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# REPORT ON THE AUDIT OF LOTTERIES YUKON

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September 09, 2008

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# EXECUTIVE SUMMARY

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In 1979 the Yukon Lottery Commission (the *Commission*) was formed with the responsibility for the conduct and management of public lotteries in the Yukon and, subject to the regulations, the allocation of the profits of public lotteries. As lottery revenues grew throughout the 1980s the Commission decided in 1987 to establish the Lotteries Yukon office as its operating arm. Shortly thereafter, the Commission became the official agent of the Government of Yukon and the territorial marketing organization of the Western Canada Lottery Corporation.

The Commission's main objectives are to achieve maximum profit through the efficient management of public lotteries and to utilize those profits for the benefit and development of sports, arts, culture and recreation in the Yukon. In 2006-07 the Commission through its operating arm, Lotteries Yukon, distributed over \$1.7 million of lottery proceeds to various non-governmental organizations, community associations and the Yukon government.

The objective of our audit was to assess the business practices, and systems of internal control over the conduct and management of public lotteries in the Yukon. In carrying out the audit, we relied on the records and files, information systems, and interviews with staff of the Lotteries Yukon office.

Our audit found the overall management practices, procedures and controls over the administration of their lottery and grant giving programs to be functioning adequately and in accordance with Commission and Yukon government policies and procedures. Specifically, we were able to provide positive assurance that:

- revenues, cost of sales, Commission and administrative expenditures, grant and travel applications, and funding allocations to non-governmental organizations, community organizations and the Yukon government were handled correctly and properly authorized in accordance with Commission and Yukon government policies and procedures; and
- the financial and risk management practices and internal controls over cash, accounts receivable and accounts payable were functioning adequately, and as intended; and
- sufficient due diligence has occurred and practices put in place to provide reasonable comfort that ticket purchasers are protected from retailer fraud.

Our audit, however, did identify a need to address the governance structure that establishes the responsibilities and reporting relationships between the Minister, Commission Chair, President of the Yukon Liquor Corporation and the General

Manager of Lotteries Yukon. The lack of clear direction in this area has led to varying interpretations of respective roles and responsibilities and may not be serving the best interests of the Yukon government or the public.

The four principle recommendations in our review of Lotteries Yukon are as follows:

- The responsibility for the day-to-day management and administration of Lotteries Yukon including the role and reporting relationship of the General Manager needs to be clarified to improve the governance structure under which the Commission is operating.
- Government and the Commission should give priority to putting in place a Protocol Agreement that clearly establishes the performance expectations of the Commission to meet the roles of the Minister, Commission board and Chair, respectively, in the work of the Commission.
- A formal shared services agreement should be developed between Lotteries Yukon and the Department of Community Services that sets out the responsibilities, financial arrangements and obligations of each party for the services provided by the department to the lottery operations.
- The comprehensive tripartite agreement between the Yukon government, the Commission and the Western Canada Lottery Corporation needs to be reviewed within the context of clearly describing the responsibilities, accountabilities, financial arrangements and obligations of each of the parties.

In this report we present an overview and our comments on the Lotteries Yukon's operations, and the key aspects of its business. We also describe governance and management issues that exist and offer a number of recommendations where there are opportunities for improvement.

We would like to recognize the high level of cooperation provided by the members, staff and management of the Commission, Lotteries Yukon office and Department of Community Services. Their cooperation was crucial to the success of this audit.

# INTRODUCTION

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## BACKGROUND

The Yukon Lottery Commission (the *Commission*) was established in 1979 pursuant to the Public Lotteries Act to conduct and manage public lotteries in the Yukon and to distribute the profits from these lotteries.

In 1989 the Commission became the official agent of the Government of Yukon and the territorial marketing organization of the Western Canada Lottery Corporation (WCLC). The WCLC is a non-profit organization enfranchised by a federal statute to promote the development, management and marketing of public lotteries. The members and shareholders of the WCLC are the governments of Manitoba, Saskatchewan and Alberta. The Yukon and Northwest Territories participate as affiliate members.

The WCLC is responsible for designing and establishing lottery schemes, administering those schemes by paying out prizes, conducting the lotteries, distributing tickets, and providing reports to its members. Under the WCLC agreement, the Commission's duties and responsibilities include, but are not limited to:

- acting as the sole distributor of lottery tickets or to appoint distributors and allocate territories to distributors, as the Commission sees fit;
- prescribing prerequisites and regulations, in addition to those prescribed by the WCLC, to regulate and control distributors and retailers within the Yukon Territory;
- causing "local affinity" advertising to be done within the Yukon Territory; and
- appointing a manager, who shall be a representative and employee of the Commission, on such terms as the Commission shall determine, and employ and retain such additional persons as the Commission shall determine as necessary.

The Commission is comprised of up to 12 volunteer members appointed by the Minister. Each member serves a two-year term; one is appointed as Chairperson and another as Vice-Chairperson. According to Section 4(2) of the Public Lotteries Act, the Chairperson serves as the Chief Executive Officer responsible for supervising and directing the work of the Commission, and for presiding at sittings of the Commission.

## **MANDATE, GOALS AND OBJECTIVES**

The Public Lottery Regulations state under Section 2 that "The Yukon Lottery Commission may pay the profits of public lotteries as grants to local authorities, municipalities and recreation or arts organizations for recreation or arts purposes."

The goals and objectives of the Commission as stated in the Commission's annual report are to:

- achieve maximum profit through the efficient management of public lotteries in the Yukon;
- utilize lottery profits for the benefit and development of sports, arts, culture and recreation in the Yukon; and
- ensure that eligible Yukoners have equal opportunity to apply for grants, and that grants are allocated in a consistent manner.

## **OPERATIONAL OVERVIEW**

Lotteries Yukon is the operational arm established by the Government of Yukon. This organization is supported by five Yukon government employees led by a General Manager. The General Manager is responsible for the management and day-to-day supervision of the public lottery operation and for supporting the Commission in the fulfillment of its duties and obligations.

## **FINANCIAL OVERVIEW**

In 2006-07 public lottery sales in the Yukon totaled over \$8.3 million from which the Commission earned revenues in excess of \$2.4 million. Of these revenues, the Commission distributed almost \$1.7 million of lottery proceeds to various beneficiaries including the Yukon government. The revenue sources can be broken down into three major categories: WCLC commissions from lottery ticket sales, break-opens including scratch-and-wins, and interest income. Expenditures include lottery operations including Commission expenses and fund allocations covered by grants and contributions.

In 2006-07 there were 37 licensed retail locations throughout the Yukon to 41 retailers in 2005-06. Retailer Commissions represented 6.5% of sales in both 2006-07 and 2005-06 and 6% in 2004-05.

By agreement with the Minister, the Commission first allocates its revenues to operation and maintenance expenditures and to specific reserves. It then allocates 48% of the revenue available to supplement Government of Yukon funding for sports and recreation and arts groups. The remaining 52% is allocated to the Yukon Recreation Advisory Committee (YRAC).

Between 2004 and 2007 total lottery revenues, net of prizes and retailer commissions, grew by over 25% in the Yukon, as shown in the table below. Ticket sales during the Canada Winter Games may have contributed to the jump in revenues that occurred in 2007. By comparison, the growth rate in lottery revenues in the four Western provinces averaged 14% over the same period. In 2006-07 expenditures represented 22% of total revenues, compared with 17% in 2004-05. The business growth during the three year period led to an increase in administrative costs drawing down on a greater proportion of revenue.

### THREE YEAR SUMMARY OF REVENUES AND EXPENDITURES

Description	Actual 2006-07	Actual 2005-06	Actual 2004-05
<i>Revenues</i>			
Commissions -WCLC	\$2,410,065	\$1,738,449	\$1,519,085
Break-open Tickets	111,858	44,440	65,135
Keno	0	382,668	431,137
Interest and charges	78,872	65,989	58,462
Terminals	9,540	9,725	9,420
Total Revenues	2,610,335	\$2,241,271	\$2,083,239
<i>Expenditures</i>			
Lotteries operations	468,102	\$303,392	\$260,810
Commission Expenses	106,389	92,927	87,852
	574,491	\$396,319	\$348,662
Net Revenues	\$2,035,844	\$1,844,952	\$1,734,577
<i>Fund Allocations</i>			
Communities	\$382,797	\$363,505	\$363,505
Recreation Projects	540,908	963,000	554,013
Travel Applicants	166,206	165,788	170,783
Yukon Government	618,299	609,446	560,666
Sponsorship program	26,000	11,000	10,000
Unclaimed Grants	(60,968)	(43,499)	(40,792)
Canada Winter Games	0	0	734,750
Total Allocations	1,673,242	2,069,240	2,352,925
Net Income (Loss)	\$362,602	\$(224,288)	\$(618,448)

Lottery revenues, expenses and profit distributions flow through the Yukon Lottery Commission Trust Fund, which is administered by the government. The Commission's financial statements are audited annually by MacKay LLP, Chartered Accountants.

# AUDIT OBJECTIVES AND SCOPE

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## WHY THE AUDIT WAS CALLED

The audit of Lotteries Yukon forms part of the approved Internal Audit Plan for 2007-08, which was passed by the Audit Committee on April 4, 2007. It was selected as an audit assignment for four reasons:

- Retailer fraud in the lottery business has received a lot of media attention across Canada. Interest continues to grow about whether lottery and gaming organizations function in a socially responsible and prudent manner.
- There are known inconsistencies between the Public Lotteries Act, the Western Canada Lotteries Corporation Agreement with Yukon, and with respect to these, gaps in the governance and accountability relationships between Lotteries Yukon, the Commission and Yukon government, which have over the years remained unchanged. It was determined that an internal audit could provide some useful advice in this area.
- Senior management wanted assurance that lottery revenues from the WCLC were properly accounted for and that funds were properly distributed by the Commission.
- The last internal audit of Lotteries Yukon was performed in 1988. A current review was considered overdue.

## AUDIT OBJECTIVES

The objective of the audit was to assess Lotteries Yukon business practices and the systems of internal control over the conduct and management of public lotteries. Specifically, we examined the organization's:

- governance and accountability framework;
- systems and processes to manage and control on-going operational responsibilities;
- sales revenues, expenses and profit distribution activities; and
- performance and reporting on the efficiency and effectiveness of its operations.

## SCOPE AND APPROACH

Our examination covered the period from October 1, 2006 to September 30, 2007. Our tests of financial transactions and their compliance to existing policies and procedures included revenues, fund allocations and operational expenses. On the revenue side, we selectively tested deposits and collections on ticket sales to assess timeliness and compliance to Yukon government financial policies. On the

fund allocation side, we randomly sampled and tested grant and travel applications to ensure that Commission goals and government policies on the allocation of funds were being adhered to. We also reviewed some administrative expenditures to ensure that they were properly accounted for and authorized for payment with due regard for economy and efficiency. The audit was conducted in accordance with the Yukon Government's policy on Internal Audit Services and Activities.

The audit criteria used to assess Lotteries Yukon's performance against the audit objectives were included in the audit plan that was submitted to and accepted by the Department of Community Services. Audit criteria are those conditions we expect Lotteries Yukon to meet with respect to the management and administration of its operations.

### **LIMITATIONS ON SCOPE**

Our audit did not examine the selection procedures of Commission appointees; nor did we review the extent to which the Commission is structured or functions in the required leadership role. Our focus was on the operational side of the lottery business.

During the course of our review the Western Canada Lottery Corporation (WCLC) hired Ernst and Young to audit its operations, which included those in the Western provinces and the Yukon. The firm reviewed major retailer win rates for a three year period and cross-referenced retailer wins against consumer complaints over a four and a half year period. We ensured that the scope of our internal audit did not interfere or replicate the external examination carried out by Ernst and Young. For example, we did not examine the issue of "Insider" lottery winners and payouts to licensees within the Yukon, which was part of the Ernst & Young review. In October 2007 the Ernst and Young issued its final seventy-five page report and concluded that they found no evidence of wrongdoing in retailer win files. Specifically, their report drew the following conclusions:

- There were no consumer complaints related to any of the retailer major prize claims and all claims were paid in accordance with the Lottery's Corporation's rules and regulations.
- If retailers are winning at the expected rate, there will be fluctuation in the results; sometimes they will win above the expected rate, sometimes below it. Their review confirmed such randomness exists.
- Over time and over games, the retailer win rate was within about half of a percentage point of expectations. Expected retailer win rate was 3.57; the calculated rate was 4.16. Ernst and Young found the "win rate" calculation to be unreliable and cautioned against drawing strong conclusions from it.

# OVERVIEW OF CURRENT OPERATIONS

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## PLANNING AND BUDGETING

In planning and budgeting for revenues, WCLC takes the lead in designing the various schemes and making projections as to how much revenue could be expected from each. The Commission has the opportunity to review projected revenues and decide which schemes they feel are appropriate for the Yukon. The General Manager works closely with WCLC to finalize the annual revenue budget.

On the expenditure side, the General Manager develops the annual budget for administration and Commission expenses, which is presented at each spring meeting of the Board for review and approval along with the revenue budget. There is no capital submission per se, but there is an annual provision for asset replacement and upgrading.

Given that the lottery business is relatively stable, we do not see a major strategic planning exercise as part of the budget process every year. This is particularly the case as the current planning resembles incremental rather than zero-based budgeting. While it may not be best practice, the process used is appropriate in the circumstances.

## MEETING FINANCIAL TARGETS

Over a five-year period we looked at how Lotteries Yukon reports on the achievement of its objectives, plans and budgets and how it strives to improve the efficiency and effectiveness of its operations. If one looks back over this period, Lotteries Yukon appears to have an acceptable record of meeting its financial targets. In large measure, the relationship and expertise provided by the WCLC has helped Lotteries Yukon to keep a good handle on its budget process and ability to meet its financial targets. The most noteworthy missed financial target we found was in 2006-07 with Break Open ticket sales. In that year the revenue from these tickets was 27% below target. As it was explained to us the poor showing of Break Open ticket sales was due in part to fewer retailers and a marketing strategy that failed to meet expectations.

Overall, we found Lotteries Yukon maintains good control over its budgets and plans, keeping the Commission regularly informed of its monitoring activities as they pertain to meeting the financial targets on revenues and expenditures.

## **MEETING THE COMMISSION'S STRATEGIC GOALS AND OBJECTIVES**

Performance information must be structured in ways which show how an agency's outputs and administered items contribute to the achievement of the outcomes sought by the organization. The Commission's current statement of goals and objectives as described in its 2006-07 Annual Report have not been modified or updated for many years. While the Commission each year prepares an annual plan that articulates more specifically the strategies for achieving these goals and objectives, the measures used for reporting on them generally focus on outputs that lack specific targets to measure goal achievement.

In any organization it is important to establish measures that have performance targets and measures that report on program effectiveness. Although the Commission seems to be meeting its financial targets from year to year, the output measures used by the Commission in its annual reporting can only provide limited performance information. Absent are operational measures and outcome drivers that establish whether maximum profits are being achieved, whether costs and overheads are being contained and whether and how lottery profits are benefiting and developing sports, arts, culture and recreation in the Yukon.

We would encourage the Commission and Lotteries Yukon to start articulating where they may want to be in five years or so. To illustrate, the 48% and 52% split payments that go to the Yukon government to support sports and recreation and arts programming, and to YRAC, respectively is based on history, and may no longer be aligned with current public needs or priorities. The question is: should this split always remain this way? In order to measure the desired level of achievement it may be necessary to establish criteria and performance indicators that would enable some meaningful measurement of program effectiveness.

## **RISK MANAGEMENT**

Our assessment of risks entailed a brainstorming session with the General Manager and Financial and Sales Officer, and a review of risk documentation with a particular focus on retailer fraud. Since 2006 the Yukon Lotteries Office has implemented a number of procedures to deal with retailer fraud and to improve their reporting on lottery winners. More information and details of prizes won over \$1,000 are now reported to the Commission. Communication directives and consumer awareness notices which are issued by the WCLC to the lottery retailers are followed up by communications from Lotteries Yukon. Mandatory rules are now in place requiring players add their names to their ticket before it is validated through the terminal. New terminals with improved audio and visual displays are also being introduced at the retail sites to better provide audio and visual displays at site of retail to better convey lottery wins to consumers.

Two risks identified as significant and needing greater attention were as follows:

1. Delay in paying out winners of prizes over \$1,000. Lotteries Yukon is now addressing this matter with the WCLC and looking at options of paying out winners possibly from Whitehorse or Watson Lake.
2. The handling of disputes with WCLC. The tripartite agreement with the WCLC is limited in that it does not provide for a dispute mechanism, which could put the Commission at risk if there are disagreements on such matters as commission revenues and costs on ticket sales.

Overall, we found very few risk-based issues that had not already been known or documented with strategies to mitigate them. Lotteries Yukon appears to be well aware of the risk environment in which it operates and has put control measures in place to deal with these risks.

### **LOTTERY SALES AND COMMISSION REVENUES**

The Commission's share of the net income of the WCLC lottery ticket sales forms the Commission's revenues. Every week WCLC will give Lotteries Yukon an advance on their revenues. This is deposited to Yukon Government's bank account by means of an electronic funds transfer. The weekly advances are then followed with a settlement cheque at the end of the following month. All the monies collected from WCLC are credited to the Lotteries Yukon Trust Fund.

In our examination of the sales and revenue accounting process and tests of transactions we identified two important issues. First, the formula that determines the Lotteries Yukon share of revenues based on lottery ticket sales is not covered in the agreement with the WCLC. Second, the sales reported by the WCLC for the Yukon is not reconciled by the Yukon Lotteries office to the sales reported by the retailers. It is actually the retailers who reconcile their daily cash sales to the reports which they receive from the WCLC.

Our overall assessment of the reported lottery ticket sales from the WCLC noted these compensating controls:

- 1) Retailers check their statements from the WCLC to their daily cash records. Any unusual anomalies could become known to the Lotteries Yukon office through their engagement with the sales and marketing staff.
- 2) The General Manager reviews every monthly report on sales from the WCLC and compares the reported figures to predetermined budgets and year-to-date monthly variances for all revenue categories.
- 3) Lotteries Yukon captures sales figures per retailer. Although its primary purpose is to track retailer performance, it can be totaled and thus ensure that retailer totals match the Yukon total.

- 4) WCLC is audited by Ernst & Young and Lotteries Yukon by Mackay LLP. Any significant control weaknesses or sales anomalies would be identified by the external auditors.

Although we would prefer to see a text book type of sales reconciliation done by the Lotteries Yukon office, the very sophisticated point-of-sale networked computer system allows retailers to check their records against WCLC statements which can be challenged at any time. Any discrepancies would also be reported to the Lotteries Yukon office.

In our view, the checks and balances that account for lottery sales and Commission revenues are sufficient to provide us with assurance that the reported sales and commission revenues are accurate and complete. It appears the WCLC also has a routine of keeping Lotteries Yukon and the Department of Finance well informed of the electronic deposits which get recorded in the Yukon Lottery Commission Trust Fund. The monthly summary from WCLC explains exactly how the final Commission net revenues have been calculated, and how they arrived at the settlement cheque. The communication system appears to work well, and the timing is sufficiently prompt after month end.

#### **ACCOUNTING FOR INTEREST**

There are two main sources of interest income: the interest earned on the cash account balances held in the Lotteries Yukon Trust Fund and interest earned on monies held by WCLC related to Commission revenues. The interest earned in the Lotteries Yukon Trust Fund is calculated at three percent (3%) below prime, based on the lower of the beginning and month end balance. At the end of each fiscal year this interest is credited to the trust account. Lotteries Yukon captures this income as a once off, year-end receipt, rather than making an accrual each month.

The interest earned on Commission revenues is based on a holdback to cover WCLC delivery expenses. The tripartite agreement does not refer to this interest payment or the rate that should be applied to this holdback. Interest on the holdback is paid out to shareholders and affiliates on a monthly basis.

Our tests on the interest income earned from the Yukon Lottery Trust Fund shows that Lotteries Yukon received all the interest that was due to them from this fund for the period under audit examination. We could not, however, verify the accuracy of the interest income earned on revenues due from the WCLC. However, there is little risk of any significant loss of interest income from this source of revenue, as it represents such a small portion of total revenues.

#### **FUNDING TO YUKON GOVERNMENT**

As authorized under Section 2 of the Public Lottery Act Regulations and through an agreement with the Minister, the Yukon Lottery Commission provides 48% of its revenues available for distribution to the Yukon government to supplement

spending on recreation and arts activities. The current agreement with the Yukon government is for a three-year period ending March 2009.

According to this agreement, the 48% allocation is split 62/38 between the Sports and Recreation Branch of the Department of Community Services and the Arts Branch of the Department of Tourism and Culture. The calculation used to determine the 48% includes revenue earned through established lottery products, plus annual interest earned from YG, plus previous year's opening surplus, less reserves and funds as restricted by the Yukon Lottery Commission, less administration and commission expenses.

The allocations are issued as two payments in May of each year. One payment reflects the budgeted amount for the upcoming year, while the other represents an adjusted amount on actual revenues from the previous year.

The split between the funding for sports and recreation (62%) and the arts (38%) is based on historical practice and arose when these two functions were together, under one roof. The division of funds has remained the same for almost twenty years.

Our review of the funding allocation process for the period under examination shows that all funds allocated were properly authorized by the Commission in accordance with the agreement with the Yukon government. There were no major issues to report on in this area.

#### **GRANT AND TRAVEL APPLICATION PROCESS**

All grant applications for project funding and travel applications are submitted to the Lotteries Yukon office where they get recorded and reviewed by the General Manager for completeness and adherence to the application requirements. Project applications are reviewed by the Commission twice a year, whereas the travel applications are reviewed by a subcommittee of the Commission roughly every two weeks.

Project applications get sorted into three categories for distribution to two subcommittees of the Board. When the full Board convenes, the subcommittees make their recommendations on whether to fund the applications. The final decision is left to the entire Commission. For larger projects over \$50,000 where other Yukon government sources, such as the Community Development Fund, have been identified the funding is granted subject to approval by those other sources.

All successful applicants are notified in writing. The applicant must then produce receipts for costs in order to be reimbursed. If the applicant requires advance funding, financial need must be proven to the Commission. Applicants whose

projects have been rejected are also notified in writing with an explanation as to why their application was denied.

Travel applications are governed by certain funding limits. A travel application larger than the allowable limits is put before the entire commission at the following meeting. Rejected applicants receive notification in writing explaining the reasons for rejection. Similarly, approved applicants are advised by letter of their funding. Receipts must be submitted in order for the applicants to be funded.

The grant application process for project funding and travel assistance follows a well-established routine. The screening carried out before submission to the Committee is a good control system. However, the application forms could be improved by having applicants declare all funding sources to which they have applied for financial assistance under the same project. Presently, applicants are only required to identify the income that they have actually received at the time of application, and not those sources where a decision on funding may still be pending. This may result in some applicants receiving duplicate funding for the same project from different funding sources.

We reviewed a sample of grant and travel applications to determine whether they had been properly authorized, duly supported and accounted for in accordance with government laws, regulations, financial policies and agreements. From our selected testing we can conclude that all applications are properly processed through the Lotteries Yukon office, authorized and approved by the Commission in accordance with Commission and Yukon government policies.

### **COMMISSION EXPENDITURES**

Commission expenditures largely pertain to travel and accommodation costs, and honoraria paid out to members for attending meetings or for work that they may perform on behalf of the Commission. Commission meetings are usually planned and authorized in advance. During the audit we selected some travel claims to see whether they had been processed correctly and in accordance with Commission and Yukon government policy.

We found that the claims for travel and other miscellaneous expenditures for Commission members were adequately supported and authorized. The rates charged for transportation, meals, accommodations and other costs typically followed the official Yukon government rates and allowable expenditures. The system of internal control over Commission expenditures appear to be very well controlled.

### **OPERATIONAL EXPENDITURES**

In 2006-07 Lotteries Yukon's operational expenditures totaled over \$468,000, representing 22% of total revenues. Salaries make up most of the office expenses followed by rent, office supplies, advertising and promotion.

In examining this area, we tested a few transactions to determine whether they were properly authorized and approved by the Commission, where appropriate, and supported by invoices and evidence that goods or services were received. The accepted practice is that all extraordinary expenditures are passed on to the Commission for approval. If the expense follows a normal budgeted item then it is approved by the General Manager.

From our review we found the system of internal control over operational expenditures to be sound and very well controlled.

### **WCLC CHARGES**

The Tripartite Agreement is not specific in its description of what costs can pass on to the Commission. Generally speaking, it is understood that the Yukon Lotteries Commission will bear the actual cost of each ticket sold through the retailer system in the Yukon. These costs include marketing, ticket production, freight and telecommunications. Some costs such as telecommunications can be directly attributable to the cost of doing business in the Yukon. Other costs such as marketing represent costs that are shared between the WCLC shareholders and affiliates

In our examination of the August 2007 expense schedule, we noted that the WCLC charges were, on the whole, very close to budget. The only exception was telecommunications and the cost variance was satisfactorily explained. Our overall assessment of the WCLC cost noted these compensating controls:

- 1) The General Manager reviews every monthly report on costs from the WCLC and compares the reported figures to predetermined budgets and year-to-date monthly variances for all cost categories.
- 2) All the shareholders and affiliates go through the same scrutinizing exercise when they get their monthly cost reports, and it is reasonable to assume that they would also raise queries if the expenses are vastly different from what they expected. Lotteries Yukon captures sales figures per retailer. Although its primary purpose is to track retailer performance, the per retailer figures can be totaled thus ensuring they match the Yukon total.
- 3) WCLC is audited by Ernst & Young and Lotteries Yukon by Mackay & Partners. Any significant control weaknesses or cost anomalies would be identified by the external auditors.

We found all WCLC charges examined were properly processed and authorized by the Lotteries Yukon office. However, we could not verify the accuracy of the WCLC charges we reviewed due to the lack of documentation supporting some of the WCLC invoices. As well, the agreement with the WCLC is not specific in defining the costs of doing business. Although this is an obvious weakness with the agreement, we found the current practices and mitigating controls that have

been in place for many years reduce the risk of any major discrepancies occurring in this area.

#### **ACCOUNTS RECEIVABLE AND PAYABLE PROCESS**

There is actually very little activity in either of the accounts receivable and payable accounts. Internal control over these accounts seems to be working well given the few transactions that pass through them. We tested a few transactions in both the accounts receivable and payable accounts to ensure the proper handling of transactions and compliance with Yukon government's financial policies. We found sufficient evidence to support the accounting for these transactions. The records and files reviewed were well maintained.

# OBSERVATIONS AND RECOMMENDATIONS

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## GOVERNANCE ISSUES

It is within the governance and accountability framework that an organization decides where it is going, monitors its performance, delegates authority, and allocates resources. It is the defining moment for clarifying roles, responsibilities and accountabilities for the effective management of the organization. Based on our review we identified two areas where elements of the governance and accountability framework can be improved.

### *Role of Chief Executive Officer and General Manager*

Section 4(2) of the Public Lotteries Act provides for the Chair of the Commission to also be the Chief Executive Officer, that is, to supervise and direct the work of the Commission. Our review of the lottery operations shows that the General Manager actually performs the duties and obligations normally attributable to a Chief Executive Officer.

The Commission within its own policies has clearly laid out the responsibilities of the Chair, Vice-Chair, Committee Chairs and members. It views the role of the Chief Executive Officer as taking care of the Commission's business rather than the supervision of the Lotteries Yukon office which falls under the supervision of the General Manager. The Commission sees the General Manager as reporting to the Commission Chair.

The Yukon government sees the General Manager as a government employee supporting the Commission Chair. The General Manager is expected to take direction from and be accountable to both the Commission and the Yukon government in relation to the performance of duties. This position is also viewed as reporting and communicating to the Deputy Minister, Community Services, acting as President, Yukon Liquor Corporation, on decisions of the Commission regarding policy, human resources, administration, finance requirements and other matters that may be sensitive to the Government of Yukon. Both parties recognize that the dual accountability role of this position has potential for conflicting direction.

Our audit shows the General Manager was appointed by the Commission with the Public Service Commission (PSC) assigning an employee number to the position. In 1993 the position was identified by the PSC as reporting to the Assistant Deputy Minister (ADM), Municipal and Corporate Affairs (*formerly of the Department of Community and Transportation Services*). The reporting relationship to the ADM was never formally determined. As mentioned above, the General Manager now reports to the Deputy Minister, Community Services.

The General Manager's reporting relationship has been an issue with successive Commission Chairs and the Yukon government since at least 1990. In more recent years, the relationship has been strained by attempts to exercise greater control over the position and the lottery operations, as discussed below. Unfortunately, the Public Lotteries Act does not establish a clear reporting relationship for the General Manager and the issue today remains unresolved.

### **Recommendation**

1. The responsibility for the day-to-day management and administration of Lotteries Yukon should be clarified including the role and reporting relationship of the General Manager so as to enable the Lotteries Yukon and the Commission to operate effectively under a clear governance structure.

### Management Comments

*Agreed that the roles and responsibilities should be clarified.*

### ***Relationship with Yukon Liquor Corporation***

In April 2002, the Yukon government initiated implementation of a corporate re-organization that established the Deputy Minister of Community Services as President of the Yukon Housing and Yukon Liquor Corporations. Concurrent with these changes, the government at that time directed that:

- the Minister responsible for the Yukon Liquor Corporation would be responsible for the Commission; and
- the administrative and operational roles of the Commission, General Manager and employees would be combined with the operations of the Yukon Liquor Corporation and directed by the President of the Yukon Liquor Corporation.

In part, the intent of this reorganization was to deal with the issue above: that is, the reporting relationship of the Yukon Lotteries staff.

In part, the intent of this reorganization was to deal with the issue above: that is, the reporting relationship of the Yukon Lotteries staff. Since October 2004 several attempts have been made to put into effect a "Protocol Agreement" between the Minister and Commission that would formally establish the relationship, as envisaged by the corporate re-organization that took place in 2002. One of the parts of the proposed agreement we reviewed would require the Commission to provide the Minister's Deputy Head, as President of the Yukon Lottery Corporation, with such reports regarding the business of the Commission, as deemed necessary. In our view such a provision would enable the Yukon Liquor Corporation to have some oversight and fiduciary responsibilities over the Commission and the Lotteries Yukon's operations.

Although the Public Lotteries Act does not provide for a protocol arrangement, the Commission acknowledges its value and would be prepared to enter a protocol agreement with the Minister. But it would likely do so with the understanding that it continue to operate at arm's length from any one department or corporation of government. A protocol that would include some reporting and accountability relationship with the Yukon Liquor Corporation could very well contradict that principle.

### **Recommendation**

2. In keeping with the recommendation above, the government and the Commission should make it a priority to conclude a Protocol Agreement to clarify the governance structure and set out the expectations of both parties.

### Management Comments

*Yukon government and the Yukon Lottery Commission will work towards an agreement which will clarify the governance structure and expectations of both parties.*

### **OPERATIONAL ISSUES**

One of the main goals of the Commission is to achieve maximum profits through the efficient management of public lotteries in the Yukon. It sets direction in achieving this goal by supervising and controlling the activities of the Lotteries Yukon office which has responsibility for administering the lottery programs. Based on our review we identified four areas where the business can be improved.

#### ***SHARED SERVICES ARRANGEMENT WITH COMMUNITY SERVICES***

Lotteries Yukon uses the services of the Department of Community Services to process all expenditure transactions for payment authorization under a shared corporate services arrangement with the department. Some human resource services are also provided by Community Services. There is no cost associated to these services and there is no formal agreement that clearly outlines the relationship between the Department and Lotteries Yukon.

Typically, shared service agreements cover administrative functions such as payroll processing, staffing, records management, accounting, and information technology services and involve a fee. While shared services have the potential of realizing improved quality of services and reducing administrative costs, the recipient should also have the ability to hold the service provider accountable if the needs are not being met. In this case a reduction of administrative costs is not possible as no fee is charged and the audit did not identify that needs were not being met.

Both the Department of Community Services and the Commission should work towards formalizing their administrative relationship under a shared service type agreement. The shared service agreement could cover such issues as the services to be provided, the cost to the organization that is relying on those services and how those costs are to be determined, benchmarks that establish the standards for service delivery, potential areas of risk and how differences between the service provider and service recipient are to be addressed.

### **Recommendation**

3. Lotteries Yukon and the Department of Community Services should establish a formal written shared services agreement.

### Management Comments

*Agreed.*

### **AGREEMENT WITH THE WESTERN CANADA LOTTERY CORPORATION**

The tripartite agreement between the Commission, Yukon government and the WCLC was signed in 1989, almost 18 years ago. Since its creation it appears to have worked well in defining on how the lottery schemes in the Yukon are to function. The Lotteries Yukon office and the WCLC have developed long-standing relationships between individuals and relationships built on trust and certain conventions and practices that have benefited all parties.

Our examination of the agreement has noted the absence of certain provisions that would help strengthen and protect the interest of the Yukon government and Commission. The Commission also recognizes that certain terms and conditions contained in the agreement need updating in order to reflect today's realities. As a minimum, we would expect to see the following provisions included in any future agreement with the WCLC:

- a schedule that explains how the Commission's portion of net revenues from the sale of lottery tickets are to be calculated and distributed;
- a schedule that shows the WCLC payment scheduling and how it calculates interest earned on monies held on behalf of the Commission;
- a section that identifies and explains the direct costs to be charged by the WCLC to the Commission and other costs that are apportioned to and among the shareholders or affiliates.
- a dispute resolution clause; and
- a renewal clause that would require each party to periodically reexamine the Agreement at regular defined intervals.

### **Recommendation**

4. The Yukon government in consultation with the Commission should renegotiate its agreement with the Western Canada Lottery Corporation.

### Management Comments

*Management agrees that modernizing the agreement would be beneficial.*

### **LOTTERIES YUKON'S POLICIES AND PROCEDURES**

Our review of the Lotteries Yukon Office Procedures Manual shows that a good effort has been made to document guidelines and practices for activities in the office. While it may not be critical in a small team to create a comprehensive procedures manual, because it is easier to get and give advice from colleagues, supervise and exercise quality control, the operational procedures manual is an important vehicle for maintaining the “know-how” of the business and the knowledge and experience gained by the senior staff who have served for many years. For example, improvement to the manual could be made in the following areas: release of information on grant applications; strategies for communicating with the press or the public; security of information; unclaimed grants; insurance policy; and certain Yukon government accounting policies.

### **Recommendation**

5. Lotteries Yukon should make efforts over the next few years to improve their Policy and Procedures Manual.

### Management Comments

*All policies are revised annually by the Yukon Lottery Commission. Therefore, the policies are current. However, management agrees that documented procedures manuals require updating as time and resources permit.*

### **USE OF PETTY CASH**

The Lotteries Yukon office maintains a petty cash fund of \$2,500, which is primarily used to cover the cost of bulk postage for lottery tickets that are distributed to the retailers in the communities.

Our tests of payments under the petty cash fund showed that they were properly authorized and accounted for. The funds are also secured in a locked safe. However, sizable payments are regularly made from the fund to purchase postage that is used for the bulk delivery of lottery tickets to the Yukon communities. The handling of cash on this basis poses a risk, particularly when there may be alternate arrangements that could be put in place to eliminate the need to purchase postage by cash. The Lotteries Yukon office may wish to consider a new arrangement with Canada Post such that an account would be established with

them to enable the cost of postage to be billed each month. This step would dramatically reduce the size of the petty cash fund.

**Recommendation**

6. The Lotteries Yukon Office should identify options to reduce the size of the petty cash fund.

Management Comments

*Agreed.*