

THOMAS P. DiNAPOLI
STATE COMPTROLLER



110 STATE STREET
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

March 4, 2008

Mr. Gordon Medenica
Director
Division of the Lottery
One Broadway Center
Schenectady, NY 12301

Re: Report 2008-F-1

Dear Mr. Medenica:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law, we have followed up on the actions taken by officials of the New York State Division of the Lottery to implement the recommendations contained in our audit report, *Controls Over the Selection and Licensing of Lottery Retailers* (Report 2004-S-11).

Background, Scope and Objective

The New York State Division of the Lottery (Lottery), which was established in 1976, is an independent unit of the Department of Taxation and Finance (Department), whose commissioner appoints the Director of the Lottery. The purpose of the Lottery is to raise revenue for education in the State of New York by administering the Lottery games. The New York State Lottery is one of the largest and oldest state lotteries in the United States. The Lottery maintains a central office in Schenectady, as well as other offices throughout the State. For the fiscal year ended March 31, 2007 the Lottery had sales of \$7.2 billion. These sales were achieved through a network of about 16,000 licensed retailers. According to Lottery officials, critical to the Lottery's success is the sales potential and public accessibility of its retailers, which must have quality locations. Retailers must demonstrate a commitment to promote, display and train staff to sell and manage Lottery products. The Lottery has policies and procedures for the selection and licensing of Lottery retailers to protect the interests of the State including procedures to verify the financial responsibility and security of the retailer's business operations. For example, the Lottery obtains criminal background information to determine if an applicant has any convictions or any pending criminal or administrative charges that would demonstrate that the applicant could jeopardize public confidence in the integrity of the Lottery or would not act responsibly as a fiduciary of the State.

Our initial audit report, which was issued on October 31, 2005, examined the Lottery's controls over the selection and licensing of Lottery retailers for the period April 1, 2003 through September 30, 2004. The objective of our audit was to determine whether the Lottery had adequate policies and procedures for the selection and licensing of Lottery retailers to protect the State's interest in the games, and whether the Lottery adheres to these policies and procedures. Our initial audit concluded that generally, the Lottery has established adequate policies and procedures for controlling the issuance of new licenses and for monitoring existing licensees. The Lottery has also adhered to most of its procedures. However, we found that Lottery should make significant improvements to identify applicants and retailers who have outstanding tax indebtedness to the State and who have not provided evidence of appropriate steps taken with the Department to satisfy outstanding tax assessments. In addition, we found that Lottery should reinstitute procedures to monitor the sales performance of new and existing retailers.

The objective of our follow-up, which was conducted in accordance with generally accepted government auditing standards, was to assess the extent of implementation as of February 13, 2008 of the five recommendations included in our initial report.

Summary Conclusions and Status of Audit Recommendations

We found Lottery officials have made progress in implementing the recommendations contained in our initial report. Of the five recommendations, four have been implemented and one has been partially implemented.

Follow-up Observations

Recommendation 1

Require applicants to submit a Tax Clearance Certificate from the Department prior to issuing a Lottery license.

Status - Implemented

Agency Action - The Lottery requires each new applicant to provide a taxpayer identification number which the Lottery uses to determine if the applicant has a State tax liability. If the Applicant has a State tax liability the Lottery requires the applicant to submit a Tax Clearance Certificate prior to issuing a Lottery license.

Recommendation 2

Match Lottery retailer data to Department records on a frequent basis, such as quarterly, to identify any retailers with an unsettled State tax liability.

Status - Implemented

Agency Action - We found that the Lottery is matching retailer data to Department records on a semi-annual basis to identify any retailers with unsettled State tax liabilities. We also found

that the Lottery is matching data to Department records weekly for retailers that, in a given week, were new or had a change in information such as business name or phone number.

Recommendation 3

Work with Department officials to obtain file match data that provides a general indication of retailer tax indebtedness. This will allow a more focused approach to collections by targeting those retail agents having the largest amounts of outstanding unsettled tax assessments.

Status - Implemented

Agency Action - Lottery officials have worked with Department officials to obtain data that provides a general indication of retailer tax indebtedness. The Department provides the Lottery with a list of retailers with unsettled State tax liabilities categorized by the amount of the tax owed.

Recommendation 4

Take appropriate action against Lottery retailers who have an unsettled tax liability to help ensure that taxes owed the State are paid.

Status - Implemented

Agency Action - During our follow-up review we found that the Lottery has taken appropriate action against retailers with unsettled State tax liabilities. Lottery officials notify retailers of the amount of the debt and a time frame for settling it. Depending on the amount owed, retailers are given 30 to 60 days to settle the debt with the Department. If the tax liability is not settled within this period the Lottery disables the retailer's Lottery terminal. After the Lottery terminal is disabled, the Lottery sends a letter notifying the retailer that its Lottery license has been suspended. The retailer may then request a hearing prior to the Lottery making a decision on whether to revoke the retailer's Lottery license.

Recommendation 5

Reinstitute the sales monitoring program to identify retailers who are not achieving their minimum sales standards or break-even sales level. Take appropriate action to increase retailer sales or consider suspension for retailers who fail to achieve at least their minimum standards and/or the current break-even sales level.

Status - Partially Implemented

Agency Action - The Lottery has not reinstated a sales monitoring program per se. However, the Lottery has taken some steps to identify retailers who are not achieving minimum sales standards or break-even sales levels. The Lottery provides retailers with poor sales performance the opportunity to improve their sales. For example, the Lottery has made an inventory management program available to retailers. This program is designed to improve sales by maximizing operation efficiency. This program, first implemented in August 2005,

has resulted in increased sales when used. However, the inventory management program is not widely used. In addition, the Lottery does not have specific policies in place to suspend retailers for poor sales performance or to ensure retailers take the appropriate actions to improve performance.

Major contributors to this report were Dennis Buckley, Don Collins and Mark Breunig.

We would appreciate your response to this report within 30 days, indicating any actions planned to address the unresolved issue discussed in the report. We wish to thank the management and staff of the Lottery for the courtesies extended to our auditors during this process.

Very truly yours,

Kenneth I. Shulman
Audit Manager

cc: Lisa Ng, Division of the Budget