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DEPUTY AUDITOR GENERAL

December 23, 2011

The Honorable Rick Murphy, Chair
Joint Legislative Audit Committee

The Honorable Carl Seel, Vice Chair
Joint Legislative Audit Committee

Dear Senator Murphy and Representative Seel:

Our Office has recently completed an 18-month followup of the Arizona State Lottery Commission (Commission) and Arizona State Lottery (Lottery) regarding the implementation status of the 10 audit recommendations (including sub-parts of the recommendations) presented in the performance audit report released in March 2010 (Auditor General Report No. 10-03). As the attached grid indicates:

- 8 have been implemented, and
- 2 are in the process of being implemented.

Unless otherwise directed by the Joint Legislative Audit Committee, this concludes our follow-up work on the Commission's efforts to implement the recommendations from the March 2010 performance audit report.

Sincerely,

Dale Chapman, Director
Performance Audit Division

DC:sjs
Attachment

cc: Jeff Hatch-Miller, Executive Director
Arizona State Lottery

Jeffrey Boehm, Chair
Arizona State Lottery Commission

Arizona State Lottery Commission and Arizona State Lottery Auditor General Report No. 10-03 18-Month Follow-Up Report

Recommendation

Status/Additional Explanation

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

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	Implemented at 18 months
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.	Implemented at 18 months
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;	Implementation in process The Lottery has begun to effectively manage its prize expenses by forecasting sales and prize expenses to analyze the effect of modifying prize distributions for \$1 and \$5 instant games. However, the Lottery has yet to conduct these forecasts and analyses for its other instant and online games. The Lottery also has not demonstrated that it is optimizing prize structures by setting them at the lowest possible amount that still encourages play and maximizes beneficiary distributions. The Lottery has sought outside assistance from experts to assist with optimizing prize payouts for instant games and reported that an internal committee will likely recommend game modifications for its drawing games.
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	Implemented at 18 months

Recommendation**Status/Additional Explanation**

- 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.
- Implemented at 18 months**

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

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;
- Implemented at 6 months**
- b. Making the necessary programming changes to its computer system to allow it to more effectively ascertain whether claimants are retail owners; and
- Implemented at 6 months**
- c. Using this information to help identify retailers who should receive an investigation for claims of more than \$599.
- Implemented at 6 months**

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.

Implementation in Process

The Lottery has taken steps to address its backlog of compliance investigations by increasing the amount of time between mandatory compliance checks, and developing the tracking and reporting tools needed to implement a risk-based approach. However, the Lottery reported that the risk-based approach will not be fully implemented until January 2012.

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.

Implemented at 6 months
