



A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit and Sunset Review

Arizona State Lottery Commission and Arizona State Lottery

March • 2010
REPORT NO. 10-03



Debra K. Davenport
Auditor General

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

March 9, 2010

Members of the Arizona Legislature

The Honorable Janice K. Brewer, Governor

Jeff Hatch-Miller, Executive Director
Arizona State Lottery

Transmitted herewith is a report of the Auditor General, a Performance Audit and Sunset Review of the Arizona State Lottery Commission and the Arizona State Lottery. This report is in response to a November 3, 2009, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Arizona State Lottery agrees with all of the findings and plans to implement all of the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on March 10, 2010.

Sincerely,

Debbie Davenport
Auditor General

Attachment

cc: Mr. Leo Valdez, Chairman
Arizona State Lottery Commission

REPORT HIGHLIGHTS
PERFORMANCE AUDIT

Our Conclusion

In 1980 Arizona citizens established the Arizona State Lottery Commission to oversee the Arizona State Lottery "... to produce the maximum amount of net revenue consonant with the dignity of the State." Eleven different programs or beneficiaries receive lottery revenues. We found that although sales and beneficiary distributions have increased over the years, both have leveled off since fiscal year 2007. The Lottery can increase its sales and beneficiary distributions by: (1) expanding its retailer network, (2) increasing the number of players, and (3) better managing its prize expenses and advertising costs. We also found that the steps the Lottery takes to ensure game integrity and player protection are generally comparable to practices that other states use or recommend, but the Lottery can enhance these steps in several ways.



2010

Lottery should take steps to increase sales and beneficiary distributions



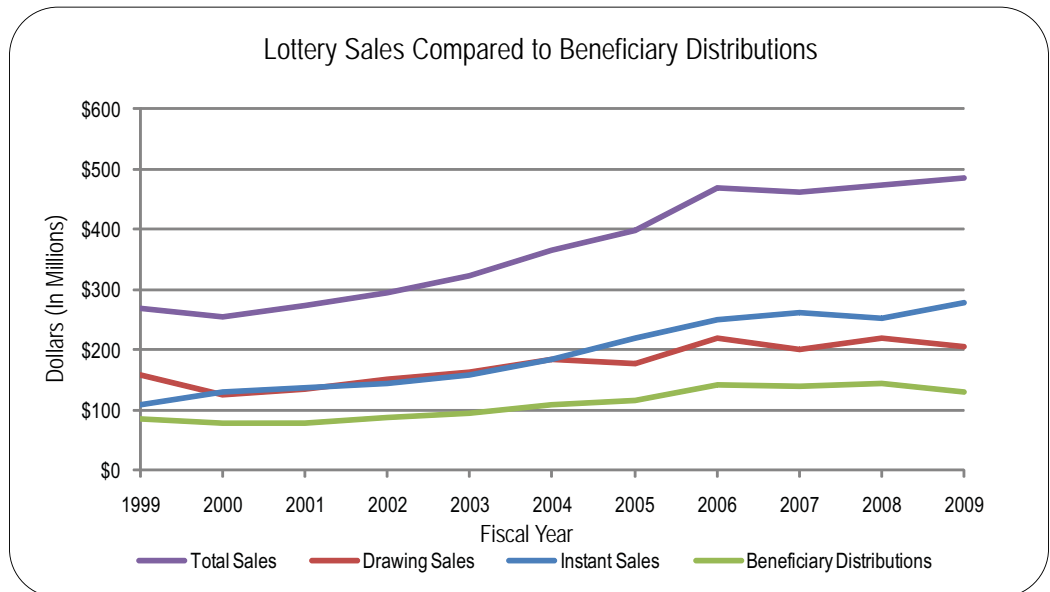
The Lottery provides both instant ticket (scratcher) and drawing games for the public to play. The Lottery had \$485 million in ticket sales and other revenues in fiscal year 2009, paying out over \$282 million in prizes and \$129 million in distributions to beneficiaries, including the State General Fund, the Local Transportation Assistance Fund, the Game and Fish Heritage Fund, and the State Park Heritage Fund. Retailers also received over \$32 million for selling lottery tickets.

Although Arizona lottery sales have generally increased since fiscal year 2000, per capita sales are low compared to other state lotteries. Compared to states with similar lottery games, Arizona ranked 24th out of 28 states in fiscal year 2008 with sales of \$73 per capita. In contrast,

Colorado ranked 17th out of the 28 states with sales of \$102 per capita. Further, Arizona lottery sales started leveling off in fiscal year 2007, and its beneficiary distributions not only leveled off, but actually declined in fiscal year 2009 (see below).

Increasing number of retailers—Arizona's low per capita lottery sales may stem partly from its having relatively few lottery retailers compared to other states. For example, Colorado had over 40 percent more retailers per capita than Arizona in fiscal year 2008. Colorado had one retailer for every 1,700 people, while Arizona had one retailer for every 2,444 people.

During the audit, the Lottery began taking steps to increase the number of retailers by assigning an employee the responsibility to recruit new retailers, and planning to develop relationships with existing and new retailers. In expanding the number of retailers, the Lottery should strategically target the highest-producing



types of retailer. For example, grocery stores and restaurants/bars in Arizona have the highest average lottery sales, and there are some grocery stores and many restaurants/bars that are not lottery retailers.

Increasing player base—The Lottery should also consider ways to increase the number of people who play the Lottery's games by using its market research company to determine what might motivate nonplayers to play and casual players to play more often.

Better managing costs—Beneficiary distributions declined in fiscal year 2009 because of increases in the amount of prizes and increases in administrative costs—primarily advertising (see textbox).

To help manage its prize expenses, when designing games, the Lottery should conduct formal analyses cited in lottery literature that will help it determine the

Costs (In Millions)	FY 2008	FY 2009
Prizes	\$262	\$282
Administration	67	75
Beneficiaries	145	129

lowest amount in prizes it can pay that still encourages play and maximizes beneficiary distributions. To ensure the Lottery effectively manages its advertising costs, it should reinstate its practice of developing an annual marketing plan. In addition, to provide its Commission with a better understanding of the impact of costs on lottery beneficiary distributions, the Lottery should report these impacts over time and report how its costs compare to those of other comparable lotteries.

Game integrity and player protection measures generally match other states' efforts, but can be enhanced

The Lottery helps ensure the games' integrity and player protection by licensing reputable retailers. It checks applicants' criminal history records, and has denied new licenses and revoked existing licenses when necessary. The Lottery also conducts proactive investigations at retailer locations, and 111 of these occurred in fiscal year 2009. In 72 of these, the Lottery identified retailers who were not complying with rules such as a rule prohibiting retailer employees from selling tickets to themselves. In a few cases, the problems involved fraud or theft. For example, a clerk at one retailer would lightly scratch instant tickets, keep the winners, and sell the nonwinners to the public. The Lottery works with law enforcement when appropriate to address the problems its investigations find.

Other states take additional action to ensure retailers' employees do not affect game integrity. For example, four of five states we contacted require winners to disclose if they are affiliated with a retailer. Because the Lottery directly pays out prizes over \$599, for those prizes, its claim form could require disclosure of any relationship between the claimant and any retailer. The Lottery could then use this information to cross-check records to determine

if further investigation is needed to ensure the tickets were obtained legitimately.

The Lottery also conducts routine compliance investigations of licensed retailers. However, in August 2009, there was a backlog of 789 retailers that had not had an investigation as planned. To address the backlog, the Lottery should continue focusing on higher-risk retailers, such as those with findings during previous investigations.

The Lottery helps players protect themselves against theft of their potential prizes. For example, it:

- Provides monitors that let players see if they have a winning ticket;
- Provides computer terminals that play a jingle when a ticket is a winner; and
- Verifies tickets at its Phoenix and Tucson offices.

Further, some retailers provide self-check machines and brochures on how to determine if a ticket is a winner, how to claim prizes, and how to avoid fraud, theft, and scams. The Lottery could enhance these player protections by posting on its Web site measures players can take to protect their tickets, such as signing the ticket upon purchase.

TABLE OF CONTENTS



Introduction & Background	1
Finding 1: Lottery should enhance efforts to maximize sales and beneficiary distributions	13
Decreased beneficiary distributions and low per capita sales indicate room for improvement	13
Lottery should raise sales revenues by recruiting more retailers and responsibly increasing player base	17
Lottery should better manage and report costs	19
Recommendations	22
Finding 2: Lottery's game integrity and player protection measures generally match other states' efforts, but can be enhanced	23
Steps to protect against retailer theft, fraud, and impropriety can be further enhanced	24
Measures to protect players should include more Web-based information	28
Lottery takes other actions to ensure game integrity	30
Recommendations	32
Sunset Factors	33
Appendix A: Methodology	a-i
Agency Response	

♦ continued



TABLE OF CONTENTS

Tables:

1	Schedule of Revenues, Expenses, and Other Changes in Fund Net Assets Fiscal Years 2007 through 2009 (Unaudited)	7
2	Effect of Decreased Beneficiary Distributions Fiscal Years 2007 and 2009 (Unaudited)	15

Figures:

1	Lottery Beneficiary Distribution Hierarchy and Amounts Distributed Fiscal Year 2009 (Unaudited)	5
2	Prizes, Beneficiary Distributions and Administrative Costs Fiscal Year 2009 (In Millions) (Unaudited)	8
3	Lottery Sales Compared to Beneficiary Distributions Fiscal Years 1999 through 2009 (Unaudited)	14
4	Prizes, Beneficiary Distributions, and Administrative Costs Fiscal Years 2008 and 2009 (In Millions) (Unaudited)	21

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INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona State Lottery Commission (Commission) and the Arizona State Lottery (Lottery) pursuant to a November 3, 2009, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

History and purpose

In 1980, through an initiative petition in the general election, Arizona citizens established the Commission to oversee a state lottery. The state agency that operates Arizona's lottery, the Arizona State Lottery, began operating in 1981. One of the Lottery's primary purposes is to generate revenue for Arizona programs. The Arizona State Lottery Commission, which oversees the Lottery, is charged by statute with ensuring that the Lottery produces "the maximum amount of net revenue consonant with the dignity of the State."¹ Voters have approved the Lottery's continuation two times since its inception. In the most recent vote, November 2002, 73 percent of the voters approved the Lottery's continuation until July 1, 2012. However, Laws 2010, 6th S.S., Ch. 2, effective from and after June 30, 2012, lets the current Lottery and Commission terminate, establishes a new Arizona State Lottery Commission and Lottery, and continues them until July 1, 2035, thereby eliminating the need for a public vote.

Games offered and beneficiary distributions

The Lottery offers both drawing and instant (scratcher) games (see textbox) and provides beneficiary distributions to Arizona programs. In fiscal year 2009, the Lottery

Examples of Arizona Lottery Games:

Drawing Games

The player or a computer picks numbers that are then printed on the ticket and later matched to numbers picked in a computer drawing:

- Powerball (a multi-state game)
- The Pick
- Cash 4
- 2 by 2
- Pick 5

Instant Ticket (Scratcher) Games

Players scratch a latex coating off numbers or symbols on the ticket. Information on the ticket determines if it is a winner. There are approximately 40 scratcher games, including:

- Roll the Dice
- Bingo
- Triple Cash Crossword
- \$100 Million Cash Spectacular

Source: Auditor General staff analysis of information from the Lottery's *Guide to all Games* brochure, Web site, and officials.

¹ A.R.S. §5-504(B).

distributed just over \$129 million to various Arizona programs and funds.¹ From fiscal years 1982 through 2009, these beneficiary distributions totaled nearly \$2.4 billion.

In September 2008, a statutory revision to A.R.S. §5-522 established a new process for distributing these monies to beneficiaries. In the past, specific games funded specific beneficiaries, but the revision created a distribution process that, with few exceptions, combines the proceeds from the various games and distributes them through a hierarchy.² Each tier of the hierarchy receives funds only if the statutory provisions for funding the tiers above it are met.³ According to the Lottery, it follows statutory and session law requirements, which provide sufficient information for the Lottery to determine the correct amounts for each beneficiary fund. However, in fiscal year 2009, the hierarchy flow was modified because of some legislative changes and a Governor-approved alternative fund transfer protocol developed to provide beneficiaries with a monthly pro rata share of the predicted distribution amount so that the beneficiaries could better meet their monthly operational needs. Figure 1 (see page 5) shows an overview of the hierarchy and the amounts each tier received in fiscal year 2009, while the following explanation covers each tier of the hierarchy in more detail:

1. **Commerce and Economic Development Commission Fund [A.R.S. §5-522(A)(2)]**—This is the only Fund that receives beneficiary distributions from two specific instant (scratcher) games. The Lottery chooses the two games annually and generally designates either \$5 or \$10 instant games to generate monies for this Fund. The beneficiary distributions are used for economic development of rural businesses, businesses employing fewer than 100 employees, and businesses in economically disadvantaged areas of the State.
2. **State General Fund [A.R.S. §5-522(F), (H), and (K)]**—Beneficiary distributions flow to the State General Fund at three points established by statute. First, if the Lottery Director determines that \$31 million may not be available for the State General Fund in a fiscal year, no monies flow to subsequent tiers in the hierarchy until the State General Fund receives \$31 million. Second, after beneficiary distributions are provided as far down the hierarchy as the Department of Economic Security—Homeless Shelters Fund (see Number 8, page 4), the State General Fund is to receive an additional \$15.49 million.⁴ Third, after all monies have been distributed to the beneficiaries specified in A.R.S. §5-522 according to statute or session law requirements, any remaining monies shall be deposited in the State General Fund. Lottery beneficiary distributions

¹ Beneficiary distributions generally come from ticket sales; however, one beneficiary, the Court Appointed Special Advocate Fund (CASA), receives 30 percent of unclaimed prize monies each month, which amounted to \$2.7 million in fiscal year 2009. In addition, in fiscal year 2009, \$775,500 in beneficiary distributions resulted from legislatively mandated reductions in the Lottery's administrative costs.

² One beneficiary, the Department of Gaming, is not listed in the hierarchy. The Lottery provides \$300,000 to the Department of Gaming to support its problem gambling programs.

³ Laws 2009, 4th S.S., Ch. 3, §3, removed two additional beneficiaries from the hierarchy that would have been eligible for funding in fiscal year 2010: the Department of Environmental Quality's Water Supply Development Fund and the State Land Department's Community Protection Initiative Fund.

⁴ Laws 2008, Ch. 287, §35, modified the State General Fund's second distribution to require that \$26 million be deposited into the State General Fund prior to monies being deposited into the University Capital Improvement Lease-to-Own Fund in fiscal year 2009.

deposited into the State General Fund are used for K-12 and higher education; public health, welfare, and safety; natural resources; and general government.

In fiscal year 2009, the amounts deposited in the State General Fund did not follow this specific pattern. Session laws required that, in addition to the regular distributions to the State General Fund, the Lottery make some additional transfers to the State General Fund in lieu of a portion of distributions to other specific lottery beneficiaries.¹ Specifically, distributions that would have gone to the Local Transportation Assistance Fund (Mass Transit), the Local Transportation Assistance Fund, and the County Assistance Fund in the amounts of \$475,000, \$1,150,000, and \$382,500, respectively, were directed to be given to the State General Fund instead of these three beneficiaries.

3. **Local Transportation Assistance Fund (Mass Transit) [A.R.S. §5-522(A)(3)]**—Statute authorizes this Fund to receive up to \$18 million annually. By statute, this fund must receive a minimum of \$9 million before funding can pass to the next tier, and by statute, this minimum amount may increase by no more than 10 percent per year. Proceeds are distributed based on county population and administered by a public transportation fund, or metropolitan planning organization, or cities and towns or county supervisors for programs such as dial-a-ride for the elderly and disabled.²
4. **Local Transportation Assistance Fund [A.R.S. §5-522(B)]**—Statute authorizes this Fund to receive up to \$23 million annually and does not specify a minimum amount that must be provided. Every incorporated city and town in Arizona receives at least \$10,000 of these monies, which they may use for public transportation operation and related capital purposes. They may also use up to 10 percent of the lottery distributions they receive in a fiscal year for cultural, educational, historical, recreational, or scientific facilities or programs. If distributions within this 10 percent are matched by private grants, cities and towns may also use them for nonresidential outpatient programs for persons with developmental disabilities.³
5. **County Assistance Fund [A.R.S. §5-522(B)]**—Statute authorizes this Fund to receive up to \$7.65 million annually and does not specify a minimum amount that must be provided. All counties receive a share of these lottery distributions based on population, which county supervisors manage.⁴
6. **Arizona State Parks and Arizona Game and Fish Heritage Funds [A.R.S. §5-522(D)]**—Statute authorizes each of these funds to receive up to \$10 million annually and does not specify a minimum amount that must be provided.

Local and county governments receive lottery distributions for transportation and other programs.

¹ Laws 2009, 1st S.S., Ch. 3, §7.

² Laws 2009, 4th S.S., Ch. 3, §22, requires that \$990,000 be transferred from this Fund to the General Fund in fiscal year 2010.

³ Laws 2009, 4th S.S., Ch 3, §22, requires that \$2.3 million be transferred from this Fund to the General Fund in fiscal year 2010.

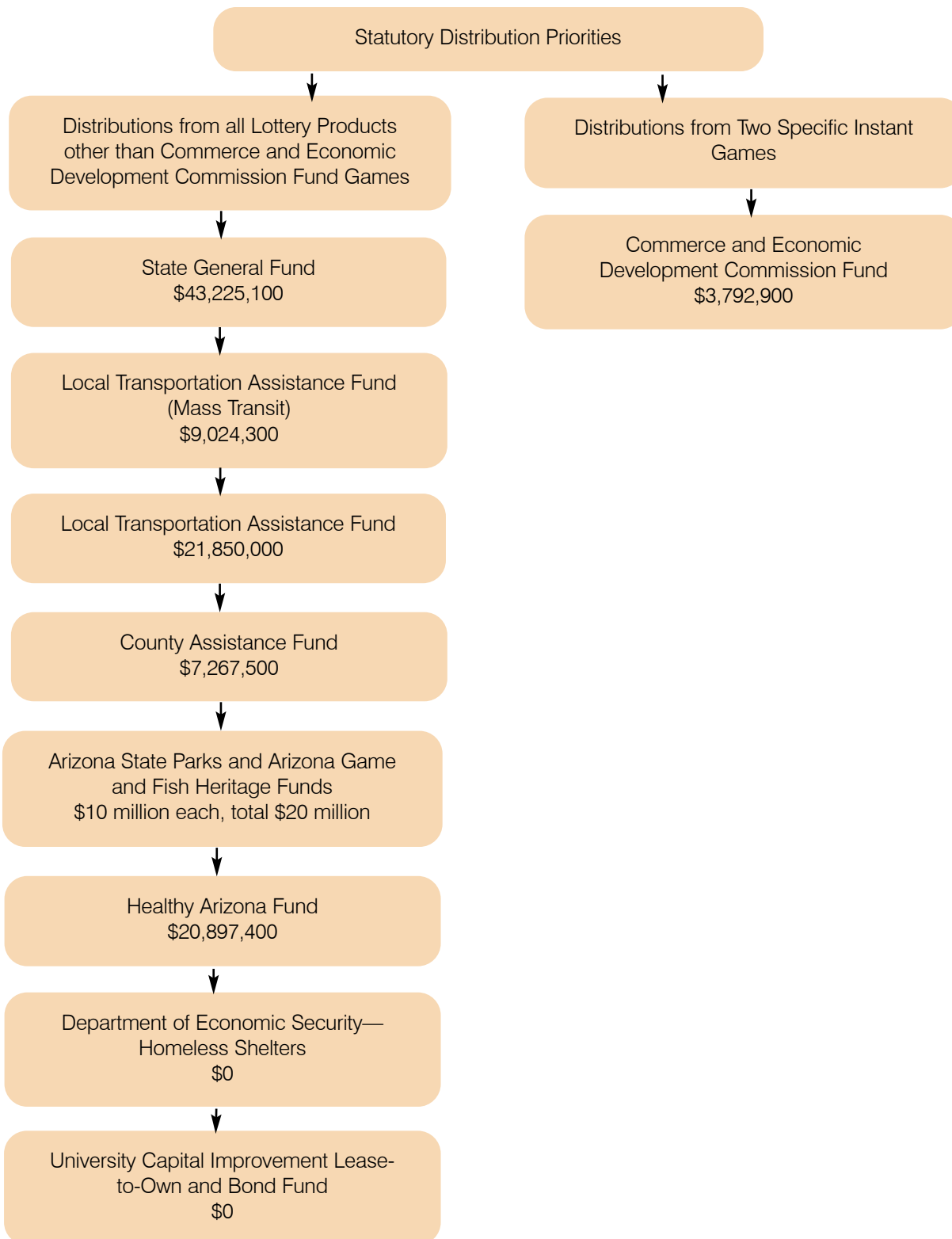
⁴ Laws 2009, 4th S.S., Ch. 3, §22, requires that \$765,000 be transferred from this Fund to the General Fund in fiscal year 2010.

Lottery beneficiary distributions deposited in the State Parks Heritage Fund are used for local, regional, or state parks; outdoor recreation; and environmental education. Distributions deposited in the Game and Fish Heritage Fund are used for public access, environmental education, schoolyard habitats, and protecting and managing urban wildlife.

7. **Healthy Arizona Fund [A.R.S. §5-522(E)]**—Statute specifies a minimum amount for this Fund of \$17 million, which is adjusted for inflation annually, and it does not specify a maximum. According to a lottery official, the adjusted total minimum amount for fiscal year 2009 was \$21.8 million. In fiscal year 2009, the actual amount available for this Fund was \$20,897,400. These beneficiary distributions are provided to several programs, such as the Department of Economic Security’s Healthy Families Program; the Arizona Board of Regents’ Arizona Health Education System; the federal Women, Infants, and Children Food Program; and programs for such purposes as teenage pregnancy prevention and disease control research. If distribution amounts do not equal the minimum amount required for a fiscal year, the amount that is available is distributed to the various beneficiaries on a pro rata basis.
8. **Department of Economic Security—Homeless Shelters Fund [A.R.S. §5-522(G)]**—Statute authorizes this Fund to receive up to \$1 million annually and does not specify a minimum amount that must be provided. These lottery beneficiary distributions are used to provide grants to nonprofit organizations for homeless emergency and transitional shelters and related support services. However, in fiscal year 2009, this Fund did not receive any lottery distribution monies.
9. **University Capital Improvement Lease-to-Own and Bond Fund [A.R.S. §5-522(H)]**—Statute authorizes that in fiscal year 2009, after at least \$46.49 million has been deposited into the State General Fund, any remaining lottery monies up to 80 percent of total payment of lease-to-own and bond agreements entered into by the Arizona Board of Regents shall be deposited into this Fund. However, in fiscal year 2009, this Fund did not receive any lottery distribution monies.

In February 2010, changes were made to the Lottery’s statutes that may impact beneficiary distributions. Specifically, Laws 2010, 6th S.S., Ch. 4, effective May 13, 2010, authorizes the Department of Administration to issue State Lottery Revenue Bonds; establishes the State Lottery Revenue Bond Debt Service Fund; and requires that amounts distributable to the State General Fund from the State Lottery Fund be transferred first to the State Lottery Revenue Bond Debt Service Fund to meet the bond requirements for the current period. In addition, Laws 2010, 6th S.S., Ch. 2, effective from and after June 30, 2012, requires that debt service for revenue bonds shall be paid first from monies that would have otherwise been deposited in the State General Fund, and that monies in the State Lottery Fund can only be distributed to beneficiaries after the bond requirements for the current period have been met.

Figure 1: Lottery Beneficiary Distribution Hierarchy and Amounts Distributed¹
 Fiscal Year 2009
 (Unaudited)



¹ For a description of each beneficiary's use of lottery monies, see Introduction and Background, pages 2 through 4.

Source: Auditor General staff analysis of A.R.S. §5-522 and the Lottery's financial report *Arizona Lottery Revenues and Transfers to Other State Funds* for fiscal year 2009.

Revenues and expenditures

The majority of the Lottery's revenues come from ticket sales (see Table 1, page 7). In fiscal year 2009, the Lottery's total ticket sales and other sources of revenue was \$485 million. According to A.R.S. §5-505(B), at least 50 percent of the Lottery's annual ticket sales revenue must be deposited in the Lottery Prize Fund to pay winning players. As shown in Figure 2 (see page 8), in fiscal year 2009, \$282 million went to player prizes.

Lottery revenues also fund the Lottery's expenditures. According to A.R.S. §5-505(A) and (D), no more than 18.5 percent of ticket sales and other sources of revenue may be used for administrative purposes, and these expenditures must be appropriated by the Legislature. In fiscal year 2009, the Lottery's total administrative costs were just over \$75 million, which is approximately 15 percent of its total ticket sales and other revenue. According to a lottery official, administrative expenses include all costs that are not prizes, such as retailer commissions, advertising, employee salaries and related expenses, and payments to vendors who print lottery tickets and provide the technology used to process lottery transactions.

Finally, in addition to the beneficiary distributions remitted to state programs, the state and federal government receive income withholding tax revenue from Arizona lottery prize winners who win at least \$600 and at least 300 times the wager on a game. In calendar year 2009, on behalf of Arizona lottery prize winners, the Lottery remitted over \$13 million in tax revenue to the federal government and over \$2.6 million to the State of Arizona.

Table 1: Schedule of Revenues, Expenses, and Other Changes in Fund Net Assets
Fiscal Years 2007 through 2009
(Unaudited)

	2007	2008	2009
Operating revenues:			
Instant ticket sales:			
Scratchers	\$250,680,198	\$239,227,853	\$262,695,972
Economic development Scratchers	10,338,253	13,220,586	16,228,385
Online ticket sales:			
Powerball	127,278,294	130,424,083	117,238,451
The Pick	52,410,989	52,552,416	45,489,149
Pick 5	12,566,113	14,191,389	16,996,584
Arizona Raffle		11,943,120	11,184,560
Pick 3	8,926,133	9,530,550	9,409,924
Cash 4			3,036,194
Fast Play		1,847,281	2,206,885
Total ticket sales	<u>462,199,980</u>	<u>472,937,278</u>	<u>484,486,104</u>
Other operating revenues	100,213	114,916	550,905
Total revenues	<u>462,300,193</u>	<u>473,052,194</u>	<u>485,037,009</u>
Expenses:			
Direct:			
Prize expense ¹	257,493,027	262,486,159	282,482,645
Retailer commissions and incentives	31,121,336	31,312,957	32,472,390
Computerized gaming system	8,171,753	8,890,551	7,813,813
Instant ticket system and distribution	2,174,504	2,107,944	2,329,018
Tickets purchased	4,152,149	4,756,628	7,037,089
Total direct expenses	<u>303,112,769</u>	<u>309,554,239</u>	<u>332,134,955</u>
Other operating:			
Advertising and promotion ²	10,683,681	10,816,867	15,687,024
Wages and related expenses	6,118,238	6,095,428	6,107,037
Contract services	368,051	348,976	393,838
Depreciation	260,370	316,099	355,971
Administrative expenses	2,531,722	2,447,080	3,129,245
Total operating expenses	<u>323,074,831</u>	<u>329,578,689</u>	<u>357,808,070</u>
Operating income	139,225,362	143,473,505	127,228,939
Nonoperating revenues—interest earnings	<u>780,136</u>	<u>1,135,098</u>	<u>752,101</u>
Income before transfers	140,005,498	144,608,603	127,981,040
Transfers to other state funds ³	<u>139,914,976</u>	<u>144,500,971</u>	<u>129,080,003</u>
Change in fund net assets	90,522	107,632	(1,098,963)
Fund net assets, beginning of year	<u>11,291,752</u>	<u>11,382,274</u>	<u>11,489,906</u>
Fund net assets, end of year	<u>\$ 11,382,274</u>	<u>\$ 11,489,906</u>	<u>\$ 10,390,943</u>

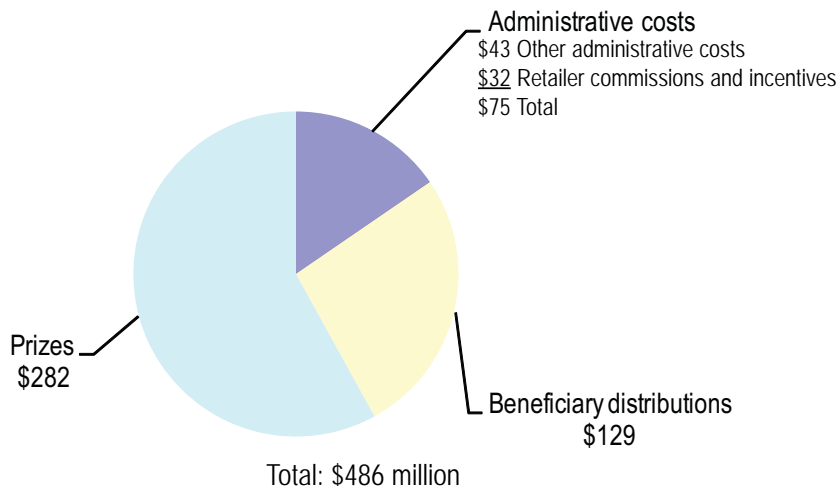
¹ Consists of the monies from ticket sales used to pay prizes to winning ticket holders.

² Amount in fiscal year 2009 increased significantly because the advertising cap was eliminated beginning in fiscal year 2009. Specifically, the advertising cap established in A.R.S. §5-505 was eliminated in Laws 2008, Ch. 285, §26, and Laws 2008, Ch. 287, §2. Consequently, there is no longer any specific limitation on advertising expenditures; however, the Commission must still meet the requirement that administrative expenditures, including advertising expenditures, do not exceed 18.5 percent of total annual revenues.

³ Consists of monies transferred to beneficiaries, including the State General Fund, Healthy Arizona Fund, Heritage Funds, and Local Transportation Assistance Funds, in accordance with A.R.S. §§5-505 and 5-522.

Source: Auditor General staff analysis of the Lottery's financial statements audited by Deloitte & Touche LLP for fiscal years 2007 through 2009.

Figure 2: Prizes, Beneficiary Distributions, and Administrative Costs
 Fiscal Year 2009
 (In Millions)
 (Unaudited)



Source: Auditor General staff analysis of the Lottery's audited financial statements for fiscal year 2009.

Lottery retailers and vending machines

The Lottery sells its drawing and instant ticket products at its offices in Phoenix and Tucson, and the Lottery indicates that as of January 2010, there were 2,740 retailers licensed to sell its products across the State. These retailer venues include convenience stores, supermarkets, liquor stores, newsstands/smoke shops, restaurants, and bars. To sell lottery tickets, retailers must be licensed by the Lottery and renew their license every 3 years. A.R.S. §5-505(A)(4), enacted in its current form in 2008, specifies that retailers can earn commissions that range from 5.5 to 8 percent of their ticket sales. However, according to a lottery official, as of January 2010, the Lottery has not yet developed the criteria for implementing the new commission percentages, and these criteria will need to be added to its administrative rules. In the meantime, the Lottery is continuing to use the commission structure established under the previous statute and agency rules, which called for all retailers to earn a minimum of 6.5 percent, but not more than 7 percent, on commissions. Under this structure, retailers are eligible to receive the additional one-half percent if they have an increase in sales that is at least 5 percent higher than the total sales increase the Lottery experienced in an identified sales period.

The majority of the Lottery's sales occur through convenience store retailers. For example, in fiscal year 2009, according to lottery information, over \$314 million, or nearly 65 percent of the Lottery's total revenue, was generated through convenience store sales (see textbox). In addition, some retailers carry ticket vending machines that house up to 24 instant games as well as drawing game tickets. In fiscal year 2009, over \$93 million in lottery sales was purchased through vending machines—over 19 percent of total sales.¹

Arizona Lottery Sales by Store Type Fiscal Year 2009

<u>Store Type</u>	<u>Sales Amount</u>
Convenience Stores	\$314,055,039
Supermarkets	147,630,268
Liquor Stores	5,316,290
Smoke/Gift Shops	3,669,717
Bars/Restaurants	3,632,380
Other ¹	10,182,410
Total	\$484,486,104

¹ The "Other" category includes additional store types such as Truck Service Centers and Specialty, Non-Grocery Stores.

Source: Arizona Lottery (fiscal year 2009), Business code review, July 2008 through June 2009. Unpublished report.

Organization and staffing

The Arizona State Lottery Commission, established in A.R.S. §5-502, oversees the Lottery. The Commission consists of five Governor-appointed members. The Commission meets monthly to make recommendations or set policy, approve lottery games, and transact other lottery business. The Governor also appoints an executive director to administer lottery operations. The executive director serves as the Commission's secretary and executive officer.

As of January 2010, according to a lottery official, the Lottery had a total of 104 approved full-time equivalent positions (FTE), 93 of which were filled. These positions were distributed as follows:

- **Director's Division (13 FTEs, 2 vacant)**—This division oversees agency operations, game design, budget and policy, human resources, and internal and external communications. In addition, this division is also responsible for monitoring legislation and updating and submitting new administrative rules.
- **Accounting/Audit Division (14 FTEs, 3 vacant)**—This division is responsible for accounting, payroll, procurement, and internal auditing, which includes testing new lottery games to ensure that they will function properly when they become active.
- **Information Technology Division (21 FTEs, 2 vacant)**—This division is responsible for network management, telecommunications, computer operations, programming development, technical support, and computer system security. This group also manages the process for the Lottery's drawing games.
- **Marketing Division (4 FTEs, 2 vacant)**—This division is responsible for advertising and marketing, including marketing research. The Lottery promotes

¹ According to a lottery official, at the end of fiscal year 2009, there were sales recorded from 725 vending machines during that year. However, not all of those machines were used for the entire fiscal year.

its products through various means such as television, radio, printed media, billboard advertisements, and the Lottery's Web site. In addition, the Lottery provides product information publications for retailers to distribute to customers.

- **Sales Division (25 FTEs, 0 vacant)**—This division is responsible for recruiting new retailers to sell lottery products. In addition, staff make sales calls to existing retailers to recommend new games, encourage purchases of additional lottery tickets, and provide promotional materials and information on how to increase ticket sales.
- **Customer Service/Security (27 FTEs, 2 vacant)**—This division is responsible for game integrity, game drawings, and security functions such as player protection, retailer licensing, monitoring retailer compliance, and investigating possible lottery ticket theft and fraud. It also includes customer service functions such as overseeing the claims offices in Phoenix and Tucson. The public can purchase and redeem their winning lottery tickets at these offices, and all lottery winners who win over \$599 must claim their winnings at one of these two offices or through the U.S. mail.

In addition to the functions that are handled by its own staff, the Lottery contracts with several vendors. For example, it contracts with multiple vendors to print instant (scratcher) tickets, and it contracts with one main vendor to supply and maintain the computer gaming system that captures daily retailer lottery information, such as the number of winners from different games. The Lottery also contracts with an advertising agency to provide advertising and marketing services. In fiscal year 2009, the Lottery spent approximately \$33 million for its key contracted services.

Scope and objectives

This performance audit and sunset review focused on three main objectives:

- Determining the effectiveness of the Lottery's efforts to increase ticket sales revenue and distributions to state programs since fiscal year 1999, and identifying any additional actions the Lottery can take to further increase sales and distributions and control costs;
- Identifying the steps the Lottery is taking to ensure gaming integrity and whether those steps are in line with industry best practices and practices used in other states; and
- Analyzing the Lottery's activities using the 12 sunset factors specified in A.R.S. §41-2954.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Auditor General and staff express appreciation to the Arizona State Lottery Commission and the Lottery's Executive Director and staff for their cooperation and assistance throughout the audit.

FINDING 1

Lottery should enhance efforts to maximize sales and beneficiary distributions

The Arizona State Lottery (Lottery) should take additional steps to increase its sales and distributions to program beneficiaries (beneficiary distributions). Arizona's lottery sales, while generally growing over the past decade, are low compared to other state lotteries, and the Lottery's beneficiary distributions have recently declined. To help meet its mission of producing the maximum amount of revenue for Arizona programs, actions are needed in two key areas. First, the Lottery should strategically recruit more retailers and develop strategies for responsibly increasing sales. Arizona's retail base is small relative to other lotteries. Second, the Lottery should better control costs by strengthening its procedures for developing prize structures and marketing plans, and it should better report to its overseer, the Arizona State Lottery Commission (Commission), about how costs affect beneficiary distributions.

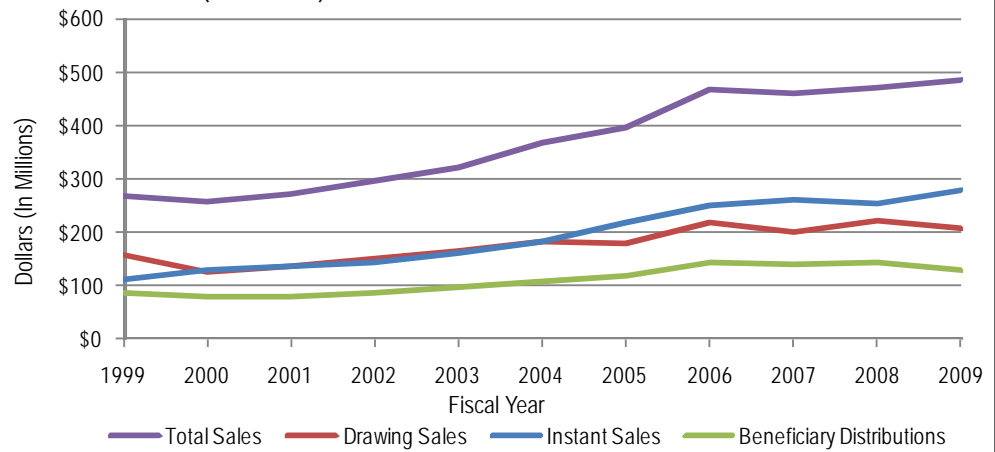
Decreased beneficiary distributions and low per capita sales indicate room for improvement

Although for much of the past decade the Lottery generally has experienced increases in sales and beneficiary distributions, three things indicate a need for attention and room for improvement. First, in the past 3 years, overall sales have leveled off—a change from steeper rises in earlier years. Second, and more significant for the State, the amount of lottery beneficiary distributions has also leveled off—and actually declined in the most recent year (fiscal year 2009). This decline meant that some programs received less money than in the past, while others received none at all. Third, Arizona's per capita lottery sales are near the bottom of 28 states with similar games, indicating that, relative to other states, people are participating in Arizona's lottery games to a lesser extent.

Lottery sales have grown, but began leveling off in fiscal year 2007—

As shown in Figure 3 (see page 14), the Lottery's total sales have increased almost every year from fiscal years 1999 through 2009, but the increase has slowed in recent years. Since fiscal year 2000, total sales have increased about 90 percent

Figure 3: Lottery Sales Compared to Beneficiary Distributions
Fiscal Years 1999 through 2009
(Unaudited)



Source: Auditor General staff analysis of the Lottery's financial records for fiscal years 1999 through 2009.

to nearly \$484.5 million in fiscal year 2009. Factors contributing to the increase in sales, according to lottery officials, include introducing higher-priced games, increasing the number of lottery vending machines, using additional advertisements and promotions, and increasing the number of “facings,” or slots, that display instant games in lottery retailers’ counters.

The Lottery’s growth in sales started leveling off after fiscal year 2006. Specifically, in fiscal year 2007, sales were down 1.4 percent from fiscal year 2006, and in fiscal years 2008 and 2009, sales grew only 2.3 and 2.4 percent, respectively. Lottery officials reported that the national economic decline has impacted recent sales growth. According to a lottery industry magazine, in fiscal year 2009, among 27 reporting state lotteries with games similar to Arizona’s lottery, 12 state lotteries had sales growth ranging from 0.5 percent to 20 percent, 1 had no growth, and 14 had decreases in sales ranging from 0.7 percent to 11 percent.^{1,2}

Beneficiary distributions have also leveled off and recently declined—Like total sales, the Lottery’s beneficiary distributions also increased during the decade, but these distributions have likewise leveled off—and most recently, declined (see Figure 3 above). Since fiscal year 2000, these beneficiary distributions have increased about 65 percent, to about \$129.1 million in fiscal year 2009. However, beneficiary distributions have actually declined in two of the three most recent years. Specifically, in fiscal year 2007, the Lottery’s beneficiaries received \$1.2 million less than they did in fiscal year 2006, and in fiscal year 2009, beneficiary distributions dropped approximately \$15.4 million from fiscal year 2008—the largest drop in 18 years. A report released by the Nelson A. Rockefeller

1 Fiscal 2009 Lottery Sales Report. (2009, September/October). *La Fleur's Magazine*, p. 37-48.

2 Sales amounts are unaudited. Auditors selected comparison state lotteries (see textbox, page 16) as those that have drawing and instant games, but not video lottery terminals (VLT) or Keno games—see footnote 2 on page 17 for more details. All of these states’ lotteries reported fiscal year 2009 sales except for Tennessee’s.

Institute of Government showed that overall beneficiary distributions from 39 reporting lotteries fell from \$15 billion to just over \$14.6 billion, or 2.6 percent in fiscal year 2009, but only two other state lotteries (Oregon and Indiana) reported larger percentage drops in beneficiary distributions than Arizona's 10.7 percent decrease.¹

As a result of the Lottery's decline in beneficiary distributions and legislatively mandated transfers to the State General Fund, some beneficiaries did not receive monies or did not receive as much money as they did the prior year (see Table 2). For example, in fiscal year 2009 no money was available to be

**Table 2: Effect of Decreased Beneficiary Distributions
Fiscal Years 2007 and 2009
(Unaudited)**

Lottery Beneficiaries ¹	Change in Distributions from Fiscal Years 2006 to 2007	Change in Distributions from Fiscal Years 2008 to 2009
Commerce and Economic Development Commission Fund	\$(1,084,100)	\$ 187,400
State General Fund	7,598,500	(10,275,700)
Local Transportation Assistance Fund (Mass Transit)	(8,216,200)	(2,487,400) ²
Local Transportation Assistance Fund	0	(1,150,000) ³
County Assistance Fund	0	(382,500) ³
Arizona State Parks and Arizona Game and Fish Heritage Funds	0	0
Healthy Arizona Funds	697,000	(423,300) ⁴
Department of Economic Security (DES)—Homeless Shelters Fund	N/A ⁵	(1,000,000) ⁴
University Capital Improvement Lease-to-Own and Bond Fund	N/A ⁵	N/A ^{5,6}
Department of Gaming	0	0
Court Appointed Special Advocate (CASA) Fund ⁷	(203,800)	110,500
Net change	\$(1,208,600)	\$(15,421,000)

¹ For a description of each beneficiary's use of lottery monies, see Introduction and Background, pages 2 through 4.

² In fiscal year 2009, the amount distributed to this Fund was reduced to \$9,499,300 (Laws 2008, Ch. 287, §37), which was \$2,012,400 less than the amount distributed in fiscal year 2008. The Legislature also redirected \$475,000 from this fund to the State General Fund (Laws 2009, 1st S.S., Ch. 3, §7).

³ The beneficiary received less than the prior year because in fiscal year 2009, the Arizona State Legislature redirected this amount to the State General Fund (Laws 2009, 1st S.S., Ch. 3, §7).

⁴ Statute required special monies to be transferred to the State General Fund that would have otherwise been available to prevent these funds from being reduced in fiscal year 2009 (Laws 2009, 1st S.S., Ch. 1, §4).

⁵ DES—Homeless Shelters Fund was added in fiscal year 2008, and the University Capital Improvement Lease-to-Own and Bond Fund was added in fiscal year 2009.

⁶ If sufficient monies had been available, this Fund could have received up to \$20 million in fiscal year 2009 (Laws 2008, Ch. 287, §35).

⁷ The CASA Fund receives 30 percent of unclaimed prize monies each month.

Source: Auditor General staff analysis of A.R.S. §§5-518 and 5-522; Laws 2008, Ch. 287; Laws 2009, 1st S.S., Ch. 1,3; lottery financial records; and lottery correspondence.

¹ Dadayan, L., & Ward, R.B. (2009). *For the first time, a smaller jackpot: Trends in state revenues from gambling*. Retrieved September 21, 2009, from http://www.rockinst.org/pdf/government_finance/2009-09-21-No_More_Jackpot.pdf

distributed to the newly created University Fund to pay up to \$20 million for building renewal projects and new facilities for the State's universities.¹ In addition, in fiscal year 2009, the State General Fund received approximately \$10.3 million less in lottery distributions than the prior year even though session law directed lottery distributions to it that would have gone to other beneficiaries.

The Arizona Lottery's per capita sales ranked 24th of 28 comparison lotteries in fiscal year 2008.

State Lotteries without VLTs or Keno Fiscal Year 2008	Per Capita Sales Fiscal Year 2008
1. New Jersey	\$292.43
2. Connecticut	285.10
3. Pennsylvania	248.16
4. Florida	227.78
5. South Carolina	221.55
6. Ohio	202.43
7. New Hampshire	198.12
8. Kentucky	182.28
9. Virginia	178.45
10. Maine	173.59
11. Vermont	164.15
12. Illinois	159.46
13. Tennessee	159.36
14. Texas	150.92
15. Indiana	129.04
16. North Carolina	113.68
17. Colorado	102.41
18. Idaho	89.81
19. Minnesota	88.41
20. Wisconsin	87.91
21. Louisiana	84.72
22. Iowa	83.02
23. New Mexico	75.49
24. Arizona	72.76
25. Nebraska	68.37
26. Oklahoma	58.83
27. Montana	45.32
28. North Dakota	34.49

Source: Auditor General staff analysis of the *La Fleur's 2009 World Lottery Almanac*.

Some of the factors that contributed to the recent drop in beneficiary distributions are outside the Lottery's control. For example, drawing game sales can vary with the size of the jackpot, including the Powerball jackpot, an unpredictable factor the Lottery cannot control. As shown in Figure 3 (see page 14), the drop in beneficiary distributions in fiscal years 2007 and 2009 is due in part to decreases in drawing games sales that were not fully offset by increases in instant ticket sales. Decreases in drawing games sales impact beneficiary distributions because drawing games have a higher contribution rate to beneficiary distributions. Specifically, typically only half of drawing games sales revenue is used for prize money and therefore half of the revenue is available for beneficiary distributions and administrative expenses. In contrast, instant games have a lower contribution rate to beneficiary distributions because about 60 percent of instant games sales revenue has been used for prize money and about 40 percent of the revenue is available for beneficiary distributions and administrative expenses.

Two factors that contributed to the decline in beneficiary distributions, however, are within the Lottery's control. The first is the increased use of instant ticket revenue for prizes. The percentage of instant ticket sales revenue used for prizes rose from 61 percent in fiscal year 2008 to 65 percent in fiscal year 2009, an increase of nearly \$28 million. Second, in fiscal year 2009, advertising costs rose by nearly \$5 million after the Legislature increased the Lottery's advertising budget from \$11 million to just over \$20 million. Lottery officials said the ability to increase prizes and advertising were key to a decision to implement a long-term strategy, consistent with industry practice, to increase sales and beneficiary distributions. However, total sales would have had to increase by about \$69 million, or 15 percent, in fiscal year 2009 to prevent beneficiary distributions from declining from fiscal year 2008 amounts.² Instead, sales only increased by about \$12 million, or 2 percent.

Per capita sales have remained comparatively low—Another indication of the Lottery's potential for improvement is its comparative ranking in per capita sales (total sales divided by population), which has remained low relative to other state lotteries over a 10-year period. According to the *La Fleur's World Lottery Almanac* (La Fleur's), when comparing Arizona's per capita sales to other state lotteries with similar

• 1 "University Fund" is the abbreviated form of the "University Capital Improvement Lease-To-Own and Bond Fund," which was allowed to receive lottery distributions starting in fiscal year 2009.

2 In fiscal year 2009, 26.6 percent of sales was used for beneficiary distributions. Therefore, the \$69 million calculation also assumes that 26.6 percent of sales would have been used for beneficiary distributions.

types of lottery games, Arizona ranked 20th out of 23 states in fiscal year 1999 and, as shown in the textbox (see page 16), 24th out of 28 states in fiscal year 2008, the most recent year comparison data is available from La Fleur's.^{1,2}

Lottery should raise sales revenues by recruiting more retailers and responsibly increasing player base

To help the Lottery continue to meet its mission of producing the maximum amount of revenue for Arizona programs, the Lottery should work to increase sales. To do so, the Lottery should strategically recruit more retailers and responsibly increase its player base.

Retailer base small relative to other states—Arizona's low per capita lottery sales may stem partly from having relatively few retailers. Arizona has the fewest lottery retailers per capita in the nation, according to La Fleur's. In Arizona, the lottery retailer-to-population ratio in fiscal year 2008 was 1:2,444, or 1 lottery retailer for every 2,444 people. In contrast, according to La Fleur's, Colorado's lottery had higher per capita sales and more retailers per capita in fiscal year 2008 with a ratio of 1:1,700.³ Among the 28 states with games that were comparable to the Lottery's games, the 5 states with the highest per capita sales had even more retailers per capita than Arizona in fiscal year 2008, with ratios ranging from 1:1,262 to 1:1,458 (see textbox).

However, from fiscal years 1999 through 2008, Arizona's population increased 36 percent; more than any other comparison state. This population increase was much greater than the Lottery's 2 percent increase in the number of lottery retailers. As a result, the number of retailers per capita diminished. According to the data in La Fleur's, no lottery with comparable games had a greater decrease in retailers per capita than Arizona during this period.

Retailers per Capita Fiscal Year 2008

<u>State Lottery</u>	<u>Lottery Retailer-to-Population Ratio</u>
Top five lotteries¹	
New Jersey	1:1,410
Connecticut	1:1,266
Pennsylvania	1:1,458
Florida	1:1,386
South Carolina	1:1,262
Arizona	1:2,444

¹ Comparison state lotteries with the highest per capita sales, ordered by rank.

Source: Auditor General staff analysis of the *La Fleur's 2009 World Lottery Almanac*.

¹ La Fleur, T. E., & La Fleur, B. A. (Eds.). (2009). *La Fleur's 2009 world lottery almanac*. Boyds, MD: TLF Publications, Inc.

² Auditors selected comparison state lotteries as those that have drawing and instant games but not video lottery terminals (VLT) or Keno games because the Arizona Lottery by statute is not allowed to have these products. VLTs are devices with video screens that offer electronic games of chance such as poker, blackjack, and slots. Keno is a game that originated in casinos and requires players to pick several numbers, allowing them to place multiple bets in a short period of time and receive drawing results within minutes.

³ Colorado is one of the 28 states with games comparable to the Lottery's games. Of the 28 comparable states, it is also the western state that is closest to Arizona in terms of both population and population density.

Recent steps to increase retailers and retailer sales can be enhanced—During this audit, the Lottery increased its efforts to recruit more retailers by assigning an employee the responsibility to recruit new retailers, offering quarterly incentives of up to \$50 to its sales representatives to recruit new retailers, and planning to enhance its partnership with a food marketing consulting firm whose role is to help the Lottery develop relationships with existing and new retailers. A lottery official indicated that the Lottery is focusing on recruiting retailers that are most willing and able to be quickly licensed, and those that have multiple stores.

The Lottery should do more to strategically increase both the number of retailers and the volume of retailer sales. These additional efforts involve greater assessment of the Lottery’s own retailer data, as well as information from other states. For example, the Lottery could conduct analysis and focus efforts as follows:

- By analyzing its own sales data by type of retailer, the Lottery could establish goals for recruiting new retailers that have the most potential for producing sales. For example, fiscal year 2008 data in La Fleur’s indicates that Arizona grocery stores and restaurants/bars may have more potential for producing sales than other types of retailers because these types of stores had higher average lottery sales than other types of retailers in Arizona (see textbox). According to lottery records, some grocery stores and many restaurants/bars in Arizona are not currently licensed lottery retailers. Therefore, the Lottery may benefit from putting a higher priority on its efforts to recruit grocery stores and restaurants/bars that are not currently licensed retailers.
- By comparing its sales revenue by type of store to other states’ information, the Lottery could determine whether additional focus should be placed on certain types of retailers. For example, data in La Fleur’s indicates that comparison state lotteries as a whole have higher average sales in convenience stores and liquor stores than Arizona (see textbox). This difference suggests there may be unrealized potential for sales in Arizona convenience stores and liquor stores. Therefore, the Lottery may benefit from assessing how to increase sales in convenience stores and liquor stores, including those already licensed as lottery retailers.

Average Lottery Sales by Retailer Type Fiscal Year 2008

	Arizona	Average of Comparison Lotteries ¹
Grocery Stores	\$305,920	\$214,081
Restaurants/Bars	\$153,577	\$ 97,790
Convenience Stores	\$148,207	\$221,374
Liquor Stores	\$ 69,135	\$109,534

¹ Of 28 comparison state lotteries, including Arizona, 23 states reported sales by retailer type. Average sales of comparison lotteries exclude Arizona sales.

Source: Auditor General staff analysis of the *La Fleur’s 2009 World Lottery Almanac*.

Additional marketing data could provide insights for increasing the player base—The Lottery should also try to increase the number of people who play the lottery. The Lottery could do this by collecting additional marketing data and using this data, along with its marketing staff, to make decisions related to designing and introducing new games. A ready avenue for collecting such data already exists.

The Lottery uses a market research company to conduct regular surveys to determine things such as demographic characteristics of its players, advertising awareness, and use of its Web site. Augmenting the market research company's efforts offers an excellent way for the Lottery to collect additional information to better understand how to increase the number of players. For example, one option for the Lottery is to use its marketing research company to find out what would motivate some nonplayers to play and what would motivate casual players to play more regularly. Once this data has been collected, the Lottery should regularly use this information as well as its marketing staff to help make decisions regarding the design and introduction of both drawing and instant games. Any such efforts to increase the amount of money players spend on lottery products should, of course, be done in concert with strategies that encourage responsible participation.

The Lottery could use its marketing research company to find out what would motivate casual players to play more regularly.

Lottery should better manage and report costs

To help ensure that increased sales lead to increased beneficiary distributions, the Lottery should take steps in three additional areas. First, the Lottery should better manage prize expenses by optimizing its games' prize structures to avoid paying too much in prizes. Second, the Lottery should better manage its advertising costs by reinstating its practice of developing an annual marketing plan that is based on the effectiveness of its previous years' marketing efforts. Finally, the Lottery should report to the commission members its analysis of how costs impact beneficiary distributions and compare to other state lotteries.

Lottery should do more to manage prize expenses—The Lottery should better manage its prize expenses by optimizing its prize structures so that revenue increases will result in the maximum amount of money possible for beneficiary distributions. Prize structures determine the prize amounts players can win and the probability of winning them. In fiscal year 2009, changes in prize structures for instant games, along with other factors, reduced beneficiary distributions by more than \$15 million from the previous year, even though total sales revenues increased. According to the vendor who helped the Lottery develop guidelines for instant game prize structures, the vendor's advice was based on experience with increasing sales in other state lotteries rather than from demand for lottery tickets in Arizona or from strategies to minimize costs. According to a different vendor who also assists the Lottery, prize structures could be improved by performing more formal analysis. In addition, literature shows that lottery prize structures for both instant and drawing games can be optimized by performing calculations based on economic theory that involve controlling prize amounts and the probability of winning.¹ For example, these calculations include forecasting sales and beneficiary distributions to analyze the potential effect of modifying prize distributions. Literature also indicates that prize structures are optimized when they

Prize structures are optimized when set at the lowest amount possible that still encourages play and maximizes beneficiary distributions.

¹ Hausch, D.B., & Ziemba, W.T. (Eds.). (2008). *Handbook of sports and lottery markets*. New York: Elsevier; Maeda, A. (2008) Optimal lottery design for public financing. *Economic Journal*, 118(532), 1698-1718; Walker, I., & Young, J. (2001). An economist's guide to lottery design [Electronic version]. *Economic Journal*, 111, F700-F722.

are set at the lowest amount possible that still encourages play and maximizes beneficiary distributions.

To ensure that its prize structures result in both increased sales and increased beneficiary distributions, the Lottery should ensure that calculations based on economic theory in lottery literature are regularly used to optimize its existing prize structures for both instant and drawing games, and when developing any new games. Due to the technical nature of prize optimization techniques, the Lottery may want to consider seeking outside assistance from experts who specialize in such work.

Lottery should better manage advertising costs—The Lottery should better manage its advertising costs by better planning and assessing its marketing efforts, which include advertising. A lottery official indicated that since fiscal year 2007, the Lottery has not developed a marketing plan. Without a marketing plan, the Lottery risks spending its advertising dollars ineffectively. For example, a lottery official indicated that without a plan, it has also been unable to take advantage of discounted media purchases. Further, the Lottery was able to spend additional advertising dollars in fiscal year 2009 after the Legislature removed from law an advertising cap and appropriated additional advertising monies in an effort to increase sales. These changes allowed the Lottery to spend an additional \$5 million for advertising. However, there was no plan in place for directing the use of those extra dollars.

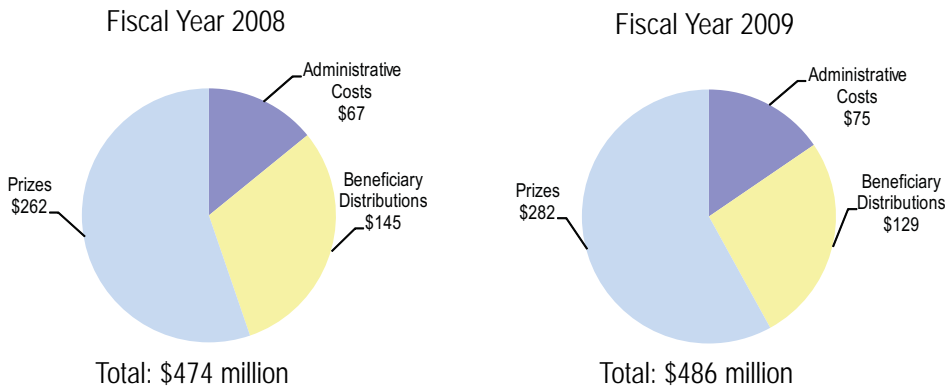
To ensure that it effectively manages its advertising costs, the Lottery should reinstate its practice of developing an annual marketing plan that is based on the effectiveness of its previous years' marketing efforts. For example, in fiscal year 2006, the Lottery had a marketing plan that included specific advertising initiatives related to Powerball. It also used its own data and data from other states to assess the effectiveness of its Powerball advertising and then updated its marketing plan in fiscal year 2007 based on that analysis. Such a process appears in line with the practices in other states auditors contacted during the audit. For example, the Colorado Lottery reported that it developed its fiscal year 2010 marketing plan based on analysis and studies, and will evaluate each marketing strategy throughout and at the end of the year to help ensure its marketing dollars generate more money for its state every year. A Colorado Lottery official also said its marketing plan has been updated annually for several years.

Lottery should report how costs impact beneficiary distributions—The Lottery can improve monthly reports to the Commission that will provide its members with a better understanding of the impact of costs on lottery beneficiary distributions. Although costs increased and beneficiary distributions decreased in fiscal year 2009, these costs and their impacts on beneficiary distributions were not described in the Lottery's monthly reports to the commission members. Specifically, the reports did not mention how increased prizes and administrative

The Lottery should reinstate its practice of developing an annual marketing plan.

costs resulted in fewer dollars and a smaller percentage of revenues going to beneficiary distributions in fiscal year 2009 (see Figure 4).¹ Instead, these reports focused on increased sales revenues and the specific dollar amounts that went to beneficiaries without explaining why lottery beneficiaries received less money than in the prior year.

Figure 4: Prizes, Beneficiary Distributions, and Administrative Costs
Fiscal Years 2008 and 2009
(In Millions)
(Unaudited)



Source: Auditor General staff analysis of the Lottery's audited financial statements for fiscal years 2008 and 2009.

Another area in which the Lottery can improve monthly reports is in providing comparative information. These reports do not provide commission members with information to compare the Lottery's costs over time or with other state lotteries to help the members determine the Lottery's relative performance. In contrast, the South Carolina Education Lottery provided a report to its board of commissioners with a 5-year analysis that showed year-over-year changes in its money available for beneficiary distributions due to changes in sales quantities, percentage of sales amounts used for prizes, and administrative expenses. The South Carolina Education Lottery's report also provided its ranking among other lotteries in administrative expenses and advertising expenses as a percentage of gross revenue. To provide a better perspective of its performance, the Arizona Lottery should analyze information similar to that used by the South Carolina Education Lottery and regularly include it in reports to its commission members, such as how costs impact beneficiary distributions over time and how its costs compare to those of other comparable lotteries.

The Lottery should report how costs impact beneficiary distributions and compare to other lotteries.

¹ Small amounts of beneficiary distributions are not from revenues. Some beneficiary distributions are from unclaimed prize money—\$2.6 million in fiscal year 2008 and over \$2.7 million in fiscal year 2009. In addition, other beneficiary distributions resulted from legislatively mandated reductions in administrative costs—\$84,400 in fiscal year 2008 and \$775,500 in fiscal year 2009.

Recommendations:

- 1.1. To maximize beneficiary distributions, the Lottery should increase sales by:
 - a. Assessing its own retailer data and information from other states to strategically increase both the number of retailers and the volume of retailer sales; and
 - b. Using its market research company to collect additional information aimed at better understanding how to increase the number of players and how to motivate casual players to play more frequently, and regularly using this information as well as its marketing staff to help make decisions regarding the design and introduction of both drawing and instant games.
- 1.2. To ensure that increased sales lead to increased beneficiary distributions, the Lottery should better manage its costs by:
 - a. Better managing its prize expenses by ensuring that calculations based on economic theory in lottery literature are regularly used to optimize its existing prize structures for both instant and drawing games, and when developing any new games; and, if necessary, seeking outside assistance from experts who specialize in such work;
 - b. Ensuring it effectively manages its advertising costs by reinstating its practice of developing an annual marketing plan that is based on the effectiveness of its previous years' marketing efforts; and
 - c. Analyzing information similar to that used by the South Carolina Education Lottery and regularly including it in reports to the Arizona State Lottery Commission members, such as how costs impact beneficiary distributions over time and how its costs compare to those of other comparable lotteries.

FINDING 2

Lottery's game integrity and player protection measures generally match other states' efforts, but can be enhanced

The steps the Arizona State Lottery (Lottery) takes to ensure its games and players are protected against dishonest, unfair, and fraudulent practices are generally comparable to practices used or recommended in other states, but the Lottery can enhance these steps in several ways. Adequate steps to ensure game integrity and player protection are important: if the public perceives, for example, that retailers are somehow withholding payments on winning tickets or that the odds of winning a game are not properly represented, the likelihood of their purchasing lottery products may be affected (see textbox). The Lottery's game integrity and player protection efforts take several forms, including licensure and investigations to ensure that retailers who sell tickets are not involved in theft or fraud, on-site computer terminals to help assure players that their winning tickets are accurately identified and fully paid, and processes for ensuring that numbers drawn are thoroughly random and odds are accurately disclosed. Three additions to existing steps would further enhance game integrity and player protection: greater efforts to monitor how frequently owners or retailer employees win prizes, instituting a risk-based approach to addressing a backlog of compliance investigations, and publishing additional information on the Lottery's Web site about measures that players can take to protect themselves against fraud or scams.

Importance of game integrity and player protection:

"A lottery that does not adequately protect its customers risks losing their confidence, potentially harming the lottery and, in turn, the government that depends on its profits." (p.13)

Source: Angrick, W.P. (2009). *Taking chances on integrity: An investigation of the Iowa lottery*. Retrieved June 5, 2009, from http://www.legis.state.ia.us/caodocs/Invstgtv_Reports/2009/CIWPA002.PDF

Steps to protect against retailer theft, fraud, and impropriety can be further enhanced

Examples of Lottery's retailer requirements

To maintain a lottery license, retailers' responsibilities include:

- Training employees on equipment and lottery products.
- Selling lottery tickets and paying the Lottery for tickets sold.
- Providing ticket validation and payment services (up to \$100) to players.¹
- Maintaining an adequate supply of instant lottery tickets in the ticket vending machines.
- Reporting stolen tickets to the Lottery and police.

¹ Players must claim high-tier prizes, which are those over \$599 (in person or by mail), from one of the two lottery offices (Phoenix or Tucson). Lottery retailers may pay prizes up to \$599, but are required only to pay prizes up to \$100. Therefore, players may also be required to claim prizes over \$100 in value at one of the two lottery offices.

Source: Auditor General staff analysis of retailer licensing requirements found in Arizona Administrative Code (A.A.C.) R19-3-205-206, 213-215, 217.

A primary concern for the Lottery is ensuring that its reputation is not tarnished by theft, fraud, and impropriety among lottery retailers, who are responsible for things such as selling lottery tickets and paying for winning tickets with values up to \$100 (see textbox).¹ The Lottery uses several methods to guard against retailers' theft, fraud, and impropriety, and while these measures are generally comparable to practices that other states use or recommend, they can be improved in a few respects. To help ensure its retailers are reputable, the Lottery requires them to be licensed, which involves both criminal history and credit background checks. In addition, the Lottery conducts two different types of retailer investigations: (1) proactive investigations, which focus on questionable retailer activity, such as concerns customers raise, and (2) compliance investigations, which help ensure retailers are complying with lottery laws and rules. A few changes to these two types of investigations could enhance the Lottery's efforts to help prevent retailer theft and fraud.

Licensing process helps ensure retailers are reputable—Similar to practices of five other state lotteries, the Lottery requires retailers to meet several requirements to be authorized to sell lottery tickets.² The Lottery, like some other states, requires retailers who sell Arizona lottery tickets to be licensed. The licensing process involves checks for criminal history and for financial solvency. Lottery personnel check the retail owner's or executive official's criminal history records for evidence of prior criminal offenses or other violations of Arizona or U.S. laws or lottery regulations. For example, the Lottery can deny a license to an applicant with a criminal record involving theft or fraud. To determine if the applicant is financially solvent, the Lottery conducts credit checks, among other things. According to a lottery official, the Lottery conducts these background checks on officers, directors, and regional managers of retail chain stores, but not on each individual store manager or employee.³ Retailers must renew their licenses every 3 years, which, according to a lottery official, includes undergoing new criminal history and credit checks.

¹ Players must claim high-tier prizes, which are those over \$599 (in person or by mail), from one of the two lottery offices (Phoenix or Tucson). Lottery retailers may pay prizes up to \$599, but are required only to pay prizes up to \$100. Therefore, players may also be required to claim prizes over \$100 in value at one of the two lottery offices.

² Auditors contacted lottery officials from California, Colorado, Florida, Idaho, and Washington. These states were chosen as a mix of states that represent regional and population diversity, and notable aspects of the lottery retailer network, including age of the lottery, sales volume, and experience. In addition, see A.R.S. §5-512 and A.A.C. R19-3-202 for Arizona's licensing requirements.

³ According to a lottery official, the exception is one chain of convenience stores, which are individual franchises. In this case, the Lottery conducts criminal history background and credit checks on each of the franchise owners.

In fiscal year 2009, the Lottery's licensing activities resulted in denials of licenses for some new applicants and revocations of licenses for some existing licensees. Specifically:

- **Some new licenses denied**—According to lottery information, out of 236 new license applications received in fiscal year 2009, lottery officials denied 4 applications for reasons including a prior criminal offense.¹ According to the Lottery's administrative rules for retailers, the Lottery may deny an applicant's license for reasons such as previous criminal behavior or poor credit history.
- **Some existing licenses revoked**—The Lottery may also revoke an active retailer's license for actions such as failure to make required payments for lottery tickets the retailer has sold, or an unreported change in ownership.² According to lottery information, during fiscal year 2009, the Lottery revoked 24 licenses, most of which were for failure to make required payments for tickets sold, according to a lottery official. However, the Lottery may also reactivate a revoked license once the retailer remedies the problem, and four retailers' licenses were reactivated in 2009.

Proactive investigations help identify or prevent theft and fraud but can be improved—The Lottery believes the majority of its retailers are honest. However, a report of the Iowa Lottery indicates that retailers, with their access to tickets and ticket checking equipment, have the potential to engage in fraud and theft unnoticed by unsuspecting players.³ The Arizona Lottery has a system of proactive investigations in which lottery personnel address customer complaints and identify potential instances of questionable activity and follow up on them. According to a lottery official, three of the Lottery's investigators proactively review game data, including the frequency of ticket validations, and look for things such as an unusual jump in sales or activity isolated to a particular work shift. The Lottery indicates that as of January 2010 there were 2,740 retailers licensed to sell its products across the State. According to a lottery official, in fiscal year 2009 it conducted 111 proactive investigations, and identified problems in 72 of the investigations, including 11 that involved fraud or theft. For example:

- **Investigation shows clerk retained winning tickets for himself**—By combining information obtained from a customer complaint and patterns identified in ticket validation data, investigators were able to identify a retail clerk who practiced "picking" tickets. This occurs when a store clerk takes unsold instant tickets, scratches them lightly to pick out the winners, and then sells the nonwinners to the public. According to the Lottery, the retail owner informed the Lottery that the employee would be terminated, and the Lottery is continuing to follow up on this case.

Lottery investigators proactively review game data, including the frequency of ticket validations.

¹ New applications may consist of applicants who have never been Arizona lottery retailers, retailer stores that come under new ownership because the new owners must apply for a license, and a retailer who used to sell lottery products but then no longer sold those products and did not maintain a license, and therefore needs to be licensed again to be a retailer.

² See A.A.C. R19-3-204.

³ Angrick, W.P. (2009). *Taking chances on integrity: An investigation of the Iowa lottery*. Retrieved June 5, 2009, from http://www.legis.state.ia.us/caodocs/Invstgtv_Reports/2009/CIWPA002.PDF

Lottery rules prohibit retail owners and employees from selling tickets and paying prizes to themselves.

Most of the 72 instances of problems identified through proactive investigations in fiscal year 2009 involved not theft or fraud, but rather some other type of violation of lottery rules and requirements. For example, lottery rules prohibit retail owners and employees from selling tickets and paying prizes to themselves.¹ According to a lottery official, the public may question the honesty and integrity of the retailer as well as the Lottery's overall fairness if it sees a retail employee or owner selling tickets and paying prizes to himself/herself. The investigations revealed instances of such violations, as in the following example:

- **Investigation showed store manager paid prizes to himself**—In September 2009, lottery data reports indicated a retail store where large numbers of \$10 instant tickets were being quickly validated in succession. The Lottery investigated the retail store and found the manager purchasing and validating lottery tickets for himself. The store owner informed the Lottery that the manager would be fired. The Lottery followed up at a later date and confirmed that the employee no longer worked there.

According to a lottery official, if evidence exists to conclude that owners or employees have committed violations, fraud, or theft, the Lottery works with the retailer to remedy the problem. However, based on the seriousness of the findings, the Lottery may revoke a retailer's license or recommend that the retail owner terminate an employee and contact law enforcement to press charges.²

Practices used or recommended in other states suggest ways in which Arizona's gaming integrity procedures can be enhanced. A report on the Iowa Lottery recommended that recording and analyzing the amount and number of high-tier prizes claimed by retailers, their employees, and members of their immediate families is important for helping ensure that they obtained the tickets legitimately.³ In addition, four of the five state lotteries auditors contacted require winners to indicate on a prize claim form if they are affiliated with a retailer, and two of these state lotteries also make use of a computer system to notify them of retailers claiming high-tier prizes.⁴ For example, according to the the California Lottery, it uses a computer system to screen for claimants who are also retail owners in addition to using claim form questions to identify a claimant as a retail owner or affiliate. If a winner is identified as a retail owner, the claim is documented and investigated when appropriate.

1 Nothing prohibits retail owners or employees from purchasing and redeeming lottery tickets in their place of employment, but they are prohibited from selling tickets and paying prizes to themselves. See A.A.C. R19-3-204.

2 According to a lottery official, lottery investigators have the authority to enforce the Lottery's statutes, but the Lottery is not a law enforcement authority and cannot make arrests or press charges. However, the Lottery partners with local law enforcement when appropriate.

3 Angrick, 2009.

4 California, Colorado, Idaho, and Washington use claim forms. California and Washington use computer systems as well.

The Lottery can take steps to implement these additional procedures and apply them to monitoring how frequently retailers, their employees, and members of their immediate family win prizes of more than \$599. According to the Lottery, because its offices pay out prizes of more than \$599, it could withhold prize payment and immediately conduct an investigation to determine the claim's validity if it were aware that a claimant is a retailer. Steps needed to better make such identifications include:

- **Gathering additional information about prize winners**—Based on practices in other state lotteries and the Iowa lottery report's recommendation, the Lottery should modify its prize claim form that is used to gather information about winners who are claiming high-tier prizes of more than \$599. The form should include a request for information on whether the claimant is a retail owner, employee, or immediate family member.
- **Cross-checking records to better ascertain if prize winners are retail owners or employees**—The Lottery is planning to make needed computer programming changes to alert lottery staff of retail owners who redeem prizes of over \$599 by cross-referencing claimant information against retailer licensing information.
- **Investigating identified instances of prize winners who are affiliated with lottery retailers**—Finally, the Lottery should then use this information along with its other data to identify and investigate retailer or retailer affiliate claims of more than \$599.

Compliance investigations provide additional oversight, but backlog needs to be addressed—Like many other states' lotteries reviewed for this audit, Arizona's Lottery also conducts compliance investigations of lottery retailers. The compliance check includes things such as verifying that the monitor is visible to the public, and inspecting instant tickets to ensure their physical integrity and secure storage. Lottery officials use a standardized checklist to conduct this investigation—a step also recommended in a study of Ontario's lottery.¹ According to a lottery official, a compliance check also provides an opportunity to educate the retailers on good practices, such as destroying validated winning tickets customers no longer want in order to prevent someone from taking the ticket from the trash and trying to reclaim the prize money. In addition, compliance investigations can identify potential instances of theft, fraud, and other criminal activity. For example, according to a lottery official, one compliance check uncovered drug paraphernalia present at a retailer that also had many high school students as customers. Consequently, the Lottery revoked the retailer's license.

Arizona's compliance investigations are not occurring as frequently as planned. According to the Lottery, although formal procedures have yet to be developed, it increasingly uses its staff to ensure the investigations are targeted to locations

Compliance checks can identify potential instances of theft, fraud, and other criminal activity.

¹ KPMG. (2006b). *Ontario Lottery and Gaming Corporation: Phase II report - lottery review*. Retrieved July 9, 2009, from http://www.olg.ca/assets/documents/play_confidence/kpmg_report_phase_two.pdf

where the risk of noncompliance is greater. The Office of the Auditor General's 2002 performance audit and sunset review of the Lottery recommended that it adopt a systematic compliance inspection plan; however, there is still a backlog of retailers who have not received timely compliance inspections. The Lottery's policy requires that all lottery retailers receive a compliance investigation every other year. Lottery records indicated that as of August 2009, there were 789 lottery retailers who had not received a compliance investigation for 2 years or more. Although it is important for all retailers to receive periodic compliance investigations, some retailers may present a lower risk. For example, the report on the Ontario lottery suggests that the scheduling of retailer compliance reviews be based on things such as findings from previous reviews, history of retailer winning, or incidents reported to the Lottery.¹ To ensure that its limited compliance investigation resources are used most effectively, the Lottery should prioritize these investigations based on risk factors.

Measures to protect players should include more Web-based information

The Lottery has measures in place to help players protect themselves against theft of their potential prizes. An Iowa report indicates that dishonest retail clerks may take advantage of unsuspecting players by indicating that the ticket the player is having the retailer check (validate) is not a winner when it actually is, and then claiming the prize for himself/herself. Retailers may also underpay on a winning ticket and retain the remaining winnings for themselves.²

To help protect players, the Lottery takes a number of steps, including the following:

- **Optional lottery monitors that identify winning tickets for the player**—To help protect players, the Lottery provides retailers with a monitor that visually indicates to players if they have a winning ticket (see textbox). This monitor visually notifies a player whether or not his/her ticket (drawing and instant) is a winner and the prize amount if the amount is \$599 or less. According to a lottery official, although the Lottery does not require retailers to use these monitors, many

Steps for checking a lottery ticket:

Player presents a ticket to the retail clerk to be checked. Player knows it is a winning ticket if:

- **The monitor displays a “winner” message.**
- **The lottery terminal plays a musical jingle.**

Player may also use a self-checker machine to see if a drawing ticket is a winner.

Source: Auditor General staff observations of players presenting tickets for validation or checking.

• 1 KPMG, 2006b

2 Angrick, 2009

retailers do so, including the Lottery's two claims offices (Phoenix and Tucson) that pay out prizes of more than \$599.^{1,2}

- **Terminals that play a jingle if a ticket is a winner**—Even if a retailer does not use the optional monitor described above, all retailers must use a lottery-supplied computer terminal that prints drawing tickets and visually notifies the clerk if drawing and instant tickets are winners. This computer terminal is also programmed to play a musical jingle, “We’re in the Money,” if the ticket is a winner, and the jingle cannot be adjusted by the retailer.
- **Self-checker machines**—Some retailers also have a small “self-checker” machine that players can use to check whether their drawing game tickets are winning tickets.³ These machines visually display the words “winner” or “not a winner,” but not the prize.
- **Verification at Phoenix and Tucson offices**—If players are concerned about lottery retailers’ integrity, they may visit one of the two lottery offices to purchase, check, and claim prizes on their lottery tickets.⁴
- **Brochures available with tips on avoiding fraud, theft, and scams**—Retailers can provide lottery brochures that inform players on how to play the lottery games, how to determine if a ticket is a winner, how to claim prizes, and tips on how to protect themselves and their tickets from fraud, theft, and lottery scams. For example, one lottery scam involves suspects who claim that they have a winning lottery ticket, but cannot redeem it because they are not U.S. citizens. They convince the victim to give them money as a sign of good faith until the victim returns with the prize money. However, the ticket provided to the victim is not a winning ticket, and the victim is unable to claim a prize to reimburse himself/herself for the money he/she provided. In Arizona, residency or U.S. citizenship is not necessary to claim prizes.

One way in which the Lottery can enhance these protections is to incorporate more information on its Web site. Unlike the five other state lotteries auditors contacted, the Lottery’s Web site does not include measures players can take to ensure they protect their tickets and prizes from theft, fraud, and scams. Some of these measures include encouraging players to sign their tickets upon purchase, making use of the self-checker machines for drawing tickets, and making players aware of possible lottery scams. The Lottery should take steps to include this set of measures on its Web site.

¹ According to a lottery official, retailers are not required to have a monitor. For example, one convenience store chain does not carry the monitor because it does not conform to its store design.

² Players must claim high-tier prizes, which are those over \$599 (in person or by mail), from one of the two lottery offices (Phoenix or Tucson). Lottery retailers may pay prizes up to \$599, but are required only to pay prizes up to \$100. Therefore, players may also be required to claim prizes over \$100 in value at one of the two lottery offices.

³ According to a lottery official, retailers are not required to have a self-checker in order to sell lottery products.

⁴ According to a lottery official, to help ensure integrity, Arizona lottery employees undergo criminal and credit background checks and are not permitted to play lottery games.

Lottery takes other actions to ensure game integrity

The Lottery takes other steps to ensure that its games are fair, including testing the equipment used to select lottery numbers for its drawing games, verifying the accuracy of its instant game odds, and employing controls consisting of industry audits and computer network structures to help ensure the electronic systems used to manage game play are operating accurately and fairly. Auditors did not identify any areas for improvement with regard to these steps.

Game controls help ensure fairness of drawing and instant games—

The Lottery has controls in place for both drawing and instant games that help ensure that all players have a fair chance to win and have accurate information about the odds of winning. These controls fall into two categories, as follows:

- **Steps to ensure lottery numbers have an equal chance of being drawn—**In fiscal year 2005, the Lottery changed from using lottery ball drawing machines to electronic random number generators (RNGs) for its drawing games. According to a lottery official, it made this change because the balls are a physical piece of equipment that could be compromised over time through physical wear, thus impacting the drawing's randomness, and it is time-consuming to maintain them to secure their integrity. Four of the five states auditors contacted also use an RNG for drawing games.¹ In addition, to further ensure Arizona lottery drawing numbers are random, a lottery contractor tests the randomness of the numbers that have been drawn for existing games and also conducts tests before new drawing games are introduced.
- **Steps to ensure players have accurate information about their chances of winning—**One of the Lottery's key game integrity controls for instant (scratcher) games focuses on ensuring that the overall odds of winning that the Lottery advertised for an instant game are accurately reflected on the printed ticket. The overall odds represent the likelihood a player has of winning any prize available in a game. For example, the overall odds of winning any prize for the instant game, Dazzlin' Diamond 7's, is 1 in 3.60, meaning that a little more than a quarter of the tickets are winners. According to a lottery official, the success of its instant games depends in part on the public's trust in their odds of winning. The Lottery takes measures to ensure the advertised odds are accurate—some by lottery officials, and others by vendors that print the lottery tickets. For example, one lottery ticket printing vendor stated that its own internal as well as external auditors review each instant ticket game to ensure it conforms to all of the Lottery's specifications, including overall odds. In addition, the Lottery's internal auditors review the final game information to ensure the game the Lottery receives is what it ordered, and the overall odds for the game are still accurate.

In fiscal year 2005, the Lottery replaced ball drawing machines with random number generators.

¹ California, Colorado, Idaho, and Washington state lotteries use random number generators for some or all of their drawing games.

Audits of IT security controls help ensure a secure game environment—Industry best practices call for independent audits of a computer gaming system’s IT controls, and the Arizona Lottery has such audits in place. The Lottery helps ensure game integrity by providing outside oversight of IT security practices. According to the Lottery, many of its IT security controls are based on requirements defined by the Multi-State Lottery Association (MUSL). MUSL issues mandatory rules, including IT security controls, to protect lottery IT systems from any combination of events that may affect the security, integrity, or availability of the games. These controls must be in place for the Lottery to participate in the multi-state Powerball drawing game. Here are examples of the kinds of controls required:

Many of the Lottery’s IT security controls are based on requirements defined by the Multi-State Lottery Association.

- **Daily reconciliation of data in lottery and vendor systems**—MUSL rules indicate that daily transaction data in the Lottery’s system and the vendor’s systems should be reconciled—a control the Lottery has in place. The Lottery’s vendor supplies and maintains the computer gaming system that captures daily retailer lottery information for instant games and for drawing games, including the number of tickets sold, total wagers (there may be more than one wager on a ticket), and the number of winners from different games, and then transmits that data electronically to the Arizona Lottery. For example, the Lottery takes the total wagers reported for the Pick game and records those numbers on a balancing report. Lottery staff then take the daily total of gross sales for the game as listed on the vendor’s report and record those numbers, comparing them against the Lottery’s report to ensure they are the same. According to a MUSL rule, without a proper reconciliation process between these systems, there is the potential to modify transactions or add illegitimate transactions.
- **Safeguards against unauthorized access**—MUSL rules also require that the Lottery’s network be separated and secured using firewalls to protect sensitive information from unauthorized access.¹ Operating with a poorly configured or no firewall could result in unauthorized users and applications compromising the Lottery’s software and hardware, and potentially modifying transactions that have already been processed. MUSL conducts standard audits of its lottery members on average every 24 months, but other obligations may delay the audits. The last MUSL audit of the Lottery and its vendor occurred in April 2008 and made several recommendations that included firewall configuration and data reconciliation issues. For example, MUSL auditors determined that the Lottery’s firewalls allowed network traffic that was not required to do business. In response, the Lottery reported that it reconfigured the firewalls to comply with MUSL standards. According to the response report, the Lottery’s vendor implemented its recommendations regarding firewall configuration, and the Lottery implemented all but one minor recommendation relating to its backup system procedures because it is still waiting for clarification from MUSL.

¹ A firewall is a part of a computer system or network that is designed to permit authorized access and prevent unauthorized access, typically to or from a private computer.

Recommendations:

- 2.1. The Lottery should continue with its plan to implement a system that allows it to track, monitor, and analyze how frequently prizes of more than \$599 are claimed by retailers, and enhance its efforts by:
 - a. Modifying its claim forms to request whether the claimant is a retail owner, employee, or immediate family member;
 - b. Making the necessary programming changes to its computer system to allow it to more effectively ascertain whether claimants are retail owners; and
 - c. Using this information to help identify retailers who should receive an investigation for claims of more than \$599.
- 2.2. To help address its backlog of compliance investigations, the Lottery should adopt and implement a risk-based approach for conducting compliance investigations by considering things such as findings from previous reviews, incidents reported to the Lottery, and a history of retailer winning. The Lottery should revise its policies accordingly.
- 2.3. The Lottery should publish player protection information on its Web site, such as measures players can take to protect themselves and their tickets from fraud, theft, and lottery scams.

SUNSET FACTORS

In accordance with Arizona Revised Statutes (A.R.S.) §41-2954, the Legislature should consider the following 12 factors in determining whether the Arizona State Lottery Commission (Commission) and the Arizona State Lottery (Lottery) should be continued or terminated.

1. The objective and purpose in establishing the Lottery.

In 1980, through an initiative petition in the general election, Arizona citizens established the Commission to oversee a state lottery. The state agency that operates Arizona's lottery, the Arizona State Lottery (Lottery), began operating in 1981. Voters have approved the Lottery's continuation two times since then. In the most recent vote, November 2002, 73 percent of the voters approved the Lottery's continuation until July 1, 2012. However, Laws 2010, 6th S.S., Ch. 2, effective from and after June 30, 2012, lets the current Commission and Lottery terminate, establishes a new Arizona State Lottery Commission and Lottery, and continues them until July 1, 2035, thereby eliminating the need for a public vote.

The Lottery's primary purpose is to generate revenue for the State and other Arizona government programs in a responsible manner. For example, the Lottery's beneficiary distributions benefit the Arizona State Parks Board Heritage Fund for local, regional, or state parks; outdoor recreation; environmental education; open space and historic preservation projects; and the Arizona Department of Game and Fish Heritage Fund, which is used for public access, environmental education, schoolyard habitats, and urban wildlife protection and management (see Introduction and Background, pages 2 through 4).¹

2. The effectiveness with which the Lottery has met its objective and purpose and the efficiency with which it has operated.

In fiscal year 2009, the Lottery distributed just over \$129 million to various Arizona government funds and programs, including the State General Fund, the Local Transportation Assistance Fund, and the Game and Fish Heritage Fund.

¹ Laws 2010, 6th S.S., Ch. 4, effective May 13, 2010, authorizes the Department of Administration to issue State Lottery Revenue Bonds; established the State Lottery Revenue Bond Debt Service Fund; and requires that amounts distributable to the State General Fund from the State Lottery Fund be transferred first to the State Lottery Revenue Bond Debt Service Fund to meet the bond requirements for the current period. In addition, Laws 2010, 6th S.S., Ch. 2, effective from and after June 30, 2012, requires that debt service for revenue bonds shall be paid first from monies that would have otherwise been deposited in the State General Fund, and that monies in the State Lottery Fund can only be distributed to beneficiaries after the bond requirements for the current period have been met.

From fiscal years 1982 through 2009, the Lottery has distributed nearly \$2.4 billion to beneficiaries.

The Lottery works to meet its purpose by offering instant ticket and drawing games the public can play. For example, the Lottery offers several drawing games such as Pick 3 and Cash 4, and it provides opportunities for players to participate in the multi-state Powerball drawing game. In addition, the Lottery offers many different instant games such as bingo and crossword games, and the \$100 Million Cash Spectacular (See Introduction and Background, page 1, for more information on the Lottery's drawing and instant games).

Although the Lottery's sales and beneficiary distributions have generally increased for much of the past decade, this audit found that there is still a need for attention and room for improvement. As indicated in Finding 1 (see pages 13 through 22), the Lottery's sales and beneficiary distributions have leveled off since fiscal year 2007, distributions fell in fiscal year 2009, and sales as a percentage of population have remained comparatively low for the past decade. To produce the maximum amount of revenue for beneficiaries, the Lottery should take steps to raise sales revenues and control costs, such as recruiting more retailers, increasing its player base, and optimizing its prize structures.

The Lottery also takes efforts to ensure revenue is generated in a responsible manner. A primary concern for the Lottery is that it uses reputable retailers to sell its products. To help ensure its retailers are reputable, similar to practices in some other states, retailers who sell Arizona Lottery tickets must be licensed to do so.^{1,2} The licensing process involves both criminal history and financial solvency background checks. Licensed retailers must also undergo a routine compliance investigation that helps instill the importance of following the Lottery's statutory and rule requirements. For example, according to statute, individuals must be at least 21 years old to play the lottery games, and lottery tickets cannot be purchased by anyone under the age of 21.³ Auditors observed an investigator helping to enforce this requirement by checking that under-age signs were appropriately posted and that retailer clerks knew of the under-age requirement. Auditors' review found that to ensure the Lottery's compliance investigation resources are used more effectively, it should prioritize these investigations based on risk factors. Although it is important for all retailers to receive periodic compliance investigations, some retailers may present a lower risk. Therefore, this audit recommends that the Lottery adopt a risk-based approach for scheduling investigations by considering things such as findings from previous reviews, incidents reported to the Lottery, a history of retailer

1 Other states contacted include California, Colorado, Florida, Idaho, and Washington. These states were chosen as a mix of states that represents regional and population diversity, and notable aspects of the retailer network, including the age of the lottery, sales volume, and experience.

2 See A.R.S. §5-512 for licensing requirements.

3 A.R.S. §§5-515 and 5-515.02.

winning, and results of reviews of retailers affiliated with multiple locations (see Finding 2, pages 23 through 32).

3. The extent to which the Lottery has operated within the public interest.

The Lottery operates within the public interest by educating the public about the programs the Lottery's beneficiary distributions support. The Lottery's Web site features a "How the Money Helps" Web page that lists the Lottery's beneficiaries. These beneficiaries include, among others: (1) the State General Fund; (2) the Local Transportation Assistance Fund, which municipalities can use for public transportation purposes, and for cultural, educational, historical, or recreational facilities or programs; (3) the Arizona State Parks Heritage Fund, which is used for local, regional, or state parks, outdoor recreation, environmental education, open space, and historic preservation projects; (4) the Arizona Department of Game and Fish Heritage Fund, which is used for public access, environmental education, schoolyard habitats, and urban wildlife protection and management; and (5) the Healthy Arizona Fund, which provides monies for health education and disease control research, among other programs. The Lottery also contributes \$300,000 annually to the Department of Gaming to support the state-wide gambling programs, which provide treatment and counseling. The Lottery provides this state-wide gambling hotline number on its instant lottery tickets and in its player brochure. In addition, the Lottery includes the words "please play responsibly" on its lottery tickets and in its advertisements.

The majority of the public also appears to feel that the Lottery operates in the public's interest. The Lottery contracts with a research firm to measure monthly the public's perception on a number of factors, including public awareness of the Lottery's games and advertising, and its perception of the Lottery. Based on a compilation of the monthly data collected during fiscal year 2009, 74 percent of those surveyed agreed that the Lottery is run honestly and with integrity, and 69 percent agreed that the Lottery is a good way to raise money for the State of Arizona.

Auditors' review also found that the steps the Lottery takes to ensure game integrity and protect players are comparable to practices used or recommended in other states, but it can enhance its efforts in a couple of areas. Game integrity, or the efforts a lottery takes to ensure its games are protected against dishonest, unfair, and fraudulent practices, impacts the public's perception of the lottery and their likelihood of purchasing lottery products. The Lottery's game integrity efforts focus on ensuring that the retailers who sell tickets are not involved in theft or fraud, providing means for players to protect themselves against retailer theft and fraud, and taking steps to ensure its games are fair. Taking additional steps such as monitoring how frequently retailers win prizes and providing more information to players on ways they can protect themselves against theft and

fraud will enhance the Lottery's game integrity processes (see Finding 2, pages 23 through 32).

4. The extent to which rules adopted by the Lottery are consistent with the legislative mandate.

General Counsel for the Auditor General has reviewed an analysis of the Arizona Lottery's rule-making statutes by the Governor's Regulatory Review Council (GRRRC) staff, performed at auditors' request, and believes that the Arizona Lottery has fully established rules required by statute. For example, statute says that the Lottery may collect a fee for retailer licenses, and corresponding rules outline the amount of those licensing fees.¹ Statute also prohibits retailers from selling lottery games to players under 21 years old, which the rules also support.²

5. The extent to which the Lottery has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

The Lottery takes steps to encourage input from the public before promulgating rules and regulations by allowing the public the opportunity to speak on rules brought before the Arizona State Lottery Commission members. According to the Lottery, any proposed rule is placed on a regular monthly commission meeting agenda for consideration. In addition, in 2007, according to the Lottery, it notified and asked for input from industry and retailer representatives of proposed rules and regulations that could affect them. Auditors reviewed Arizona State Lottery Commission meeting minutes and found there is a standard agenda item to allow the public to speak. Auditors observed that the meeting notices are posted at both the Lottery's Phoenix and Tucson offices, as well as on the Lottery's Web site. In addition, the meeting minutes are available on the Lottery's Web site. Finally, the Lottery's Web site has both newsletters and press releases that inform the public of what is happening at the Lottery, and the public may sign up for newsletter updates through the Web site.

6. The extent to which the Lottery has been able to investigate and resolve complaints that are within its jurisdiction.

Although the Lottery is not a regulatory agency, the Lottery receives and responds to various informal complaints from both retailers and the public. According to the Lottery, in addition to proactive and compliance investigations (see Finding 2, pages 23 through 32), the Lottery's investigators may address common grievances, including complaints about lottery terminal functionality, retailer concerns about missing or stolen tickets, and player complaints about damaged or stolen tickets. The Lottery assigns the complaints to appropriate

1 A.R.S. §5-512(C) and A.A.C. R19-3-202.

2 A.R.S. §§5-515 and A.A.C. R19-3-208.

personnel, such as its Security Division investigators, for further research. Actions taken may include filing criminal complaints with law enforcement agencies and revoking retailer licenses.

7. The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under the enabling legislation.

A.R.S. §5-512.01 provides the Attorney General and county attorneys concurrent prosecution authority for an offense arising out of or in connection with the formation, management, operation, or conduct of the state lottery. In addition, A.R.S. §5-506 gives the Lottery's director the authority to enforce lottery laws and rules. For example, the Lottery is working with Yavapai County law enforcement officials to investigate and prosecute a case involving retailer theft of a customer's lottery ticket that took place in June 2009.

8. The extent to which the Lottery has addressed deficiencies in its enabling statutes, which prevent it from fulfilling its statutory mandate.

The Lottery has successfully sought changes to its statutes since 2002. For example:

- Laws 2004, Ch. 176—This change eliminated subsection E of A.R.S. §5-504, removing the Lottery's need to create its own personnel rules for a specific class of sales staff.
- Laws 2008, Ch. 287—This law included several changes to the Lottery's statutes. For example:
 - Amended A.R.S. §5-504 to add subsection J prohibiting the Lottery from offering games that use video lottery terminals (VLTs), including monitor games that produce or display outcomes or results more than once per hour. VLTs are devices with video screens that offer electronic games of chance such as poker, blackjack, and slots. Keno, a drawing game, is also prohibited because it allows players to place multiple bets in a short period of time and receive drawing results within minutes.
 - Amended A.R.S. §5-505(A)(1) to remove language limiting the percentage expended for promotional or advertising services to 4 percent of the total gross annual revenues. This resulted in advertising costs being limited only by the statutory limitation placed on the Lottery's operation and administrative costs. Specifically, A.R.S. §5-505(A) limits the Lottery's operating and administrative costs, which includes advertising, to not more than 18.5 percent of total annual

revenues accruing from the sale of lottery tickets and shares and other sources deposited in the State Lottery Fund.

- o Amended A.R.S. §5-505(A)(4) to modify compensation for licensed sales agents from 6 1/2 to 7 percent to 5 1/2 to 8 percent. However, according to a lottery official, as of January 2009, the Lottery has not yet developed the criteria for implementing the new commission percentages and this criteria will need to be added to its administrative rules. In the meantime, according to lottery information, all retailers earn 6.5 percent and are eligible to receive an additional one-half percent if the retailer has an increase in its sales that is at least 5 percent higher than the percentage increase in total sales the Lottery experienced for an identified sales period.
- o Amended A.R.S. §§5-505 and 5-522 to modify the beneficiary distribution mechanism. Specifically, beneficiaries are no longer tied to a specific lottery game or series of games to receive funding, except the Commerce and Economic Development Commission Fund, which receives beneficiary distributions from two specific instant games.

In addition, Laws 2010, 6th S.S., Ch. 4, effective May 13, 2010, authorizes the Department of Administration to issue State Lottery Revenue Bonds; establishes the State Lottery Revenue Bond Debt Service Fund; and requires that amounts distributable to the State General Fund from the State Lottery Fund be transferred first to the State Lottery Revenue Bond Debt Service Fund to meet the bond requirements for the current period. In addition, Laws 2010, 6th S.S., Ch. 2, effective from and after June 30, 2012, requires that debt service for revenue bonds shall be paid first from monies that would have otherwise been deposited in the State General Fund, and that monies in the State Lottery Fund can only be distributed to beneficiaries after the bond requirements for the current period have been met.

9. The extent to which changes are necessary in the laws of the Lottery to adequately comply with the factors in the sunset law.

This audit did not identify any needed changes to the Lottery's statutes.

10. The extent to which the termination of the Lottery would significantly harm the public's health, safety, or welfare.

Terminating the Lottery would not significantly harm public health, safety, or welfare. However, terminating the Lottery would eliminate a significant amount of revenue that has been made available to Arizona governmental programs. In fiscal year 2009, the Lottery transferred over \$129 million to beneficiaries. These beneficiaries include, among others: (1) the State General Fund; (2) the Local

Transportation Assistance Fund, which municipalities can use for public transportation purposes, and for cultural, educational, historical, or recreational facilities or programs; (3) the Arizona State Parks Heritage Fund, which is used for local, regional, or state parks, outdoor recreation, environmental education, open space, and historic preservation projects; (4) the Arizona Department of Game and Fish Heritage Fund, which is used for public access, environmental education, schoolyard habitats, and urban wildlife protection and management; and (5) the Healthy Arizona Fund, which provides monies for health education and disease control research, among other programs. In addition, from fiscal years 1982 through 2009, the Lottery has distributed nearly \$2.4 billion to its beneficiaries.

As mentioned in Sunset Factor 1 (see page 33), Arizona citizens established the Lottery in 1980 through an initiative petition in the general election, and voters have approved the Lottery's continuation two times since then. In the most recent vote, in November 2002, 73 percent of the voters approved Proposition 301, which continued the Lottery until July 1, 2012. However, Laws 2010, 6th S.S., Ch. 2, effective from and after June 30, 2012, lets the current Commission and Lottery terminate, establishes a new Arizona State Lottery Commission and Lottery, and continues them until July 1, 2035, thereby eliminating the need for a public vote.

11. The extent to which the level of regulation exercised by the Lottery is appropriate and whether less or more stringent levels of regulation would be appropriate.

The Lottery is not a regulatory agency. However, statute requires the Lottery to license the retailers who sell lottery tickets.¹ This practice is in line with the practices of some of the five other state lotteries auditors contacted to learn more about their gaming integrity and player protection practices. As indicated in Finding 2 (see pages 23 through 32), the licensing process includes checking criminal history records for evidence of prior criminal offenses or other violations of Arizona or U.S. laws or lottery regulations. In addition, credit checks conducted during the licensing process help the Lottery determine if the applicant demonstrates financial solvency. According to the Lottery's retailer rules, the Lottery may deny a license to an applicant for reasons such as previous criminal behavior or poor credit history.² The Lottery may also revoke an active retailer license for actions such as a retailer selling a ticket to a person younger than 21 years old or an unreported change in ownership.³

¹ See A.R.S. §5-512 for licensing requirements.

² See A.A.C. R19-3-202.

³ See A.A.C. R19-3-204.

12. The extent to which the Lottery has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished.

The Lottery uses many contractors to help it perform its duties, and this report identified one additional area where the Lottery should consider making use of private contractors. In fiscal year 2009, according to the Lottery, it spent approximately \$33 million for its key contracted services. Some of the Lottery's key contracted services include online game systems and ticket distribution services, instant ticket printing, and marketing. According to the vendor who assisted the Lottery in developing guidelines for instant game prize structures, the vendor's advice was based on experience with increasing sales with other lotteries rather than from demand for lottery tickets in Arizona or from strategies to minimize costs. This report recommends that the Lottery ensure calculations based on economic theory in lottery literature are used to optimize prize structures for its games, and consider seeking outside assistance from experts who specialize in such work (see Finding 1, pages 13 through 22).

APPENDIX A

Methodology

Auditors used various general methods to study the issues addressed in this report, including interviewing lottery officials and staff; attending an Arizona State Lottery Commission meeting; and reviewing statutes and rules, the Lottery's Web site, and its audited financial statements for fiscal years 2005 through 2009. In addition, auditors observed a lottery drawing and toured the Lottery's instant ticket vendor's distribution center. Auditors also assessed internal controls in several areas, including its cash-handling processes at the Lottery's Phoenix Office, its Internal Audit Unit's responsibilities, and the Lottery's compliance with the State's travel policies and the State's conflict-of-interest statutes. Auditors found that these areas merited initial review, but were not consequential to the audit's objectives, and no further audit work was done.

In addition, auditors used various specific methods to study the issues addressed in this report:

- To evaluate the Lottery's efforts and additional steps needed to increase ticket sales revenues and distributions to Arizona programs (beneficiary distributions), auditors analyzed other state lottery measures and practices, reviewed literature, and obtained financial and other information and documents from lottery staff.¹ Auditors analyzed the Lottery's performance as compared to other state lotteries on measures such as sales per capita, retailers per capita, and sales by retailer type. Auditors analyzed these measures for fiscal years 1999 and 2008 based on data from the *La Fleur's World Lottery Almanac*.² Auditors selected comparison state lotteries as those that have drawing and instant games, but do not have video lottery terminals (VLT) or Keno games because the Arizona Lottery by statute is not allowed to provide these products. Auditors contacted six other state lotteries to learn about their practices. The states were

¹ Literature reviewed included: Dadayan, L., & Ward, R.B. (2009). *For the first time, a smaller jackpot: Trends in state revenues from gambling*. Retrieved September 21, 2009, from http://www.rockinst.org/pdf/government_finance/2009-09-21-No_More_Jackpot.pdf; Hausch, D.B., & Ziemba, W.T. (Eds.). (2008). *Handbook of sports and lottery markets*. New York: Elsevier; Maeda, A. (2008). Optimal lottery design for public financing. *Economic Journal*, 118 (532), 1698-1718; Walker, I., & Young, J. (2001). An economist's guide to lottery design [Electronic version]. *Economic Journal*, 111, F700-F722.

² Auditors assessed the reliability of data from *La Fleur's World Lottery Almanac* by determining the source of data and how it was collected and verified, and by comparing data representing the Arizona Lottery with its audited financial statements for fiscal years 1999 and 2008.

chosen based on their high sales per capita among 28 comparison states and among western states, or based on a reportedly large increase in beneficiary distributions in fiscal year 2009.¹ In addition, auditors contacted a lottery expert in Arizona to discuss lottery practices. To understand the Lottery's ability to increase prizes and changes to beneficiary distributions, auditors reviewed reports from the Joint Legislative Budget Committee and changes to the statutes, including Laws 2008, Ch. 287, and Laws 2009, 1st S.S., Ch. 1 and 3. Finally, to understand the Lottery's efforts to increase beneficiary distributions, auditors reviewed documentation such as the Lottery's financial records, reports to its commission members, strategic plan, sales reports, game analysis, marketing research surveys, and marketing plans, and interviewed lottery officials, staff, and vendors.²

- To assess the controls the Lottery has in place to ensure game integrity and player protection and whether its controls are in line with practices in other states, auditors obtained information and documents from lottery staff and two of its vendors, and compared it to other state lotteries' practices and ombudsman reports regarding the Iowa and Ontario lotteries and two consultant reports on the Ontario lottery.^{3,4} To evaluate how the Lottery's licensing process helps ensure game integrity, auditors reviewed licensing applications and case files, including files related to licensing denials, suspensions, revocations, and reactivations. To determine how investigations of retailers can help ensure game integrity, auditors interviewed lottery investigators, reviewed investigative procedures and the Lottery's unaudited licensing and investigation statistics, observed investigations of retailer stores, and inquired about investigation units in other state lotteries. Auditors also reviewed investigative and audit reports, as well as information provided by other states, regarding what steps help ensure player protection at point of sale, including both equipment and procedural controls, and compared these against current controls in place at the Lottery. To address how the Lottery ensures randomness of lottery drawings, auditors reviewed audits of 2007 and 2008 data that test the reliability of the random number generators. To determine how the Lottery monitors the accuracy of the odds designed for a game, auditors interviewed a ticket print vendor and lottery personnel, and documented the Lottery's internal auditors' review of the final game structure for one 2009 instant ticket game, and the reports of final game data provided by the

1 State lotteries that replied to auditors included Connecticut, Colorado, Idaho, New Jersey, North Carolina, and South Carolina.

2 Auditors assessed the reliability of the Lottery's financial records by comparing them to audited financial statements.

3 Reports reviewed by auditors: Angrick, W.P. (2009). *Taking chances on integrity: An investigation of the Iowa lottery*. Retrieved June 5, 2009, from http://www.legis.state.ia.us/caodocs/Invstgtv_Reports/2009/CIWPA002.PDF; (KPMG. (2006a). *Ontario Lottery and Gaming Corporation: Phase I report - lottery review*. Retrieved July 9, 2009, from http://www.olg.ca/assets/documents/play_confidence/kpmg_report_phase_one.pdf; KPMG. (2006b). *Ontario Lottery and Gaming Corporation: Phase II report - lottery review*. Retrieved July 9, 2009, from http://www.olg.ca/assets/documents/play_confidence/kpmg_report_phase_two.pdf; Marin, A. (2007). *A game of trust*. Retrieved June 5, 2009, from http://www.ombudsman.on.ca/media/3268/a_game_of_trust_20070326.pdf

4 Auditors contacted lottery officials from California, Colorado, Florida, Idaho, and Washington. These states were chosen as a mix of states that represents regional and population diversity, and notable aspects of the retailer network, including the age of the lottery, sales volume, and experience.

printer and a review by an outside audit agency for that game. In addition, to verify the Lottery's information technology controls, auditors reviewed its network controls and two IT audits from 2006 and 2008. Auditors also observed procedures for drawing games and measured the Lottery's controls and procedures against standards set by the Multi-State Lottery Association and other IT standard-setting organizations.

- To develop the Introduction and Background section, auditors compiled information from the Arizona State Lottery's financial statements audited by Deloitte & Touche LLP for fiscal years 2007 through 2009, state laws, and information from interviews with lottery officials, the Lottery's Web site, and other internal documents such as sales and beneficiary distribution transfer reports and organizational documents.
- To respond to the sunset factors, auditors relied on work conducted to complete the audit report's introduction and background and findings. In addition, auditors used information obtained from the Governor's Regulatory Review Council and the Secretary of State. Auditors also used information from the Lottery, including information on its Web site, a list of statutory changes it provided, and Arizona State Lottery Commission meeting minutes for March through May 2009, including observation of meeting notice postings, and various contract-related documents.

AGENCY RESPONSE

Janice K. Brewer
Governor



Jeff Hatch-Miller
Executive Director

March 4, 2010

Ms. Debbie Davenport
Auditor General
Office of the Auditor General
2910 N. 40th St.
Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport:

The Arizona Lottery is pleased to respond to the performance audit and sunset review conducted by the Office of the Auditor General. Our first meeting on this topic was held almost a full year ago; this report clearly documents the hard work of your staff and the Lottery.

Early on in the process, your staff mentioned that a performance audit could also be an excellent business development tool. We took this advice to heart, and considered your team to be a group of consultants, eager to help us identify ways to improve our internal and external processes. Having this expertise available at no cost has been an unexpected benefit of the audit.

We agree with the report's findings and intend to implement all of the recommendations. You will note in our implementation schedule that many of the recommendations are scheduled to be completed by July 1, 2010. We are eager to start the new fiscal year with these improvements already in place.

We appreciate your staff's dedication to conducting a fair and thorough review. We are proud of this review, and the effort everyone put into making it a success.

Sincerely,

Jeff Hatch-Miller
Executive Director

Cc: Leo Valdez, Chairman,
Arizona Lottery Commission

Phoenix Office · 4740 East University Drive · Phoenix, Arizona 85034 · 480.921.4400 · Fax: 480.921.4512
Tucson Office · 4010 E. Grant Road · Tucson, Arizona 85712 · 520.628.5107 · Fax: 480.921.4456
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Arizona Lottery Performance Audit Response

Background

In four of the last five fiscal years, the Arizona Lottery has seen sales grow year over year. The Lottery has introduced new products in response to player demand, offered incentives for retailers, promotions for players, and developed a variety of marketing and promotional partnerships, all strategically intended to meet our mission to maximize revenue for state programs. As a result, sales for fiscal 2009 were almost 22% higher than fiscal year 2005, eclipsing the industry average of 10.8% growth for the same period.

Lottery sales in most states, including Arizona, have shown a more modest growth rate in the last three years. A report from the Nelson A. Rockefeller Institute of Government noted that state and local gambling revenues from lotteries, casinos, and racinos declined by -2.6% in fiscal 2009—the first such decline in at least three decades.¹ Revenues from tribal casino gaming in Arizona are reported to have declined every quarter since the start of 2008, with a 13% drop in the fourth quarter of 2009. The Lottery believes these Arizona-specific indicators reflect a downturn in the economy and a general population with less disposable income.

Although the Lottery's 2.4% growth in FY 2009 could be considered leveling off, the Lottery believes any growth to be a positive indicator when measured against the above-mentioned factors, and the lottery industry as a whole. Growth in the instant product line is significant, since it represents the products a lottery can best control. For calendar year 2009, the Arizona Lottery was by a wide margin the top performer of all US lotteries when ranked by instant games sales growth, and #2 nationally in total sales growth.

Decrease in beneficiary distributions and low per-capita sales indicate room for improvement.

When the Lottery's statutory beneficiary distribution method was modified in the FY2008 legislative session, it enhanced the Lottery's ability to fully fund its current and potential new beneficiaries. Under the old process, beneficiaries received proceeds from the sale of specific products, often at different rates of return. If Powerball jackpots were unusually high, those beneficiaries received full funding, while those dependent on other products might not. Funding all beneficiaries from the sale of all products corrected this inequity.

Increased prize expense, as the audit report notes, is a factor in decreased distributions, but the ability to offer increased payouts (prize expense) was essential to the substantial growth of the Lottery's instant ticket product. If prize payouts had remained at their pre-2009 levels, the Lottery would have been unable to introduce its *\$100 Million Cash Spectacular* game. The estimated \$7.4 million returned from this game's sales represented more than 5% of FY 2009's total distributions. With sales to date of more than \$67 million, the game is likely to make a similar contribution to this fiscal year's distributions.

Arizona's per-capita sales have been comparatively low since 1999. Several factors outside the Lottery's control contribute to this situation. First, this period coincides with unprecedented population growth in Arizona, which the Arizona Department of Commerce estimates to have been slightly more than 30% from 2000 to 2009.² Second, Arizona also has a relatively high proportion of the general population morally opposed to gambling and by extension, the Lottery. In a 2007 study commissioned by the Lottery, this group was estimated to be approximately 17% of the general population.³ And finally, Arizona's marketing/advertising budget was capped at 2.7% of sales during much of the last decade, while advertising costs climbed. The ability to tell players, especially new residents who may have played in other states, about our products was limited by the advertising cap. When the cap was lifted in FY 2009, Arizona saw 2.4%

¹ Nelson A. Rockefeller Institute of Government, Sept 21, 2009. *For the First Time, a Smaller Jackpot*

² Arizona Dept of Commerce website: azcommerce.com/econinfo/demographics/Population+Estimates.html

³ Ipsos Reid *Arizona Lottery Gamer Segmentation Study*, December 2007

Arizona Lottery Performance Audit Response

per capita growth over the prior year. This may well be a barometer of future direction; Arizona's 11.4 percent of per capita growth from 2005 to 2009 is well above the industry's 5.6 percent average.⁴

Lottery should raise sales revenues by recruiting more players and responsibly increasing player base.

The Lottery has not traditionally recruited non-players. For many in this group, the choice to not participate in gaming activities is a moral decision, not one driven by convenience or lack of motivation. Actively recruiting this group might be perceived as offensive to many of our constituents, and damaging to public perception of the Lottery as a good way to raise money for the State. From a practical perspective, the Lottery believes the most effective use of its resources is in offering products that will encourage casual players to play more often, and to sustain or increase the interest of more frequent players.

In early FY 2010, the Lottery conducted an instant game player segmentation study as a follow up to its 2004 general market player segmentation study. The Lottery seeks to identify what motivates players to purchase one game play style or price point over another. The study's focus on why people play will help form a comprehensive strategy for attracting players beyond our current audience. The study will provide the Lottery a better understanding of instant game players and their preferences.

The development of games appealing to a broad range of Lottery players will aid in increasing revenues and distributions. The study information will also be helpful in post-game analysis, providing another tool for determining if games were well-received by the audience they were designed to attract.

Lottery should better manage and report costs.

Statutory changes to the beneficiary distribution method were enacted during the FY 2008 legislative session; these changes made additional monies available to increase prize payouts. For at least ten years, Arizona's 60% aggregate payout had kept it in the bottom quarter of all states. Industry data indicated that the states with the highest sales also had average instant-game prize payouts well above Arizona's. The ability to increase payouts gave the Lottery a vital tool to support the introduction of higher price-point games that could generate increased revenue.

Once this legislation was enacted in August 2008, the Lottery was tasked with immediately increasing sales with hopes of funding the newest beneficiary, bonding for university capital improvements. Increasing instant game payouts remains the industry's most effective tool for increasing sales, but it is normally a 24- to 36-month process. The initial "more winners, better prizes" concept fairly quickly attracts players' attention and achieves the goal of increasing sales. However, a long-term investment in finding the balance between higher payouts, better odds and more prizes while sustaining return to beneficiaries is equally important, and highly dependent upon learning more about players' response to those factors.

In FY 2009, the first year this plan was in effect, increased payouts and increased advertising led to record-breaking sales, but not at the unrealistic levels the Lottery was pressured to endorse. Distributions also failed to meet expected levels.

As the Lottery approaches almost two years of increased prize funding, plans are in place to lower selected instant game payouts while avoiding a significant decrease in product sales. These actions, combined with the strategic use of advertising funds, provide a pivot point for the Lottery. Analytical tools for the measurement of growth trajectories are necessary to assess the full impact of adjustments to prize structures. A considerable number of problems are inherent in the measurement and analyses of change. If sales drop as a result of lower prizes and less advertising, distributions also decline. This is a complex issue and will be discussed at length with lottery staff, vendors and ultimately, the Lottery Commission.

⁴ LaFleur's Almanac, 2005-2009

Arizona Lottery Performance Audit Response

Game controls ensure fairness of drawing and instant games

The Lottery has long maintained its success is based on the delivery of two products: its games and its integrity. Players must be confident that they have the same chance of winning as anyone else; players and non-players alike must be assured that the process, from game design to distribution to prize payment, is above reproach. Although these responsibilities may be delegated to retailers or vendors, they intentionally remain directly within the control of the Lottery. Vendors who print or distribute our products are held to same exacting standards as Lottery employees. The Lottery's requirements for physical and logical data security and general business practices are consistent with industry standards.

Steps to protect against retailer theft, fraud, and impropriety can be further enhanced

For many players, licensed Lottery retailers are the "face" of the Lottery; they sell Lottery games, pay Lottery prizes and respond to player questions about Lottery products. Obtaining a license to sell Lottery products is not the end of the process. Every Lottery retailer receives training immediately and is subject to planned and unexpected compliance investigations to monitor activities in the field and to identify obvious issues at the retail location. In addition, customer complaints, licensing and financial concerns and routine monitoring of retailer activity all contribute valuable information to identify potential retailers whose activities may classify them as at-risk. Routine compliance investigations are a long-accepted industry tool for identifying retailer problems. Unfortunately, as the retailer base grows, lotteries require an increasing number of personnel qualified to conduct these investigations. When the Lottery was unable to sustain staffing levels to conduct these investigations, the focus shifted to the use of technology to help identify potential issues prior to a complaint being filed. Added in FY07, this at-risk program seeks to utilize and enhance industry best practices in proactive loss prevention and player protection. When necessary, the Lottery works with local law enforcement to support criminal investigations and offer expert witness for prosecution in cases of fraud or theft.

Measures to protect players should include more web-based information

The lottery provides player protection at multiple levels, including its website. Every ticket clearly explains the odds of winning a particular prize, and the prize amount. Players have a variety of ways to confirm if a ticket is a winner; they may call a hotline for winning draw numbers, check the Lottery website or a local newspaper or television broadcast, or visit any Lottery retailer. In 2006 the Lottery added additional prize verification tools for players. Ticket checkers at virtually every location allow players the opportunity to independently confirm if a drawing ticket is a winner; this ability will be expanded to include instant tickets in 2011. When a retailer validates a winning ticket, the prize amount is displayed for the player. At any time, players may visit the Lottery website to determine how many prizes remain in an instant game. The Arizona Lottery was at the forefront of lotteries who remove games from market as soon as the last top prize is claimed, ensuring once again, that every player has an equal chance of winning.

Although not traditionally considered player protection, the Lottery also provides information about problem gambling on all products and player information collateral. Funded by a \$300,000 appropriation from the Lottery's budget, the Problem Gambling Program offers resources to both gamblers and their families. Lottery products are rarely cited as a source of gambling problems, but the Lottery remains committed to ensuring resources are available.

Arizona Lottery Performance Audit Response

Finding 1: Lottery should enhance its efforts to maximize its sales and beneficiary distributions.

Audit Recommendations:

- *To maximize beneficiary distributions, the Lottery should increase sales by:*
 - a. *Assessing its own retailer data and information from other states to strategically increase both the number of retailers and the volume of retailer sales.*
 - b. *Using its market research company to collect additional information aimed at better understanding how to increase the number of players and how to motivate casual players to play more frequently, and regularly using this information as well as its marketing staff to help make decisions regarding the design and introduction of both drawing and instant games.*
- *To ensure that increased sales lead to increased beneficiary distributions, the Lottery should better manage its costs by:*
 - a. *Better managing its prize expenses by ensuring calculations based on economic theory are regularly used to optimize its existing prize structures for both instant and drawing games, and when developing any new games, and if necessary seeking outside assistance from experts who specialize in such work.*
 - b. *Ensuring it effectively manages its advertising costs by reinstating its practice of developing an annual marketing plan that is based on the effectiveness of its previous years' marketing efforts.*
 - c. *Analyzing information to that used by the South Carolina Education Lottery and regularly including in its reports to the Arizona State Lottery Commission members, such as how costs impact beneficiary distributions over time and how its costs compare to those of other comparable lotteries.*

Lottery Response:

The Lottery agrees with these recommendations, and provides the following detail.

Strategically increase both the number of retailers and the volume of retailer sales.

The Lottery has reviewed the information in LaFleur's almanac and assessed areas for improvement, identifying Arizona retail segments that have been under-developed in comparison to the national average. An important area of focus appears to be bars and restaurants. Using information from other states, information available on the State Liquor License website, and information gained by contacting individuals within the trade, the Lottery hopes to expand this important retailer category.

The Lottery continues to work with a food marketing consultant to contact corporate accounts not currently selling lottery products. The Lottery will also continue to work with its gaming vendor GTECH Corporation, who is working at a national level to recruit corporate accounts.

In FY10 the Lottery added a corporate account manager with the strategy of enhancing current corporate accounts, adding displays in smaller accounts and expanding the retail base. This approach will eventually be expanded to include all corporate accounts.

An expanded marketing/advertising budget allowed the Lottery to conduct promotional events for both players and retailers. A consistent presence at retailer locations is a key component of increasing the volume of retailer sales. In several instances, the Lottery was able to combine promotions to the benefit of both players and retailers. A recent 2by2 promotion rewarded players who purchased a \$2 ticket with a free Powerball ticket, cross-promoting products. At the same time, clerks at participating stores were entered into a drawing for a \$25 Arizona Lottery branded VISA gift card. Of the 800 clerk entries submitted, one retail chain was selected to receive a \$2,000 incentive. During the promotion period, sales of the 2by2 game increased more than 30% compared to the game's first three weeks of sales.

Arizona Lottery Performance Audit Response

Additional support is provided to retailers who also have ticket vending machines at their locations. Past promotions have rewarded retailers who kept these dispensers full, but this required a resource-intensive mystery shopping campaign by lottery staff. Earlier this fiscal year the sales department employed a different tactic by informing retailers of the commissions they were losing because dispensers were empty. While vending machine sales will always be a reflection of overall instant sales, it is worth noting that sales through vending machines grew by more than 29% in FY09 over the prior fiscal year.

Collect information to learn how to increase number of players and motivate more frequent play; use this information in the design and introduction of games.

For a number of years the Lottery has collected information about its players and their product preferences. The most consistent research consists of a monthly tracking study, which focuses on attitudinal statements such as the lottery being a good way to raise money for the State, and whether the lottery is run with honesty and integrity. In recent years, the survey has been expanded to include information about advertising recall and use of the lottery website. While players are asked about the games they play, detailed information about their play habits is not monitored.

Routine tracking studies lack the specificity the Lottery requires to determine which new products are likely to be successful. Research, most often web-based or focus groups, is conducted when potential new products are being considered. In early 2009 the Lottery considered offering a new drawing game at a \$2 price point. Since this would be a departure from the Lottery's traditional \$1 games, player research was critical to moving this concept forward. Player response indicated the \$2 price point was not a barrier, and several concepts appealed to a broad base of respondents. This research encouraged the Lottery to introduce not one, but two, new games. Each game responds to a different segment of players, one offering a lower top prize and good overall odds of winning a prize. While the second game's top prize is higher, the odds are slightly less attractive. Follow-up research conducted several months after the games' introductions substantiated the lottery's belief that both products could successfully co-exist. This research had the added benefit of pointing out that retailer and player support could be enhanced by increasing awareness of the games, especially among retailers, and by offering special game-specific promotions for both groups.

Research on both the national and local level has indicated the most potential for growth in our player base may lie with younger players. The Lottery has been able to use that information to increase its marketing activities and establishing a strong brand presence that focuses on this particular group, while still appealing to a broader range of players. The success of the above mentioned \$2 drawing games was due in part to an advertising campaign strategically designed to attract the younger market research indicated would find this product appealing.

A Scratchers segmentation study conducted earlier this year is expected to provide valuable insight on the purchasing habits of instant game players. This information is essential in determining the factors to support per capita growth.

Better manage its prize expense

While much of the audit report focuses on the impact of higher instant game expenses on beneficiary distributions, the Lottery believes reducing those payouts is not the only viable option. Drawing games have a lower payout, averaging 50% to instant games' aggregate 68%. By continuing to introduce new drawing-type games, the Lottery has an additional tool to maximize return to beneficiaries. Approximately thirty cents of every dollar in sales from drawing games is returned to beneficiaries; the return on instant games is lower, depending on the game. To assist in the growth of drawing games, the Lottery introduced two new games, CA\$H4 and 2by2. Both products were introduced at the \$2 price point, making Arizona one of the few states to successfully launch a \$2 drawing game. The Lottery also began the development of a new

Arizona Lottery Performance Audit Response

multi-state jackpot game that will be introduced in April 2010. The Lottery continues to explore new drawing game options.

In response to the audit's recommendation that the Lottery ensure its prize structure calculations are based on economic theory within lottery literature, in late February the Lottery asked the National Association of State and Provincial Lotteries (NASPL) to conduct a survey of its members regarding the "...use of economic theory in controlling prize amounts and the probability of winning." A similar survey was sent to each of the lottery's gaming products/services vendors. Several responding states contacted the Arizona Lottery directly, asking for clarification of the term "economic theory". No state responded that they specifically used economic theory; most referred to the same strategy the Arizona Lottery employs, performing analysis of past games to identify key elements likely to lead to a game's success. As the executive director of one US lottery noted in his response: *"Price, graphics, play style, product mix at retail, regional preferences and seasonality are also factors affecting the profitability of a game...the best way to optimize a prize structure is to analyze historical sales, taking into account all of the factors mentioned above."*

A leading instant game printer provided the following response: *"While we do not utilize economic models for individual prize structure development we do have the capabilities to procure an optimal prize payout analysis on behalf of the lottery which will provide them the optimum payouts by price point. This analysis is conducted by a partner Economics firm and has been performed for many of our customers. In addition to internal expertise, we maintain a [proprietary] database...which contains detailed prize structure, game attribute and sales data. With this data, we correlate prize structure characteristics to game performance to determine what works best in a given market at a given time. It's because of the information in [proprietary database] that the economist is able to perform the analysis. We supply them with the information and they use that to build their models. While we do not use economic modeling per say to develop individual prize structures, we use it to validate the overall approach we take to create them, in addition to many other types of analyses so that we can develop the best prize structure "fit" for each game in each circumstance."*

Many of the articles the audit cites regarding economic analysis in controlling prize amounts refer to the design of drawing games. For example, one topic discussed is the breakdown of game revenue designated for the jackpot prize, and how much should go to the other prizes. When a new online concept is presented, careful attention is paid to factors like the balance between jackpot and other prize amounts, with the online games vendor providing their expertise and insight. This information, coupled with the sales performance of similar games in Arizona and other lottery states, is used to determine the optimal prize payout.

The lottery has also begun to manage the impact of higher instant game payouts introduced in FY2009. Payouts for several price points are now slightly above the national average. The lottery will gradually reduce payouts at the \$1 and \$5 price points by an estimated 2%, bringing them closer to the national average. The lottery has collected sales data for these games at higher payouts; this data is key to managing the gradual reduction of payouts without a significant impact on game sales. The lottery estimates that by the end of FY11, savings of as much as \$1.8 million can be realized by reducing payouts; this translates to increased distributions to beneficiaries.

The lottery has an ongoing relationship with the WP Carey School of Business at Arizona State University. Since one of the experts identified by the auditor is affiliated with this school, the lottery will ask if conducting economic analysis of lottery products would make a good research project.

Effectively manage its advertising costs by reinstating annual marketing plan

Beginning in FY 08, the marketing plans were provided in an alternative format for easy comprehension and the flexibility of ongoing initiative adjustments. The team is currently pulling all past marketing and initiative

Arizona Lottery Performance Audit Response

presentations from 2008, 2009 and 2010 and is in the process of transferring the content into a narrative format as per audit recommendation. The Lottery requested its advertising agency vendor re-format the plans.

The goal is to have three marketing plans (2008, 2009, and 2010) in a narrative format similar to the 2007 marketing plan's information and analysis. The narrative will provide an improved overview for staff not participating in the marketing planning presentations. The traditional narrative format will continue with the planning and development of the FY11 marketing plan.

Provide additional information to the Lottery Commission

The Lottery agrees that more information should be made available to the Lottery Commission. While the auditor's report suggests sharing information about how costs impact beneficiary distributions, there may be additional items that are equally important to the Commission. The Lottery will, with the Commission's input, develop a standard reporting schedule, and append that as necessary, or at the request of the Commission.

The Lottery recognizes that it may be beneficial to provide an introductory session on the selected topics in advance of the first presentations. A similar strategy will also be employed with new Commissioners, to ensure the information provided is both useful and relevant.

Arizona Lottery Performance Audit Response

Finding 2: Lottery's game integrity and player protection measures generally match other states' efforts, but can be enhanced.

Audit Recommendations:

- 2.1 *The Lottery should continue with its plan to implement a system that allows it to track, monitor and analyze how frequently prizes of more than \$599 are claimed by retailers, and enhance its efforts by:*
 - a. *Modifying its claim forms to request whether the claimant is a retail owner, employee, or immediate family member.*
 - b. *Making the necessary programming changes to its computer system to allow it to more effectively ascertain whether claimants are lottery retail owners; and*
 - c. *Using this information to help identify retailers who should receive an investigation for claims of more than \$599.*
- 2.2 *To help address its backlog of compliance investigations, the Lottery should adopt and implement a risk-based approach for conducting compliance investigations by considering things such as findings from previous reviews, incidents reported to the Lottery, and a history of retailer winning. The Lottery should revise its policies accordingly.*
- 2.3 *The Lottery should publish player protection information on its Web site, such as measures players can take to protect themselves and their tickets from fraud, theft and lottery scams.*

Lottery Response:

The Lottery agrees with these recommendations, and provides the following detail.

Monitor prizes of more than \$599 claimed by retailers

Winner claim forms will be updated to require a response to the following question: *"I am a licensed retailer or its employee, a lottery vendor, lottery employee or family member in the same household."* Since all prizes over \$599 must be claimed at the Lottery office, claims store staff will notify the investigation staff of all claimants who respond in the positive before processing the claim. The agency's assistant attorney general has approved the inclusion of this language.

Policies and procedures will be developed in support of this change; the assistant attorney general will review these documents to determine if changes are required to either statutory or rule authority to enforce this additional requirement before prize payment.

Programming changes are also required to support the collection of this information. In the interim, security staff is using an ad hoc report to monitor social security numbers of claimants against the social security numbers of Lottery retailers. To date, no such matches have occurred, although this data is routinely collected only for claims greater than \$599.

Address backlog of compliance investigations

In February the Lottery began the process of formalizing its at-risk retailer compliance program. It is currently evaluating the tools available, since the reporting of results is as important as collecting the initial findings. It is likely that resources will be re-allocated to support this program.

Publish player protection information on the Lottery website

The process to add this information to the website is already underway. The Lottery is intent upon assuring the information is immediately apparent to website visitors, much like the help for problem gamblers that appears on virtually every page. The information will be located under the "I Won, Now What?" section and accessible via the global footer. This information will include measures that players can take to protect themselves and their tickets from fraud, theft and lottery scams. This content is consistent with the "PLAY SAFE" brochure developed by the Arizona Lottery Security Department along with industry best practices.

Arizona Lottery Performance Audit Response

Conclusion

The Lottery believes the performance audit process has yielded benefits beyond the agency's expectations. The audit's findings and the resulting recommendations reflect areas where the Lottery was already at work. The insight of the Auditor General's staff not only supports the Lottery's approach to increasing sales and beneficiary distributions, it also provides a valuable, independent review of our long-range strategy.

The Arizona Lottery is grateful for the assistance of the Auditor General's staff over the past eleven months. As we move forward with our annual strategic planning process, we are fortunate that the audit recommendations, and our responses, have already created a framework upon which to build a plan focused on the increased importance of the agency's mission to maximize revenue for State programs.

Arizona Lottery Performance Audit Response: Implementation Schedule

Implementation Date	Recommendation	Comments
7/10	Finding 1: Increase number of Lottery retailers <ul style="list-style-type: none"> • Review lottery's own retailer data • Review data from other lottery states 	<ul style="list-style-type: none"> • Focus on underperforming category: bars/restaurants • Gather information on estimated 14,000 licensees from State Liquor Department; develop customized recruitment strategy • Contact non-traditional retail organizations like the Arizona Restaurant Association • Continue work with outside consultation team to contact corporate accounts who are not lottery retailers • Continue work with GTECH national corporate account team in support of recruiting national chain retailers • Review information in the LaFleur's almanac; evaluate industry best practices and develop implementation strategy
7/10	Finding 1: Increase volume of retailer sales <ul style="list-style-type: none"> • Review lottery's own retailer data • Review data from other lottery states 	<ul style="list-style-type: none"> • Continue efforts to educate corporate retailers on potential increased revenue by reducing inventory out-of-stock • Increase secondary dispenser locations in current retailers • Continue to execute three-tiered promotions strategy, targeting customers, corporate participation and reaching the point of sale (clerk) level. • Align Sales Rep incentive to reflect agency product initiatives • Gather and evaluate information on best practices from vendors, research questionnaires, NASPL information, and standard industry publications.
7/10	Finding 1: Collect information to increase number of players and frequency of play <ul style="list-style-type: none"> • Best practices to expand the player base • How to motivate more frequent play • Game design targeted to new players 	<ul style="list-style-type: none"> • Attract interest from specific audience segments by increasing marketing activities • Establish a stronger brand presence with increased visibility • Introduce new products to the market on a more frequent basis • Expand use of routine, player-focused research • Report/present findings to all team to ensure cross-function communication and implementation • Implement results of Scratchers segmentation study in instant game design/predictive tool • Include segmentation study results in game performance analysis • Add question about first purchase to monthly tracking study

Arizona Lottery Performance Audit Response: Implementation Schedule

		<ul style="list-style-type: none"> • Add quarterly research to track new players • Use instant player segmentation in future research recruitments • Research elements of segmentation study: use of merchandise and second-chance drawings
7/10—12/10	<p>Finding 1: Better manage prize expense by using economic theory to optimize prize structures</p> <ul style="list-style-type: none"> • Ensure these calculations are used to optimize game design • Seek assistance from experts in this field 	<ul style="list-style-type: none"> • Contact WP Carey School of Business regarding economic theory/review of lottery prizes structures as research project • Manage the impact of higher instant game payouts introduced in FY2009 • Gradually reduce payouts at the \$1 price point by 2% and \$5 price points by an estimated 2%. Savings estimated to be \$1.8M in FY11 • Manage gradual reduction of payouts without a significant impact on game sales; report impact FY11, first quarter. • Continue to develop new online games to balance expense/distribution rates of instant and drawing product lines
7/10	<p>Finding 1: Reinstate annual marketing plan</p>	<ul style="list-style-type: none"> • Lottery goal is to have three marketing plans (2008, 2009, 2010) in a narrative format such as the 2007 marketing plan reflecting similar information and analysis. The narrative will provide an improved overview for those team members not participating in the marketing planning presentations • Involve advertising agency vendor to assist in re-formatting plans. • Additional narrative format will continue with the planning and development of the FY11 marketing plan
8/10	<p>Finding 1: Provide additional information regarding sales and distributions to Lottery Commission</p>	<ul style="list-style-type: none"> • Survey Commission on items from other lottery’s agendas • Survey Commission on other suggestions • Survey staff leadership for suggestions • Implement new reports. Changes will be implemented with first meeting of new fiscal year. If applicable, year-end reporting for FY 2010 will reflect requested changes.
5/10	<p>Finding 2: Modify claim form</p>	<ul style="list-style-type: none"> • Revise form and supporting programs • Create policy and procedures

Arizona Lottery Performance Audit Response: Implementation Schedule

		<ul style="list-style-type: none"> • Request legal review • Provide staff training
7/10	Finding 2: Address investigations backlog	<ul style="list-style-type: none"> • Formalize at-risk program • Create policy and procedures • Evaluate resource allocation • Provide staff training
5/10	Finding 2: Add player protection info to website	<ul style="list-style-type: none"> • Determine where to add player protection information on the Arizona Lottery website. This information will include measures that players can take to protect themselves and their tickets from fraud, theft and lottery scams.

Performance Audit Division reports issued within the last 24 months

08-01	Electric Competition	09-05	State Compensation Fund
08-02	Arizona's Universities— Technology Transfer Programs	09-06	Gila County Transportation Excise Tax
08-03	Arizona's Universities—Capital Project Financing	09-07	Department of Health Services, Division of Behavioral Health Services—Substance Abuse Treatment Programs
08-04	Arizona's Universities— Information Technology Security	09-08	Arizona Department of Liquor Licenses and Control
08-05	Arizona Biomedical Research Commission	09-09	Arizona Department of Juvenile Corrections—Suicide Prevention and Violence and Abuse Reduction Efforts
08-06	Board of Podiatry Examiners	09-10	Arizona Department of Juvenile Corrections—Sunset Factors
09-01	Department of Health Services, Division of Licensing Services— Healthcare and Child Care Facility Licensing Fees	09-11	Department of Health Services—Sunset Factors
09-02	Arizona Department of Juvenile Corrections—Rehabilitation and Community Re-entry Programs	10-01	Office of Pest Management— Restructuring
09-03	Maricopa County Special Health Care District	10-02	Department of Public Safety— Photo Enforcement Program
09-04	Arizona Sports and Tourism Authority		

Future Performance Audit Division reports

Arizona Department of Agriculture—Food Safety and Quality Assurance Inspection
Programs