



## Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

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June 20, 2000

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

Dear Ms. Nielsen:

**Subject: Final Letter Report on the Audit of Government Revenues from the CNMI Lottery Operations for the First Quarter of Fiscal Year 1999 Ending December 31, 1998 (LT-00-06)**

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 1999 ending December 31, 1998. The objective of the audit was to determine whether government revenues from the CNMI lottery operations were accurately computed in accordance with the Memorandum of Understanding and terms of agreement between the CNMI Government, as represented by the Department of Finance (DOF), and the CNMI lottery operators, namely, TMS Saipan, Ltd. (TMS), Numbers International Lottery (NIL), and Just For Fun (JFF).

Our audit showed that government revenues of \$157,830 from the CNMI lottery operations for the first quarter of fiscal year 1999 ending December 31, 1998 were understated due to computation error and delay in remitting quarterly license fees by the CNMI lottery operators. As a result, government revenues were understated by \$25,232 and should be increased to \$183,062.

Our audit also showed that NIL and JFF sold tickets with different number series as well as different colors and formats, making it impossible to account for the actual number of tickets sold. Accordingly, there was no assurance that government revenues received from NIL and JFF were complete.

The accompanying schedule (**Appendix A**) shows a detailed summary of government revenues for the first quarter of fiscal year 1999 ending December 31, 1998 with comparative figures for the first quarter of fiscal year 1998, after making required adjustments.

We recommended that the Secretary of Finance (1) instruct the DOF Finance and Accounting Division to record the \$232 additional commission from TMS; (2) address our pending recommendations relating to the development and implementation of written procedures and monitoring log sheets by DOF and lottery operators, to ensure that tickets printed and issued to agents are controlled and that sold and unsold tickets are accounted for on a regular basis; (3) determine the proper license that should be issued to Saipan Scratchies to operate the CNMI retail lotto services; and (4) check whether JFF reported revenues from Mr. Demapan's operations in the computation of commissions remitted to DOF. If the revenues were not reported, the commissions due to the CNMI Government from the undeclared revenues, including interest and penalty, should be recovered immediately from JFF.

In her letter response dated May 12, 2000 (**Appendix B**), the Secretary of Finance concurred with the recommendations and provided OPA copies of the letters issued and received, and the adjusting journal entry made, to address some of the recommendations.

Based on the response we received from the Secretary, we consider Recommendation 1 closed. Recommendations 2 and 3 are considered resolved pending adoption of proposed amendments to the rules and regulations for the lottery operations, and completion of review of the proper license that should be issued to Saipan Scratchies. Recommendation 4 is considered open because the response did not address the recommendation. The additional information or action required to close the recommendations 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. 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 three companies to conduct public lotteries in the CNMI.

## Tattersall Sweep Consultation and Subsequent Assignment of Lottery Operator License to TMS

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. (TMS) was locally incorporated in the CNMI by Mr. John Hycenko, President of The Mail Service 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 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.

On June 30, 1998, DOF entered into an agreement assigning Tattersall's lottery operator license to TMS. 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 periods in order to facilitate the parties' undertaking and discharge of responsibilities under the agreement.

#### 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 two designated boxes printed on each ticket. The player 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 procedures 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 similarly 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.

#### Just For Fun

Just For Fun, Inc., doing business under the name of Just For Fun (JFF), was issued a lottery operator's license for the period January 9, 1998 to January 8, 2003. The license granted JFF to sell tickets for a public lottery game called "Jueteng." JFF operates the same Jueteng games conducted by NIL as described above.

JFF conducts daily lottery drawings in its office at night when the ticket sellers have reported their collections for the day. It uses a "spin a wheel." The wheel, which has numbers 1 to 37, is spun twice; the first number that comes out in the spinning wheel is the first winning number

in the two number game, and the second number that comes out is the second winning number. Any one of the two numbers 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 the 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, TMS Saipan, Ltd. (TMS), Numbers International Lottery (NIL), and Just For Fun (JFF). The scope of the audit covered government revenues from CNMI lottery operations for the first quarter of fiscal year 1999 ending December 31, 1998.

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 TMS' games, we 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. In addition, we also verified, on a test basis, whether the tickets sold were among those included in our physical count. For NIL and JFF Jueteng games, we reviewed the General Cashier's Recap Reports and the Daily Activity Reports, respectively, which were prepared by each operators' accountants. We also verified, on a test basis, whether the amount of lottery sales reported to DOF tied in with the lottery tickets sold based on OPA's count of tickets. For all the games, we also reviewed DOF records and bank statements to verify recording and receipt of government revenues.

Quarterly audits of the government revenues from the CNMI lottery operations are performed pursuant to 1 CMC §9320. This performance audit was conducted at the offices of TMS, NIL, JFF, and DOF in Saipan between June 7, 1999 and January 28, 2000. 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 January 28, 2000.

As part of our audit, we evaluated DOF's internal controls over the computation, receipt, and recording of government revenue, as well as ensuring the completeness of lottery sales. We found weaknesses in these areas, which are discussed in the Findings and Recommendations section of this report. Our recommendations when implemented should improve controls in these areas.

## **FINDINGS AND RECOMMENDATIONS**

### **A. Government Revenues were Understated**

Government revenues from the CNMI lottery operations should be computed based on the Memorandum of Understanding (MOU) and terms of agreement between the CNMI Government and the CNMI lottery operators. Our audit showed that government revenues of \$157,830 from the CNMI lottery operations for the first quarter of fiscal year 1999 ending December 31, 1998 were understated due to computation error and delay in remitting quarterly license fees by the CNMI lottery operators. This occurred because (1) TMS computed government revenues from one of the on-line games using a 26.5 percent compensation rate instead of the required minimum 35 percent rate and (2) JFF remitted the quarterly license fee monthly instead of quarterly, with two monthly fee payments remitted after the quarter under audit. As a result, government revenues were understated by \$25,232 and should be increased to \$183,062.

#### ***Lottery Operators' Terms of Agreement***

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 commissions, 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 June 30, 1998, Tattersall's rights and obligations to the CNMI, as they related to the operations of lottery games, were assigned to TMS pursuant to the assignment of lottery operator license entered into by DOF and TMS.

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 Jueteng games. Under the LOA, NIL is required to pay an annual license fee of \$150,000, payable in equal quarterly installments beginning on the first day of each 12-month period, beginning within the term of the agreement. 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.

On January 9, 1998, the Acting Secretary of Finance also entered into a Lottery Operator's Agreement with JFF. The terms and conditions set forth in the LOA with JFF are mostly identical with those set forth in the LOA with NIL as described above.

**Error in Computing Government Revenues and Delay in Remitting License Fee**

Government revenues from the CNMI lottery operations for the first quarter of fiscal year 1999 totaled \$157,830. Of this amount, \$21,206 was paid by TMS, \$86,119 by NIL, and \$45,585 by JFF. Our audit showed, however, that government revenues were understated by \$25,232 due to computation error, and delay in remitting quarterly license fees by the CNMI lottery operators. The following presents the details of government revenues earned and the understatement found during our audit.

Particulars	Unadjusted Revenues	Understatement	Adjusted Revenues
TMS Saipan, Ltd.			
– On-line games	\$5,525	\$232	\$5,757
– Instant Tickets	15,681	-	15,681
Sub-total	\$21,206	\$232	\$21,438
NIL Jueteng			
– Two number games	\$44,758	-	\$44,758
– One number games	3,861	-	3,861
– License fee	37,500	-	37,500
Sub-total	\$86,119	\$0	\$86,119
JFF Jueteng			
– Two number games	\$29,910	-	\$29,910
– One number games	2,175	-	2,175
– License fee	12,500	\$25,000	37,500
Sub-total	\$44,585	\$25,000	\$69,585
Interest/Other Income	\$5,920	-	\$5,920
TOTAL	\$157,830	\$25,232	\$183,062

This condition occurred because (1) TMS computed government revenues from one of the on-line games using a 26.5 percent compensation rate instead of the required minimum 35 percent rate and (2) JFF remitted the quarterly license fee monthly instead of quarterly with two monthly fee payments remitted after the quarter under audit.

Under the MOU, TMS is required to pay at least 35 percent of the subscription price for each on-line ticket sold as government revenue; however, TMS multiplied its sales from the Keno game (an on-line game) by only 26.5 percent. This resulted in a \$232 understatement. The error was found during the lottery audit. We recommended that DOF ask TMS to correct its records and remit the net underpayment. TMS explained that the amount being paid on Keno games changed due to an inadvertent accounting computation error from July 1, 1998 to September 30, 1999. A total of \$1,287.31 (adjustment for five quarters ending September 30, 1999, \$232 of which is for this quarter) was deposited by TMS to the CNMI lottery bank account on December 9, 1999. Consequently, no recommendation on this matter needs to be proposed for this quarter.

JFF remitted the first quarter FY 1998 license fee in equal monthly installment of \$12,500, with the last two months (for November and December 1998) remitted on January 11 and February 23, 1999, respectively, *i.e.*, after the quarter under audit. Under the LOA, however, the annual license fee is payable in equal quarterly installments beginning on the first day of the month following the date of the agreement, *i.e.*, February 1, May 1, August 1, and November 1. This finding existed also in OPA's latest lottery audit and we recommended that DOF instruct JFF to timely remit its quarterly license fee. DOF issued a letter to JFF instructing timely remittance of the quarterly license fees due to the CNMI Government and stating that imposing administrative sanctions against JFF would be warranted in case of continuous delay in payment.

On or about September 30, 1999, JFF's legal counsel responded to DOF and complained that certain licensing fees charged by DOF to JFF to operate a lottery game in the CNMI are not permissible, and therefore fees paid should be refunded by the CNMI Government to JFF. The issue raised was whether DOF may require an entity licensed to conduct a lottery in the CNMI to pay a licensing fee that in part is a fixed amount and in part is computed as a percentage of gross sales of lottery tickets. The matter was referred to the Attorney General's Office (AGO), which issued an opinion on January 14, 2000 that the requirement to pay fees based on both a percentage of gross sales and a fixed amount is consistent with the expressed intent of the Commonwealth Lottery Commission Act to produce "the maximum amount of net revenues" for the Commonwealth, since pursuant to the CNMI Constitution, all gambling activities, including lottery, are specifically prohibited "unless otherwise provided by law." Because of its contractual obligation to pay such fees, JFF's failure to make all payments when due should result in it being charged with violating the LOA and the Commonwealth Lottery Commission Act.

On March 21, 2000, JFF's legal counsel filed a notice of surrender of JFF's lottery license to the Department of Commerce and AGO. The notice states the following "Due to the policies of the Department of Finance in connection with the treatment of Just For Fun, Inc., Just For Fun ceased operating the lottery game of Jueteng effective at 12:00 midnight March 20, 2000 and hereby surrenders its Lottery License effectively (sic) immediately. The surrender of Just For Fun's lottery license moots the issue of revocation of its lottery license. The issue of the propriety of the commissions previously assessed by the Department of Finance against Just For Fun in connection with operation of the lottery game of Jueteng remains in controversy." Based on the response received from DOF and additional information gathered after the issuance of our latest audit report, no recommendation on this matter needs to be proposed for this quarter.

As a result, government revenues were understated by \$25,232 and should be increased to \$183,062.

## **B. No Assurance of Completeness of Government Revenues**

Adequate procedures should be in place to ensure completeness of lottery sales, which is the basis for the computation of government revenues reported by the CNMI lottery operators. Our audit showed, however, that NIL and JFF sold tickets with different number series as well as different colors and formats, making it impossible to account for the actual number of tickets sold. This occurred because the lottery operators and DOF did not employ control procedures that can assist in verifying lottery sales reported to DOF. Accordingly, there was no assurance that government revenues received from NIL and JFF were complete.

### ***Monitoring of Lottery Sales***

DOF should adopt procedures to ensure the completeness of lottery sales, which is the basis for the computation of government revenues reported by the CNMI lottery operators. DOF should require lottery operators to ensure that tickets printed and issued to agents are controlled, and that sold and unsold tickets are accounted for on a regular basis. Without such a procedure, lottery sales could be easily understated without detection. Therefore, this procedure should be documented through monitoring log sheets signed by the printing company, lottery operator or agents (depending on the log sheet), and reviewed by DOF.

### ***JFF Lottery Sales***

Our review showed that DOF maintained only the Daily Activity Reports prepared by the JFF accountants. These reports include information on the daily lottery ticket transactions such as tickets sold, gross income derived, prizes paid, prizes unclaimed, computation of commissions due to the government, amount of commissions credited against the Business Gross Receipt Tax, and any additional commissions.

OPA verified, on a test basis, whether the amount of lottery sales reported to DOF tied in with the lottery tickets sold. Our review revealed immaterial discrepancies. We noted, however, that it is impossible to account for the actual number of tickets sold because JFF sold tickets in different number series and not in sequence, and various types of tickets were printed, *i.e.*, in different colors - dark blue, light blue, or red; and different formats, *i.e.*, either in 4 or 5 quantities per ticket number (assigning *A* to *D* or *A* to *E*, respectively, after the number). For example, in our previous quarter's review of lottery tickets sold during the three consecutive days, we noted that ticket series # 841111 to 841128 were sold on March 11, 1998 while ticket # 8133760 - a higher seven-digit number - was sold on March 9, 1998. The ticket series in between these numbers (# 841129 to 8133759) totaling about 29 million tickets was not included as tickets sold on selected days we tested. Another example was ticket # 152650 which was sold on March 11, 1998 while ticket # 493276 was sold on March 9, 1998. The ticket series in between these numbers (# 152651 to 493275) totaling about 1 million tickets was not included as tickets sold on selected days we tested. This occurred because the lottery operators and DOF did not employ control procedures that can assist in verifying lottery sales reported

to DOF. Accordingly, there was no assurance that government revenues received from JFF were complete.

#### NIL Lottery Sales

Our review showed that DOF maintained only the General Cashier's Recap reports prepared by the NIL accountants. These reports include information on the daily lottery ticket transactions such as each cashier's collections from tickets sold, computation of commissions due to the government, and details of prizes paid per agent.

OPA verified, on a test basis, whether the amount of lottery sales reported to DOF tied in with the lottery tickets sold. Our review revealed immaterial discrepancies. We noted, however, that as with JFF, it is impossible to account for the actual number of tickets sold because NIL sold tickets in different number series and not in sequence, and various types of tickets were printed, *i.e.*, in different colors - dark blue, light blue, or green. This occurred because the lottery operators and DOF did not employ control procedures that can assist in verifying lottery sales reported to DOF. Accordingly, there was no assurance that government revenues received from NIL were complete.

#### Response to the Finding

In the previous quarters' audits, we recommended that the Secretary of Finance require NIL and JFF to ensure that tickets printed and issued to agents are controlled, and that sold and unsold tickets are accounted for on a regular basis. To address the recommendation, the Secretary of Finance initially provided OPA copies of the letters issued to NIL and JFF. The response did not close the recommendation pending receipt of copies of the written procedures and monitoring log sheets established and implemented by DOF, NIL, and JFF. Subsequently, JFF provided DOF and OPA copies of proposed monitoring log sheets and samples of the proposed tickets. Based on OPA's initial review, the proposed documents needed further improvement for efficiency and to better monitor completeness of lottery sales. These initial comments were communicated by OPA to DOF and JFF. JFF then provided DOF and OPA copies or samples of the proposed revised monitoring log sheets and tickets for DOF's approval, after considering OPA's recommended formats.

In response to OPA's previous quarters' audits, the Secretary of Finance provided OPA a copy of the proposed policies and procedures in draft form for the accounting and controlling of lottery operations of the Number Games (Jueteng). Based on our review, the proposed policies and procedures can be further enhanced for better control and monitoring of accountability (*e.g.*, identifying the assigned individual responsible for a certain procedure [either the lottery operator, agent, or DOF], and making the procedures more specific). OPA's initial comments were communicated to DOF. The DOF representative suggested, however, that OPA assist in revising the draft proposed policies and procedures. Accordingly, we proposed revisions which were transmitted to DOF on November 15, 1999. We emphasized to DOF that to avoid impairment of OPA's independence to do future audits, it should be clearly understood that

OPA’s proposed revisions were intended only to guide DOF in developing the policies and procedures. Subsequently, OPA received information that DOF was reviewing the proposed revisions including sample forms and log sheets that we provided.

In response to OPA’s latest lottery audit, the Secretary of Finance stated that the development and implementation of written procedures and monitoring log sheets will be undertaken after completing the revised Lottery Regulations (to include the “Jueteng” game), which DOF is currently working on with AGO.

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

Particulars	Lottery Bank Account	Total Revenues
Unadjusted DOF Balances - 12/31/98	\$193,611	(\$447)
Reconciling Items:		
1. Government revenues for the 3 <sup>rd</sup> Quarter FY 1998 recorded twice <sup>a</sup>	(654)	
2. Prior year error adjusted (deducted from revenue) only in the 1 <sup>st</sup> Quarter FY 1999		447
3. Government revenues deposited during the 1 <sup>st</sup> Quarter FY 1999 but not recorded by DOF as of 12/31/98 <sup>b</sup>		
Commissions		
- 4 <sup>th</sup> Quarter FY 1998 - TMS	3,133	
- 1 <sup>st</sup> Quarter FY 1999 - All operators	94,267	94,267
License Fees		
- 2 <sup>nd</sup> Quarter FY 1998 - JFF	37,500	
- 3 <sup>rd</sup> Quarter FY 1998 - JFF	37,500	
- 4 <sup>th</sup> Quarter FY 1998 - JFF	12,500	
- 1 <sup>st</sup> Quarter FY 1999 - JFF	12,500	12,500
- 1 <sup>st</sup> Quarter FY 1999 - NIL	37,500	37,500
Interest		
- 1 <sup>st</sup> Quarter FY 1999 - All operators	5,920	5,920
4. Accrual of government revenues for the 1 <sup>st</sup> Quarter FY 1999 <sup>b</sup>		7,643
5. Delay in deposit by JFF for the 1 <sup>st</sup> Quarter FY 1999 license fee not in accordance with LOA <sup>c</sup>		25,000
6. Understatement of government revenues of TMS for the 1 <sup>st</sup> Quarter FY 1999, per audit <sup>d</sup>		232
Adjusted DOF Balances -12/31/98	\$433,777	\$183,062

Notes:

- a. Adjusted by DOF on July 31, 1999.
- b. Recorded by DOF on March 31, 1999.

- c. Deposited by JFF at \$12,500 each on January 11 and February 23, 1999, respectively, and recorded by DOF on March 31, 1999.
- d. In response to OPA's latest lottery audit, DOF collected and TMS deposited the underpayment on December 9, 1999.

## **C. Other Matters**

### ***Assignment of Tattersall's Lottery Operator License to TMS and the Right of the Pacific Instant Lottery General Manager to Operate the Retail Lotto Services***

It appears that the Assignment of Lottery License signed on June 30, 1998 by the DOF Secretary and Mr. John Hycenko (on behalf of TMS) was not an actual assignment of Tattersall's license. If it were, the terms of the agreement would have been the same as the original license which was effective until July 28, 2003, and not a 90-day term from the date of implementation which may be renewed for one or more successive 90-day terms with the consent of both parties. 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.

On August 31, 1999, OPA received a memorandum dated August 30, 1999 addressed to the Secretary of Finance from Mr. Hycenko. The memorandum stated that TMS had closed its business as of June 30, 1998 and that the PIL General Manager was continuing the CNMI retail lottery operation in his own right. The memorandum further stated that TMS-Australia assisted the PIL General Manager in starting his lottery operations by providing him (as an advance to be repaid later) lottery equipment and products valued at \$45,000. It is OPA's understanding that TMS is authorized to appoint accredited representatives, including sub-accredited representatives, for the sale of lottery tickets, games, and related materials here in the CNMI. It is also OPA's understanding that the PIL General Manager, not being a party to an assignment, is only an accredited representative of TMS authorized to operate as a lottery shop retailer here in Saipan. To obtain relevant information pertaining to lottery operators that may affect their operations and the determination of their revenues, OPA made an inquiry to DOF (thru a September 8, 1999 letter) as follows: (1) whether TMS had indeed closed shop as of June 30, 1998; (2) whether the operation of the CNMI lottery had been assigned by TMS to the PIL General Manager; and (3) whether DOF had any knowledge of the arrangements between Mr. Hycenko and the PIL General Manager with regards to continued operation of the retail lotto services here in Saipan.

In OPA's latest lottery audit, we discussed this matter and recommended that DOF review the PIL General Manager's right to operate the CNMI retail lotto services. The Secretary of Finance issued a letter to the PIL General Manager stating that DOF needs additional time to review his right to operate because DOF is currently working on revised Lottery Regulations. DOF, however, authorized the PIL General Manager to continue operations for an additional 90-day period, effective January 8, 2000, under the same conditions. A final decision will be issued at the expiration of the 90-day period (which is on April 6, 2000).

Subsequent to the release of our draft audit report, OPA was furnished a copy by Saipan Scratchies of its May 16, 2000 letter to the Secretary of Finance where the following information

was obtained: TMS had indeed closed shop on June 30, 1998; the PIL General Manager was laid off and offered the opportunity to buy the business from TMS; the PIL General Manager established a lottery operation company named “Saipan Scratchies” doing business as CNMI Lottery; and Saipan Scratchies was authorized by DOF to continue lottery operation under the same terms and conditions of the June 30, 1998 Assignment of Lottery License, *i.e.*, 90-day term. However, Saipan Scratchies questioned the said assignment because the Lottery Act (1 CMC §9313 (d)) specifically prohibits assignment of a license [although the Lottery Regulations allow transfer provided there is DOF’s prior written consent]. In view of this, Saipan Scratchies has requested a direct license from DOF so it (Saipan Scratchies) can operate an instant ticket lottery in the CNMI. DOF had not resolved the issue to date of this audit report.

#### **Mr. Juan S. Demapan’s Agreement with JFF to Operate Lottery Games**

On July 21, 1999, JFF and Mr. Juan S. Demapan entered into an exclusive agency agreement through which Mr. Demapan was allowed to operate lottery games as an agent of JFF. A business license was issued to Mr. Demapan under the name of Business Management Service Gaming Entertainment. To determine whether Mr. Demapan and JFF were complying with the Lottery Operator’s Agreement (LOA) between JFF and DOF and with CNMI laws and regulations applicable to lottery operations, OPA sent a letter to the Secretary of Finance on November 19, 1999 to obtain information about the matter. On December 2, 1999, DOF responded to OPA’s query and attached copies of Mr. Demapan’s September 3, 1999 letter (notifying DOF of his business license and his exclusive agency agreement with JFF), and the exclusive agency agreement. Our comments are as follows:

1. It appears that the exclusive agency agreement entered into by JFF and Mr. Demapan on July 21, 1999 violated the LOA between JFF and DOF. First, Mr. Demapan’s operation was not restricted to daily lottery number games called “Jueteng.” The agreement provided that “JFF hereby appoints Demapan, ... as its exclusive agent for the operation of games on Saipan except for the game known as Jueteng.” Sections 2 and 17 of the LOA provided, however, that JFF’s *operation*<sup>1</sup> will consist of daily lottery number games called “Jueteng” and subcontracting by JFF should be for the performance of any services required to be performed by JFF under the LOA.

Second, the exclusive agency agreement was executed without DOF’s written approval. When asked, the Secretary of Finance stated that DOF became aware of the agreement only on September 3, 1999, the day after Mr. Demapan was arrested for illegal gambling (Mr. Demapan personally delivered the notification letter and the agreement to the Secretary). Section 17 of the LOA, however, restricted JFF from entering into a subcontract for the performance of any services required to be performed or provided under LOA without DOF’s prior written consent.

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<sup>1</sup> The word “operation” was added to make the sentence more meaningful.

Although it was DOF's Business License section which issued a license to Mr. Demapan, this business license is not equivalent to DOF's authorization for JFF to subcontract its lottery operator license to Mr. Demapan. Separate written approval should have been obtained by JFF from DOF prior to subcontracting.

2. There is no assurance that revenues from Mr. Demapan's operations are being reported by JFF in the computation of commissions being remitted to DOF. When asked, the Secretary of Finance stated that she cannot respond to this matter pending receipt of information from DOF-Revenue and Taxation Division. Section 6 of the LOA permitted JFF to designate "sub-agents" as their representatives to sell the JFF lottery games provided, however, that at all times JFF and not the "sub-agents" would be liable, responsible, and accountable to DOF for the proper operation of the JFF lottery game and the payment of monies due to DOF.

In OPA's latest lottery audit, we discussed this matter and recommended that DOF review the exclusive agency agreement between JFF and Mr. Juan S. Demapan and investigate the gambling activities of Mr. Demapan to determine whether imposing administrative sanctions against JFF is warranted. The Secretary of Finance stated that the issue of the exclusive agency agreement between JFF and Mr. Demapan has been referred to AGO for further review. On March 21, 2000 JFF ceased operating the lottery game of Jueteng and surrendered its lottery license (see details on page 8). DOF, however, should still check whether JFF reported revenues from Mr. Demapan's operations in the computation of commissions remitted to DOF.

### ***Conclusions and Recommendations***

Government revenues were understated by \$25,232 due to computation error and delay in remitting quarterly license fees by the CNMI lottery operators. Therefore, government revenues should be increased from \$157,830 to \$183,062. The accompanying schedule (**Appendix A**) shows a detailed summary of government revenues for the first quarter of fiscal year 1999 ending December 31, 1998, with comparative figures for the first quarter of fiscal year 1998, after making required adjustments. As explained in the body of this report, NIL and JFF sold tickets with different number series as well as different colors and formats, making it impossible to account for the actual number of tickets sold. Accordingly, there was no assurance that government revenues received from NIL and JFF were complete. Also, DOF should determine the proper license that should be issued to Saipan Scratchies to operate the CNMI retail lotto services. Furthermore, although JFF ceased operating the lottery game of Jueteng effective March 21, 2000, DOF should still check whether JFF reported revenues from Mr. Demapan's operations in the computation of commissions remitted to DOF.

We recommend that the Secretary of Finance:

1. Instruct the DOF Finance and Accounting Division to record the \$232 additional commission from TMS.

2. Address our pending recommendations relating to the development and implementation of written procedures and monitoring log sheets by DOF and lottery operators, to ensure that tickets printed and issued to agents are controlled and that sold and unsold tickets are accounted for on a regular basis.
3. Determine the proper license that should be issued to Saipan Scratchies to operate the CNMI retail lotto services<sup>2</sup>.
4. Check whether JFF reported revenues from Mr. Demapan's operations in the computation of commissions remitted to DOF. If the revenues were not reported, the commissions due to the CNMI Government from the undeclared revenues, including interest and penalty, should be recovered immediately from JFF.

### **DOF Response**

In her letter response dated May 12, 2000 (**Appendix B**), the Secretary of Finance concurred with the recommendations and provided OPA copies of the letters issued and received, and the adjusting journal entry made, to address some of the recommendations, as follows.

*Recommendation 1* - The Secretary of Finance made the necessary journal entry to record the \$232 additional commission from TMS (part of the \$1,287.31 recorded adjustment).

*Recommendation 2* - The Secretary of Finance has developed procedures and monitoring log sheets for the Number Games (Jueteng) to ensure that tickets printed and issued to agents are controlled, and that sold and unsold tickets are accounted for on a regular basis. The procedures were included in the proposed amendments to the rules and regulations for the operation of the CNMI Lottery which were published in the Commonwealth Register on April 20, 2000. The procedures will be implemented upon DOF's adoption of the proposed amendments as published in the Commonwealth Register.

*Recommendation 3* - The Secretary of Finance issued a letter on April 27, 2000 to TMS requesting information on TMS's business relationship with Saipan Scratchies and the former PIL General Manager's involvement with TMS. The Secretary also asked if Saipan Scratchies is a full service retail agency of TMS (these issues were originally raised in DOF's March 30, 2000 letter to TMS). In response to DOF, TMS stated that "we are investigating our operation in Saipan, including distribution to ensure sales are returned to levels previously enjoyed. This includes assessing the agency arrangements and determining other viable opportunities."

### **OPA Comments**

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<sup>2</sup>

Based on the additional information gathered after the issuance of our draft report, the original recommendation has been revised.

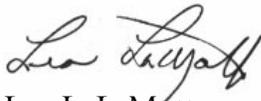
Based on the response we received from the Secretary, we consider Recommendation 1 closed. Recommendations 2 and 3 are considered resolved pending adoption of proposed amendments, and completion of review of the proper license that should be issued to Saipan Scratchies. Recommendation 4 is considered open because the response did not address the recommendation.

The additional information or action required to close the recommendations 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  
Twelfth CNMI Legislature (27 copies)  
Attorney General (temporary)  
Special Assistant for Management and Budget  
Press Secretary  
NIL President  
JFF President  
Saipan Scratchies General Manager  
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 1999 Ending December 31, 1998  
(With comparative figures for the first quarter of fiscal year 1998)**

Lottery Games	Number of Games or Tickets Sold	Amount Subject to Commissions	Commission Rate (%)	Revenues First Quarter 1999	Revenues First Quarter 1998
TMS Saipan, Ltd.					
On-Line Games					
– Saturday	43,522	\$10,856	35.00	\$3,800	\$8,017
– Mid-week	3,578	559	35.00	196	-
– Oz Lotto	3,220	2,006	35.00	702	1,571
– Keno	3,534	2,069	37.41	774	2,355
– Power Ball	2,610	813	35.00	285	-
Sub-total	56,464	\$16,303		\$5,757	\$11,943
Instant Tickets					
– Five Dollars	5,250	\$16,721	26.50	\$4,431	-
– Two Dollars	-	-	-	-	(\$2,253)
– One Dollar	45,000	45,000	25.00	11,250	23,334
Sub-total	50,250	\$61,721		\$15,681	\$21,081
Total TMS	106,714	\$78,024		\$21,438	\$33,024
NIL Jueteng					
Two Number	447,575	\$447,575	10.00	\$44,758	\$42,368
One Number	77,229	77,229	5.00	3,861	3,449
License Fees	-	-	-	37,500	37,500
Total NIL Jueteng	524,804	\$524,804		\$86,119	\$83,317
JFF Jueteng					
Two Number	299,098	\$299,098	10.00	\$29,910	-
One Number	43,502	43,502	5.00	2,175	-
License Fees	-	-	-	37,500	-
Total JFF Jueteng	342,600	\$342,600		\$69,585	-
Interest/Other Income				\$5,920	\$1,272
GRAND TOTAL				\$183,062	\$117,613



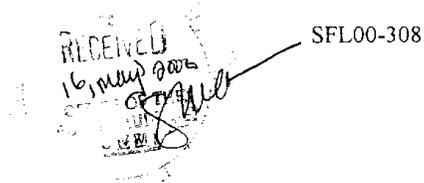
Office of the Secretary  
Department of Finance

P.O. Box 5234 CHRBSAIPAN, MP 96950

TEL. (670) 664-1100 FAX: (670) 664-1115

May 12, 2000

Mr. Leo L. LaMotte  
CNMI Public Auditor  
Office of the Public Auditor  
Commonwealth of the Northern  
Mariana Islands  
Saipan, MP. 96950



**RE: Response to Draft Audit Report on the Audit of Government Revenues from the CNMI Lottery Operations for the First Quarter of Fiscal Year 1999 Ending December 31, 1998.**

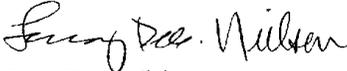
This letter responds to the draft audit letter report on the audit of government revenues from the operations of the CNMI Lottery for the first quarter of Fiscal Year 1999.

The following is our specific response to your recommendations:

1. We have instructed the Finance and Accounting Division to record the \$1,287.31 deposited to the CNMI Lottery bank account by The Mail Service (TMS) on December 16, 1999. This represents the additional commission due to the CNMI Government because TMS made errors in their computation for the Keno games. A copy of the journal entry is enclosed for your reference.
2. The Department of Finance has developed the proposed amendments to the rules and regulations for the operation of the Commonwealth of the Northern Mariana Islands Lottery to include the lottery number games known as "Jueteng". It was published in the Commonwealth Register on April 20, 2000. The implementation of written procedures and monitoring log sheets will follow when the amendments to the rules and regulations are finalized.
3. We sent a letter to Mr. John Hycenko, Managing Director of TMS Global Services Pty Ltd. on March 30, 2000 and a follow up on April 27, 2000 regarding TMS's plans to expand its lottery operations in the CNMI and the involvement of Saipan Scratchies and Craig Patillo with TMS. A facsimile respond was received by the Secretary of Finance's office on May 2, 2000. A copy of these correspondences are enclosed for your reference.

Should need additional information or have any questions, please let us know.

Sincerely,

  
Lucy DLG. Nielsen  
Secretary of Finance

09200 Account Ledger Inquiry  
 From Date/Period 10/01/99  
 Account . . . . . 3760.45710 Thru Date/Period 05/31/00  
 CNMI Share-TATTSLOTTO Ledger Type . . . AA  
 Skip to Doc/Type . . . . . Subledger . . . . . \*  
 Y-T-D Period End . . . . . 2,040.62-  
 Cumul Period End . . . . . 2,040.62-

Q	DT	Document	Date	Explanation	Debit	Credit	P
	CR	23647	05/12/00	TR CM 2000-008		386.04-	P
	CR	23647	05/12/00	TR CM 2000-008		367.27-	P
	CR	23647	05/12/00	TR CM 2000-008		1,287.31-	P
						-----	
						2,040.62-	
Ledger Total						2,040.62-	
Unposted Total							

Opt: 1/2=Orig Entry 5=Details F21=Prt Ledg F17=Top F18=Totals F24=More



Office of the Secretary  
Department of Finance

P.O. Box 5234 CHRBSAIPAN, MP 96950

TEL: (670) 664-1100 FAX: (670) 664-1115

March 30, 2000

*Sent Via Facsimile and U.S. Mail*

Mr. John Hycenko  
Managing Director  
TMS Global Services Pty Ltd.  
P.O. Box 2937 DD G.P.O.  
Melbourne, VIC 3001 Australia

SFL 2000-230

RE: TMS Lottery Operator's License

Dear Mr. Hycenko:

This is concerning questions raised on the validity of TMS's Lottery Operator's License and an inquiry on our part, on TMS's plans for its lottery operations in the Commonwealth of the Northern Mariana Islands (CNMI).

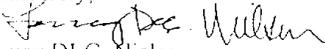
The Assignment of Lottery License, dated June 30, 1998, entered between the CNMI Government and TMS Saipan, Ltd., remains valid and in full force and effect. Pursuant to the terms and conditions of the Assignment, the parties through conduct, have renewed and extended this Assignment at 90-day intervals from June 30, 1998 through the current date. Assuming that the parties do not terminate this Assignment, it will expire on June 29, 2003 as provided for in the original agreement with Tattersall's.

As we have established the matter on the validity of your lottery license, we would like to know what plans TMS has in order for the expansion of its lottery operations in the CNMI. In your correspondence dated March 10, 2000, you expressed plans to establish new operators in the CNMI. Please provide us a copy of your business plan indicating the schedule of when the new operators will be established, gross revenue projections, and projection for the CNMI share.

Also, please let us know what your plans are with respect to Saipan Scratchies and Craig Patillo's involvement with your business. As the sole CNMI agent for TMS, any decision you have made or have yet to make concerning Mr. Patillo will directly impact the revenue received by the CNMI.

I do hope to hear from you on the issues we have raised on the future direction TMS will take on its lottery operations.

Sincerely,

  
Lucy D.L.G. Nielsen  
Secretary of Finance

**FAXED**  
CV 3/30



Office of the Secretary  
Department of Finance

P.O. Box 5234 CHRBSAIPAN, MP 96950

TEL. (670) 664-1100 FAX: (670) 664-1115

April 27, 2000

SFL 2000-264

Sent via Facsimile and U.S. Mail

Mr. John Hycenko  
Managing Director  
TMS Global Services Pty. Ltd.  
P.O. Box 2937 DD G.P.O.  
Melbourne, VC 3001 Australia

RE: TMS Lottery Operator's License

Dear Mr. Hycenko:

This is a follow-up on my letter dated March 30, 2000, regarding TMS's Lottery Operator's License. I am enclosing a copy of the letter for reference.

Please advise us on your plans to expand your lottery operations in the CNMI. We have received proposals from potential companies who have expressed an interest in establishing lottery operations in the CNMI. We cannot ascertain the need for additional operators until you advise us of your future plans with respect to the CNMI lottery.

We are also trying to determine your "business" relationship with Saipan Scratchies and Craig Patillo's involvement with TMS. Specifically, we want to know if Saipan Scratchies is a full service retail agency of TMS.

Your prompt attention to these issues will assist us in resolving outstanding matters relative to the operation of the CNMI lottery.

Thank you.

Sincerely,

LUCY DLG. NIELSEN  
Secretary of Finance



FACSIMILE

COMMERCIAL - IN - CONFIDENCE

PLEASE NOTE: The information contained in this facsimile transmission is confidential information, intended only for the use of the recipient named below. If the reader of any of the information contained in this facsimile transmission is not the recipient named below, then you, that reader, are warned that any distribution, copying or dissemination of the information contained in this facsimile transmission or the facsimile transmission itself is strictly prohibited. If you have received this facsimile transmission by error or are not the named recipient, please immediately advise TMS by telephone and return the facsimile transmission so received to our address by courier or post, the reasonable costs of which will be borne by TMS. Thank you.

DATE	: 2/05/00
TO	: LUCY DLG. NIELSEN
COMPANY	: Secretary of Finance Department of Finance
FAX NO.	: 0015-1-670-664-1115
FROM	: ANDREW KERCKES
FAX NUMBER	: +613 9328 3009
NUMBER OF PAGES	: 1
(INCLUDING COVER)	

*Copy - Puffin / Kather / Debbie / Connie*

Dear Ms Nielsen

Thank you for your letter and attention.

We are investigating our operation in Saipan, including distribution to ensure sales are returned to levels previously enjoyed. This includes assessing the existing Agency arrangements and determining other viable opportunities.

As soon as our plans are formulated we will advise you, to seek your approval.

Yours faithfully

  
Andrew Kerckes  
CEO

TMS Global Services Pty Ltd  
ACN 089 771 835

Telephone: +61 3 9329 9388  
Facsimile: +61 3 9328 3009

G.P.O. Box 2937DD, Melbourne  
Vic. 3001, Australia

Internet: [www.lotteries.net.au](http://www.lotteries.net.au)  
Email: [info@lotteries.net.au](mailto:info@lotteries.net.au)

**Audit of Government Revenues from the CNMI Lottery Operations  
For the First Quarter of Fiscal Year 1999 Ending December 31, 1998**

**STATUS OF RECOMMENDATIONS**

Recommendations	Agency to Act	Status	Agency Response/ Additional Information or Action Required
1. Instruct the DOF Finance and Accounting Division to record the \$232 additional commission from TMS.	DOF	Closed	<p>The Secretary of Finance concurred with the recommendations and provided OPA copies of the letters issued and received, and the adjusting journal entry made, to address some of the recommendations, as follows.</p> <p>Recommendation 1 - The Secretary of Finance made the necessary journal entry to record the \$232 additional commission from TMS (part of the \$1,287.31 recorded adjustment).</p> <p>Recommendation 2 - The Secretary of Finance has developed procedures and monitoring log sheets for the Number Games (Jueteng) to ensure that tickets printed and issued to agents are controlled, and that sold and unsold tickets are accounted for on a regular basis. The procedures were included in the proposed amendments to the rules and regulations for the operation of the CNMI Lottery which were published in the Commonwealth Register on April 20, 2000. The procedures will be implemented upon DOF's adoption of the proposed amendments as published in the Commonwealth Register.</p>
2. Address our pending recommendations relating to the development and implementation of written procedures and monitoring log sheets by DOF and lottery operators, to ensure that tickets printed and issued to agents are controlled and that sold and unsold tickets are accounted for on a regular basis.	DOF	Resolved	<p>Recommendation 3 - The Secretary of Finance issued a letter on April 27, 2000 to TMS requesting information on TMS's business relationship with Saipan Scratchies and the former PIL General Manager's involvement with TMS (these issues were originally raised in DOF's March 30, 2000 letter to TMS). The Secretary also asked if Saipan Scratchies is a full service retail agency of TMS. In response to DOF, TMS stated that "we are investigating our operation in Saipan, including distribution to ensure sales are returned to levels previously enjoyed. This includes assessing the agency arrangements and determining other viable opportunities."</p>

**Audit of Government Revenues from the CNMI Lottery Operations  
For the First Quarter of Fiscal Year 1999 Ending December 31, 1998**

**STATUS OF RECOMMENDATIONS**

Recommendations	Agency to Act	Status	Agency Response/ Additional Information or Action Required
3. Determine the proper license that should be issued to Saipan Scratchies to operate the CNMI retail lotto services.	DOF	Resolved	<i>Further Actions Required</i>  Recommendation 2 - Provide OPA a copy of the adopted rules and regulations for the operation of the CNMI lottery.
4. Check whether JFF reported revenues from Mr. Demapan's operations in the computation of commissions remitted to DOF. If the revenues were not reported, the commissions due to the CNMI Government from the undeclared revenues, including interest and penalty, should be recovered immediately from JFF.	DOF	Open	Recommendations 3 and 4 - Provide OPA copies of the results of the review and supporting documents.