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Commonwealth of the Northern Mariana Islands

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April 25, 2001

Ms. Lucy DLG. Nielsen
Secretary, Department of Finance
P.O. Box 5234
Saipan, MP 96950

Dear Ms. Nielsen:

Subject: Final Letter Report on the Audit of Government Revenues from the CNMI Lottery Operations for the Third Quarter of Fiscal Year 1999, Ended June 30, 1999 (Report No. LT-01-01)

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 third quarter of fiscal year 1999, ended June 30, 1999. The objective of the audit was to determine whether government revenues from the CNMI lottery operations were accurately computed in accordance with the individual Memorandum of Understanding (MOU) and terms of agreement between the CNMI Government, as represented by the Department of Finance (DOF), and the three CNMI lottery operators, referred as Operators A, B, and C in the report¹.

Our audit showed that government revenues from the CNMI lottery operations for the third quarter of fiscal year 1999, ended June 30, 1999, were understated by \$37,729 due to a computation error on the part of one lottery operator and late remittance of quarterly license fees by another operator. As a result, government revenues should be increased from \$123,603, as previously recorded, to \$161,332. No recommendation on these matters needs to be proposed for this quarter because the lottery operators subsequently took corrective action to address the matters.

Our audit also showed that the two Number Game (Jueteng) operators sold tickets with different number series as well as different colors and formats, making it impossible to account for the

¹ In accordance with statutory restrictions in the Auditing and Ethics Acts, the names of individuals and corporations in this audit are not disclosed in the report.

actual number of tickets sold. Accordingly, there was no assurance that government revenues received from the two operators were complete.

The accompanying schedule (**Appendix A**) shows a detailed summary of government revenues for the third quarter of fiscal year 1999, ended June 30, 1999, with cumulative totals for the three quarters of both fiscal years 1998 and 1999, after making required adjustments.

We recommend that the Secretary of Finance (1) request that Operator A correct its records and transmit to DOF the unremitted revenues of \$7,584; (2) address our pending recommendation on initiating action to implement the adopted amendments relating to control procedures established to ensure completeness of government revenues received from the Number Game (Jueteng) operators; (3) provide the basis for concluding that Agency A was an agent of Operator A, and therefore should not be issued a lottery license; the conflict between the Lottery Act (1CMC §9313(d) which specifically prohibits assignment of a license) and the Lottery Regulations (which allow transfer upon DOF's prior written consent) should be resolved by a legal opinion of the Attorney General's Office (AGO); and, (4) recover the commissions which DOF acknowledges are due from Operator C for its agent's failure to declare revenues from operations.

In her letter response dated December 27, 2000 and in a subsequent meeting held at DOF office, the Secretary of Finance responded to all the recommendations. Based on the response we received from the Secretary, we consider all recommendations closed. DOF and the lottery operators had taken corrective action to address the recommendations, *i.e.*, initiation of action to implement the adopted amendments. OPA was also provided copies of the bank statements reflecting deposit and opinion letters to address the recommendations.

BACKGROUND

The CNMI Lottery

The Commonwealth Lottery Commission Act, in 1 CMC §9301 et seq., authorized the operation of a public lottery in the Commonwealth to be administered by a Commonwealth Lottery Commission.

Effective 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. Under the Executive Order, the Secretary of Finance, in consultation with the Secretary of Commerce and the Attorney General, assumed the administrative functions of the defunct Commission as necessary for administration of the CNMI Lottery.

CNMI Lottery Operators

The CNMI Government, through the former Commonwealth Lottery Commission and DOF, issued lottery operator licenses authorizing three companies to conduct public lotteries in the

CNMI. These companies are referred to in this report as Original Lottery Operator Licensee, Operators B, and C.

Original Lottery Operator Licensee and Subsequent Assignment of Lottery License to Operator A

The Original Lottery Operator Licensee (Original Licensee) was issued a lottery operator's license effective July 29, 1993, to July 28, 2003. The license granted Original Licensee the exclusive right to conduct all public lotteries in the CNMI. The license also allowed Original Licensee to appoint accredited representatives to sell the lottery games. On September 1, 1993, Operator A was incorporated in the CNMI and became the sole accredited and authorized representative for the overseas operations of the Original Licensee's games, to manage lottery operations and to sell instant lottery tickets in the CNMI.

On October 14, 1993, Operator A began its lottery operations in the CNMI. Currently, two types of games are offered to the public by Operator A. These games, as described in the lottery operation rules and regulations, are 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. Operator A 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 the Original Licensee's lottery license to Operator A. As explained in the agreement, Original Licensee exercised its termination rights, alleging that the CNMI Government breached the Original Licensee's exclusive lottery license by granting additional "exclusive lottery license(s)" to other entities. As a result, Original Licensee would no longer make its lottery games available or permit its lottery games to be sold in the CNMI subsequent to June 30, 1998. Operator A, 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 Original Licensee. The CNMI accepted Operator A'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.

Operator B

Operator B was issued a lottery operator’s license for the period December 12, 1997, to July 28, 2003. The license granted Operator B the exclusive right to sell tickets for a public lottery game called “Jueteng.”

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

- Two Number Game - A two number game is played using tickets sold to players by Operator B’s 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 Operator B 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.

Operator B conducts daily lottery drawings in its office between approximately 11:00 p.m. and midnight, after the ticket sellers have reported their collections for the day. The actual drawing of the winning numbers is similar to that of a more popular game known as Bingo. Balls numbered 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. At the top of the container is an opening for a single ball. At the 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 two number combination, and at the same time, the first ball drawn represents the winners of the one number game.

Operator C

Operator C was issued a lottery operator’s license for the period January 9, 1998, to January 8, 2003. The license granted Operator C the right to sell tickets for a public lottery game called “Jueteng.” Operator C operates the same Jueteng games conducted by Operator B as described above.

Operator C conducts daily lottery drawings in its office at night after 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. Either one of the two numbers drawn represents the winners of the one number game.

Operator C ceased operations on March 21, 2000.

OBJECTIVE, SCOPE, AND METHODOLOGY

Quarterly audits of government revenues from the CNMI lottery operations are performed pursuant to 1 CMC §9320. The objective of the audit was to determine whether government revenues from the CNMI lottery operations were accurately computed in accordance with the individual MOU and terms of agreements between the CNMI Government, as represented by DOF, and the three CNMI lottery operators. The scope of the audit covered government revenues from the CNMI lottery operations for the third quarter of fiscal year 1999, ended June 30, 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 Operator A's 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 an accountant hired by Operator A 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 Operators B and C's 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 reviewed DOF records and bank statements to verify recording and receipt of government revenues.

This performance audit was conducted at the offices of the three lottery operators and DOF in Saipan between January 6, 2000, and March 31, 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 March 31, 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 in accordance with the individual MOU and terms of agreement between the CNMI Government and the CNMI lottery operators. Our audit showed that government revenues from the CNMI lottery operations for the third quarter of fiscal year 1999, ended June 30, 1999, were understated by \$37,729 due to a computation error on the part of one lottery operator and late remittance of quarterly license fees by another operator. This occurred because (1) Operator A 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) Operator C remitted the quarterly license fee late, *i.e.*, after the quarter under audit. As a result, government revenues should be increased from \$123,603, as previously recorded, to \$161,332. No recommendation on these matters needs to be proposed for this quarter because the lottery operators subsequently took corrective action to address the matters.

Lottery Operators' Terms of Agreement

Under DOF's 1994 MOU with Operator A, the sole accredited representative of Original Licensee, 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. For CNMI revenue computation, instant game tickets are considered sold once the shipped tickets are received and available for sale in the CNMI.

The Lottery Operator's Agreements (LOAs) with Operators B and C required the two operators to pay an annual license fee of \$150,000, payable in equal quarterly installments beginning on the first day of the month following the date of the agreement, *i.e.*, October 1 for Operator B and February 1 for Operator C. Operators B and C are 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.

Error in Computing Government Revenues and Delay in Remitting License Fee

Government revenues from the CNMI lottery operations for the third quarter of fiscal year 1999 totaled \$123,603. Of this amount, \$13,487 was paid by Operator A, \$77,101 by Operator B, and \$28,995 by Operator C. Our audit showed, however, that government revenues were understated by \$37,729 due to a computation error by Operator A and late remittance of quarterly license fees by Operator C.

The table below presents the details of government revenues earned and the understatement found during our audit.

Particulars	Unadjusted Revenues	Understatement	Adjusted Revenues
Operator A			
- On-line games	\$5,930	\$229	\$6,159
- Instant Tickets	7,557	-	7,557
Sub-Total	\$13,487	\$229	\$13,716
Operator B			
- Two number games	\$35,772	-	\$35,772
- One number games	3,829	-	3,829
- License fee	37,500	-	37,500
Sub-total	\$77,101	\$0	\$77,101
Operator C			
- Two number games	\$26,324	-	\$26,324
- One number games	2,671	-	2,671
- License fee	-	\$37,500	37,500
Sub-total	\$28,995	\$37,500	\$66,495
Interest/Other Income	\$4,020	-	\$4,020
TOTAL	\$123,603	\$37,729	\$161,332

This understatement of revenues occurred because (1) Operator A 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) Operator C remitted the quarterly license fee late, *i.e.*, after the quarter under audit.

Under the MOU, Operator A is required to pay at least 35 percent of the subscription price for each on-line ticket sold as government revenue, however, Operator A multiplied its sales from the Keno game (an on-line game) by only 26.5 percent. This resulted in a \$229 understatement. The error was found during the lottery audit. We recommended that DOF ask Operator A to correct its records and remit the net underpayment. Operator A 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 ended September 30, 1999, \$229 of which is for this quarter) was deposited by Operator A to the CNMI lottery bank account on December 9, 1999. Consequently, no recommendation on this matter needs to be proposed for this quarter.

Operator C remitted the three months of the third quarter FY 1999 license fee after the quarter under audit, *i.e.*, \$6,250, \$18,750, and \$12,500 each on August 18, and September 28, and 30, 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 also existed in OPA's previous quarters audits, and we recommended that DOF instruct Operator C to timely remit its quarterly license fees. DOF issued a letter to Operator C instructing timely remittance of the quarterly license fees due to the CNMI Government, and stating that imposing administrative sanctions against Operator C would be warranted in case of continuing delay in payment.

On March 21, 2000, a notice of surrender of Operator C's lottery license was filed by its legal counsel with the Department of Commerce and AGO. The notice states that "*Due to the policies of the Department of Finance in connection with the treatment of [Operator C], [Operator C] 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 [Operator C'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 [Operator C] 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.

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 of government revenues from the CNMI lottery operations for the third quarter of fiscal year 1999, ended June 30, 1999, showed however, that the two Number Game (Jueteng) operators 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 the two Number Game (Jueteng) operators were complete.

Monitoring of Lottery Sales

Control procedures should be established to ensure the completeness of lottery sales, which is the basis for the computation of government revenues reported by the CNMI lottery operators. Lottery operators should be required 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 easily be 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.

Operator C Lottery Sales

Our review showed that DOF maintained only the Daily Activity Reports prepared by Operator C's 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 Operator C 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 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 Operator C were complete.

Operator B Lottery Sales

Our review showed that DOF maintained only the General Cashier's Recap reports prepared by Operator B's 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 Operator C, it is impossible to account for the actual number of tickets sold because Operator B 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 Operator B were complete.

Adoption of the Control Procedures for the Lottery Operations of the Number Games

In response to OPA's previous quarter's audits, 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 adopted amendments to the rules and regulations for the operations of the CNMI Lottery which were 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 needed to be adjusted by DOF. Except for the

\$7,584 revenue from Operator A (representing 2nd quarter FY 1999 commission of \$7,532 and other income of \$52) which had not yet been deposited in the CNMI lottery bank account² and had not yet been recorded by DOF, all reconciling items were adjusted subsequent to the quarter under audit³. A summary of the reconciliation is shown in the table below.

Particulars	Lottery Bank Account	Total Revenues
Unadjusted DOF Balance - 6/30/99	\$608,331	\$414,271
Reconciling Items:		
1. Government revenues for the 3 rd Quarter FY 1998 recorded twice ^a	(654)	
2. Prior year error adjusted (deducted from revenue) in the 1 st Quarter FY 1999		447
3. Government revenues earned and deposited in prior year recorded by DOF on 3/31/99		
Commissions		
- 1 st Quarter FY 1998 - Operator B		(3,946)
- 4 th Quarter FY 1998 - Operator A		(3,133)
License Fees of Operator C		
- 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 3 rd Quarter FY 1999 but not recorded by DOF as of 6/30/99 ^b		
- 2 nd Quarter FY 1998 - Operator B Understatement	4,273	
- 3 rd Quarter FY 1999 - All Operators	83,056	83,056
5. License fees deposited during the 3 rd Quarter FY 1999 but not recorded by DOF as of 6/30/99 ^b		
- 2 nd Quarter FY 1999 - Operator C	18,750	18,750
- 3 rd Quarter FY 1999 - Operator B	37,500	37,500
6. Accrual of government revenues for the 3 rd Quarter FY 1999 ^b		3,047
7. Delay in deposit by Operator A of government revenues and by Operator C of license fees not in accordance with LOA		
- 2 nd Quarter FY 1999 - Operator A instant tickets		7,532
- 2 nd Quarter FY 1999 - Operator C ^c		6,250
- 3 rd Quarter FY 1999 - Operator C ^d		37,500
8. Understatement of government revenues of Operator A, per audit ^e		
- 1 st Quarter FY 1999		232
- 2 nd Quarter FY 1999		201
- 3 rd Quarter FY 1999		229
Adjusted Balances - 6/30/99	\$751,256	\$514,436

See next page for description of Notes.

² The Operator A Remittance Advice, dated April 7, 1999, reflects a transfer of \$7,584 to the lottery bank account. However, our review of the bank statement for the month of April 1999 did not show such transfer.

³ Based on documents furnished to OPA which were as of September 30, 1999.

Notes:

- a. Adjusted by DOF on July 31, 1999.
- b. Recorded by DOF on August 24, 1999, except for the \$52 revenue accrual from Operator A instant tickets.
- c. Deposited by Operator C in July 1999 and recorded by DOF on August 24, 1999.
- d. Deposited by Operator C in amounts of \$6,250, \$18,750, and \$12,500 on August 18, and September 28 and 30, 1999, respectively, and recorded by DOF in September 1999.
- e. Deposited by Operator A on December 9, 1999 and recorded by DOF on May 12, 2000.

C. Other Matters

Assignment of the Original Licensee's Lottery License to Operator A and the Right of Agency A to Operate the Retail Lotto Services

It appears that the Assignment of Lottery License, signed on June 30, 1998, by the DOF Secretary and a Representative of Operator A, was not an actual assignment of Original Licensee'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 Original Licensee agreed to assign its license to Operator A.

On August 31, 1999, OPA received a copy of a memorandum dated August 30, 1999, addressed to the Secretary of Finance from the Representative of Operator A. The memorandum stated that Operator A had closed its business as of June 30, 1998, and that the Manager of Agency A was continuing the CNMI retail lottery operation in its own right. The memorandum further stated that Operator A assisted the Manager of Agency A in starting its lottery operations by providing it (as an advance to be repaid later) with lottery equipment and products valued at \$45,000. Based on the MOU between the CNMI and Operator A, the latter is authorized to appoint accredited sub-representatives for the sale of lottery tickets, games, and related materials here in the CNMI. Based on several documents received from Operator A, the Manager of Agency A, not being a party to an assignment, is only an accredited sub-representative of Operator A authorized to operate as a lottery shop retailer on 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 (through a September 8, 1999, letter) as follows: (1) whether Operator A had indeed closed shop as of June 30, 1998; (2) whether the operation of the CNMI lottery had been assigned by Operator A to the Manager of Agency A; and (3) whether DOF had any knowledge of the arrangements between the Operator A Representative and the Manager of Agency A with regard to continued operation of the retail lotto services on Saipan.

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

Subsequently, Agency A furnished OPA with a copy of its May 16, 2000, letter to the Secretary of Finance from which the following information was obtained: Operator A had indeed closed shop on June 30, 1998; the Manager of Agency A was laid off and offered the opportunity to buy the business from Operator A; the Manager of Agency A established a lottery operation company (Agency A) doing business as CNMI Lottery; and, Agency A was authorized by DOF to continue lottery operations under the same terms and conditions of the June 30, 1998, Assignment of Lottery License, *i.e.*, a 90-day term. However, Agency A 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, Agency A has requested a direct license from DOF so it (Agency A) can operate an instant ticket lottery in the CNMI. The Secretary of Finance also issued various letters to Operator A requesting information on Operator A's business relationship with Agency A (whether a full service retail agency of Operator A) and Agency A's status as a lottery operator. This is because neither Operator A nor Agency A agrees that Agency A is an agent of Operator A.

In OPA's latest lottery audit, we recommended that DOF determine the proper license that could be issued to Agency A to operate the CNMI retail lotto services. The Secretary of Finance responded that DOF determined that Agency A was an agent of Operator A, and therefore should not be issued a lottery license. No basis for this opinion was submitted, however.

Agreement Between the Owner of Agency B and Operator C to Operate Lottery Games

On July 21, 1999, Operator C and the owner of Agency B entered into an exclusive agency agreement through which the owner of Agency B was allowed to operate lottery games as an agent of Operator C. To determine whether the owner of Agency B and Operator C were complying with the LOA between Operator C 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 the owner of Agency B's September 3, 1999, letter (notifying DOF of its business license and its exclusive agency agreement with Operator C), and the exclusive agency agreement. Our comments are as follows:

1. It appears that the exclusive agency agreement entered into by Operator C and the owner of Agency B on July 21, 1999, violated the LOA between Operator C and DOF. First, Agency B's operations were not restricted to daily lottery number games called "Jueteng." The agreement provided that "[Operator C] hereby appoints [the owner of Agency B], ... 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 Operator C's *operation*⁴ would consist of daily lottery number games called "Jueteng," and subcontracting by Operator C should be for the performance of any services required to be performed by Operator C under the LOA.

⁴ The word "operation" was added to make the sentence more meaningful.

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 the owner of Agency B was arrested for illegal gambling (the owner of Agency B personally delivered the notification letter and the agreement to the Secretary). Section 17 of the LOA, however, restricted Operator C from entering into a subcontract for the performance of any services required to be performed or provided under the LOA without DOF's prior written consent.

Although DOF's Business License section issued a license to the owner of Agency B, this business license is not equivalent to DOF's authorization for Operator C to subcontract its lottery operator license to the owner of Agency B. Separate written approval should have been obtained from DOF by Operator C prior to subcontracting.

2. There is no assurance that revenues from Agency B's operations are being reported by Operator C 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 Operator C to designate "sub-agents" as their representatives to sell the Operator C lottery games provided, however, that at all times Operator C, and not the "sub-agents," would be liable, responsible, and accountable to DOF for the proper operation of the Operator C 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 Operator C and the owner of Agency B, and investigate the business activities of the owner of Agency B to determine whether imposing administrative sanctions against Operator C was warranted. The Secretary of Finance stated that the issue of the exclusive agency agreement between Operator C and the owner of Agency B had been referred to AGO for further review. On March 21, 2000, Operator C ceased operating the lottery game of Jueteng, and surrendered its lottery license (see details on page 8).

In response to OPA's latest lottery audit, the Secretary of Finance stated that there appears to be no indication that revenues from Agency B's operations were included in the computation of commissions remitted to DOF. Legal issues are currently pending at AGO regarding Agency B's operations. DOF does not anticipate immediate recovery of undeclared revenues, including interest and penalty, until those legal issues are resolved.

Conclusions and Recommendations

Government revenues were understated by \$37,729 due to a computation error by Operator A, and late remittance of quarterly license fees by Operator C. Therefore, government revenues should be increased from \$123,603, as previously recorded, to \$161,332. The accompanying schedule (**Appendix A**) shows a detailed summary of government revenues for the third quarter of fiscal year 1999, ended June 30, 1999, with cumulative totals for the three quarters of both fiscal years 1998 and 1999, after making required adjustments. As explained in the body of this report, the two Number Game (Jueteng) operators 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 the two operators were complete. Also, DOF should provide its basis for concluding that Agency A was an agent of Operator A, and therefore should not be issued a lottery license. Furthermore, although Operator C ceased operating the lottery game of Jueteng effective March 21, 2000, DOF should still recover the commissions which it acknowledges are due from Operator C for its agent's failure to declare revenues from operations.

We recommend that the Secretary of Finance:

1. Request that Operator A correct its records and transmit to DOF the unremitted revenues of \$7,584.
2. Address our pending recommendation on initiating action 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).
3. Provide the basis for concluding that Agency A was an agent of Operator A, 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 upon DOF's prior written consent) should be resolved by a legal opinion of AGO. Also, Operator A's business relationship with Agency A (whether a full service retail agency of Operator A), and Agency A' status as a lottery operator should be further reviewed (these issues have already been raised in DOF's various letters to Operator A), because neither Operator A nor Agency A agrees that Agency A is an agent of Operator A.
4. Recover the commissions which DOF acknowledges are due from Operator C for its agent's failure to declare revenues from operations.

DOF Response

In her letter response dated December 27, 2000, and in a subsequent meeting held at DOF office, the Secretary of Finance responded to all the recommendations as follows.

Recommendation 1 - The Secretary of Finance stated that Operator A was informed via facsimile on December 20, 2000, to transmit to DOF the unremitted revenues of \$7,584. DOF subsequently provided OPA with a copy of the bank statement reflecting deposit of the above amount to the CNMI lottery bank account on December 28, 2000.

Recommendation 2 - The Secretary of Finance has initiated action to implement the adopted amendments by providing Operator B with a copy of the adopted amendments. Operator B partially implemented the use of the recommended log sheets, and DOF requested OPA to assist DOF and Operator B in fully implementing the adopted amendments. A series of meetings were held in March 2001 by DOF, OPA, and Operator B for this purpose.

Recommendation 3 - The Secretary of Finance provided OPA with copies of the Assistant Attorney General's (AAG) March 15, 2000, letter, and Operator A's June 27, 2000, letter, discussing the current status of Operator A's lottery license to address the recommendation. The letters provided that it is the conduct of the Secretary and the Manager of Agency A, *i.e.*, DOF's authorization to Agency A for continued operation of the CNMI Lottery on behalf of Operator A for a 90-day period, that manifest their intentions to continue the relationship on the terms and conditions initially set forth in the Assignment of Lottery License. Furthermore, although the Lottery Act and the Lottery Regulations conflict with regard to assignment of a license, the AAG's letter concluded that the Assignment of Lottery License entered into between DOF and Operator A was valid when signed by the parties, and pursuant to applicable law, remains valid and in full force and effect since, pursuant to the language of this Agreement, the parties, through their conduct, have renewed and extended the Assignment at 90-day intervals from June 30, 1998, through the current date.

Recommendation 4 - The Secretary of Finance stated that AGO is currently investigating the case of Agency B's operations. With regard to the undeclared revenues from Agency B's operations, DOF stated that the revenues were derived from operation of games not related to Jueteng, thus the revenues should be subjected to gross receipts tax which will be determined by the Division of the Revenue and Taxation, and not be subjected to commissions from lottery operations.

OPA Comments

Based on the response we received from the Secretary and additional information gathered after the issuance of our draft audit letter report, we consider all recommendations closed. DOF and the lottery operators have taken corrective action to address the recommendations, *i.e.*, initiation of action to implement the adopted amendments. OPA was also provided copies of the bank statements reflecting deposit and opinion letters to address the recommendations.

Sincerely,



Michael S. Sablan
Public Auditor

xc: Governor
Lt. Governor
Twelfth CNMI Legislature (27 copies)
Attorney General
Special Assistant for Management and Budget
Press Secretary
Operator B President
Operator C President
Agency A Manager
Local Media

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

**Schedule of Government Revenues from the CNMI Lottery Operations
For the Third Quarter of Fiscal Year 1999, Ended June 30, 1999
(With cumulative totals for the three quarters of both fiscal years 1998 and 1999)**

Lottery Games	Number of Games or Tickets Sold	Amount Subject to Commissions	Commission Rate (%)	Revenues Third Quarter 1999	Total Revenues FY 1999	Total Revenues FY 1998
Operator A						
On-line Games						
- Saturday	47,377	\$12,355	0.350	\$4,324	\$11,885	\$23,423
- Oz Lotto	2,443	1,593	0.350	558	1,770	4,850
- Power ball	3,519	1,148	0.350	402	1,283	-
- Mid-Week	1,498	245	0.350	86	357	-
- Keno	3,473	2,135	0.370	789	2,240	6,166
Sub-Total	58,310	\$17,476		\$6,159	\$17,535	\$34,439
Instant Tickets						
- Five Dollars	3,000	\$9,555	0.265	\$2,532	\$10,761	\$1,182
- Two Dollars	-	-	0.265	-	-	3,604
- One Dollar	20,100	20,100	0.250	5,025	26,275	73,158
Sub-Total	23,100	29,655		7,557	37,036	77,944
Total Operator A	81,410	\$47,131		\$13,716	\$54,571	\$112,383
Operator B						
Two Number	357,719	\$357,719	0.100	\$35,772	\$120,960	\$130,688
One Number	76,573	76,573	0.050	3,829	11,331	10,667
License Fees	-	-	-	37,500	112,500	112,500
Total Operator B	434,292	\$434,292		\$77,101	\$244,791	\$253,855
Operator C						
Two Number	263,241	\$263,241	0.100	\$26,324	\$82,481	\$81,432
One Number	53,425	53,425	0.050	2,671	7,276	3,047
License Fees	-	-	-	37,500	112,500	75,000
Total Operator C	316,666	\$316,666		\$66,495	\$202,257	\$159,479
Interest/Other Income				\$4,020	\$12,817	\$7,002
GRAND TOTAL				\$161,332	\$514,436	\$532,719