

Office of the State Auditor

Division of State Audit

North Dakota Lottery Bismarck, North Dakota

Audit Report for the
Years Ended June 30, 2007 and 2006
Client Code 125.1

Robert R. Peterson
State Auditor



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INDEPENDENT AUDITOR'S REPORT

Honorable John Hoeven, Governor
Members of the Legislative Assembly

Chuck Keller, Director
North Dakota Lottery

We have audited the accompanying financial statements of the North Dakota Lottery, a division of the Office of the Attorney General, state of North Dakota, as of and for the fiscal years ended June 30, 2007 and 2006, which collectively comprise the North Dakota Lottery's basic financial statements as listed in the table of contents. These financial statements are the responsibility of North Dakota Lottery management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the North Dakota Lottery are intended to present the financial position and changes in the financial position and cash flows of only that portion of the business-type activities of the state of North Dakota that are attributable to the transactions of the North Dakota Lottery. They do not purport to, and do not present fairly the financial position of the state of North Dakota as of June 30, 2007 and 2006, and the changes in its financial position and its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the North Dakota Lottery, as of June 30, 2007 and 2006, and the respective changes in the financial position and cash flows for the period then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation

of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2007, on our consideration of the North Dakota Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Robert R. Peterson
State Auditor

October 25, 2007

NORTH DAKOTA LOTTERY

Management's Discussion and Analysis For the Fiscal Year Ended June 30, 2007

This Management's Discussion and Analysis is for readers of the Lottery's financial statements and is an overview of the Lottery's financial activity for the fiscal year ended June 30, 2007. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the Lottery's financial activity based on facts, decisions, and conditions that presently face the director.

Understanding the Lottery's Financial Statements

The Lottery, a division of the Office of Attorney General, is accounted for as an enterprise fund that reports all income, expense, assets, and liabilities using the accrual basis of accounting, like a private business entity. In accordance with generally accepted accounting principles, this report consists of three financial statements and explanatory notes. The financial statements are: 1) Statement of Net Assets; 2) Statement of Revenues, Expenses, and Changes in Net Assets; and 3) Statement of Cash Flows. The financial statements are designed to highlight the Lottery's operating activity and provide a snapshot of its financial condition.

A vital factor of the Lottery's financial statements is a statutory requirement that the Lottery transfer all net proceeds, less the amount allocated to the compulsive gambling prevention and treatment fund and a holdback of any reserve funds the director may need for continuing operations, to the State Treasurer on at least an annual basis for deposit in the state general fund. Accordingly, the primary focus of these financial statements is to determine the net proceeds that are available for transfer to the state general fund. It is also important to note that most financial statement balances have a direct or indirect relationship to revenue. As lottery sales increase, the amount to be transferred to the state general fund would also increase. Similarly, as lottery sales increase, there is a direct increase in prizes, retailer commissions, game group dues, and vendor fees.

Most of the assets included on the Statements of Net Assets represent current amounts such as cash and accounts receivable from lottery retailers. Most liabilities represent current prizes, including prizes payable to players in North Dakota and prizes payable to the Multi-State Lottery Association (MUSL) to fund grand/jackpot prizes, and an amount due to the state general fund.

Financial Highlights

The Lottery is unique compared to all other state lotteries because it may only conduct multi-state online games. The constitution restricts the Lottery to multi-state games. The law restricts the Lottery to online games. Therefore, the Lottery may not conduct common in-state lotto games, instant ticket games, or pick 3 or 4 numbers games.

The Lottery is relatively new. The Lottery enjoys broad public support in the play of its games and has achieved exceptional success in sales and net proceeds during its first three and one-third years. The challenge facing the Lottery is to increase sales and net proceeds by actively promoting sales of tickets for present and new games in a very competitive retail environment.

The Lottery launched its first game of Powerball on March 25, 2004; its second game of Hot Lotto on June 24, 2004, its third game of Wild Card 2 on September 23, 2004; and its fourth game of 2by2 on February 2, 2006.

Total prizes on winning tickets for the fiscal year ended June 30, 2007, were \$11,289,566, including prizes payable in North Dakota of \$6,603,548 and prizes payable to the MUSL to fund grand/jackpot prizes of \$5,078,807. In addition, North Dakota had expired prizes in the amount of \$392,789.

When the Lottery adds a new game, a greater portion of each dollar of sales goes toward net proceeds since operating expenses like salaries and fringe benefits, travel, telephone, and MUSL board dues are generally fixed and would not necessarily increase incremental to sales. Some operating expenses like advertising and marketing would increase. There are variable expenses that have a direct incremental relationship to sales like prizes, retailer commissions, game group dues, and vendor fees.

The Lottery's operating expenses are minimized because the Lottery blueprinted its organizational structure, functions, and gaming system features to optimize efficiency.

The Lottery earned \$6,801,454 of net proceeds. Of that amount, \$200,000 was transferred to the compulsive gambling fund; \$140,859 was transferred to the MUSL for the prize reserve pools and unreserved account; and \$6,300,000 was transferred to the state general fund. It was initially projected that the Lottery would generate \$10 million for the state general fund during the 2005-2007 biennium. The Lottery actually generated \$12.6 million.

Overview of the Financial Statements

Statement of Net Assets Summary:

	<u>06/30/2007</u>	<u>06/30/2006</u>	<u>06/30/2005</u>
Total Current Assets	\$7,445,505	\$7,307,726	\$6,493,820
Total Noncurrent Assets	<u>921,674</u>	<u>743,618</u>	<u>536,001</u>
Total Assets	<u>\$8,367,179</u>	<u>\$8,051,344</u>	<u>\$7,029,821</u>
Total Current Liabilities	\$7,105,431	\$7,087,184	\$6,513,750
Total Noncurrent Liabilities	<u>75,468</u>	<u>79,334</u>	<u>54,229</u>
Total Liabilities	<u>\$7,180,899</u>	<u>\$7,166,518</u>	<u>\$6,567,979</u>
Net Assets			
Invested in Capital Assets	\$ 37,197	\$ -	\$ -
Restricted	884,477	743,618	536,001
Unrestricted	<u>264,606</u>	<u>141,208</u>	<u>(74,159)</u>
Total Net Assets	<u>\$1,186,280</u>	<u>\$ 884,826</u>	<u>\$ 461,842</u>

Statement of Revenues, Expenses, and Changes in Net Assets Summary:

	<u>6/30/2007</u>	<u>6/30/2006</u>	<u>6/30/2005</u>
Total Operating Revenue	\$22,772,976	\$22,413,359	\$19,223,089
Total Operating Expense	<u>16,068,060</u>	<u>15,622,027</u>	<u>12,818,529</u>
Operating Income	\$ 6,704,916	\$ 6,791,332	\$ 6,404,560
Total Non-Operating Income	<u>96,538</u>	<u>131,652</u>	<u>60,335</u>
Net Proceeds before Operating Transfers	\$ 6,801,454	\$ 6,922,984	\$ 6,464,895
Total Transfers to Other Funds	<u>6,500,000</u>	<u>6,500,000</u>	<u>6,098,494</u>
Change in Net Assets	\$ 301,454	\$ 422,984	\$ 366,401
Total Net Assets, Beginning of Year	<u>884,826</u>	<u>461,842</u>	<u>95,441</u>
Total Net Assets, End of Year	<u>\$ 1,186,280</u>	<u>\$ 884,826</u>	<u>\$ 461,842</u>

Revenue:

	<u>6/30/2007</u>	<u>6/30/2006</u>	<u>6/30/2005</u>
Powerball Ticket Sales	\$12,236,312	\$15,419,401	\$13,207,729
Hot Lotto Ticket Sales	3,699,800	2,730,714	3,898,592
Wild Card 2 Ticket Sales	3,496,663	2,192,519	2,020,969
2by2 Ticket Sales	<u>3,208,679</u>	<u>1,985,719</u>	<u>0</u>
Total Ticket Sales	\$22,641,454	\$22,328,353	\$19,127,290
Other Operating Revenue	<u>131,522</u>	<u>85,006</u>	<u>95,799</u>
Total Revenue	<u>\$22,772,976</u>	<u>\$22,413,359</u>	<u>\$19,223,089</u>

Expenses:

	<u>6/30/2007</u>	<u>6/30/2006</u>	<u>6/30/2005</u>
Prize Expense	\$11,289,566	\$11,044,222	\$ 9,085,551
Retailer Commissions	1,124,773	1,115,826	956,365
Retailer Bonuses	40,000	41,250	0
Operating Expenses	<u>3,613,721</u>	<u>3,420,729</u>	<u>2,776,613</u>
Total Expenses	<u>\$16,068,060</u>	<u>\$15,622,027</u>	<u>\$12,818,529</u>

Net Proceeds:

	<u>6/30/2007</u>	<u>6/30/2006</u>	<u>6/30/2005</u>
Net Proceeds before Operating Transfers	<u>\$6,801,454</u>	<u>\$6,922,984</u>	<u>\$6,464,895</u>
Percent of Net Proceeds to Total Operating Revenue	29.9%	30.9%	33.6%

Online Gaming System

The Lottery executed an eight-year contract, effective March 25, 2004, with Scientific Games International, Inc. (Scientific Games) to provide the Lottery with online and secondary online gaming systems hardware, terminal and games management system software (GMS), satellite-based retailer telecommunications network, four hundred lottery terminals, electronic scrolling and logo backlit signs, primary and secondary internal control systems (ICS), general manager, and four field technicians to provide service to lottery retailers. The Lottery does not own any of this equipment. The GMS provides management reports on retailers and tracks and controls the sale of tickets, validation of winning tickets, and payments on winning tickets. The ICS's are independent databases of all retailer sales transactions that are controlled only by the Lottery, and are used for each draw to determine the number of winning tickets, by prize value and retailer.

The Lottery's online and secondary online gaming systems are co-located with the primary and secondary online gaming systems of the Oklahoma Lottery at a computer data center located in Oklahoma City, OK. The computer data center is managed by Scientific Games which is the gaming system vendor for both the Oklahoma Lottery and North Dakota Lottery.

Disaster Recovery and User Acceptance Testing

The Lottery established a responsive disaster recovery and efficient user acceptance testing site to continue operating in the face of any disaster and test new software releases of the Games Management System. The site is located at the online gaming system vendor's site in Oklahoma City, Oklahoma.

Potential Factors Affecting Future Operations

By law, the Lottery is restricted to multi-state online games. The Lottery must partner with one or more other government-authorized lotteries to conduct a game. This restriction generally limits the Lottery to games administered by the MUSL. The MUSL may not have a broad range of games available to fulfill the Lottery's desired product mix or the MUSL's games may become stale. Should the MUSL dissolve, although it is not anticipated, the Lottery would not have a source of games to conduct.

Looking Ahead

The Lottery's primary goal is to maximize revenue for the state general fund. To accomplish this, the Lottery must offer exciting and attractive games that add value to the Lottery's product mix for players to play, license retailers that are in convenient locations to sell tickets, create effective annual marketing plans, provide quality customer service to retailers and players, and control operating expenses. To be attractive, games must be interesting to play and have a broad range of player odds and minimum jackpot prizes. The MUSL game groups periodically freshen their games by replacing them, or relaunching the games with new features or options.

Total sales of a game are dramatically affected by the size of the game's jackpot and, to a lesser degree, on the odds of winning a prize. Larger jackpots generate higher sales. However, larger jackpots cannot be predicted or counted upon. Therefore, a variety of games with varying jackpots and odds of winning a prize is necessary to attract players.

The Lottery has 400 licensed retailers located in 127 towns and cities, and in every county but one. This is about 1 lottery terminal for each 1,586 residents.

During the 2007-2009 biennium, the Lottery plans to:

1. Generate sales of tickets of \$48.1 million and state general fund revenue of \$11.2 million;
2. Develop an inspiring slogan;
3. Develop and conduct effective marketing promotions;
4. Develop an active and effective retailer outreach program;
5. Work closely with the five-member Lottery Advisory Commission;
6. Re-launch the games of Hot Lotto, Wild Card 2, and 2by2;
7. Conduct public and player surveys about the Lottery; and
8. Invite retailers to participate in statewide semi-annual meetings.

Compulsive Gambling Prevention and Treatment Fund

By law, starting July 1, 2005, fifty thousand dollars must be transferred to the State Treasurer each quarter for deposit in the compulsive gambling prevention and treatment fund.

The Lottery is sensitive to problem gambling and encourages players to play responsibly.

Drug Task Force Grant Fund

By law, starting July 1, 2007, one hundred five thousand, six hundred and twenty-five dollars must be transferred to the State Treasurer each quarter for deposit in the drug task force grant fund.

Contacting the Lottery

If a person has a question on any information in this report or desires additional information, the person should write to: North Dakota Lottery; Office of Attorney General; 600 E. Boulevard Avenue - Dept. 125; Bismarck, ND 58505-0040.

North Dakota Lottery
Statement of Net Assets
For the Fiscal Years Ended June 30, 2007 and 2006

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Assets:		
Current Assets:		
Cash and Cash Equivalents	\$ 7,056,920	\$ 6,539,715
Accounts Receivable	385,379	760,579
Due From Other State Funds	7	372
Prepaid Expenses	3,199	7,060
Total Current Assets	<u>\$ 7,445,505</u>	<u>\$ 7,307,726</u>
Noncurrent Assets:		
Reserves on Deposit	\$ 884,477	\$ 743,618
Equipment and Software, Net	37,197	-
Total Noncurrent Assets	<u>\$ 921,674</u>	<u>\$ 743,618</u>
Total Assets	<u>\$ 8,367,179</u>	<u>\$ 8,051,344</u>
Liabilities:		
Current Liabilities:		
Accounts Payable	\$ 281,686	\$ 180,972
Due to Other State Funds	6,318,334	6,303,108
Accrued Payroll	43,243	51,875
Prizes Payable	322,310	361,715
Deferred Revenue	130,781	182,908
Compensated Absences Payable	9,077	6,606
Total Current Liabilities	<u>\$ 7,105,431</u>	<u>\$ 7,087,184</u>
Noncurrent Liabilities:		
Compensated Absences Payable	\$ 75,468	\$ 79,334
Total Noncurrent Liabilities	<u>\$ 75,468</u>	<u>\$ 79,334</u>
Total Liabilities	<u>\$ 7,180,899</u>	<u>\$ 7,166,518</u>
Net Assets:		
Invested in Capital Assets	\$ 37,197	\$ -
Restricted	884,477	743,618
Unrestricted	264,606	141,208
Total Net Assets	<u>\$ 1,186,280</u>	<u>\$ 884,826</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

NORTH DAKOTA LOTTERY
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Years Ended June 30, 2007 and 2006

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Operating Revenues:		
Ticket Sales	\$ 22,641,454	\$ 22,328,353
Other Operating Revenue	131,522	85,006
Total Operating Revenues	<u>\$ 22,772,976</u>	<u>\$ 22,413,359</u>
Operating Expenses:		
Prize Expense	\$ 11,289,566	\$ 11,044,222
Retailer Commissions	1,164,773	1,157,076
Contractual Services Expense	2,376,779	2,366,279
Marketing	503,659	366,475
Salaries and Benefits	533,428	486,529
Operating	199,855	201,446
Total Operating Expenses	<u>\$ 16,068,060</u>	<u>\$ 15,622,027</u>
Operating Income	<u>\$ 6,704,916</u>	<u>\$ 6,791,332</u>
Nonoperating Revenues:		
Interest Income	\$ 96,538	\$ 131,652
Total Nonoperating Revenues	<u>\$ 96,538</u>	<u>\$ 131,652</u>
Income Before Transfers	<u>\$ 6,801,454</u>	<u>\$ 6,922,984</u>
Transfers to Other Funds:		
Compulsive Gambling Fund	\$ 200,000	\$ 200,000
State General Fund	6,300,000	6,300,000
Total Transfers to Other Funds	<u>\$ 6,500,000</u>	<u>\$ 6,500,000</u>
Change in Net Assets	\$ 301,454	\$ 422,984
Total Net Assets – Beginning of Year	<u>884,826</u>	<u>461,842</u>
Total Net Assets – End of Year	<u>\$ 1,186,280</u>	<u>\$ 884,826</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

NORTH DAKOTA LOTTERY
Statement of Cash Flows
For the Fiscal Years Ended June 30, 2007 and 2006

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Cash Flows from Operating Activities:		
Ticket Sales	\$ 16,337,845	\$ 16,698,946
Other Revenues	116,272	76,422
Paid to Prize Winners	(1,373,847)	(5,077,878)
Paid to Vendors	(7,395,036)	(4,917,928)
Paid to Employees	(543,455)	(446,737)
Reserves on Deposit	(164,449)	(177,014)
Net Cash Provided by Operating Activities	<u>\$ 6,977,330</u>	<u>\$ 6,155,811</u>
Cash Flows from Noncapital Financing Activities:		
Paid to Compulsive Gambling Treatment Fund	\$ (200,000)	\$ (200,000)
Paid to State General Fund	(6,300,000)	(5,836,571)
Net Cash Used in Noncapital Financing Activities	<u>\$ (6,500,000)</u>	<u>\$ (6,036,571)</u>
Cash Flows from Capital and Related Financing Activities:		
Purchase of Equipment and Software	\$ (47,519)	
Cash Flows from Investing Activities:		
Interest Income	87,394	\$ 64,730
Net Cash Provided by Investing Activities	<u>\$ 87,394</u>	<u>\$ 64,730</u>
Cash and Cash Equivalents at Beginning of Year	<u>\$ 6,539,715</u>	<u>\$ 6,355,745</u>
Cash and Cash Equivalents at End of Year	<u>\$ 7,056,920</u>	<u>\$ 6,539,715</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	\$ 6,704,916	\$ 6,791,332
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation	10,323	
Changes in Assets and Liabilities:		
(Increase) Decrease in Accounts Receivable	377,620	(623,508)
(Increase) Decrease in Due from Other State Funds	365	(372)
(Increase) Decrease in Prepaid Expenses	3,861	(2,446)
(Increase) Decrease in Reserves on Deposit	(134,137)	(177,014)
Increase (Decrease) in Accounts Payable	100,715	(77,858)
Increase (Decrease) in Accrued Payroll	(8,632)	19,046
Increase (Decrease) in Compensated Absences Payable	(1,395)	20,746
Increase (Decrease) in Prizes Payable	(39,405)	121,297
Increase (Decrease) in Due to Other State Funds	15,226	(4,683)
Increase (Decrease) in Other Current Liabilities	(52,127)	89,271
Total Adjustments	<u>\$ 272,414</u>	<u>\$ (635,521)</u>
Net Cash Provided by Operating Activities	<u>\$ 6,977,330</u>	<u>\$ 6,155,811</u>
Noncash Transactions:		
Interest Revenue on Prize Reserves	\$ 6,722	\$ 62,676
Total Noncash Transactions	<u>\$ 6,722</u>	<u>\$ 62,676</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

NORTH DAKOTA LOTTERY

Notes to the Financial Statements

For the Fiscal Year Ended June 30, 2007

Note 1. Summary of Significant Accounting Policies

Organization

On November 5, 2002, North Dakota citizens approved a constitutional amendment that enables the state to participate in multi-state lottery games. The 2003 Legislative Assembly passed House Bill No. 1243 that became law on April 4, 2003. This law, chapter 53-12.1 (Lottery) of the North Dakota Century Code, created the North Dakota Lottery as a division within the Office of Attorney General. The law restricts the Lottery to multi-state online games. In-state lotto games, instant ticket games, and pick 3 or 4 numbers games are prohibited.

The mission of the Lottery is to maximize net proceeds for the benefit of the state by promoting entertaining games, providing quality customer service to retailers and players, achieving the highest standards of integrity, security, and accountability, and maintaining public trust.

The Lottery is our state's newest government-sponsored business enterprise. The Lottery manages, regulates, and promotes this business. As a business, the Lottery must be profitable in the eyes of the Legislature. To be profitable, the Lottery must prosper, have a positive public image, and players must be confident that games are fair and honest. The success of the Lottery will depend on how well the Lottery is managed, the variety of games that are available to players, and how effectively games are promoted.

The Lottery is a member of the Multi-State Lottery Association (MUSL). The Lottery has been authorized to conduct the games of Powerball, Hot Lotto, Wild Card 2, and 2by2. The Powerball game was launched on March 25, 2004. The Powerball matrix is 5 of 55 and 1 of 42. The Hot Lotto game was launched on June 24, 2004. The Hot Lotto matrix is 5 of 39 and 1 of 19. The Wild Card 2 game was launched on September 23, 2004. The Wild Card 2 matrix is 5 of 31 and 1 of 16. The 2by2 game was launched on February 2, 2006. The 2by2 matrix is 2 of 26 and 2 of 26. Drawings for Powerball, Hot Lotto, and Wild Card 2 are held each Wednesday and Saturday evening. Drawings for 2by2 are held each Monday, Tuesday, Wednesday, Thursday, Friday, and Saturday evening.

To play the Power Play option on a Powerball ticket, a player pays an additional one dollar per play for an opportunity to multiply the player's set prize (excluding the jackpot prize) by 2, 3, 4, or 5. Before each Powerball drawing, the Power Play prize multiplier number is selected for that draw.

Reporting Entity

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, the Lottery should include all component units over which the Lottery exercises such aspects as (1) appointing a voting majority of an organization's governing body and (2) has the ability to impose its will on that organization or (3) the potential for the organization to provide specific financial benefits to, or impose specific burdens on the Lottery.

Based on the criteria of GASB Statement No. 14, no organization was determined to be part of the Lottery as a reporting entity. The Lottery is a division of the Office of Attorney General, which is part of the primary government of the state of North Dakota.

Basis of Accounting and Measurement Focus

The Lottery's activity is accounted for as a proprietary type enterprise fund for the state of North Dakota. A proprietary fund is accounted for using the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized when they are incurred.

An enterprise fund is used to account for an activity that is financed and operated in a manner similar to a private business enterprise where the costs of providing goods or services to the public on a continuing basis are financed through the sale of those goods or services. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. An enterprise fund is accounted for by using the economic resources measurement focus in which all assets and liabilities associated with the operation of the funds are included on the statement of net assets. Net assets are segregated into investments in capital assets and restricted and unrestricted components. The statement of revenues, expenses, and changes in net assets present increases, like revenues, and decreases, like expenses, in total net assets. The statement of cash flows presents the cash flows for operating, investing, and non-capital financing activities.

The lottery law prescribes that general fund monies of the state may not be used or obligated to pay expenses or prizes of the Lottery. The Lottery must be self-sustaining.

Accounting Standards

The Lottery follows the pronouncements of the GASB, which is the nationally accepted standard-setting body for establishing generally accepted accounting principles for governmental entities. In accordance with GASB Statement No. 20, the Lottery follows all applicable GASB Pronouncements and Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with GASB pronouncements.

The preparation of financial statements in conformity with generally accepted accounting principles requires the director to make estimates and presumptions that affect reported amounts of assets, liabilities, income, and expenses. Actual results could differ from those estimates.

Operating and Nonoperating Revenues

An enterprise fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the proprietary fund's principal ongoing operation. The principal operating revenue of the Lottery is sales of tickets. The principal operating expenses of the Lottery are prizes, retailer commissions, contractual services, marketing, MUSL game group dues, and salaries and fringe benefits. All revenue and expenses not meeting the criteria are reported as nonoperating income and expenses.

Cash and Cash Equivalents

Cash and cash equivalents are defined as deposits with the Bank of North Dakota and the State Treasurer. The Lottery does not invest in marketable securities.

Retailer Security Deposits

If retailers have an unsatisfactory credit rating, the Lottery requires those retailers to provide the Lottery a security deposit to protect the Lottery from bad debts. Security may be in the form of a performance bond, deposit in cash, an irrevocable letter of credit, or a certificate of deposit. Security deposits in the form of checks or certificates of deposit are classified as assets. Security deposits in the form of letters of credit or performance bonds are classified as collateral.

Accounts Receivable

Accounts receivable primarily represents prizes due from MUSL and lottery funds due from retailers for ticket sales, less commissions and prizes on winning tickets paid by retailers. Lottery funds are collected weekly through electronic funds transfer by the Lottery from retailers' bank accounts. The Lottery has not incurred and does not project any bad debts.

Reserves on Deposit

The Lottery has \$884,477 on deposit with the MUSL related to the Prize Reserve Pools and Unreserved Account. See Note 7.

Prepaid Expenses

Prepaid expenses of \$3,199 are retailer commissions on future sales.

Equipment and Software

Equipment and software are stated at cost, net of accumulated depreciation. Equipment and software with a cost of \$5,000 or more per unit are capitalized and reported in the accompanying financial statements. Depreciation is computed using the straight-line method over the estimated useful lives of the assets which range from three to five years.

Prizes

Prize expense is recorded based on actual drawing results.

Prizes payable represents the difference between the amount of prize expense recognized and actual prizes paid.

Players may redeem winning tickets for up to 180 days after the draw for the game. As of June 30, 2007, unclaimed prizes were \$321,272. Prizes that expired in fiscal years ended June 30, 2007, 2006, 2005, and 2004 were \$392,789, \$352,329, \$328,225, and \$0, respectively.

Deferred Revenue

A liability has been recorded for lottery tickets sold on or before June 30, 2007 on multi-draw tickets and for subscriptions sold on or before June 30, 2007 that contain plays for future draws that will occur after June 30, 2007. The amount related to future ticket sales on multi-draw tickets of \$57,692 and future sales on subscriptions of \$69,926 are classified as deferred revenue. Sales of uncashed gift certificates in the amount of \$3,163 are also classified as deferred revenue.

Interfund Balances and Transfers

At June 30, 2007, the Lottery had nominal accounts payables and receivables involving normal business expenses with several state agencies and had net proceeds due to be transferred to one state fund.

By law, the net proceeds of the Lottery, less the amount allocated to the compulsive gambling prevention and treatment fund, Lottery's share of a game's prize reserve pool, and holdback of any reserve funds the director may need for continuing operations, must be transferred to the State Treasurer on at least an annual basis for deposit in the state general fund. By law, \$50,000 must be transferred to the State Treasurer each quarter for deposit in the compulsive gambling prevention and treatment fund. The reserve funds held by the director are funds that are required to be transferred to the MUSL for prize reserve pools. The balance of the net proceeds is transferred to the state general fund.

Retailer Commissions

Lottery retailers receive a 5% commission on each ticket sold or otherwise provided to players, and for subscriptions that retailers initiated. Effective January 1, 2006, the Lottery provides retailers a bonus commission, as a sales incentive, for selling jackpot/grand prize and certain high tier prize winning tickets. The Lottery does not provide retailers a commission for redeeming winning tickets. Total retailer commissions were \$1,164,773, including bonus commissions of \$40,000.

Marketing and Advertising

Costs incurred for developing creative, including point-of-sale items, research, and media advertising are expensed when incurred which generally is when point-of-sale items are first distributed to retailers or advertising first takes place.

Accumulated Unpaid Vacation, Sick Pay, and Compensatory Pay

Annual leave and sick leave are a part of permanent employees' compensation as set forth in Section 54-06-14 of the North Dakota Century Code. Annual leave is earned based on tenure of employment, within a range of a minimum of one working day per month of employment, to a maximum of two working days per month of employment, to be fixed by rules and regulations adopted by the employing unit. In general, accrued annual leave cannot exceed 30 days at each year-end, as set by the Office of Attorney General. Employees are paid for unused annual leave upon termination or retirement.

Sick leave is earned at the rate of one working day per month of employment. There are no limitations on the amount of sick leave that an employee can accumulate. Employees who have ten continuous years of service are paid one-tenth of their accumulated sick leave upon termination or retirement under chapter 54-52 of the North Dakota Century Code. A liability is recognized for that portion of accumulated sick leave benefits that is estimated will be taken as required by the GASB Statement No. 16, *Accounting for Compensated Absences*.

Compensatory leave is earned by employees who work overtime each week in accordance with the Office of Attorney General's policy. Generally, upon termination or retirement, employees are not eligible to receive compensation for their compensatory leave balances.

Note 2. Deposits

Custodial Credit Risk

State law generally requires all state funds be deposited in the state owned Bank of North Dakota. North Dakota Century Code (NDCC) Section 21-04-01 provides that public funds belonging to or in the custody of the state shall be deposited in the Bank of North Dakota. Also, NDCC Section 6-09-07 states, “[a]ll state funds ... must be deposited in the Bank of North Dakota” or must be deposited in accordance with constitutional and statutory provisions.

Lottery deposits at the Bank of North Dakota at June 30, 2007 and 2006 include \$7,056,920 and \$6,539,715 respectively.

These deposits are exposed to custodial credit risk as uninsured and uncollateralized. However, these deposits at the Bank of North Dakota are guaranteed by the state of North Dakota through NDCC Section 6-09-10.

Note 3. Compensated Absences

A summary of compensated absences follows:

Beginning balance, July 1	\$ 85,940
Addition	
Reduction	1,395
Ending balance, June 30	<u>\$ 84,545</u>
Amount payable within one year	<u>\$ 9,077</u>

Note 4. Due to / Due from Other State Funds

At June 30, 2007, accounts payable due to several state agencies and transfers of net proceeds due to the state general fund are:

Due to the Department of Transportation	\$ 2,396
Due to the Information Technology Department	1,431
Due to the Office of Management & Budget	888
Due to the Office of State Tax Commissioner	13,574
Due to the ND State Historical Society	45
Due to the state General Fund	<u>6,300,000</u>
Total	<u>\$6,318,334</u>

At June 30, 2007 the amount due from the Office of Attorney General was \$7.

Note 5. Equipment and Software

A summary of changes in equipment, software, and accumulated depreciation is as follows:

	Equipment & Software	Accumulated Depreciation	Net Equipment
Balance, June 30, 2006	\$ -	\$ -	\$ -
Additions	47,520	10,323	37,197
Disposals	-	-	-
Balance, June 30, 2007	<u>\$ 47,520</u>	<u>\$ 10,323</u>	<u>\$ 37,197</u>

Note 6. Employee Pension Plan

The Office of Attorney General participates in the North Dakota Public Employees' Retirement System (NDPERS) administered by the state of North Dakota. The following is a brief description of the plan.

NDPERS is a cost-sharing multiple-employer defined benefit pension plan covering substantially all classified employees of the Office of Attorney General. The plan provides retirement, disability, and death benefits. If an active employee passes away with less than three years of credited service, a death benefit equal to the value of the employee's accumulated contributions, plus interest, is paid to the employee's beneficiary. If the employee has earned more than three years of credited service, the surviving spouse is entitled to a single payment refund, life-time monthly payments in an amount equal to 50% of the employee's accrued normal retirement benefit, or 60 monthly payments equal to the employee's accrued normal retirement benefit calculated as if the employee were age 65 the day before death occurred or monthly payments in an amount equal to the employees' accrued 100% joint and survivor retirement benefit if the member had reached normal retirement age prior to date of death. If the surviving spouse passes away before the employee's accumulated pension benefits are paid, the balance is payable to the surviving spouse's designated beneficiary.

Eligible employees who become totally disabled after a minimum of 180 days of service receive monthly disability benefits that are equal to 25% of their final average salary with a minimum benefit of \$100. To qualify under this section, the employee must meet the criteria established by the Retirement Board for being considered totally disabled.

Employees are entitled to unreduced monthly pension benefits equal to 2.00% of their final average salary for each year of service beginning when the sum of age and years of credited service equal or exceed 85, or at normal retirement age (65). The plan permits early retirement at ages 55-65, with three or more years of service.

Benefit and contribution provisions are administered in accordance with chapter 54-52 of the North Dakota Century Code. This state statute requires that 4% of the participant's salary be contributed to the plan by either the employee or by the employer under a "salary reduction" agreement. The Office of Attorney General has implemented a salary reduction agreement and is currently contributing the employee's share. The Office of Attorney General is required to contribute 4.12% of each participant's salary as the employer's share. The required contributions are determined using an entry age normal actuarial funding method. The North Dakota Retirement Board was created by the State Legislature and is the governing authority of NDPERS. The Office of Attorney General required an actual contribution to NDPERS for the

fiscal years ended June 30, 2007, 2006, and 2005 of \$31,088, \$28,375, and \$21,777, respectively.

NDPERS issues a publicly available financial report that includes financial statements and the required supplementary information for NDPERS. The report may be obtained by writing to NDPERS; 400 East Broadway, Suite 505, PO Box 1214, Bismarck, ND 58502-1214.

Note 7. Multi-State Lottery Association

The Lottery is a member of the MUSL which administers games on behalf of member lotteries. MUSL administers the Powerball, Hot Lotto, Wild Card 2, and 2by2 games for the Lottery. Each member lottery sells game tickets through its retailers and makes weekly wire transfers to MUSL in an amount equal to the member lottery's share of the jackpot prize liability. If this results in a negative amount, the MUSL transfers funds to the Lottery. Lesser prizes are paid directly to the winners by each member lottery. The prize pools for Powerball, Hot Lotto, and 2by2 are 50% of each drawing period's sales, after the prize reserve accounts are funded to the amounts set by the game groups. The prize pool for Wild Card 2 is 55%. Up to 2% of sales for Powerball and Hot Lotto are deducted from the prize pool and placed in prize reserve pools. For Hot Lotto, up to 1% of sales is deducted from the prize pool and placed in a prize reserve pool when the jackpot prize exceeds \$2 million. An additional 2% of sales are placed in the prize reserve fund after the annuitized jackpot prize exceeds \$5 million. When the prize reserve funds exceed the designated caps, the excess amount becomes part of the jackpot prize pool.

The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize liabilities and the money in this reserve fund is used at the discretion of the MUSL board of directors. The prize reserve fund monies are refundable to MUSL member lotteries if MUSL dissolves or if a member lottery leaves MUSL. A member lottery leaving MUSL must wait one year before receiving their remaining share, if any, of the prize reserve funds. Any amount remaining in the prize pools at the end of the games is carried forward to a replacement game or expended in a manner as directed by the game group. The MUSL prize reserve pool account balance and the Lottery's share of that balance are as follows:

	6/30/2007	6/30/2006	6/30/2005	6/30/2004
MUSL prize reserve pool account	\$99,318,639	\$103,189,693	\$100,162,066	\$94,050,041
Lottery's share of the MUSL's prize reserve pool account (on deposit)	\$ 877,464	\$ 713,015	\$ 536,001	\$ 78,259
Lottery's present amount due the MUSL	\$ 4,944	\$ 1,633	\$ 4,841	\$ 15,748
Lottery's future amount due the MUSL	\$ 271,629	\$ 60,345	\$ 471,631	\$ 677,244

The Lottery also has an unreserved account with MUSL. Interest earned on MUSL funds, and any unclaimed jackpot prizes may be deposited into this account and Lottery board and game group dues and other MUSL related expenses may be paid from this fund.

	6/30/2007	6/30/2006	6/30/2005	6/30/2004
MUSL Unreserved Account	\$20,231,617	\$16,731,645	\$ 11,961,734	\$ 9,737,349
Lottery's share of the MUSL's Unreserved Account (on deposit)	\$ 7,013	\$ 30,603	\$ (58,080)	\$ (18,028)

A winner of a Powerball or Hot Lotto jackpot prize may select that the prize be paid at the cash value of the prize or as an annuity. A Powerball jackpot prize is paid out in 30 installments and

a Hot Lotto jackpot prize in 25 installments. Powerball annuitized prizes are paid annually in thirty graduated payments (increasing each year) by a rate determined by the Powerball game group. If a jackpot prize winner selects annual installments, the MUSL buys United States zero coupon bonds in the name of the member lottery that becomes the beneficiary. Winner trusts hold securities used to fund the MUSL's payment of cash to the member lotteries so the lotteries can, as obligated, pay winning players when annuitized payments are due. The source of this money is a game group's grand prize pool. The assets and related liabilities are reflected in the MUSL's financial statements and, therefore, are not reflected in the Lottery's financial statements. MUSL is responsible for transferring the cash or the annuity installment amounts to the member lottery before the payment to the jackpot prize winner. The Lottery currently is not paying any prize winner any annuity prize payments. The Wild Card 2 jackpot prize and 2by2 grand prize are paid in cash. The Powerball, Hot Lotto, and Wild Card 2 jackpot prizes are divided equally among multiple winning tickets among the participating state lotteries.

As a member of the MUSL board and Powerball, Hot Lotto, Wild Card 2, and 2by2 game groups, the Lottery is responsible for its pro-rated share of the MUSL board dues. MUSL Board dues for fiscal years ended June 30, 2007, 2006, and 2005 were \$42,452, \$52,439, and \$50,263, respectively.

Note 8. Commitments and Contingencies

The Lottery entered into contracts with:

1. Scientific Games International, Inc. of Alpharetta, GA on February 3, 2004. The vendor provides an online lottery gaming system and related services through March 24, 2012, with a possible extension through March 24, 2014. Payments for the fiscal years ended June 30, 2007, 2006, 2005, and 2004 totaled \$2,376,779, \$2,366,279, \$1,973,152, and \$606,060, respectively. The Lottery's future obligation is based on 10.63% of ticket sales, there is no minimum fee or retainer fee;
2. H2M of Fargo, ND on July 1, 2007 (new contract). The vendor provides marketing and related services through June 30, 2010, with a possible extension through June 30, 2012. Payments for the fiscal years ended June 30, 2007, 2006, 2005, and 2004 totaled \$394,547, \$331,564, \$175,188, and \$237,418, respectively. The Lottery's future obligation is for actual services requested, there is no minimum fee or retainer fee; and
3. Safety & Security Services, Inc. of Oklahoma City, OK on March 1, 2006. The vendor provides standby services and, if necessary, security of the Scientific Games International, Inc.'s computer data center on days of the drawings through February 28, 2009. The payment for the fiscal years ended June 30, 2007 and 2006 totaled \$80 and \$80, respectively. There is no minimum future compensation per year since there is no compensation for standby services. Future compensation is based only on actual services performed at the data center.

The Lottery has a contingent gain estimated at \$127,366 from prizes that may be forfeited due to winning players not claiming them within the required time frame. This contingent gain has not been accrued in these financial statements but will be recognized when realized.

Note 9. Line of Credit

In accordance with subsection 2 of section 53-12.1-02 of the North Dakota Century Code, the Lottery has secured a short-term line of credit with the Bank of North Dakota. The law provides that the line of credit be limited to the amount of each cash prize of \$100,000 or more that relates to prize funds known to be due and forthcoming to the Lottery from other government-

authorized lotteries through the MUSL. The line of credit may not exceed \$1 million in the aggregate. To date, no credit advances have been requested.

Note 10. Risk Management

The Lottery is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery, as a division of the Office of Attorney General, participates in the same funds/pools established by the state for risk management issues.

The 1995 Legislative Assembly established the Risk Management Fund (RMF), an internal service fund, to provide a self-insurance vehicle for funding the liability exposures of state agencies resulting from the elimination of the state's sovereign immunity. The RMF manages the tort liability of the state, its agencies' employees, and the University System. All state agencies participating in the RMF and their fund contribution was determined using a projected cost allocation approach. The statutory liability of the state is limited to a total of \$250,000 per person and \$1 million per occurrence.

The Office of Attorney General also participates in the North Dakota Fire and Tornado Fund. The office pays an annual premium to the Fire and Tornado Fund to cover property damage to building and personal property. Replacement cost coverage is provided by estimating replacement cost in consultation with the Fire and Tornado Fund. The Fire and Tornado Fund is reimbursed by a third party insurance carrier for losses in excess of \$1 million per occurrence during a 12-month period.

The Office of Attorney General also historically participated in the State Bonding Fund in which the office was automatically enrolled on an annual basis and received blanket employee fidelity bond coverage in the amount of \$2.5 million. The State Bonding Fund did not charge any premium for this coverage. However, the 2005 Legislative Assembly changed the law effective January 1, 2006 to require state agencies to apply biennially for and specify the amount of coverage needed under the State Bonding Fund.

Note 11. Postretirement Benefits

Former employees receiving retirement benefits under the Retirement Plan for Employees of the Lottery are eligible to participate in the Retiree Health Benefits Fund, a cost-sharing multiple employer plan, as administered by the Public Employees Retirement Board. During each month of employment, the Lottery contributes 1% of each employee's salary into the Retiree Health Benefits Fund. Total contributions for the fiscal years ending June 30, 2007, 2006, and 2005 were \$3,829, \$3,495, \$2,682, respectively.

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Honorable John Hoeven, Governor
Members of the Legislative Assembly

Chuck Keller, Director
North Dakota Lottery

We have audited the financial statements of the business-type activities of the North Dakota Lottery, as of and for the year ended June 30, 2007, which collectively comprise the North Dakota Lottery's basic financial statements and have issued our report thereon dated October 25, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the North Dakota Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of North Dakota Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of North Dakota Lottery's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent and detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the organization's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the organization's financial statements that is more than inconsequential will not be prevented or detected by the organization's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statement will not be prevented or detected by the organization's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses or significant deficiencies, as defined above. However, we noted other matters involving internal control over financial reporting that we have reported to management of the North Dakota Lottery, in a separate letter dated October 25, 2007.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the North Dakota Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of the Governor, Legislative Audit and Fiscal Review Committee, North Dakota Lottery Advisory Commission, and management of the North Dakota Lottery and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Robert R. Peterson
State Auditor

October 25, 2007

NORTH DAKOTA LOTTERY

SPECIAL COMMENTS REQUESTED BY THE LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE For The Year Ended June 30, 2007

The Legislative Audit and Fiscal Review Committee requires that certain items be addressed by auditors performing audits of state agencies. These items and our responses are as follows:

RESPONSES TO LAFRC AUDIT QUESTIONS

1. What type of opinion was issued on the financial statements?

Unqualified Opinion.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Yes.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

Yes.

6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.

Yes, a management letter was issued and is included on page 26 of this report, along with management's response.

LAFRC AUDIT COMMUNICATIONS

1. Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.

There were no significant changes in accounting policies.

No management conflicts of interest were noted.

No contingent liabilities were identified.

There were no significant or unusual transactions.

2. Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.

The North Dakota Lottery's financial statements do not include any significant accounting estimates.

3. Identify any significant audit adjustments.

Significant audit adjustments were not necessary.

4. Identify any disagreements with management, whether or no resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.

None.

5. Identify any serious difficulties encountered in performing the audit.

None.

6. Identify any major issues discussed with management prior to retention.

This is not applicable for audits conducted by the Office of the State Auditor.

7. Identify any management consultations with other accountants about auditing and accounting matters.

None.

8. Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.

ConnectND Finance, Human Resource Management System (HRMS), Games Management System (GMS), and Internal Control System (ICS) are high risk systems critical to the ND Lottery.

Management Letter (Informal Recommendations)

October 25, 2007

Chuck Keller, Director
North Dakota Lottery
600 E. Boulevard Avenue –Dept. 125
Bismarck, North Dakota 58505

Dear Mr. Keller,

We have audited the financial statements of the North Dakota Lottery for the year ended June 30, 2007, and have issued a report thereon. As part of our examination, we gained an understanding of the North Dakota Lottery's internal control structure to the extent we considered necessary to report on the internal control structure. We have issued our report on the internal control structure October 19, 2007. We also performed tests of compliance as described in our report on compliance with laws and regulations dated October 25, 2007.

It should be noted that our audit procedures are designed primarily to enable us to report on the internal control structure and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above we noted certain conditions that we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will then reconsider their status as non-reportable conditions. These conditions were considered in preparing the reports referenced above and in no way alter the opinion expressed in those reports.

The following sections of the letter present our informal recommendations.

CASH

We recommend the ND Lottery:

- a. Ensure all refunds are prepared by an appropriate individual;
- b. Ensure all refunds are properly approved;
- c. Ensure all refunds are adequately supported; and
- d. Maintain a log of all credit card refunds processed.

Response: *ND Lottery agrees with these recommendations. The Lottery is now tracking all refunds of retailer application/license fees and credit card payments. Only the Administrative Assistant II and Administrative Staff Officer II are authorized to request refunds of retailer application/license fees. Only the Administrative Staff Officer II and Accountant/Budget Specialist III are authorized to request refunds of credit card payments. Only the director may approve refunds based on sufficient evidential documentation. The director will record relevant data of each approved refund on a control log that is maintained by the director. Lottery staff may only view the control log. The Accountant/Budget Specialist III maintains custody of all refund files. Each month the director will reconcile the control log to the PeopleSoft payment itemized transaction list for fund 292 and BND credit card statement to detect and address any variances.*

ACCOUNTS PAYABLE / EXPENDITURES

We recommend the Office of Attorney General assign accounts payable approval roles in PeopleSoft, to the appropriate Lottery personnel, through the workflow process in PeopleSoft.

Response: *ND Lottery agrees with this recommendation. We are currently exploring this recommendation with the Office of Management and Budget.*

We recommend the Office of Attorney General ensure that a three-way tie-out is performed each month for purchase cards by reconciling the monthly individual purchase card statements to the Transaction Detail report from the SAM database and then reconciling the Transaction Detail report to the purchase card transactions that have been posted in PeopleSoft by OMB.

Response: *ND Lottery agrees with this recommendation. This recommendation was implemented in August 2007.*

PAYROLL

We recommend that the NDS_HR-PR_USER_8.9 role be limited to only those who are not responsible for approving payroll.

Response: *ND Lottery agrees with this recommendation. This recommendation has been implemented.*

I would encourage you to call our office if you have any questions about the implementation of recommendations included in your audit report or this letter. You may either call me or one of our audit managers at 328-2241.

Sincerely,

Michael W. Schmitcke, CPA
Auditor in-charge