,000
Percent of Total Annual Lottery Sales	27.9%	26.6%	27.7%

Instant tickets made up approximately 55.9% of total sales by game for the fiscal year ended June 30, 2021, 58% for the fiscal year ended June 30, 2020, and 55.2% for the fiscal year ended June 30, 2019. Prize expense incurred in the fiscal years ended June 30, 2021, 2020, and 2019, represents 62.1%, 63.0%, and 61.7% of the total sales, respectively.

As presented in its audited financial statements, CLC's Statement of Net Position for June 30, 2021, 2020, and 2019, follows:

	June 30, 2021	June 30, 2020	June 30, 2019
ASSETS			
Current Assets			
Cash and Cash Equivalents	\$ 24,980,751	\$ 9,461,073	\$ 20,880,599
Accounts Receivable, Net of Allowance	24,218,681	37,113,594	30,547,825
Investments for Prize Payments at Net Present Value	4,229,822	4,704,003	5,402,978
Accrued Interest Receivable	995,070	1,079,190	1,205,710
Ticket Inventory, Net of Allowance	715,956	1,797,125	3,788,220
Prepaid Expenses	3,183,555	2,204,279	2,269,635
Total Current Assets	58,323,835	56,359,264	64,094,967
Noncurrent Assets			
Investments for Prize Payments at Net Present Value	122,139,650	120,492,096	120,913,070
Prize Reserve Held by Multi-State Lottery Association	5,366,709	6,043,363	6,200,819
Capital Assets, Net	408,003	503,780	641,288
Prepaid Expenses	1,289,197	3,008,125	4,727,054
Total Noncurrent Assets	129,203,559	130,047,364	132,482,231
Total Assets	187,527,394	186,406,628	196,577,198
DEFERRED OUTFLOWS OF RESOURCES			
Deferred Amount for Pensions	14,121,895	17,191,401	12,911,333
Deferred Amount for OPEB	20,233,302	20,284,815	3,714,307
Total Deferred Outflows of Resources	34,355,197	37,476,216	16,625,640
LIABILITIES			
Current Liabilities			
Annuities Payable at Net Present Value	4,901,063	5,325,774	5,969,129
Prizes Payable	26,594,310	28,049,438	38,486,982
Accrued Interest Payable	995,070	1,079,190	1,205,710
Accounts Payable and Accrued Expenses	7,594,777	9,159,161	8,861,591

Due to Regional Game States	648,963	1,050,269	590,757
Due to Multi-State Lottery Association	645,182	654,643	675,033
Unearned Revenue	638,849	803,257	772,625
Total Current Liabilities	42,018,214	46,121,732	56,561,827
Long-Term Liabilities			
Long-Term Annuities Payable at Net Present Value	121,950,161	120,492,096	120,913,070
Deferred Rent	170,594	255,891	341,189
Net Pension Liability	57,434,854	59,569,843	50,615,060
Net OPEB Liability	67,125,223	67,403,249	47,074,834
Total Long-Term Liabilities	246,680,832	247,721,079	218,944,153
Total Liabilities	288,699,046	293,842,811	275,505,980
DEFERRED INFLOWS OF RESOURCES			
Deferred Amount for Pensions	4,948,767	3,479,159	5,228,564
Deferred Amount for OPEB	12,377,730	8,501,032	8,384,848
Total Deferred Inflows of Resources	17,326,497	11,980,191	13,613,412
NET POSITION			
Net Investment in Capital Assets Unrestricted	408,003 (84,550,955)	503,780 (82,443,938)	641,288 (76,557,842)
Total Net Position	\$ (84,142,952)	\$ (81,940,158)	\$ (75,916,554)

Total assets decreased by \$10.2 million (5.2%) in fiscal year 2020 as compared to the prior fiscal year and increased by \$1.1 million (0.6%) in fiscal year 2021.

The decrease in fiscal year 2020 was primarily due to a \$11.4 million (54.7%) reduction in cash and cash equivalents. This decrease was slightly offset by increases in various other current and non-current asset categories. The growth in fiscal year 2021 was mainly due to a \$15.5 million (164%) increase in cash and cash equivalents, which was mostly offset by a \$12.9 million (34.7%) decrease in accounts receivable, net of allowances. Additional decreases in various other current and non-current asset categories also reduced total assets.

Total deferred outflows of resources increased by \$20.9 million (125.4%) in fiscal year 2020 as compared to the prior fiscal year and decreased by \$3.1 million (8.3%) in 2021. Deferred outflows of resources fluctuate based on CLC's contributions to the SERS pension and OPEB plans subsequent to the measurement date, the net impact of the differences between expected and actual experience, the net difference between projected and actual earnings on pension plan investments, and changes in actuarial assumptions.

Total liabilities increased by \$18.3 million (6.7%) in fiscal year 2020 as compared to the prior fiscal year and decreased by \$5.1 million (1.8%) in fiscal year 2021.

The increase in fiscal year 2020 was mainly due to growth in pension and OPEB liability of \$8.9 million (17.7%) and \$20.3 million (43.2%), respectively. This increase was partially offset by a decrease of \$10.4 million (27.1%) in prizes payable. The decrease in fiscal year 2021 was primarily due to reductions in prizes payable, accounts payable and accrued expenses, and net pension liability in the amounts of \$1.5 million (5.2%), \$1.6 million (17.1%), and \$2.1 million (3.6%), respectively.

Total deferred inflows of resources decreased by \$1.6 million (12%) in fiscal year 2020 as compared to the prior fiscal year and increased by \$5.3 million (44.6%) in fiscal year 2021. Deferred inflows of resources fluctuate based on changes in CLC's proportionate share of the state's pension and OPEB liabilities.

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Our prior audit report on the Connecticut Lottery Corporation (CLC) contained two recommendations. Both have been implemented or otherwise resolved.

- The Connecticut Lottery Corporation should strengthen internal controls to ensure compliance with reporting requirements prescribed by the Connecticut General Statutes. **This recommendation has been resolved.**
- The Connecticut Lottery Corporation should ensure that it promptly corrects payroll audit findings in accordance with its Internal Control Procedures for Personnel Actions. **This recommendation has been resolved.**

Current Audit Recommendations:

The current audit did not result in any recommendations.

ACKNOWLEDGMENTS

The Auditors of Public Accounts wish to express our appreciation for the courtesies and cooperation extended to our representatives by the personnel of the Connecticut Lottery Corporation during the course of our examination.

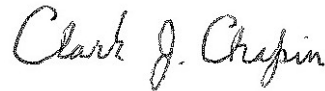
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