

VIRGIN ISLANDS LOTTERY
FINANCIAL STATEMENTS
SEPTEMBER 30, 2008

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INDEPENDENT AUDITORS' REPORT

Board of Commissioners
Virgin Islands Lottery
St. Thomas, U.S. Virgin Islands

We have audited the accompanying statement of net assets of the Virgin Islands Lottery (the "Lottery") as of September 30, 2008, and the related statement of revenues, expenses and changes in net assets and cash flows for the year ended September 30, 2008. The Virgin Islands Lottery is an enterprise fund of the Government of the U.S. Virgin Islands. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Lottery's 2007 financial statements and, in our report dated February 4, 2009, we expressed a qualified opinion on those statements.

Except as discussed in the following paragraph, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we express no such opinion. 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 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 opinion.

The Lottery did not maintain sufficient documentation of an amount due to the treasury of the Virgin Islands of \$4,468,304; therefore, this amount could not be substantiated. Accordingly, we were unable to satisfy ourselves with respect to whether the amount is fairly stated. Consequently, due to the treasury of the Virgin Islands, may have required adjustments, had we been able to determine whether the balance was fairly stated.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the amount due to treasury, the financial statements referred to in the first paragraph presents fairly, in all material respects, the net assets of the Virgin Islands Lottery as of September 30, 2008 and the changes in net assets and cash flows for the year 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 6 is not a required part of the financial statements but is supplementary information required by the Government Accounting Standards Board. This information is the responsibility of the Lottery's management. We did not audit the information and express no opinion on it. However, we were unable to apply to the information certain limited procedures due to material weaknesses in internal controls over the Lottery's financial reporting and recording keeping.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 13, 2009, on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grants and other matters. 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 the audit.

November 13, 2009

VIRGIN ISLANDS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED SEPTEMBER 30, 2008

I. INTRODUCTION

The Virgin Islands Lottery (the Lottery) was created by statute in 1937, and in 1971 was established as an independent agency of the Virgin Islands Government. The Lottery is an enterprise fund of the U.S. Virgin Islands Government. Under provisions of the Virgin Island Code, Title 32, Chapter 13, the Executive Director is appointed by the Governor of the U.S. Virgin Islands, by and with the content of the Legislature.

This section of the Lottery's annual financial report presents management's discussion and analysis of the financial position and changes in net assets for the fiscal year ended September 30, 2008. This information is being presented to provide additional information regarding the activities of the Lottery and to meet the disclosure requirements of Government Accounting Standards Board Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Government*. This analysis should be read in conjunction with the Report of Independent Auditors', the audited financial statements and accompanying notes.

II. REQUIRED BASIC FINANCIAL STATEMENTS

The Lottery's financials are accounted for as an enterprise fund, reporting business activities under the accrual basis of accounting, much like a private business enterprise.

The basic financial statements of the Lottery report information about the Lottery's use of accounting methods similar to those used by private sector companies. These statements offer information about the Lottery's activities.

The Statement of Net Assets: This statement includes all of the Lottery's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). The assets and liabilities are presented in order of liquidity. The resulting net assets presented in these statements are displayed as restricted or unrestricted. Assets are restricted when their use is subject to external limits such as legal agreements or statutes. Assets falling outside this category are characterized as unrestricted.

Statement of Revenue, Expenses and Changes in Net Assets: All of the current year's revenue and expenses are accounted for in the Statement of Revenue, Expenses and Changes in Net Assets. This statement measures the activities of the Lottery's operations over the past year and can be used to determine whether the Lottery has successfully recovered all of its cost through the services it provided.

Statement of Cash Flows: The primary purpose of this statement is to provide information about the Lottery's net cash used in operating activities, capital and related financing activities and provide information regarding the sources and uses of cash and the changes in the cash balance during the reporting period. The notes to the financial statements provide additional information essential to the full understanding of the Lottery's financial statements.

III. FINANCIAL HIGHLIGHTS

- The assets of the Lottery exceeded its liabilities as of September 30, 2008 by \$2,377,663 (net assets), which represents a \$1,064,163 increase in net assets from the previous fiscal year;
- The Lottery's cash balance as of September 30, 2008 decreased by \$1,947,476 from the previous year; and
- Total operating revenues, including activities from the traditional games and compensation from contractors, increased 1% or \$242,826.

IV. FUTURE EVENTS

The Lottery adopted an operating budget for the fiscal year ended September 30, 2009. The proposed budget reflects total revenue of \$23,091,740. This amount is composed of the traditional games, third party lottery games, and instant games. In addition, the 2009 budget reflects total expenses of \$21,435,752. This amount is composed of prize obligation, operating expenses and contribution to Education Initiative Funds and Pharmaceutical Assistance Program.

V. CONDENSED FINANCIAL INFORMATION

The following table presents condensed information about the net assets of the Lottery as of September 30, 2008 and 2007, and changes in the balances of selected items during the fiscal year ended September 30, 2008:

	<u>2008</u>	<u>2007</u>	<u>Variance</u>
Cash	\$ 1,859,287	\$ 3,806,763	\$(1,947,476)
Other Assets	8,747,036	4,506,879	4,240,157
Capital Assets, net	<u>540,604</u>	<u>508,708</u>	<u>31,896</u>
Total Assets	<u>11,146,927</u>	<u>8,822,350</u>	<u>2,324,577</u>
Current and Other Liabilities	7,891,190	6,724,432	1,166,758
Noncurrent Liabilities	<u>878,074</u>	<u>784,417</u>	<u>93,657</u>
Total Liabilities	<u>8,769,264</u>	<u>7,508,849</u>	<u>1,260,415</u>
Net Assets			
Invested in Capital Assets	540,604	508,708	31,896
Unrestricted (Deficit)	<u>1,837,059</u>	<u>804,793</u>	<u>1,032,266</u>
Total Net Assets (Deficit)	<u>\$ 2,377,663</u>	<u>\$ 1,313,501</u>	<u>\$1,064,162</u>

Assets increased by \$2,324,577 or 26% from September 30, 2007 to September 30, 2008 primarily due to an increase in cash receipts from the Lottery's contractors of \$1,114,060 and the reduction in required payments made to the Special Education Initiative Fund and the Pharmaceutical Assistance Program. The Lottery also invested \$4,200,306 in a certificate of deposit during the year.

Additionally, vehicles and computers were acquired which also contributed to the increase in assets by \$31,896 from the previous year. Of the Lottery's total assets, 81% represents cash and investment, 13% receivable from contractors, 1% consists of inventory, prepaid and other assets, and capital assets make up the remaining 5%.

The Lottery's total liabilities comprise of 51% obligations due to the Virgin Islands General Fund, 10% compensated absences and 27% funds due to the Education Initiative funds and Pharmaceutical programs. The remaining 12% represents accounts payables and other liabilities. Total liabilities increased by 17% mainly due to the Lottery's obligation to the Pharmaceutical Assistance Program and Education Initiative Fund increased by \$821,629 in FY 2008.

The following table presents statements of revenues, expenses and changes in net assets for the Lottery as of September 30, 2008 and 2007, and the change from the prior year:

	<u>2008</u>	<u>2007</u>	<u>Variance</u>
Operating Revenues:			
Traditional Games	\$ 8,337,859	\$ 8,579,743	\$ (241,884)
On-Line Games	11,044,997	10,560,868	484,129
License and Permit Fees	<u>13,399</u>	<u>12,818</u>	<u>581</u>
Total Operating Revenue	<u>19,396,255</u>	<u>19,153,429</u>	<u>242,826</u>
Operating Expenses			
Direct Costs	8,165,248	6,691,529	1,473,719
Salaries and Benefits	3,524,042	3,333,446	190,596
Advertising and Promotion	249,088	192,096	56,992
Professional Services	332,006	345,469	(13,463)
Donation and Scholarship	377,954	75,985	301,969
Other General and Administrative	1,114,750	875,604	239,146
Depreciation Expense	<u>152,761</u>	<u>104,636</u>	<u>48,125</u>
Total Operating Expenses	<u>13,915,849</u>	<u>11,618,765</u>	<u>2,297,084</u>
Operating Income	<u>5,480,406</u>	<u>7,534,664</u>	<u>(2,054,258)</u>
Non-operating Revenues			
Other Income	<u>267,808</u>	<u>428,459</u>	<u>(160,651)</u>
Total Non-operating Revenues	<u>267,808</u>	<u>428,459</u>	<u>(160,651)</u>
Net Income Before Funds Transfer	5,748,214	7,963,123	<u>(2,214,909)</u>
Funds Transfer	<u>(4,684,052)</u>	<u>(4,972,102)</u>	<u>(288,050)</u>
Changes in Net Assets (Deficit)	1,064,162	2,991,021	(1,926,859)
Net Assets (Deficit) Beginning of Year	<u>1,313,501</u>	<u>(1,677,520)</u>	<u>2,991,021</u>
Net Assets (Deficit) End of Year	<u>\$ 2,377,663</u>	<u>\$ 1,313,501</u>	<u>\$ 1,064,162</u>

Operating revenue increased by \$242,826 or 1% from September 30, 2007 to September 30, 2008 primarily due to the increase in compensation from contractors resulting from the establishment of entertainment centers.

Operating expenses increased by \$2,297,084 or 20% from September 30, 2007 to September 30, 2008 primarily due to increases in prize payments of \$1.4 million, salaries and benefits of \$190,596, and donations of \$301,969. Other general and administrative expenses increased by \$239,146 primarily due to increases in printing and office supplies.

Fund transfers decreased as the Lottery made reduced payments to the General Funds due to overpayments made in the prior year.

VI. CAPITAL ASSETS

The Lottery's capital assets as of September 30, 2008 are \$540,604 (net of accumulated depreciation). The capital assets added during the fiscal year included vehicles, computer equipment and other equipment. The Lottery disposed of three vehicles during the year.

	<u>2008</u>	<u>2007</u>
Furniture and Equipment	\$ 226,269	\$ 217,674
Vehicles	319,931	319,931
Computer Equipment	589,050	519,050
Drawing Machinery	363,221	363,221
Other Equipment	129,075	72,211
Security Equipment	<u>85,421</u>	<u>36,222</u>
	1,712,967	1,528,309
Less: Accumulated Depreciation	<u>(1,172,363)</u>	<u>(1,019,601)</u>
Net Capital Assets	<u>\$ 540,604</u>	<u>\$ 508,708</u>

VII. CONTACTING FINANCIAL MANAGEMENT

This management discussion and analysis is designed to provide a general overview of the Lottery's finances for all parties with an interest in the Lottery's finances. Questions concerning any of the information provided in this report or request for additional information should be addressed to:

Virgin Islands Lottery
 Barbel Plaza South, 8A Estate Ross,
 Charlotte Amalie, St. Thomas, VI 00802
 Telephone: (340)774-2502

BASIC FINANCIAL STATEMENTS

VIRGIN ISLANDS LOTTERY
STATEMENT OF NET ASSETS
AS OF SEPTEMBER 30, 2008
(With Comparative Totals for 2007)

	2008	2007
ASSETS		
Current Assets		
Cash	\$ 1,859,287	\$ 3,806,763
Accounts Receivables, net	1,010,169	1,354,497
Due from Treasury of Virgin Islands	439,110	29,750
Inventory	22,781	23,733
Investment - Certificate of Deposit	7,200,306	3,000,000
Prepaid and Other Assets	<u>74,670</u>	<u>98,899</u>
Total Current Assets	10,606,323	8,313,642
Capital Assets, net	<u>540,604</u>	<u>508,708</u>
Total Assets	<u>\$ 11,146,927</u>	<u>\$ 8,822,350</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Prize Payable	\$ 202,382	\$ 115,573
Accounts Payable	84,543	152,596
Accrued Liabilities	349,091	261,987
Deferred Revenue	188,255	115,483
Due to Pharmaceutical Assistance Program	874,795	566,684
Due to Educational Initiative Fund	1,457,992	944,474
Due to Treasury of Virgin Islands	4,468,304	4,468,304
Other Liabilities	<u>265,828</u>	<u>99,331</u>
Total Current Liabilities	7,891,190	6,724,432
Non-Current Liabilities		
Compensated Absences	<u>878,074</u>	<u>784,417</u>
Total Liabilities	<u>8,769,264</u>	<u>7,508,849</u>
Net Assets (Deficit)		
Invested in Capital Assets	540,604	508,708
Unrestricted (Deficit)	<u>1,837,059</u>	<u>804,793</u>
Total Net Assets (Deficit)	<u>\$ 2,377,663</u>	<u>\$ 1,313,501</u>

The accompanying notes are an integral part of these financial statements.

VIRGIN ISLANDS LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2008
(With Comparative Totals for 2007)

	<u>2008</u>	<u>2007</u>
Operating Revenues:		
Traditional Games	\$ 8,337,859	\$ 8,579,743
On-Line Games	11,044,997	10,560,868
License and Permit Fees	<u>13,399</u>	<u>12,818</u>
Total Operating Revenues	<u>19,396,255</u>	<u>19,153,429</u>
Operating Expenses		
Direct Costs:		
Prizes	8,137,548	6,677,079
Retailer Bonuses and Incentives	<u>27,700</u>	<u>14,450</u>
Total Direct Costs	8,165,248	6,691,529
Salaries and Benefits	3,524,042	3,333,446
Professional Services	332,006	345,469
Advertising and Promotion	249,088	192,096
Donation and Sponsorship	377,954	75,985
General and Administrative	1,114,750	875,604
Depreciation	<u>152,761</u>	<u>104,636</u>
Total Operating Expenses	<u>13,915,849</u>	<u>11,618,765</u>
Operating Income	<u>5,480,406</u>	<u>7,534,664</u>
Non-operating Revenues		
Interest Income	246,322	123,471
Other Income	<u>21,486</u>	<u>304,988</u>
Total Non-operating Revenue before Transfers	<u>267,808</u>	<u>428,459</u>
Net Income Before Transfers	<u>5,748,214</u>	<u>7,963,123</u>
Transfers: Special Educational Initiative Fund	(2,761,257)	(2,640,217)
Pharmaceutical Assistance Programs	(1,656,754)	(1,584,130)
General Fund	<u>(266,041)</u>	<u>(747,755)</u>
Total Transfers	<u>(4,684,052)</u>	<u>(4,972,102)</u>
Change In Net Assets	1,064,162	2,991,021
Net Assets (Deficit) Beginning of Year	<u>1,313,501</u>	<u>(1,677,520)</u>
Net Assets (Deficit) End of Year	<u>\$ 2,377,663</u>	<u>\$ 1,313,501</u>

The accompanying notes are an integral part of these financial statements.

VIRGIN ISLANDS LOTTERY
STATEMENT OF CASH FLOWS
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2008
(With Comparative Totals for 2007)

	2008	2007
Cash Flows from Operating Activities		
Cash Received from Sales of Tickets	\$ 8,351,258	\$ 8,592,561
Cash Received from Contractors	11,389,325	10,275,265
Cash Paid to Winners (prizes)	(8,078,439)	(6,619,166)
Cash Paid for Goods and Services	(1,790,297)	(1,231,575)
Cash Paid to Employee for Services	<u>(3,430,385)</u>	<u>(3,222,373)</u>
Net Cash Provided by Operating Activities	<u>6,441,462</u>	<u>7,794,712</u>
Cash Flows from Non-capital Financing Activities		
Cash Payments to Special Educational Initiative Fund	(2,247,739)	(1,928,197)
Cash Payments to Pharmaceutical Assistance Programs	(1,348,643)	(1,203,016)
Cash Payments to General Fund	(675,401)	(777,505)
Other Proceeds	<u>267,808</u>	<u>428,459</u>
Net Cash Used in Non-capital Financing Activities	<u>(4,003,975)</u>	<u>(3,480,259)</u>
Cash Flows from Capital Related Financing Activities		
Payment for Acquisition of Equipment	<u>(184,657)</u>	<u>(308,696)</u>
Net Cash Used in Capital and Related Financing Activities	<u>(184,657)</u>	<u>(308,696)</u>
Cash Flows from Investing Activities		
Investment - Certificate of Deposit	<u>(4,200,306)</u>	<u>(3,000,000)</u>
Net Cash Used in Investing Activities	<u>(4,200,306)</u>	<u>(3,000,000)</u>
Net Increase in Cash	(1,947,476)	1,005,757
Cash, Beginning of Year	<u>3,806,763</u>	<u>2,801,006</u>
Cash, End of Year	<u>\$ 1,859,287</u>	<u>\$ 3,806,763</u>
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating Income	\$ 5,480,406	\$ 7,534,664
Adjustments to Reconcile Excess of Expenses Over Revenues to Net Cash Used in Operating Activities		
Depreciation	152,761	104,636
Changes in Assets and Liabilities:		
(Increase) Decrease in Accounts Receivable	344,328	(285,603)
Decrease in Inventory	952	698
Decrease (Increase) in Prepaid and Other Assets	24,229	3,683
Increase (Decrease) in Prize Payable	86,809	72,363
Increase (Decrease) in Accounts Payable	(68,053)	105,606
Increase (Decrease) in Other Liabilities	166,497	26,741
Increase (Decrease) in Accrued Liabilities	87,104	122,300
(Decrease) in Deferred Revenue	72,772	(1,449)
Increase in Compensated Absences	<u>93,657</u>	<u>111,073</u>
Net Cash Used in Operating Activities	<u>\$ 6,441,462</u>	<u>\$ 7,794,712</u>

The accompanying notes are an integral part of these financial statements.

VIRGIN ISLANDS LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED SEPTEMBER 30, 2008

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. **ORGANIZATION:** The Virgin Islands Lottery (the "Lottery"), was created by statute in 1937 and established as an independent agency of the Government of the Virgin Islands in 1971. The Lottery operates a traditional biweekly lottery and earns a percentage of gross revenue as compensation from Caribbean Lottery Services and a percentage of net revenue from Southland Gaming. The Lottery also derives revenue from the licensing of agents and dealers.
- B. **REPORTING ENTITY:** The Lottery has adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 14, The Financial Reporting Entity, under which the financial statements include all the organizations, activities, function and component units for which the Lottery is financially accountable. Financial accountability is defined as the appointment of a voting majority of the component unit's board, and either (1) the Lottery's ability to impose its will over the component unit, or (2) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the Lottery.

The Lottery has determined that no outside agency meets the above criteria and, therefore, no other agency has been included as a component unit in the Lottery's financial statements. The Lottery is an enterprise fund of the United States Virgin Islands and as such, its financial statements are included in the U.S. Virgin Islands Comprehensive Annual Financial Report.

- C. **BASIS OF PRESENTATION:** The Lottery is accounted for as an enterprise fund of the governmental propriety fund type and its financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Lottery follows the accrual basis of accounting wherein revenues are recognized when earned and expenses when incurred. The Lottery has elected to apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless the pronouncements conflict with or contradict GASB pronouncements. The Lottery has further elected to not apply FASB pronouncements issued after November 30, 1989, in accordance with GASB Statement No. 20.

As an enterprise fund, the Lottery distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the Lottery's principal ongoing operations. Operating expenses include the cost of sales and services, selling and administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

- D. **GAMES AND PRIZES:** The Lottery's main sources of income are from traditional games, on-line games, instant games, and pull tabs. The traditional games comprise of 22 regular games and two extraordinary games. On-line games have two major components: 1) Pairs, Daily Pick 3, Daily Pick 4, Lucky 6, Keno, and Power Ball which are all managed by Caribbean Lottery Services, Inc. through a contractual agreement with Virgin Islands Lottery; and 2) On-Line Gaming, a game that is managed by Southland Gaming of the Virgin Islands through a contractual agreement with the Virgin Islands Lottery.

The Lottery's primary obligations are in the form of prize payouts for its traditional, instant and pull-tab games. The prize liability is recorded at the time of the drawing based on the known prize payout structure.

- E. **CASH:** Cash consists of cash on hand held by depository institutions in the Lottery's name.
- F. **REVENUE AND ACCOUNTS RECEIVABLE RECOGNITION:** Revenue and accounts receivable for the traditional lottery is recognized when tickets are sold to the public. Revenue from the Lottery's contractors is recognized when sales reports are received.
- G. **ACCOUNTS RECEIVABLE:** This amount consists of receivables due from contractors, employees and cashiers. The employee and cashier receivables represent returned checks and cash shortages from the cashier's daily transactions.
- H. **ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS:** The Lottery uses the allowance method to account for uncollectible accounts receivables.
- I. **PREPAID AND OTHER CURRENT ASSETS:** Prepaid and other current assets are consists of certain payments to vendors, which reflect costs applicable to future accounting periods.
- J. **INVENTORY:** Inventories for ticket stock are stated at the lower of cost (determined by first-in, first out method) or market.
- K. **CAPITAL ASSETS:** Capital assets are carried at cost less accumulated depreciation. The Lottery defines capital assets as those with an initial, individual cost of more than \$500. Depreciation is computed using the straight-line method over estimated lives. When assets are retired or otherwise dispose of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in operations in the period of disposal.

The estimated useful lives by asset classification are as follows:

Furniture	10 years
Equipment	5 years
Vehicles	5 years

- L. **PRIZE EXPENSE/PAYABLE:** Expenses are recognized based on a predetermined price structure. Prize payable represents prizes unclaimed at the end of the fiscal year by winners.
- M. **UNCLAIMED PRIZES:** Prizes must be claimed within 180 days after the drawing date for the games. Prizes unclaimed for six months after the drawing date are forfeited by the ticket holder. Total prizes lapsed amounted to \$392,218 for the fiscal year 2007. These forfeited prizes are netted against prize expense in the Statement of Revenues, Expenses and Changes in Net Assets.
- N. **ACCOUNTS PAYABLE:** Accounts payable represents the liability for the value of assets or services received at the balance sheet date for which payment is pending
- O. **ACCRUED LIABILITIES:** Accrued liabilities represent the liability for the salaries earned by employees, and the related payroll costs at the balance sheet date for which payment is pending.
- P. **DEFERRED REVENUE:** Revenues from the sale of tickets for future drawings are deferred until the drawings are held.

- Q. ***DUE TO TREASURY OF VIRGIN ISLANDS:*** This represents the funds that are required to be transferred to the General Fund of the Treasury of the Virgin Islands at the balance sheet date for which transfers are pending.
- R. ***DUE FROM TREASURY OF VIRGIN ISLANDS:*** This represents overpayments made to the General Fund of the Treasury of the Virgin Islands at the balance sheet date.
- S. ***DUE TO EDUCATION AND PHARMACEUTICAL FUNDS:*** This represents the funds that are required to be transferred at the balance sheet date for which transfers are pending.
- T. ***COMPENSATED ABSENCES:*** The compensated absences balance represents the liability that becomes "due" upon the occurrence of relevant events such as transfer to other government department, resignation, retirements, and use of leave balances by covered employees. Liabilities are reported separately as either current or non-current in the Statement of Net Assets.
- U. ***NET ASSETS:*** The Lottery's net assets are classified as follows:
- Invested in Capital Assets – this represents the Lottery's total investment in capital assets net of debt.
 - Unrestricted Net Assets – assets are unrestricted when their use is not subject to external limits such as legal agreements or statutes.
- V. ***USE OF ESTIMATES:*** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.
- V. ***ADVERTISING COSTS:*** Advertising and promotion costs are expended as incurred.

NOTE 2 CUSTODIAL CREDIT RISK

The custodial credit risk for deposits is the risk that in the event of a bank failure, the Lottery's deposits may not be recovered. Cash consists of cash on hand held by various depository institutions in the Lottery's name. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$100,000. Of the cash balance stated, \$8,918,159 was exposed to custodial credit risk as uninsured and uncollateralized as of September 30, 2008.

NOTE 3 ACCOUNTS RECEIVABLE

Accounts receivable at September 30, 2008 consisted of the following:

Dealers and Contractors	\$ 942,099
Interest Receivable	67,929
Cashiers	413,634
Employees	<u>349,224</u>
	1,772,886
Allowance for Doubtful Accounts	<u>(762,717)</u>
Accounts Receivable, Net	<u>\$ 1,010,169</u>

NOTE 4 CAPITAL ASSETS

Capital assets activity for the year ended September 30, 2008 is as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Furniture and Equipment	\$ 1,208,378	\$ 184,657	\$ -	\$ 1,393,035
Vehicles	<u>319,931</u>	<u>-</u>	<u>-</u>	<u>319,931</u>
Total Assets being depreciated	<u>1,528,309</u>	<u>184,657</u>	<u>-</u>	<u>1,712,966</u>
Less Accumulated Depreciation for:				
Furniture and Equipment	922,812	96,921	-	1,019,733
Vehicles	<u>96,789</u>	<u>55,840</u>	<u>-</u>	<u>152,629</u>
Total Accumulated Depreciation	<u>1,019,601</u>	<u>152,761</u>	<u>-</u>	<u>1,172,362</u>
Net Capital Assets	<u>\$ 508,708</u>	<u>\$ 31,896</u>	<u>\$ -</u>	<u>\$ 540,604</u>

The related depreciation for the year ended September 30, 2008 totaled \$152,761.

NOTE 5 ALLOWANCES FOR UNCOLLECTIBLES

The receivables from employees and cashiers at September 30, 2008 totaled \$413,634 and \$349,224, respectively. These receivable are 99.99 % reserved as of September 30, 2008. There is no uncollectible amount charged to general expense for the fiscal year ended September 30, 2008.

NOTE 6 DUE TO THE VIRGIN ISLANDS GOVERNMENT

The Virgin Islands Code requires the Lottery to transfer a minimum of 20% of the Lottery's net income to the General Fund of the Virgin Islands Treasury. The regulations also requires that 25% and 15% of the proceeds derived from the games under each contract between the Virgin Islands Lottery and private

contractors of lottery games be transferred to the Virgin Islands Educational Initiative Fund and the Pharmaceutical Assistance to the Aged Program, respectively. Mandatory funds transfer due at September 30, 2008 is as follows:

Due to Education Initiative Funds	\$ 874,795
Due to Pharmaceutical Assistance Program	1,457,992
Due to Treasury of Virgin Islands – General Fund	<u>4,468,304</u>
Total	<u>\$6,801,091</u>

NOTE 7 NONCURRENT LIABILITIES

Non-current liability activities represent compensated absence for the year ended September 30, 2008. The balance as of September 30, 2008 was \$878,074. A net increases of \$93,657 from prior year.

NOTE 8 RISK MANAGEMENT

The Lottery faces various risks of loss related to torts; theft of, damages to and destruction of assets; and natural disasters for which the Lottery has commercial insurance coverage. Annual premiums payments are made in proportion to the anticipated exposure to the liability losses assessed.

NOTE 9 LEASES

The Lottery leases its offices, facilities and storage spaces; lease expense incurred during fiscal year 2008 amounted to \$230,065. The aggregate lease commitment for the Lottery is as follows as of September 30, 2008:

<u>Fiscal Year</u>	<u>Operating Lease</u>
2009	\$140,340

NOTE 10 CONTRACTUAL ARRANGEMENTS

Except for the traditional lottery and pull tab games, all other lottery games are supported by the services of two contractors: Caribbean Lottery Services, Inc. (CLS) and Southland Gaming of the Virgin Islands, Inc. (Southland Gaming).

Video lottery games are serviced by Southland Gaming. Southland Gaming is responsible for the design, installation and operation of a video lottery control system that includes maintaining video lottery terminals and other related equipment. The contract is in effect for five years (effective July 29, 2003) and has two additional five year renewal periods. Southland Gaming allocates a percentage of the weekly net game revenues to the Lottery.

Caribbean Lottery Services, Inc. provides services and equipment to operate lottery games that include Caribbean Lotto, Caribbean Keno, Hot 5 Cash Lotto, Lucky 6, Daily Numbers (Pairs, Pick 3 and Pick 4),

Instant Scratch Ticket and Powerball. Under the terms of the contract, the Lottery receives an allocation of gross revenues.

The Lottery is a member of Multi-State Lottery Association (MUSL), a group of states and district lotteries that operates the on-line Powerball game. CLS is responsible for administering the Powerball game on behalf of the Lottery.

NOTE 11 CONTINGENCIES

The Lottery is subject to various claims and legal proceedings that arise in the ordinary course of its business activities. These cases are pending arbitration or hearing and management is not able to make an estimate of the amount of loss, if any, that could result from an unfavorable resolution of these matters.

On June 22, 2009, the Virgin Islands Government (the Government) on behalf of the Lottery filed a lawsuit against the video gaming contractor Southland Gaming of the Virgin Islands (SGVI) for monies the Government states is due to the Lottery. The dispute relates to the interpretation of its contract concerning the computation of the fees earned by SGVI and the revenues remitted to the Lottery. Since the inception of the contract, SGVI has computed net proceeds to the Lottery by reducing its fees and payments made to the gaming retailers. However, the Lottery's position regarding this matter is that payments to the retailers should be borne by SGVI and not the Lottery. On July 13, 2009, SGVI filed a motion to dismiss the suit. The outcome of this litigation cannot be predicted at this time and no recovery amount has been recorded.

NOTE 12 PENSION PLAN

The Government Employees Retirement System of the Virgin Islands ("GERS") is a cost sharing, multiple employer public employee retirement system, established by the Government of the Virgin Islands to provide retirement, death and disability benefits to its employees. The Lottery's part-time employees who regularly work more than 50% of the normal work period, and full-time regular employees who at the time of employment are under age 55 years with one year of government services are eligible to participate in the system. The Lottery's required contribution for the fiscal years ended September 30, 2008, 2007 and 2006 was 17.5%, 14.5% and 14.5% of the member's annual salary, respectively. Member contributions were 8% of annual salary for each of the fiscal years 2007, 2006 and 2005. The Lottery's contributions to the retirement plan were \$343,648, \$291,207 and \$196,018 in fiscal years 2008, 2007 and 2006, respectively.

Plan descriptions, funding policies, and a schedule of employee contributions required and paid for defined benefit plans are presented in the Virgin Islands Comprehensive Annual Financial Report (CAFR) for the fiscal year ended September 30, 2008. The CAFR also provides detailed historical trend information showing the progress in accumulating sufficient assets to pay benefits when due. In addition, GERS issues a publicly available report that includes financial statements and required supplementary information. That report may be obtained by writing to Employees Retirement System of the Government of the Virgin Islands, GERS Complex, Veterans Drive, St. Thomas, V.I. 00802.

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

Board of Commissioners
Virgin Islands Lottery
St. Thomas, U.S. Virgin Islands

We have audited the financial statements of the Virgin Islands Lottery (the Lottery) as of and for the year ended September 30, 2008, and have issued our report thereon dated November 13, 2009. 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 Lottery's internal control over financial reporting as a basis for designing 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 the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the 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. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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 or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity'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 entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiencies described in the accompanying schedule of findings to be significant deficiencies in internal control over financial reporting: 2008-1 through 2008-4.

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 statements will not be prevented or detected by the entity's internal control.

Our consideration of the 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 the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 2008-1, 2008-2 and 2008-3 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether The Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings as item 2008-6, *Failure to Transfer Funds in Accordance with Virgin Island Code*.

This report is intended solely for the information and use of management, the Board of Commissioners, and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

November 13, 2009

**VIRGIN ISLANDS LOTTERY
FY 2008 FINDINGS AND RECOMMENDATIONS**

2008-1 Financial Reporting (Material Weakness)

Certain risks are inherent in all operating environments; however most can be mitigated with an appropriate system of internal controls. Best organizational practices include establishing and maintaining an environment that supports compliance; identifying risks and designing control activities to manage those risks; documenting and implementing policies and procedures to ensure complete and accurate reporting; establishing processes to ensure relevant and reliable information is recorded and communicated throughout the organization; and monitoring activities to assess the quality of performance over time.

Effective internal controls provide the level of integrity, accuracy, reliability and timeliness of information. Accurate and timely information will enable management to identify and respond to significant issues such as revenue shortfalls and expenditures in excess of budget. In addition, it is also essential that the financial management system in place is adequate to accommodate the level of detail and tracking of transactions necessary to prepare financial reports required by management.

Consistent with prior years, improperly designed controls and/or ineffective implementation of those controls led to material weaknesses over the Lottery's operations in the following functional areas:

- Financial Reporting
- Internal Control System (See 2008-2)

These observations and their impacts are detailed below:

- ***Year end accruals not recorded.*** The Lottery recorded its transactions on a cash basis during the year and failed to record the appropriate year end accruals to bring its financial records into conformity with the U.S. generally accepted accounting principles.
- ***Lack of monitoring of transactions posted to the general ledger to ensure propriety and completeness, specifically:***
 1. Improperly posted transactions were noted during the period, including insurance premium payments (automobile, flood and regular insurance) related to the subsequent fiscal year not captured as prepaid expenses, but rather expensed; revenues related to future drawings neither recorded nor reported as deferred revenues; and workers' compensation premiums were erroneously recorded against the compensated absences liability account instead of as an expense.
 2. The Lottery performed bank reconciliations for five (5) out of its eleven (11) bank accounts. However, it failed to record the \$9M in reconciling items noted during the year until prompted by the auditors during fieldwork. Also noted were cashiers who incurred cash shortages, but accounting failed to record a receivable for the shortage. Employee receivables associated with those cash shortages have not been processed since 2001. There were no reporting controls to ensure that the various

account balances were complete and accurate, which resulted in inaccurately reported financial statements.

3. The Lottery failed to record several cash receipt transactions for which the deposit slips were found discarded in one of its offices. These transactions were approximately \$41,000.
- ***Intensive Manual Processes.*** The Lottery utilized an unlicensed financial management system (Great Plains) and a payroll system (Legacy) independent of the main financial reporting software as the payroll module of Great Plains was never installed. Manual journal entries are therefore needed to capture the payroll transactions within Great Plains. We noted numerous erroneous general ledger postings which resulted in inaccurate and incomplete financial data being reported.
 - ***Inadequately Trained Financial Staff and Lack of Segregation of Duties.*** We have concluded that some of the financial staff do not have the requisite accounting background and have not been adequately trained to competently perform their accounting functions. The financial staff was unable to roll-forward its prior year's balances within the accounting software therefore limiting the Lottery's reporting abilities to current year balances. There appeared to be a lack of understanding of key accounting concepts/transactions. The accounting department continued to have unfilled positions and as a result of the inadequate staffing levels, we noted that certain custodial functions and recording functions were not segregated.
 - ***Inadequate Financial Management Procedures over Accounts Receivables.*** The accounting staff did not perform analyses to determine the net realizable value of its accounts receivables. In addition, there: 1) was a failure to credit the appropriate accounts receivable balances upon the receipt of payments; 2) were no procedures in place to write-off uncollectible receivable accounts; and 3) collection efforts were not effectively pursued. As a result of the occurrences noted, the financial reports were not properly stated nor presented. Finally, the reports from the Lottery's two contractors who are responsible for administering the games were not analyzed by the Lottery to determine the accuracy of the earnings reported.
 - ***Failure to Capitalize Fixed Assets.*** The Lottery has no formal asset capitalization policy in effect. There were several instances in which fixed asset purchases were expensed rather than capitalized, with the expense amount reduced for trade in values. Failure to capitalize fixed asset acquisitions distorts the interim financial statements and understates the Lottery's assets.
 - ***Improper Capitalization of Prize.*** The Lottery capitalized the vehicle purchased as a prize giveaway for an extraordinary drawing rather than expense it.
 - ***Failure to Establish Required Accounts and Perform Reconciliations.*** The Lottery failed to establish an escrow account for past due receivables, although there is an amended professional service contract in place requiring such escrow account for remission of past due receivables. Additionally, the Lottery did not prepare bank reconciliations for six of its eleven bank accounts for the entire fiscal year. Failure to perform routine monitoring of cash accounts and establish escrow account diminishes the Lottery's likelihood of receiving payments on those outstanding receivables and timely detecting fraudulent activity.

Recommendations: Critical to the viability of any operating structure is the ability to provide accurate, timely and reliable financial reports and analyses that management can use to make effective and informed decisions. While we understand that the Lottery is performing a comprehensive review of its financial management and reporting structure, we again recommend that it make improvements to its operations by:

- Modifying the financial reporting process to ensure that transactions are accurately recorded. Monthly financial reporting should also be established and proper cut-off should be adhered to. This should require posting of month end accruals to properly reflect substantive transactions.
- Requiring supervisory reviews be conducted to minimize omissions and improper postings. This essential internal control function will greatly improve the accuracy of the Lottery's financial reports and reduce the year-end audit adjustments.
- Ensuring the timely and accurate performance of bank reconciliations. Reconciling items should be promptly investigated and a supervisory level review and sign-off should be required.
- Enforcing its existing policy regarding frequent cashier shortages and should consider bonding all employees who directly handle cash. The Lottery needs to assess the net realizable value of all receivables balances on its books and should seek Board approval to write off those balances that are deemed uncollectible.
- Implementing procedures that will ensure that outstanding contractor receivables are timely reconciled and that monthly revenue reconciliations are performed for its third party contractors.
- Establishing effective written policies and procedures over financial operations.
- Establishing and implementing a capitalization policy which would designate expenditures for a single item over a certain dollar value, possibly \$1,000, as capital expenditures to be recorded as depreciable fixed assets.
- Assessing the adequacy of current staffing levels and the hiring of competent personnel with backgrounds in accounting. The Lottery should perform an assessment of its accounting department to determine the staffing levels that is required to achieve effective and efficient financial operations which also satisfy adequate segregation of duties.
- Developing of training programs that include cross-training of staff in order to minimize the disruption of operation should a staff be absent or permanently separated from the Lottery.
- Establishing a procedural accounting manual in order to provide appropriate guidance and to ensure uniformity of routine accounting tasks.
- Performing supervisory reviews of all journal entries prior to posting into the general ledger to ensure accuracy and completeness of information.

- Obtaining and installing a licensed financial management system. Adequate training must be received by the Lottery's staff to ensure that all modules are utilized efficiently and effectively.

2008-2

Internal Control System (*Material Weakness*)

Internal controls help to safeguard an organization's assets, prevent irregularity and fraud, as well as promote operational efficiency and encourage adherence to management policies and procedures. One of the conditions that give rise to fraud risk is opportunity and the deficiencies in the Lottery's control system give rise to ample opportunity in several areas.

These deficiencies and their impacts are detailed below:

- ***Inadequate Maintenance of Supporting Documentation.*** The Lottery was unable to provide the support for a significant number of journal entries. We also noted that the underlying records for several account balances did not support the general ledger balances of those accounts. Specifically:
 1. There is currently no second review and sign off when payroll information is updated. For 7 out of 25 samples selected for testwork over payroll controls, the employees' timecards were not signed off by their supervisor. In 1 out of 25 samples selected, the employee was paid for 80 regular hours although the timecard indicated 72 regular and 8 sick hours. In 1 out of 25 samples selected, the timesheet to support the hours paid could not be provided. The Lottery did not maintain W-4s on file for 10 out of the 25 sampled employees.
 2. Supporting documentation for journal entries used to post substantial amounts into the general ledger could not be located. In 2 out of the 25 cash disbursement samples tested, the Lottery did not maintain proper documentation to support the transactions. In 2 out of 25 samples selected only one signature was noted on the check instead of the two signatures required.
 3. During our testwork of expenses and search for unrecorded liabilities, the Lottery was unable to provide supporting documents for 6 of the samples selected in both areas.
- ***Irregular Prize Payments.*** It was noted that certain sites had unusually high payout rates which in some instances averaged 78 to 80 percent of the bets placed. The Lottery acknowledged that situations exist in which machine prize payouts exceed collections and asserts that it has entered into a contract to perform machine testing, to ensure the equipment meets industry standards and best practices. In the prior year, the contractor conducted site visits and reported that all the machines had been tested. Based on its review, the contractor recommended an increase in personnel and training, however, the review did not address the integrity of the machines.
- ***Improper Maintenance of Fixed Assets Inventory.*** The Lottery did not maintain a schedule or database of its assets. The maintenance of a proper fixed asset database

and the regular performance of physical inventories are essential in safeguarding the Lottery's fixed assets from theft. Additionally noted, the Lottery failed to remove from the inventory balance the scratch game tickets that were sold during the fiscal year. Inventory of ticket stock must be performed at year end at all Lottery sites that maintain ticket stock in order to accurately report inventory.

- ***Inadequate Controls over Purchasing and Disbursement Transactions.*** The Lottery's policy and procedures require the issuance of approved purchase orders before expenditures are incurred. The Lottery did not adhere to its policy, such that goods and services were received before purchase orders were prepared and authorized. We noted several instances where the accounting staff prepared purchase orders after the invoices were received. We also noted that the lease agreement for the Frederiksted office space was never executed, although the Lottery has continued to occupy the space and make payments to the landlord. The lack of internal controls over purchasing and disbursements increase the risk of duplicate and improper payments being made to vendors.
- ***Failure to Assess Reliance of Automated Gaming System Contractor's Internal Controls.*** The Lottery is responsible for monitoring and performing quality control to ensure that its on-line gaming contractor adequately performs the services in accordance with the terms of its contract. However, we noted that the Lottery did not require an independent audit (SAS 70 Type II audit - *Report on Controls Placed in Operations and Tests of Operating Effectiveness of Internal Controls*) of its automated gaming system operated by its gaming contractor. The Lottery relied exclusively on information provided by its contractor in determining the revenues for the on-line games without evidence of the reliability of the design and operating effectiveness of the contractor's internal controls over its gaming systems.
- ***Inadequate and Ineffective Controls over Ticket Sales.*** Specifically:
 1. Inefficient validation process: There is no system in place for the automatic determination of amounts paid out for winning tickets. Reliance is placed on the cashier and validated by internal auditors; however, due to the labor-intensive process for validating the payouts, reviews occur approximately one month later, which results in the untimely detection of over and under-payments.
 2. Inadequate reviews of daily cash collection reports: The daily cash report is required to be certified by a supervisor or an assistant supervisor and then reviewed and recertified by the internal auditor. In a test sample of 25 daily cash receipts, we noted 7 instances in which the cash receipt lacked a supervisory approval. The recertification procedure was performed by the internal auditor, however this procedure was done approximately one month after the daily cash report was completed. This resulted in errors including shortages, going undetected for an extended period of time. During our cash receipts internal control testwork, we noted 1 instance where the auditor's recertification process was not evident.

Recommendations: The Lottery should establish and implement formal policies and procedures to address the risk of errors going undetected during daily operations. We recommend the Lottery improve its internal control environment by the following:

- Prepare an assessment that includes all of the areas susceptible to fraud, and then design/enhance a process to address those risks.
- Revise and incorporate policies and procedures to address the reconciliation process, review and approval processes and monitoring of third party contracts and gaming equipment
- Ensure all accounting records are properly maintained and filed to facilitate timely and accessible retrieval.
- Perform an inventory of its current fixed assets to determine the assets that are in its possession. All fixed assets in existence should be tagged. Procedures should be established and implemented to ensure that a comprehensive fixed assets database is adequately maintained and includes the following essential information: asset acquisition date, asset acquisition cost, category type (such as computer, furniture, etc.), the location of the asset, the condition of the asset, the useful life, and the computation of the depreciation expense in accordance with Lottery's policy. Any disposed or retired assets should include the date of disposal, sales price and method used to determine the current fair market value. The policy should also require that the Lottery perform regular inventory and assessments for potential impairments of the fixed assets on an annual basis.
- Establish policies and procedures that require year-end inventory of ticket stock at all Lottery sites that maintain ticket stock.
- Enforce its established policies and procedures pertaining to the authorization and payment of expenses.
- Perform regular reviews of the automated gaming system, as well as reviews of certain game software to help maintain the integrity of the Lottery's on-line gaming. Additionally, current controls in place should be assessed for adequacy to ensure that the gaming equipment is regularly monitored for malfunctioning due to heat, obsolescence and or tampering.
- Amend its contract with its on-line gaming vendor to require that the contractor provide annual reports on the effectiveness of its internal controls. Annual independent audits of the automated gaming system, as well as reviews of gaming software are necessary to help maintain the integrity of the on-line games.
- Assess whether the validation process for winning payouts can be automated.
- Require supervisory reviews be conducted to minimize omissions and improper postings. The internal audit of the cash sheets should be done more timely to detect errors and to initiate the collection of employee accounts receivable.

Inadequate Controls over the Traditional Game (Material Weakness)

During fiscal year 2009, the Lottery reported that unsold winning tickets were stolen from St. Thomas and subsequently claimed for payment in St. Croix. In order to determine whether the occurrence was an isolated or pervasive one, we performed a review of four lottery drawings (three regular and one extraordinary) in fiscal year 2008. Our findings revealed several issues with material consequences:

1. **Inadequate Traditional Game Processes:** The Lottery lacks the processes required to maintain the integrity of its traditional game.
 - There is no system in place to identify the ticket numbers sold during a particular drawing. Ticket sales are documented on ticket sales order forms, these forms are stored away and not used.
 - There is no methodology in place to determine the validity of the tickets presented for prize payment. The Lottery pays out on winning tickets as long as the number is reflected on the winning scheme. They have no process in place to link the ticket to a dealer sale to ensure the ticket's validity.
 - There is no methodology in place to determine the completeness of the unsold tickets manually logged by the drawing board. The unsold tickets presented to the board for counting is taken at face value as being complete. However, the current process in place to account for unsold tickets allows for the opportunity of fraud, as there are still unsold tickets in the sales office at the time of the drawing. Therefore, the possibility exists that an unsold winning ticket can be removed before the unsold tickets are turned into the main office and subsequently turned in for prize payment.
 - The traditional game is a labor intensive process; the ticket numbers purchased by dealers are manually recorded on the ticket sales orders. We noted illegible ticket entries and could not determine the numbers sold. We also noted that the sales clerks and the cashiers do not in most cases include their names on the ticket sales order as required.
 - The methodology used by the Lottery to maintain the documents related to the traditional drawing does not allow for easy and complete retrieval. During the course of our testwork, we were provided with four boxes, which were identified as the ticket sales for the four drawings we selected. Our review revealed that ticket sales orders from previous and subsequent drawings were sometimes erroneously included in our test boxes. The same was noted in the case of the prize payment boxes, which although labeled per drawing, contained prize payments from multiple drawings.
2. **Duplicated Lottery Tickets:** We noted that the Lottery does not adequately review its printed lottery tickets to ensure duplicate tickets are not issued. We found several instances that indicate the sale of duplicated tickets, which in turn would result in the Lottery making duplicated prize payments.

- In 64 instances a single ticket number was documented on two separate ticket sales orders as being sold for a single drawing.
 - In 3 instances a single ticket number appeared twice on the same ticket sales order.
 - In 4 instances, although there was documentation of the sale of the winning ticket numbers, unsold winning tickets were found for the same.
3. **Inadequate Review by the Internal Auditors:** We noted that the audit of the lottery ticket sales is poorly performed. In all instances the ticket sales orders showed evidence of a review by the internal auditor, which is denoted by a division stamp, date and signature of the auditor. However,
- In 2 instances the ticket number was not documented on the ticket sales order making it impossible to determine the ticket sold.
 - In 2 instances the dealer's ticket listing was not attached to the ticket sales order; we were however able to obtain a copy of the listing from storage in order to complete our review.
 - In 3 instances the number of tickets documented on the ticket sales order differed from the number of tickets reported as the total sold on both the ticket sales order and the cashier's receipt.
 - In 1 instance the dealer name and number on the ticket sales order differed from the dealer name and number on the cashier's receipt.
4. **Assignment of Dealer Numbers:** During the course of our review, we noted 7 instances in which the dealer making the purchase was assigned an incorrect dealer number on the ticket sales order. This can result in inaccurately sales information being reported to the Internal Revenue Bureau (IRB) at the end of the year. We also noted that dealers are allowed to switch their assigned number between family members (husband/wife, mother/daughter etc.) during the annual renewal process when one party is unable to obtain an IRB tax clearance letter in order to avoid paying taxes due the IRB.
5. **Missing Unsold Winning Tickets:** Our review revealed several unsold winning tickets that were unaccounted for.

	Draw 684	Draw 693	Draw 702	Draw Ex-55
# of tickets	34	35	54	480*
Worth	\$ 4,220	\$ 3,230	\$ 11,650	\$ 50,990

* The box of ticket sales for the Ex-55 drawing provided by the Lottery did not contain all ticket sales orders. We tallied 14,990 ticket numbers while the ticket sales reports indicate that 18,471 tickets were sold for the drawing. We therefore did not have a complete population of ticket sales from which to

perform our analysis. The number of tickets reported as unsold winning tickets for drawing Ex-55 may therefore be overstated.

6. **Prizes Erroneously Assigned:** During our review of the unsold prize listings we noted several instances where non-winning numbers had been erroneously assigned a prize and was signed off on by the drawing board. This will understate the Lottery's liability with regard to prize payments during the year.
7. **Unsecured Unsold Tickets:** Upon the return of the unsold tickets to the main office, the tickets are laid out on tables in the audit area until they are distributed to the sorting staff for cancellation. This method increases the likelihood of fraud, as the tickets are accessible to any staff member with access to the building including janitorial staff.

Recommendation: The Lottery should explore the possibility of suspending the traditional game until such time that a point of sale system can be installed, and policies and procedures put in place that would eliminate the majority of its deficiencies by mitigating the possibility of intentional and unintentional errors. In the interim, the following procedures will help maintain the games' integrity:

- Care must be taken by the sales clerks to ensure that the ticket numbers are written clearly and that dealers are assigned the appropriate dealer number. The sales clerks and cashiers must also print their names in the required section of the ticket sales order.
- Tickets sold must be recorded into a database like Microsoft Excel on a daily basis. The documentation must include the receipt number, the ticket number, the dealer number and the dealer name. This database can be stored on a shared drive as a ready-only document and used for multiple purposes including (i) the validation of tickets submitted for prize payments by ensuring the ticket number was sold to a dealer, (ii) ensuring the completeness of the unsold tickets logged by the drawing board and (iii) identifying duplicated tickets
- Unsold tickets must be removed from the sales offices to the main office and secured once the unsold tickets are tallied up to prevent them from being accessible during the drawing.
- The process in place to vet the lottery tickets prior to distribution to ensure duplications are removed needs to be reviewed to determine the cause of duplicate tickets being sold.
- Care must be taken during the audit of the ticket sales orders to ensure that the number of tickets listed is consistent with the total number of tickets reported and to the amount of funds collected.
- The Lottery must have processes in place to ensure that it does not aid its dealers in their attempts to evade taxes.
- Unsold lottery tickets must be secured after delivery to the main office until the tickets are ready to be cancelled.

- Care must be exercised to ensure that documentation is maintained in a manner that would allow for completeness and easy retrieval.

2008-4 Unresolved Significant Transfers Due to the State (*Significant Deficiency*)

The Virgin Islands Code requires the Lottery to make mandatory transfers to the Treasury of the Virgin Islands. The Lottery reported on its books a Due to Treasury of the Virgin Islands in the amount of \$4,468,306 for outstanding transfers for the fiscal years prior to 2004. No transfers were made during the year for the obligations prior to 2004.

Recommendation: The Lottery should reconcile with the central government the outstanding liability due for the fiscal years prior to 2004.

2008-5 Excessive Number of Signatories to the Lottery's Operating Account (*Significant Deficiency*)

As a result of our audit we found that there were nine authorized signatories at any one point in time on Lottery's bank accounts. While this practice allows for the assurance of availability of the two signers required for the dual signature policy, it poses a significant internal control risk over cash.

Recommendation: We suggest that the following practices be adopted to strengthen Lottery's control:

- Establish a threshold above which dual signatures are required.
- Limit the number of authorized check signers to two or three signatories.

2008-6 Failure to Transfer Funds in Accordance with Virgin Islands Code (*Significant Deficiency*)

The Virgin Islands Code requires the Lottery to transfer a minimum of 20% of its net income to the General Fund of the Virgin Islands Treasury. The regulations also requires that 25% and 15% of the proceeds derived from the games under each contract between the Virgin Islands Lottery and private contractors of lottery games be transferred to the Virgin Islands Educational Initiative Fund and the Pharmaceutical Assistance to the Aged Program, respectively.

During FY08, the Lottery failed to transfer the all required funds to the Educational Initiative Fund and the Pharmaceutical Assistance to the Aged Program resulting in a liability at year-end of \$1,457,992 and \$874,795, respectively. The Lottery also made excessive payments to the General Fund of \$439,110 as it erroneously calculated its monthly net income amounts.

Recommendation: The Lottery needs to take steps to ensure the propriety of its calculation of net income on a monthly basis and ensure that it remits to the various funds and programs the required amounts.

**VIRGIN ISLANDS LOTTERY
STATUS OF PRIOR YEAR AUDIT FINDINGS**

PRIOR YEAR	FINDING	STATUS
2007-1	Financial Reporting (Material Weakness) <ul style="list-style-type: none"> • Inadequately Trained Financial Staff and Lack of Segregation of Duties • Year End Accruals Not Recorded • Significant Transactions Not Recorded • Intensive Manually-Drive Processes • Inadequate Review and Monitoring of Receivables • Failure to Report Employee Bonuses • Failure to Capitalize Fixed Assets • Failure to Perform Reconciliations 	2008-1 Financial Reporting (Material Weakness) - All findings repeated
2007-2	Internal Control/Governance (Material Weakness) <ul style="list-style-type: none"> • Inadequate Maintenance of Supporting Documentation • High Percentage of Prize Payments • Improper Maintenance of Fixed Assets Inventory • Inadequate Controls Over Purchasing and Disbursement Transactions • No Independent Review of Contractors System of Internal Controls • Inadequate and Ineffective Controls Over Ticket Sales 	2008-2 Internal Control/Governance (Material Weakness) – All findings repeated
2007-3	Unresolved Significant Transfers Due to the State (Significant Deficiency)	2008-4 Unresolved Significant Transfers Due to the State (Significant Deficiency) – Finding Repeated
2007-4	Excessive Number of Signatories to the Lottery's Operating Account (Significant Deficiency)	2008-5 Excessive Number of Signatories to the Lottery's Operating Account (Significant Deficiency) – Finding Repeated