

# Chapter 14

## Lotteries Commission of New Brunswick/Atlantic Lottery Corporation Inc.

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# Lotteries Commission of New Brunswick/Atlantic Lottery Corporation Inc.

## Background

**14.1** In our 1996 Report we discussed a number of issues relating to the Lotteries Commission of New Brunswick and the Atlantic Lottery Corporation Inc. (ALC). The most significant of these issues were highlighted in *Results in brief*, paragraphs 12.7 through 12.12 of that Report and covered:

- the joint audit of ALC carried out with our colleagues from the Office of the Auditor General of Nova Scotia;
- a recommendation for segmented financial information showing separately the results of the Video Lottery Program (VLP) and ALC's ticket games;
- a recommendation that the Lotteries Commission prepare a comparative cost analysis of two models of operation for the VLP prior to expiry of the agreement with the New Brunswick Coin Machine Operators Association on 31 March 2002;
- the need for the Lotteries Commission to improve reporting on regulatory functions;
- a recommendation that the Lotteries Commission request ALC to provide sufficient financial reporting to demonstrate compliance with the regulated payout percentages for the VLP; and
- a statement that Commissioners serving on the Lotteries Commission have a conflict of interest if they are also serving on the board of ALC.

## Scope

**14.2** In this chapter we are following up on the issues previously highlighted in the 1996 Report of the Auditor General. The issue on conflict of interest has been dealt with in Chapter 12, *Crown Corporation Governance*.

## Results in brief

**14.3** Together with the Office of the Auditor General of Nova Scotia, we completed the joint audit of ALC. The Auditor General of Nova Scotia released the *1996 Shareholder's Audit Assignment Report* in March 1997. Results are summarized in Exhibit 14.1.

**14.4** ALC has improved its reporting by providing a schedule of *Segmented Operations by Province* in its annual report.

**14.5 Neither the Lotteries Commission nor ALC have yet published information to demonstrate that the Video Lottery Program complies with the payout percentages established by regulation.**

**Follow-up on issues discussed in 1996**

*ALC joint audit*

**14.6** In our 1996 Report, we discussed the ongoing audit of the ALC being carried out in conjunction with the Office of the Auditor General of Nova Scotia. We have completed the audit. The Auditor General of Nova Scotia issued the *1996 Shareholder's Audit Assignment Report* to the Nova Scotia Gaming Corporation in March 1997. We in turn delivered copies to the Lotteries Commission of New Brunswick.

**14.7** We believe it is important that this joint audit receive some coverage in our 1997 Report. Consequently, we have prepared Exhibit 14.1. This exhibit reproduces the Results in Brief from the *1996 Shareholder's Audit Assignment Report* and therefore should serve in providing the Legislative Assembly and the general public with a synopsis of the findings.

*Segmented reporting by ALC*

**14.8** Last year we dealt with the need for ALC to show the results of operations segmented by ticket games and the Video Lottery Program. We were pleased to find this type of reporting in ALC's 1996-1997 Annual Report. ALC presented the information in a supplemental schedule called *Segmented Operations by Province*.

*Comparative costs of operation for VLP*

**14.9** In last year's Report we discussed the comparative costs of the Video Lottery Program in New Brunswick and Nova Scotia. We recommended the Lotteries Commission prepare an analysis of the comparative costs prior to expiry of the agreement with the New Brunswick Coin Machine Operators Association Inc. That agreement expires in 2002.

**14.10** It has been widely reported that the government has entered into discussions with the Association. At a meeting of the Standing Committee on Crown Corporations on 26 September 1997 the Deputy Minister of Finance stated:

*The Minister and the government are on the public record, and have been for some time, saying that they will not wait until the year 2002 to look at the program and see if there is another model that will work. It will essentially begin and will be put in place well before the expiration of the contract. There will be a new revenue sharing formula to replace the one that is there now, and it will work to produce extra revenue for the province.*

**14.11** During the past year we asked the Lotteries Commission about two aspects of the existing agreement that had come to our attention. These are:

- The agreement appears to be signed by only one member of the Lotteries Commission of NB. Our understanding of the Commission bylaws is that at least two signatures are required.
- Clause 7 of the agreement states “The Commission warrants that it is authorized by the Lieutenant Governor in Council, pursuant to the requirements of the New Brunswick Lotteries Act, to enter into this agreement.” We were unable to identify an Order in Council authorizing the contract although one appeared to be necessary.

**14.12** The Commission has informed us that our understanding is correct.

### ***Reporting on regulatory activity***

**14.13** Our 1996 Report discussed the importance of the Lotteries Commission providing sufficient and appropriate reporting of its regulatory activity in its annual report. Our understanding is that the Commission has accepted our 1996 recommendation in this regard. At the 26 September 1997 meeting of the Standing Committee on Crown Corporations the Deputy Minister of Finance indicated this type of reporting would be included in the Commission’s 1996-97 annual report.

**14.14** Our 1996 Report also discussed the value in having ALC providing the Commission with an annual representation giving assurance that it has fulfilled its regulatory responsibilities under provincial regulation. We were informed that the Commission has placed this issue on the agenda of its November 1997 board meeting.

### ***Compliance with video lottery payout percentages***

**14.15** In our 1996 Report we discussed the importance of demonstrating compliance with section 6(h) of Regulation 90-142 under the Lotteries Act of New Brunswick. The section states that a video gaming device “shall be programmed to award as prizes not less than eighty per cent, and not more than ninety percent, *of the money it accepts.*” (*Emphasis ours*). We reviewed the ALC financial statements and annual report for the year ended 31 March 1997 and noted this information was not included.

**14.16** As part of our report for the prior two years, we presented a schedule showing that *prize expense/cash out* is deducted from *gross video lottery receipts/cash in* to arrive at the ALC financial statement line item called net video lottery receipts. We would like to update this schedule for this year’s Report to include results for the year ended 31 March 1997. We have included it as Exhibit 14.2.

**14.17** In examining this exhibit, it is evident that the cash out or prize expense does not fall in the range of 80%-90%. We recognize that the Commission and ALC maintain that in order to demonstrate compliance with the regulation, one has to look at additional information on credits won and credits played. Yet the regulation seems quite clear in referring to *the money it accepts*, not credits won plus the money it accepts. What Exhibit 14.2 may be showing then, is that the VLP program is not in compliance with the regulation.

**14.18 We recommend that the Lotteries Commission review Regulation 90-142 and the results of the Video Lottery Program to determine if the program is in compliance.**

*Exhibit 14.1  
Results in brief from 1996  
Shareholder's Audit Assignment  
Report*

28.1 At the outset, we feel it appropriate to observe that while we are reporting on a number of matters with respect to the management and control of ALC's operations, nothing was observed that would indicate the integrity of ALC's lottery and other gaming products has been adversely affected.

There has been, and continues to be, considerable time and resources invested by ALC to implement improved updated systems and practices to support the ongoing management and control of the corporation. Such changes or initiatives have had, and should continue to have, a constructive impact on the overall adequacy of ALC's management systems and practices. During the course of this 1996 audit, a number of opportunities for further improvement were identified, the more significant of which are presented in this report for consideration and, where appropriate, action by the appropriate combination of ALC's management, Board of Directors, shareholders and/or shareholder provinces.

28.2 Based on the results of the audit, most of our defined criteria for the identified lines of inquiry were assessed as either met or partially met. We have identified some opportunities to improve the level of control and reporting in selected areas, and have included recommendations in this report for consideration by the appropriate combination of ALC's management, Board, shareholders and/or shareholder provinces. ALC's response to this report indicated that action has been taken or planned to address certain of our recommendations and suggestions.

28.3 ALC is an established organization, with various systems, processes and procedures in place to manage and control its ongoing operational responsibilities. Considerable time and resources have been and continue to be invested in implementing new or updated systems and practices to support the corporation's operations and activities. With respect to more traditional internal accounting or procedural controls, we did not identify any significant control weakness that would impact upon the overall integrity of financial records of ALC. This is also supported by the results of other audit and review functions associated with the corporation's activities.

28.4 Changes necessary to improve the overall governance and accountability arrangements with respect to ALC need to be considered. For example, during our audit we noticed a number of issues which indicate the inter-provincial agreements and corporate bylaws should be revisited to determine if they provide the appropriate level of guidance to ALC and its shareholders. These key issues include:

- the requirement to more precisely define ALC's status as a crown agency;
- concerns over the content and method of accountability reporting to the Legislature in each shareholder province;
- a responsibility to more explicitly define the division of business and social responsibility for gaming between ALC and the shareholder governments;
- a need for periodic re-examination of the profit allocation methodology;
- concerns over the fairness and equity of the distribution of corporate activity among shareholder jurisdictions;
- the applicability of legislation from various shareholder provinces (e.g., wage restraint, financial budgeting and reporting); and
- moves towards increased Atlantic co-operation in various fields.

Exhibit 14.1 - cont.  
Results in brief from 1996  
Shareholder's Audit Assignment  
Report

We suggest the inter-provincial agreements and the corporate bylaws be revisited by the shareholders and the shareholder provinces to ensure they provide the necessary guidance with respect to the operations and overall accountability and control of an inter-provincial organization of the size and complexity of ALC.

28.5 While matters like business ethics and conflict of interest are dealt with to some extent in certain management-level policy statements, there is no formal corporate code of conduct policy statement. One has been drafted, but not finalized and released to staff. As a result of Board discussions in late 1996, and subsequent to our audit fieldwork, in January 1997 a policy relating to past Board members and employees involvement with corporate suppliers was approved.

28.6 The Board does not receive sufficient information to evaluate the degree of achievement of most of the corporate strategic objectives. Additionally, sufficient and appropriate information and reporting on the corporation's plans and performance (i.e., financial and non-financial) should be available to the shareholders and the Legislature in each province on a timely basis. The content and distribution of ALC's annual report needs to be improved.

There are opportunities for improved disclosure in the corporation's financial statements and/or elsewhere in its annual report. Four key improvements in our view would be:

- disclosure of gross profit by game type;
- reconciliations demonstrating compliance with the video lottery payout regulations for each of the shareholder provinces;
- inclusion of depreciation expense in the divisional expenses; and
- comparison of budget figures to actual with appropriate variance analysis.

28.7 In general, our review of procurement activities indicated ALC's procurement policies were being complied with. We did identify some opportunities for improvement in policies, including improved reporting which would support an enhanced level of review with respect to compliance and due regard for economy.

28.8 The corporation is subject to external and internal audit coverage in selected areas. However, information technology systems and resources, which are seen as mission critical, should be subject to expanded audit coverage to ensure the Board has the appropriate assurance as to the adequacy and operational performance of controls in this area.

Further, the internal audit function, an important and integral element in the corporation's overall control framework, should formalize its planning for the use of available resources on an annual and assignment basis, including an expanded focus on value for money issues.

28.9 ALC's profit allocation methodology was established in 1991 when the Video Lottery Program (VLP) was just being implemented. This key program, which now represents 58% of ALC's net sales, is not charged with any of ALC's general overheads. Further, certain costs related to the VLP are being allocated instead to ALC's other games. This inconsistency has highlighted the need to re-examine the whole profit allocation methodology. In our view, ALC management should have identified such matters to the Board so the shareholders could have determined if an earlier review of allocation methodologies was in order.

*Exhibit 14.1 - cont.*  
*Results in brief from 1996*  
*Shareholder's Audit Assignment*  
*Report*

Our analysis indicates that the manner in which costs and profit are currently being allocated results in certain shareholder provinces, in essence, subsidizing the results in other jurisdictions by having more than their share of direct costs charged against their net sales. This latter point is especially relevant to retail commissions and depreciation, which more reasonably should be charged directly to each province as opposed to being allocated based on net sales.

28.10 Our review and analysis raised concerns about the adequacy of the audit/management trail supporting the Board's deliberations and decisions relating to the acquisition of ALC's new head office facilities, which will consolidate head office staff and related activities in one location. Although the issue of ALC's head office space was dealt with at numerous Board meetings, the net benefits to accrue to shareholders as a result of the additional costs to be incurred were not formally quantified and provided to the Board as part of its decision making process. Further, it is unclear as to the extent of review, challenge or approval provided with respect to key assumptions made and analysis provided by management (i.e., average space standard per position and projections for staff growth).

Further, the Board's decision by majority vote, was made at a time when one of the shareholders was in the process of reviewing the structure and arrangements for the corporation. This should have warranted deferral of a decision until such matters could be fully resolved by the shareholders.

28.11 The Board decided in the late fall of 1996 to proceed with the \$31 million New Retail Terminal Project. The project represents a significant revision to what ALC had originally detailed in its 1992 IT Strategic Plan. The project has been subject to several discussions at the Board level supported by presentations and analysis prepared by management, including some aspects reviewed by external consultants. It is our understanding that the net benefits of this project to accrue to the shareholders through future profit distributions were not specifically and formally updated from those that had been identified in 1992. In our view, it would have been appropriate for this to have taken place.

28.12 The current commission rates for VLT site-holders are set by the shareholder governments through regulation, and are among the highest in Canada. We are not aware of ALC or others having formally assessed the costs and risks associated with the VLT site-holders involvement or responsibilities with respect to the VLP to justify the level of commission paid. This suggests that the issue of commissions should be examined in some detail.

## Exhibit 14.2

Atlantic Lottery Corporation Inc.

Video Lottery Receipts

(thousands of dollars)

Source: ALC &amp; ALC's external auditor

	New Brunswick		Prince Edward Island		Nova Scotia		Newfoundland		Total	
	\$	%	\$	%	\$	%	\$	%	\$	%
<b>1996 - 1997</b>										
Cash In	287,971	100.0	38,478	100.0	374,307	100.0	222,802	100.0	923,558	100.0
Cash Out	171,697	59.6	21,605	56.1	268,300	71.7	162,009	72.7	623,611	67.5
Net Sales	116,274	40.4	16,873	43.9	106,007	28.3	60,793	27.3	299,947	32.5
<b>1995 - 1996</b>										
Cash In	254,204	100.0	36,001	100.0	345,992	100.0	202,495	100.0	838,692	100.0
Cash Out	146,904	57.8	19,825	55.1	246,809	71.3	144,107	71.2	557,645	66.5
Net Sales	107,300	42.2	16,176	44.9	99,183	28.7	58,388	28.8	281,047	33.5
<b>1994 - 1995</b>										
Gross Video Lottery Receipts	211,718	100.0	32,659	100.0	311,006	100.0	160,918	100.0	716,301	100.0
Prize Expense	120,020	56.7	17,936	54.9	220,646	70.9	111,192	69.1	469,794	65.6
Net Video Lottery Receipts	91,698	43.3	14,723	45.1	90,360	29.1	49,726	30.9	246,507	34.4
<b>1993 - 1994</b>										
Gross Video Lottery Receipts	180,093	100.0	31,152	100.0	225,350	100.0	117,272	100.0	553,867	100.0
Prize Expense	100,286	55.7	17,755	57.0	160,585	71.3	79,748	68.0	358,374	64.7
Net Video Lottery Receipts	79,807	44.3	13,397	43.0	64,765	28.7	37,524	32.0	195,493	35.3
<b>1992 - 1993</b>										
Gross Video Lottery Receipts	176,464	100.0	32,502	100.0	258,271	100.0	70,937	100.0	538,174	100.0
Prize Expense	105,367	59.7	19,560	60.2	183,029	70.9	46,321	65.3	354,277	65.8
Net Video Lottery Receipts	71,097	40.3	12,942	39.8	75,242	29.1	24,616	34.7	183,897	34.2
<b>Totals - five years</b>										
	1,110,450	100.0	170,792	100.0	1,514,926	100.0	774,424	100.0	3,570,592	100.0
	644,274	58.0	96,681	56.6	1,079,369	71.2	543,377	70.2	2,363,701	66.2
Net Video Lottery Receipts	466,176	42.0	74,111	43.4	435,557	28.8	231,047	29.8	1,206,891	33.8

Figures for 92/93 to 94/95 provided by KPMG; figures for 95/96 and 96/97 provided by ALC