



# Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

World Wide Web Site: <http://opacnmi.com>  
2nd Floor J. E. Tenorio Building, Chalan Pale Arnold  
Gualo Rai, Saipan, MP 96950

Mailing Address:  
P.O. Box 1399  
Saipan, MP 96950

E-mail Address:  
[mail@opacnmi.com](mailto:mail@opacnmi.com)

Phone: (670) 234-6481  
Fax: (670) 234-7812

March 31, 1999

Ms. Lucy DLG. Nielsen  
Secretary of Finance  
Department of Finance  
Capitol Hill  
Saipan, MP 96950

Dear Secretary Nielsen:

**Subject: Final Letter Report on the Audit of Government Revenues from the CNMI Lottery Operations for the First Quarter of Fiscal Year 1998 Ending December 31, 1997 (LT-99-04)**

This letter report presents the results of our audit of government revenues from the Commonwealth of the Northern Mariana Islands' (CNMI) lottery operations for the first quarter of fiscal year 1998 ending December 31, 1997. The objective of the audit was to determine whether government revenues from CNMI lottery operations were accurately computed in accordance with the Memorandum of Understanding and terms of agreements between the CNMI Government as represented by the Department of Finance (DOF) and the CNMI lottery operators, namely, Tattersall Sweep Consultation of Australia (Tattersall's) and Numbers International Lottery (NIL).

Our audit showed that government revenues of \$113,667 from CNMI lottery operations for the first quarter of fiscal year 1998 ending December 31, 1997 were understated due to computation errors committed by one of the CNMI lottery operators. This occurred because NIL (1) computed government revenues based on net sales instead of gross sales, and (2) computed government revenues from the two types of lottery tickets sold using a 10 percent commission rate although one of the games was subject only to a 5 percent rate. As a result, government revenues were understated by an estimated \$3,946 and should be increased to \$117,613.

The accompanying schedule (**Appendix A**) shows a detailed summary of government revenues for the first quarter of fiscal year 1998 ending December 31, 1997 with comparative figures for the first quarter of fiscal year 1997, after reflecting required adjustments. As explained in the body of this report, we were not able to examine copies of the lottery tickets providing the basis for the computation of government revenues reported by NIL. Accordingly, there was no assurance that government revenues received from NIL were complete.

We recommended that the Secretary of Finance (1) request NIL to correct its records and transmit to DOF the estimated net underpayment of \$3,946; and (2) instruct the DOF Finance and Accounting Division to prepare the necessary adjustments to the CNMI Lottery bank and revenue account to correct the reconciling items noted by the audit.

In her letter response dated March 8, 1999 (**Appendix B**), the Secretary of Finance concurred with all the recommendations, and provided OPA copies of the letter issued, deposit slip received, and adjusting journal entry made to address the recommendations.

Based on the response we received from the Secretary, we consider Recommendation 1 closed and 2 resolved pending recording of the \$3,946 additional commission. Additional information or action required to close the recommendation is presented in **Appendix C**.

## **BACKGROUND**

### *The CNMI Lottery*

The Commonwealth Lottery Commission Act, codified in 1 CMC §9301 et seq. of the Commonwealth Code, authorized the operation of a public lottery in the Commonwealth. The Act mandated that the public lottery be administered by a Commonwealth Lottery Commission, whose members were the Director of Finance, the Attorney General, and the Director of Commerce and Labor.

On August 24, 1994, the Commonwealth Lottery Commission was abolished, and its functions were transferred to the Department of Finance pursuant to Section 307 (a) of Executive Order 94-3 issued by the Governor of the CNMI. Under the Executive Order, the Secretary of Finance was to assume the administrative functions of the defunct Commission. The Secretary of Finance, however, was still required to consult with the Secretary of Commerce and the Attorney General as necessary for administration of the CNMI Lottery.

### *CNMI Lottery Operators*

The CNMI Government, through the former Commonwealth Lottery Commission and the Department of Finance, issued lottery operator licenses authorizing the following two companies to conduct public lotteries in the CNMI.

#### *Tattersall Sweep Consultation*

The Trustees of the Will and Estate of the late George Adams, carrying on business under the name of Tattersall Sweep Consultation (Tattersall's), were issued a lottery operator's license effective July 29, 1993 to July 28, 2003. The license granted Tattersall's the exclusive right to conduct all public lotteries in the CNMI. The license also allowed Tattersall's to appoint accredited representatives to sell the lottery games. On September 1, 1993, TMS Saipan, Ltd. was locally incorporated in the CNMI by Mr. John Hycenko, President of The Mail Service (TMS)

Pty. Ltd., the sole accredited and authorized representative for the overseas operations of Tattersall's games, to manage lottery operations and sale of instant lottery tickets for Tattersall's.

On October 14, 1993, TMS Saipan began its lottery operations in the CNMI. Currently, two types of games are offered to the public by TMS. These games are described as follows:

- On-Line Games - An on-line game is one of various types of lottery games which utilize electronic equipment such as a computer system to administer play, and in which a player may select; (1) a combination of numbers to be played; (2) the type of game to be played; and (3) the amount of play for one or more specified drawing dates. The CNMI Lottery operator then conducts a random drawing whereby, pursuant to chance, the winning combinations of numbers are selected, with such numbers then used to determine the award of prizes in accordance with the rules of the specific on-line game being played.
- Instant Tickets - An instant ticket is a lottery game in which the player purchases a ticket with a play area which in some manner is hidden from view. The play area contains numbers or symbols which when revealed (by scratching) will determine whether one or more prizes have been won by the player. The numbers or symbols are printed in such a manner that distribution of prizes within each game has been predetermined as to the number and amount of prizes but not as to the random basis upon which prizes are awarded.

#### Numbers International Lottery

Numbers International, Inc., doing business under the name of the Numbers International Lottery (NIL), was issued a lottery operator's license for the period December 12, 1997 to July 28, 2003. The license granted NIL the exclusive right to sell tickets for a public lottery game called "Jueteng".

NIL began its lottery operations on September 15, 1997 under a temporary license issued by the Department of Finance. The Jueteng games conducted by NIL are described as follows:

- Two Number Game - A two number game is played using tickets sold to players by NIL authorized sellers. Each ticket is printed in triplicate and the numbers 1 to 38 are printed on it. The player selects two numbers and prints them in 2 designated boxes printed on each ticket. The buyer keeps one copy, the seller keeps the duplicate, and then the seller turns in the triplicate copy to the NIL office where the daily drawing is held.
- One Number Game - A one number game is also played using the same type of tickets and procedure used for the two number games. However, as the name of the game implies, the player selects only one number, and the prize for winning is smaller.

NIL conducts daily lottery drawings in its office between approximately 11:00 p.m. and midnight when the ticket sellers have reported their collections for the day. The actual drawing of the winning numbers is done similar to those of a more popular game known as Bingo. Balls with number 1 to 38 are placed in a transparent plastic container. The container is connected to a tube

that feeds air which causes the balls to be constantly in motion. On top of the container is an opening for a single ball. On top of the opening, a cylindrical tube is attached for holding a ball that will pop out of the container. The opening also has a cover inserted through the tube. When it is time to draw a number, the opening cover is removed and the air causes one ball to pop into the tube. Two balls are drawn to represent the winning 2 number combination and at the same time, the first ball drawn represents the winners of the one number game.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

The objective of the audit was to determine whether government revenues from CNMI lottery operations were accurately computed in accordance with the Memorandum of Understanding and terms of agreements between the CNMI Government, as represented by the Department of Finance (DOF), and the CNMI lottery operators, namely, Tattersall Sweep Consultation of Australia (Tattersall's) and Numbers International Lottery (NIL). The scope of the audit covered government revenues from CNMI lottery operations for the first quarter of fiscal year 1998 ending December 31, 1997.

To accomplish our objective, we performed independent computations of government revenues. We also compared government revenues earned during the quarter with amounts received by DOF. For Tattersall's games, we also determined whether subscription prices of all on-line games sold and instant game tickets shipped into the CNMI were accurately included in the computation base for government revenues. We relied on the weekly summary reports submitted by a chartered accountant hired by TMS (in Australia) in determining subscription prices of on-line games. We also conducted physical counts of instant game tickets before the tickets were sold. In addition, we also verified, on a test basis, whether the tickets sold were among those included in our physical count. For NIL Jueteng games, we reviewed the General Cashier's Recap reports prepared by the NIL accountants. However, we were not able to examine the basis for the reports because NIL did not maintain separate records and did not keep copies of the lottery tickets sold during the period under audit. We also reviewed DOF records and bank statements to verify recording and receipt of government revenues.

This performance audit was conducted at the offices of Tattersall's, NIL, and DOF in Saipan between June 2, 1998 and July 31, 1998. This audit was made, where applicable, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures as were considered necessary under the circumstances. We completed our field work on July 31, 1998.

As part of our audit, we obtained an understanding of management controls to the extent we considered necessary to accomplish the audit objective. These included internal controls over the computation, receipt, and recording of government revenues. We found control weaknesses in these areas which are discussed in the Findings and Recommendations section of this report. Our recommendations, if implemented, should improve management controls.

## **FINDINGS AND RECOMMENDATIONS**

### **Government Revenues were Understated**

Government revenues from the CNMI lottery operations should be computed based on the Memorandum of Understanding (MOU) and terms of agreements between the CNMI Government and the CNMI lottery operators. Our audit showed that government revenues of \$113,667 from the CNMI lottery operations for the first quarter of fiscal year 1998 ending December 31, 1997 were understated due to computation errors committed by one of the CNMI lottery operators. This occurred because NIL (1) computed government revenues based on net sales instead of gross sales, and (2) computed government revenues from the two types of lottery tickets sold using a 10 percent commission rate although one of the games was subject only to a 5 percent rate. As a result, government revenues were understated by an estimated \$3,946 and should be increased to \$117,613.

### ***Memorandum of Understanding and Terms of Agreements***

On February 9, 1994, the Secretary of Finance entered into a Memorandum of Understanding (MOU) with TMS, the sole accredited representative of Tattersall's. The MOU set forth the rights and obligations of each party as they relate to the operation of lottery games. Under the MOU, the CNMI Government is to receive and be compensated directly and indirectly by the payment of commission, taxes, duties and fees in an amount equivalent to at least 35 percent of the subscription price paid for each on-line ticket sold, and in an amount equivalent to 26.5 percent of the subscription price for each instant game ticket sold. TMS, however, subsequently agreed to compensate the CNMI Government upon shipment and delivery of instant game tickets for sale in the CNMI.

On August 28, 1997, the Acting Secretary of Finance entered into a Lottery Operator's Agreement (LOA) with NIL. The LOA set forth the terms and conditions for allowing NIL to conduct the Jueteng games. Under the LOA, NIL is required to pay an annual license fee of \$150,000, payable in equal quarterly installments. NIL is to also pay a commission to the DOF General Lottery Account in the amount of 10 percent of gross sales on the two number games and 5 percent of gross sales on the one number games.

### ***Computation of Government Revenues***

Government revenues received from CNMI lottery operators for the first quarter of fiscal year 1998 totaled \$113,667. Of this amount, \$33,024 was paid by TMS and \$79,371 by NIL. Our audit showed, however, that government revenues were understated by an estimated \$3,946 due to computation errors committed by NIL. The following table presents the details of government revenues earned and the computation errors we found during our audit.

Particulars	Unadjusted Revenues	Computation Errors	Adjusted Revenues
Tattersall's			
- On-line games	\$ 11,943	\$ -	\$ 11,943
- Instant Tickets	<u>21,081</u>	<u>-</u>	<u>21,081</u>
	<u>33,024</u>	<u>-</u>	<u>33,024</u>
NIL Jueteng			
- Two number games	41,871	497	42,368
- One number games	-	3,449	3,449
- License fees	<u>37,500</u>	<u>-</u>	<u>37,500</u>
	<u>79,371</u>	<u>3,946</u>	<u>83,317</u>
Interest/Other Income	1,272	-	1,272
Total	\$ 113,667	\$ 3,946	\$ 117,613

This condition occurred because NIL (1) computed government revenues based on net sales instead of gross sales, and (2) computed government revenues from the two types of lottery tickets sold using a 10 percent commission rate although one of the games was subject only to a 5 percent rate. In computing government revenues, NIL based its computation only on net sales or cash receipts from lottery games net of the 15% commissions paid to sales and collection agents (referred to locally as "Cabo"). Under the LOA, however, NIL is required to compute government revenues based on gross sales. NIL also failed to separate sales of two number games from one number games. Consequently, NIL multiplied the 10 percent compensation rate for two number games with the total sales amount. Under the LOA, however, one number games are subject only to a 5 percent compensation rate.

Further inquiries showed that NIL did not maintain separate records for each type of game. Copies of the original lottery tickets that can be used to identify the type of game sold were also not available because NIL disposed of all used tickets on a periodic basis. At the request of OPA, NIL began maintaining separate records for the two types of games and retaining copies of tickets sold starting June 5, 1998. Also, in response to our recommendation in the previous audit, the acting Secretary of Finance issued a letter to NIL on August 12, 1998 requesting them to maintain separate and adequate records for each type of game for tax and audit purposes. Information from the separate records from June 5 to July 31, 1998 (end of field work) showed that the average daily ticket sales consisted of 86 percent two number games and 14 percent one number games. These percentages were used to allocate the total sales reported by NIL between the two types of games for the purpose of estimating the amount of computation errors committed by NIL during the period under audit. The following is a computation of the estimated net understatement based on the allocation percentages described above:

Government revenues per audit (based on gross sales)			
- Two number games	\$492,649 x 86% x 10%	=	\$ 42,368
- One number games	492,649 x 14% x 5%	=	<u>3,449</u>
			<u>45,817</u>
Government revenues per NIL (based on net sales)			
- Two number games	\$418,712 x 10%	=	41,871
- One number games	-	=	<u>-</u>
			<u>41,871</u>
Estimated net understatement			<u>\$ 3,946</u>

As a result, government revenues should be increased by the estimated net understatement of \$3,946 from \$113,667 to \$117,613.

**Recording of Government Revenues**

We reviewed the accounting records of DOF to determine if government revenues were accurately recorded and deposited in the CNMI lottery bank account. We also reconciled DOF revenue and bank balances with the adjusted balances after reflecting the required adjustments. Our review showed several reconciling items that need to be adjusted by DOF. A summary of the reconciliation is shown in the following table:

Particulars	Lottery Bank Account	Total Revenues
Unadjusted DOF balances - 12/31/97	\$ 154,913	\$ 0
Reconciling Items:		
1. Government revenues for 3 <sup>rd</sup> Quarter FY 1997 erroneously recorded under the CNMI General Fund*	42,912	
2. Government revenues received but not recorded by DOF as of 12/31/97 - 4 <sup>th</sup> Quarter FY 1997 - 1 <sup>st</sup> Quarter FY 1998**	447 111,005	111,005
3. Accrual of government revenues for 1 <sup>st</sup> quarter FY 1998**		1,390
4. Interest income for 1 <sup>st</sup> quarter FY 1998 received but not recorded by DOF as of 12/31/97**	1,272	1,272
5. Understatement of government revenues for 1 <sup>st</sup> Quarter FY 1998, per audit		3,946
Adjusted Balances - 12/31/97	\$ 310,549	\$ 117,613

\* In response to our recommendation in the previous quarter's audit, the Acting Secretary of Finance made a journal entry on August 13, 1998 to adjust this reconciling item.

\*\* Recorded by DOF on May 31, 1998.

DOF should prepare the necessary adjustments in its books to correct the reconciling items noted in the table above.

## ***Subsequent Events***

### Issuance of Additional Lottery Operator's License

On or before January 9, 1998, the former Acting Secretary of Finance issued another lottery operator's license to Just For Fun, Inc. (JFF), effective January 9, 1998 to January 8, 2003. The license allowed JFF to sell Jueteng games which were supposedly covered by the exclusive license issued earlier to NIL. Based on available documents, it appears that JFF's license was granted upon authorization by the former Governor on January 8, 1998, nearly the last day of his term as Governor.

On February 9, 1998, the Acting Secretary of Finance (appointed by the current Governor) notified JFF that DOF intended to rescind JFF's license because it infringed on one or both of the exclusive licenses already issued to Tattersall's and NIL. In its letter to JFF, DOF noted that it was also reviewing the license issued to NIL to determine whether it infringed on the existing license issued to Tattersall's. JFF, however, requested an administrative hearing regarding its case. As of the date of this report, the matter is currently being heard by a hearing officer from the Department of Commerce.

OPA will review the issuance of the additional lottery operator licenses by DOF to determine whether there was any violation of applicable laws and regulations. OPA will also review NIL and JFF's compliance with their lottery operator's agreements with DOF. A separate report covering these matters will be issued at a later date.

### Assignment of Lottery Operator's License

On June 30, 1998, DOF entered into an agreement assigning Tattersall's lottery operator license to TMS, the sole accredited agent of Tattersall's for overseas operations. As explained in the agreement, Tattersall's exercised its termination rights alleging that the CNMI Government breached Tattersall's exclusive lottery license by granting additional "exclusive lottery license(s)" to other entities. As a result, Tattersall's would no longer make its lottery games available or permit its lottery games to be sold in the CNMI subsequent to June 30, 1998. TMS, however, had offered to continue sale of lottery games from other lottery jurisdictions, with the government revenue share continuing on a basis equivalent to the revenue share previously guaranteed to the CNMI Government by Tattersall's. The CNMI accepted TMS's offer "to continue to generate maximum revenues for the CNMI general fund as required by law while the CNMI seeks to reestablish the value of the CNMI lottery license which value was substantially diminished as a result of issuance of so-called additional lottery licenses." The term of the agreement was for 90 days from the date of its implementation, and could be renewed for one or more successive 90-day terms in order to facilitate the parties' undertaking and discharge of responsibilities under the agreement.

It appears, however, that the agreement entered into by DOF with TMS was not an actual assignment of Tattersall's license. If it were, the terms of the agreement should have been the same as the original license which was effective until July 28, 2003. We also found no documents

showing that Tattersall's agreed to assign its license to TMS. OPA will further review this matter and will issue its findings in a separate report.

## **Conclusions and Recommendations**

Government revenues were understated by an estimated \$3,946 due to computation errors committed by NIL. Therefore, government revenues should be increased from \$113,667 to \$117,613. The accompanying schedule (**Appendix A**) shows a detailed summary of government revenues for the first quarter of fiscal year 1998 ending December 31, 1997 with comparative figures for the first quarter of fiscal year 1997, after reflecting required adjustments. As explained in the body of this report, we were not able to examine copies of the lottery tickets supporting the basis for the computation of government revenues reported by NIL. Accordingly, there was no assurance that government revenues received from NIL were complete.

We recommend that the Secretary of Finance:

1. Request NIL to correct its records and transmit to DOF the estimated net underpayment of \$3,946.
2. Instruct the DOF Finance and Accounting Division to prepare the necessary adjustments to the CNMI Lottery bank and revenue account to correct the reconciling items noted by the audit.

### **DOF Response**

In her letter response dated March 8, 1999 (**Appendix B**), the Secretary of Finance concurred with all the recommendations, and provided OPA copies of the letter issued, deposit slip received, and adjusting journal entry made to address the recommendations, as follows.

Recommendation 1 - The Secretary of Finance issued a letter on February 11, 1999 to NIL requesting to transmit the additional \$3,946 that is due to the CNMI Government. The said amount was deposited by NIL to the CNMI lottery bank account on February 10, 1999.

Recommendation 2 - The Secretary of Finance made an adjusting journal entry to reflect the \$447 4<sup>th</sup> quarter FY 1997 unrecorded revenues. DOF has not recorded, however, the collection of the \$3,946 additional commission pending receipt of the bank statement.

### **OPA Comments**

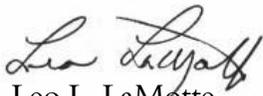
Based on the response we received from the Secretary, we consider Recommendation 1 closed and 2 resolved pending recording of the \$3,946 additional commission. Additional information or action required to close the recommendation is presented in **Appendix C**.

Our office has implemented an audit recommendation tracking system. All audit recommendations will be included in the tracking system as open or resolved until we have

received evidence that the recommendations have been implemented. An *open* recommendation is one where no action or plan of action has been made by the auditee (department or agency). A *resolved* recommendation is one in which the auditors are satisfied that the auditee cannot take immediate action, but has established a reasonable plan and time frame for action. A *closed* recommendation is one in which the auditee has taken sufficient action to meet the intent of the recommendation or we have withdrawn it.

Please provide to us the status of recommendation implementation within 30 days along with documentation showing the specific actions that were taken. If corrective actions will take longer than 30 days, please provide us additional information every 60 days until we notify you that the recommendation has been closed.

Sincerely,



Leo L. LaMotte  
Public Auditor, CNMI

cc: Governor  
Lt. Governor  
Eleventh CNMI Legislature (27 copies)  
Acting Attorney General  
Acting Special Assistant for Management and Budget  
Public Information Officer  
Norma Arnold, President, NIL  
Craig J. Patillo, Pacific Instant Lottery, General Manager  
John Hycenko, The Mail Service, Managing Director  
Press

**COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS  
DEPARTMENT OF FINANCE**

**Schedule of Government Revenues from the CNMI Lottery Operations  
For the First Quarter of Fiscal Year 1998 Ending December 31, 1997  
(With comparative figures for the first quarter of fiscal year 1997)**

Lottery Games	Number of Games or Tickets Sold	Amount Subject to Commissions	Commission Rate	Revenues - First Quarter 1998	Revenues - First Quarter 1997
Tattersall's					
On-Line Games					
- Saturday	83,873	\$ 22,905	35.00%	\$ 8,017	\$ 13,778
- Midweek	-	-	35.00	-	-
- OZ Lotto	6,460	4,489	35.00	1,571	2,067
- Keno	9,887	6,492	36.27	2,355	-
	<hr/> 100,220	<hr/> 33,886		<hr/> 11,943	<hr/> 15,845
Instant Tickets					
- Five Dollar	-	-	26.50	-	1,899
- Two Dollar	(5,000) <sup>1</sup>	(8,500)	26.50	(2,253)	15,768
- One Dollar	105,000	88,053	26.50	23,334	27,779
	<hr/> 100,000	<hr/> 79,553		<hr/> 21,081	<hr/> 45,446
	<hr/> 200,220	<hr/> 113,439		<hr/> 33,024	<hr/> 61,291
NIL Jueteng					
Two Number	423,678	423,678	10.00	42,368	-
One Number	68,971	68,971	5.00	3,449	-
License Fees	-	-	-	37,500	-
	<hr/> 492,649	<hr/> 492,649		<hr/> 83,317	<hr/> -
Interest/Other Income				<hr/> 1,272	<hr/> 6,553
				<hr/> <hr/> \$ 117,613	<hr/> <hr/> \$ 67,844

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Represents two dollar instant ticket received during the 3<sup>d</sup> Qtr. FY 1997 (June 25, 1997) and was returned to Tattersall's during the 1<sup>st</sup> Qtr. FY 1998 (November 13, 1997).

Note: Appendix B (5 pages) which contains the response letter of the Secretary of Finance was intentionally omitted to reduce the size of the electronic version of this report. The response has been incorporated in the text of this report. A copy of the response letter may be requested by e-mail to [mail@opacnmi.com](mailto:mail@opacnmi.com).

**Audit of Government Revenues from the CNMI Lottery Operations  
For the First Quarter of Fiscal Year 1998 Ending December 31, 1997**

**STATUS OF RECOMMENDATIONS**

Recommendations	Agency to Act	Status	Agency Response/ Additional Information or Action Required
1. Request NIL to correct its records and transmit to DOF the estimated net underpayment of \$3,946.	DOF	Closed	The Secretary of Finance concurred with all the recommendations, and provided OPA copies of the letter issued, deposit slip received, and adjusting journal entry made to addresses the recommendations. For Recommendation 1, a letter was issued on February 11, 1999 to NIL requesting to transmit the additional \$3,946 that is due to the CNMI Government. The said amount was deposited by NIL to the CNMI lottery bank account on February 10, 1999.
2. Instruct the DOF Finance and Accounting Division to prepare the necessary adjustments to the CNMI Lottery bank and revenue account to correct the reconciling items noted by the audit.	DOF	Resolved	<p>For Recommendation 2, a journal entry was made to reflect the \$447 4th quarter FY 1997 unrecorded revenues.</p> <p><i>Further Action Required</i></p> <p>Recommendation 2 - Provide OPA a copy of the journal entry to record the \$3,946 additional commission.</p>