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Commonwealth of the Northern Mariana Islands

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September 18, 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 Second Quarter of Fiscal Year 1999 Ending March 31, 1999 (LT-00-08)

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 second quarter of fiscal year 1999 ending March 31, 1999. 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 \$144,841 from the CNMI lottery operations for the second quarter of fiscal year 1999 ending March 31, 1999 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 \$25,201 and should be increased to \$170,042.

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 second quarter of fiscal year 1999 ending March 31, 1999 with cumulative totals for the two quarters of both fiscal years 1998 and 1999, after making required adjustments.

We recommended that the Secretary of Finance (1) initiate actions to implement the adopted amendments relating to control procedures established to ensure completeness of government revenues received from the Number Game (Jueteng) operators (Rule 24 - Jueteng Documentation and Record-Keeping, and Rule 25 - Game Rules for Jueteng Game); (2) address our pending recommendation on determining the proper license that should be issued to Saipan Scratchies (formerly referred to as TMS) to operate the CNMI retail lotto services; and (3) address our pending recommendation on determining 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 August 7, 2000 (**Appendix B**), the Secretary of Finance concurred with all the recommendations.

Based on the response we received from the Secretary, we consider Recommendations 1 to 3 resolved pending implementation of the adopted amendments relating to control procedures established to ensure completeness of government revenues received from the Number Game (Jueteng) operators; submission of the basis for concluding that Saipan Scratchies was an agent of lottery operator TMS and therefore should not be issued a lottery license; and recovery of commissions which DOF acknowledges are due from JFF for JFF's failure to declare revenues from Mr. Demapan's operations. 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, Number International Lottery, and Just For Fun.

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 that 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 the

right 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 second quarter of fiscal year 1999 ending March 31, 1999.

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 operator’s 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 August 12, 1999 and February 7, 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 February 7, 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 \$144,841 from the CNMI lottery operations for the second quarter of fiscal year 1999 ending March 31, 1999 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 fees remitted after the quarter under audit. As a result, government revenues were understated by \$25,201 and should be increased to \$170,042.

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 second quarter of fiscal year 1999 totaled \$144,841. Of this amount, \$19,217 was paid by TMS, \$81,571 by NIL, and \$41,177 by JFF. Our audit showed, however, that government revenues were understated by \$25,201 due to computation error, and delay in remitting quarterly license fees by the CNMI lottery operators. The table below 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	\$5,419	\$201	\$5,620
- Instant Tickets	13,798	-	13,798
Sub-total	\$19,217	\$201	\$19,418
NIL Jueteng			
- Two number games	\$40,430	-	\$40,430
- One number games	3,641	-	3,641
- License fee	37,500	-	37,500
Sub-total	\$81,571	\$0	\$81,571
JFF Jueteng			
- Two number games	\$26,247	-	\$26,247
- One number games	2,430	-	2,430
- License fee	12,500	\$25,000	37,500
Sub-total	\$41,177	\$25,000	\$66,177
Interest/Other Income	\$2,876	-	\$2,876
TOTAL	\$144,841	\$25,201	\$170,042

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 \$201 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, \$201 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 last two months of the second quarter FY 1999 license fee after the quarter under audit, *i.e.*, the February fee of \$12,500 was paid on May 5, 1999, and the March fee was

paid in equal installment of \$6,250 on June 17, and July 9, 1999. 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 previous quarters' audits, and we recommended that DOF instruct JFF to timely remit its quarterly license fees. 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 \$25,201 and should be increased to \$170,042.

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 was 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 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

operations of the CNMI Lottery which were published in the Commonwealth Register on April 20, 2000. Subsequent to the release of the final audit report, DOF adopted the proposed amendments as published in the Commonwealth Register on June 20, 2000.

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 Balance - 3/31/99	\$530,856	\$336,797
Reconciling Items:		
1. Government revenues for the 3 rd Quarter FY 1998 recorded twice ^a	(654)	
2. Prior year error adjusted (deducted from revenue) only in the 1 st Quarter FY 1999		447
3. Government revenues earned and deposited in prior year recorded by DOF only on 3/31/99		
Commissions		
- 1 st Quarter FY 1998 - NIL		(3,946)
- 4 th Quarter FY 1998 - TMS		(3,133)
License Fees of JFF		
- 2 nd Quarter FY 1998		(37,500)
- 3 rd Quarter FY 1998		(37,500)
- 4 th Quarter FY 1998		(12,500)
4. Government revenues deposited during the 2 nd Quarter FY 1999 but not recorded by DOF as of 3/31/99 ^b	26,362	26,362
5. License fees deposited during the 2 nd Quarter FY 1999 but not recorded by DOF as of 3/31/99 ^b		
- NIL	37,500	37,500
- JFF	12,500	12,500
6. Accrual of government revenues for the 2 nd Quarter FY 1999 ^b		8,644
7. Delay in deposit by JFF for the 2 nd Quarter FY 1999 license fees not in accordance with LOA ^c		25,000
8. Understatement of government revenues from TMS, per audit ^d		
- 1 st Quarter FY 1999		232
- 2 nd Quarter FY 1999		201
Adjusted Balances - 3/31/99	\$606,564	\$353,104

See next page for description of Notes:

Notes:

- a. Adjusted by DOF on July 31, 1999.
- b. Recorded by DOF on May 31, 1999.
- c. \$12,500, \$6,250, and \$6,250 were deposited by JFF in May, June, and July 1999, respectively, and recorded by DOF on August 24, 1999.
- d. Deposited by TMS on December 9, 1999 and recorded by DOF on May 12, 2000.

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 could 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 copy of 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 our 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 previous quarters' audits, 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).

Subsequently, 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.

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*¹ 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.

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.

¹ The word "operation" was added to make the sentence more meaningful.

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 the previous quarters' audits, 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 \$25,201 due to computation error and delay in remitting quarterly license fees by the CNMI lottery operators. Therefore, government revenues should be increased from \$144,841 to \$170,042. The accompanying schedule (**Appendix A**) shows a detailed summary of government revenues for the second quarter of fiscal year 1999 ending March 31, 1999, with cumulative totals for the two quarters of both fiscal years 1998 and 1999, 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. Initiate actions to implement the adopted amendments relating to control procedures established to ensure completeness of government revenues received from the Number Game (Jueteng) operators (Rule 24 - Jueteng Documentation and Record-Keeping, and Rule 25 - Game Rules for Jueteng Game).
2. Address our pending recommendation on determining the proper license that should be issued to Saipan Scratchies to operate the CNMI retail lotto services.

3. Address our pending recommendation on determining 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 August 7, 2000 (**Appendix B**), the Secretary of Finance concurred with all the recommendations, as follows.

Recommendation 1 - The Secretary of Finance stated that DOF will provide NIL with a copy of the adopted amendments to the rules and regulations for the operations of the CNMI Lottery, specifically Rule 24 - Jueteng Documentation and Record-Keeping, and Rule 25-Game Rules for Jueteng Game.

Recommendation 2 - The Secretary of Finance stated that DOF determined that Saipan Scratchies was an agent of lottery operator TMS and therefore should not be issued a lottery license.

Recommendation 3 - The Secretary of Finance stated that there appears to be no indication that revenues from Mr. Demapan's operations were included in the computation of commissions remitted to DOF. Legal issues are currently pending at the Attorney General's Office regarding Mr. Demapan's operations. Immediate recovery of undeclared revenues, including interest and penalty, is not anticipated until those legal issues are resolved.

OPA Comments

Based on the response we received from the Secretary, we consider Recommendations 1 to 3 resolved pending:

1. Implementation of the adopted amendments relating to control procedures established to ensure completeness of government revenues received from the Number Game (Jueteng) operators.
2. Submission of the basis for concluding that Saipan Scratchies was an agent of lottery operator TMS and therefore should not be issued a lottery license. The conflict between the Lottery Act [1 CMC §9313(d) which specifically prohibits assignment of a license] and the Lottery Regulations (which allow transfer provided there is DOF's prior written consent) should be resolved. Also, TMS's business relationship with Saipan Scratchies (whether a full service retail agency of TMS) and Saipan Scratchies status as a lottery operator should be further reviewed (these issues were already raised in DOF's various letters to TMS). This is because neither TMS nor Saipan Scratchies agrees that Saipan Scratchies is an agent of TMS.

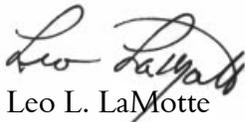
3. Recovery of commissions which DOF acknowledges are due from JFF for JFF's failure to declare revenues from Mr. Demapan's operations.

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
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 Second Quarter of Fiscal Year 1999 Ending March 31, 1999
(With cumulative totals for the two quarters of both fiscal years 1998 and 1999)**

Lottery Games	Number of Games or Tickets Sold	Amount Subject to Commissions	Commission Rate (%)	Revenues Second Quarter 1999	Total Revenues FY 1999	Total Revenues FY 1998
TMS Saipan, Ltd.						
On-Line Games						
– Saturday	42,291	\$10,743	35.00	\$3,760	\$7,560	\$15,688
– Oz Lotto	2,301	1,458	35.00	510	1,213	3,424
– Power ball	5,388	1,705	35.00	597	882	-
– Mid-Week	1,361	215	35.00	76	271	-
– Keno	3,047	1,815	37.30	677	1,451	4,447
Sub-total	54,388	\$15,936		\$5,620	\$11,377	\$23,559
Instant Tickets						
– Five Dollars	4,500	\$14,333	26.50	3,798	8,229	-
– Two Dollars	-	-	26.50	-	-	2,252
– One Dollar	40,000	40,000	25.00	10,000	21,250	51,113
Sub-total	44,500	\$54,333		\$13,798	\$29,479	\$53,365
Total TMS	98,888	\$70,269		\$19,418	\$40,856	\$76,924
NIL Jueteng						
Two Number	404,302	\$404,302	10.00	\$40,430	\$85,188	88,303
One Number	72,818	72,818	5.00	3,641	7,502	7,188
License Fees	-	-	-	37,500	75,000	75,000
Total NIL Jueteng	477,120	\$477,120		\$81,571	\$167,690	\$170,491
JFF Jueteng						
Two Number	262,473	\$262,473	10.00	\$26,247	\$56,157	\$44,229
One Number	48,595	48,595	5.00	2,430	4,605	1,315
License Fees	-	-	-	37,500	75,000	37,500
Total JFF Jueteng	311,068	\$311,068		\$66,177	\$135,762	\$83,044
Interest/Other Income				\$2,876	\$8,796	\$3,956
GRAND TOTAL				\$170,042	\$353,104	\$334,415



Office of the Secretary
Department of Finance

P.O. Box 5234 CHRBSAIPAN, MP 96950

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August 7, 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 Second Quarter of Fiscal Year 1999 Ending March 31, 1999

Dear Mr. LaMotte:

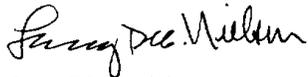
This letter responds to the draft audit letter report on the audit of government revenues from the operations of the CNMI Lottery for the second quarter of Fiscal Year 1999.

The following is our specific response to your recommendations:

1. We will be providing Numbers International Lottery today a copy of the adopted amendments of the CNMI Lottery Regulations relating to control procedures established by the Department of Finance to ensure completeness of government revenues received from the numbers game (Jueteng), specifically Rule 24 - Jueteng Documentation and Record-Keeping, and Rule 25 - Game Rules for Jueteng Game).
2. We have determined that Saipan Scratchies was an agent of the lottery operator & therefore should not be issued a lottery license. The lottery operator is TMS which was issued a license to operate the CNMI lottery in 1998 and to date, continues to be the license holder.
3. In reviewing JFF's daily activity report submitted to DOF, there appears to be no indication that revenues from Mr. Demapan's operations was included in the computation of commissions remitted to DOF. There is currently pending legal issues at the Attorney General's Office regarding Mr. Demapan's operations. Immediate recovery of undeclared revenues, including interest and penalty is not anticipated until legal issues are resolved.

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

Sincerely,

A handwritten signature in black ink that reads "Lucy DLG. Nielsen". The signature is written in a cursive style with a large initial 'L'.

Lucy DLG. Nielsen
Secretary of Finance

**Audit of Government Revenues from the CNMI Lottery Operations
For the Second Quarter of Fiscal Year 1999 Ending March 31, 1999**

STATUS OF RECOMMENDATIONS

Recommendations	Agency to Act	Status	Agency Response/ Additional Information or Action Required
<p>1. Initiate actions to implement the adopted amendments relating to control procedures established to ensure completeness of government revenues received from the Number Game (Jueteng) operators (Rule 24 - Jueteng Documentation and Record-Keeping, and Rule 25 - Game Rules for Jueteng Game).</p>	<p>DOF</p>	<p>Resolved</p>	<p>The Secretary of Finance concurred with all the recommendations, as follows.</p> <p>Recommendation 1 - The Secretary of Finance stated that DOF will provide NIL with a copy of the adopted amendments to the rules and regulations for the operations of the CNMI Lottery, specifically Rule 24 - Jueteng Documentation and Record-Keeping, and Rule 25-Game Rules for Jueteng Game.</p> <p>Recommendation 2 - The Secretary of Finance stated that DOF determined that Saipan Scratchies was an agent of lottery operator TMS and therefore should not be issued a lottery license.</p>
<p>2. Address our pending recommendation on determining the proper license that should be issued to Saipan Scratchies to operate the CNMI retail lotto services.</p>	<p>DOF</p>	<p>Resolved</p>	<p>Recommendation 3 - The Secretary of Finance stated that there appears to be no indication that revenues from Mr. Demapan's operations were included in the computation of commissions remitted to DOF. Legal issues are currently pending at the Attorney General's Office regarding Mr. Demapan's operations. Immediate recovery of undeclared revenues, including interest and penalty, is not anticipated until those legal issues are resolved.</p> <p><i>Further Actions Required</i></p> <p>Recommendation 1 - Provide OPA copies of documents evidencing that NIL implemented the adopted rules and regulations for the operation of Jueteng Game.</p>
<p>3. Address our pending recommendation on determining 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.</p>	<p>DOF</p>	<p>Resolved</p>	<p>Recommendation 2 - Provide OPA copies of documents evidencing the basis for concluding that Saipan Scratchies was an agent of lottery operator TMS and therefore should not be issued a lottery license. Issues with regards to the conflict between the Lottery Act and the Lottery Regulations on assignment of a license, and TMS's business relationship with Saipan Scratchies, should be resolved.</p> <p>Recommendation 3 - Provide OPA copies of documents evidencing recovery of commissions owed by JFF for Mr. Demapan's operations.</p>