

December 2003

A Review of the SC Education Lottery and the State's Use of Lottery Proceeds



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LAC

Report to the General Assembly

**A Review of the
SC Education Lottery
and the State's Use of
Lottery Proceeds**

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Synopsis

Members of the General Assembly requested the Legislative Audit Council to conduct an audit of the South Carolina Education Lottery (SCEL). We reviewed general management controls at the lottery and issues involving retailers. We also reviewed the distribution and use of lottery proceeds by several state agencies to ensure that funds in the education lottery account are spent in accordance with the law.

Lottery Operations

We found that overall the SCEL has instituted adequate management controls and has taken steps to limit administrative costs. In some areas, we have recommendations for improvements in lottery operations.

- The SCEL has made appropriate efforts to control administrative costs, which have been less than the 15% allowed by law. We identified two areas, cellular phones and vehicle use, where the lottery could further cut costs, resulting in more revenue for education. The SCEL could reduce the number of cellular phones provided to employees who have primarily administrative desk jobs in the main office. Also, the lottery could obtain additional savings from re-evaluating its use of vehicles.
- We reviewed the lottery's management of its contracts, including its advertising and gaming contracts. Generally we found that the lottery has adequate controls. However, in one case, the South Carolina Law Enforcement Division (SLED) has provided services to the lottery without a written contract.
- The SCEL does not have a formal system of measuring results throughout the organization. The lottery measures its performance by meeting or exceeding its revenue goal. While revenue is a key indicator of the lottery's performance, it is not the only area in the organization that should be monitored for results.
- We reviewed the S.C. Education Lottery Act and lottery operations to identify amendments to the statutes that could be beneficial to the state. We found that some of the restrictions on advertising could be changed to reduce costs and increase lottery sales. Also, the lottery is restricted from competitively procuring communication services. The use of a competitive procurement method helps to ensure that the providers selected are cost-effective and of high quality.
- Our review of retailer licensing files indicated that the SCEL has appropriate controls over the licensing process. We also noted that the lottery has experienced a low percentage of outstanding debt by retailers.

However, the lottery should update its licensing policies and procedures regularly, and should implement a written policy on the use of the fidelity fund for uncollectible debts.

- We did not find problems in the area of retailer recruitment and retention. Evidence indicated that most retailer terminations were because the retailer was not making anticipated profits. The rate of compensation paid to lottery retailers in South Carolina (7%) is higher than average, ranking 7th out of 39 lotteries.
- The lottery has a good system of controls over prize payments; however, an independent review of policy compliance would strengthen these controls. Also, the General Assembly should consider lowering the threshold (currently \$5,000) at which the lottery must withhold debts owed to the state.

Use of Lottery Proceeds

Lottery funds have been distributed to a variety of programs as directed by the General Assembly. Higher education scholarships have been the largest beneficiary. Controls to ensure the appropriate use of these funds are uneven and still being established.

- Generally, lottery proceeds have been used as required by law. However, in some cases the General Assembly released agencies from the statutory requirements due to the state's budget situation. The state's school districts and South Carolina State University were allowed to use lottery funds for general operating purposes.
- We found that controls over the use of lottery funds are uneven and still being established. For example, lottery-funded scholarships are subject to a system of audits and controls that are already established. However, some agencies have not yet instituted appropriate controls. The State Auditor's office is directed by the FY 03-04 appropriations act to ensure that agencies receiving lottery funds have appropriate controls.
- Some lottery funds have not been used in a timely manner. For example, using the first \$1 million in unclaimed prize funds, the Budget and Control Board was required by state law to contract for services assisting in the prevention and treatment of gambling disorders. However, although funds have been available since November 2002, as of August 2003, these contracts had not yet been awarded.

Introduction

Audit Objectives

Members of the General Assembly requested the Legislative Audit Council to conduct an audit of the South Carolina Education Lottery (SCEL). Since the lottery's operations just began in FY 01-02, it was appropriate to review general management controls. The requesters also raised some concerns about lottery retailers and their compensation. Finally, we reviewed controls to ensure that lottery proceeds for education are spent as the General Assembly intended. This is not the responsibility of the SCEL, but of other agencies designated by the General Assembly. Our specific fieldwork objectives are listed below.

- Review the lottery's administrative expenditures and determine whether there are opportunities for cost savings.
- Review the lottery's contracts and contract management to determine whether they have adequate controls to ensure cost-effective vendor performance.
- Review the lottery's performance measures and benchmarks to determine whether they are appropriate and how they compare to those in other states.
- Review suggested changes in the statutes governing the lottery to determine whether they would be beneficial.
- Determine whether the lottery has adequate controls to ensure that retailers are licensed appropriately and that they comply with the law.
- Review retailer compensation and retention to determine the adequacy of provisions for retailers.
- Review controls over the payment of prizes to ensure proper accountability for winners.
- Review the expenditure of funds from the education lottery account to determine whether they have been spent in compliance with the law.

Scope and Methodology

The audit focused on the South Carolina Education Lottery, the agency charged with administering the lottery. We reviewed most aspects of the SCEL's management with the exception of its security procedures. S.C. Code §59-150-320(8) authorizes the LAC to contract with an independent firm to conduct a comprehensive study of all aspects of the lottery's security. We also reviewed the disposition of lottery proceeds by several state agencies that must ensure that funds in the education lottery account are spent in accordance with the law. The period of review began with the lottery's creation in FY 01-02 and continued through FY 02-03 or the most recent period for which data was available.

We conducted interviews with lottery officials and officials with other state agencies. We consulted a variety of sources of information at the lottery including the following:

- Accounting and financial records.
- Contracts and procurement records.
- Retailer licensing records.
- Prize distribution records.
- Personnel records.
- Policies and procedures.
- Meeting minutes.
- Reports from consultants, auditors, and other external sources.

We reviewed financial and accounting records and audit reports from the agencies charged with disbursing lottery funds. We also obtained and reviewed information about lotteries in other states, primarily from *La Fleur's World Lottery Almanac* and materials published by the North American Association of State and Provincial Lotteries.

We measured the lottery's performance against the South Carolina statutes that established the lottery and general criteria for the establishment of appropriate internal controls. We also considered other states' experience as criteria where relevant. We performed nonstatistical sampling in our review of retailer licensing, controls over prizes, and administrative and contract expenditures. We also used limited sampling of vouchers in our review of the distribution of lottery funds. We used information that we did not verify, but this information was not central to our audit objectives. When this information was viewed in context with other available evidence, we believe that opinions, conclusions, and recommendations in this report are valid.

This audit was conducted in accordance with generally accepted government auditing standards with the exception of the general standard concerning quality control. Due to LAC budget reductions, funding was not available for a timely external quality control review. In our opinion, this omission had no effect on the results of the audit.

Background

The South Carolina Education Lottery (SCEL) provides funding for education in South Carolina through the sale of various types of instant and online games. Created by the South Carolina Education Lottery Act, the lottery began selling tickets in January 2002. The legislation that created the lottery also established a governing board of nine members appointed for three-year terms. Three commissioners are appointed by the governor, three by the President Pro Tempore of the Senate, and three by the Speaker of the House of Representatives.

SCEL is a quasi-state agency; it does not receive appropriations from the General Assembly but generates its own funds through the sale of lottery products. As of June 30, 2003, the lottery had 129 employees and 3,545 retailers selling tickets. The headquarters are located in downtown Columbia. The lottery also has three regional claim centers located in Columbia, Greenville, and Mount Pleasant, and three warehouses.

The SCEL offers two types of games —

INSTANT TICKETS

The player scratches a latex-covered section to reveal the play area. The player then reads the instructions to find out if he is a winner. The lottery regularly develops new instant ticket games. In FY 02-03, the lottery introduced 39 instant ticket games, such as Harley Davidson, Cash Explosion, and Super 7's.

ONLINE GAMES

The player selects a set amount of numbers, depending on the game, or marks the “quick pick” box which will cause the numbers to be selected at random by a computer terminal. The games have set dates and times when winning numbers are selected, and players win by matching some or all of the numbers. The online games in South Carolina are Pick 3, Pick 4, Carolina 5, and Powerball. Powerball is the only multi-state game offered in South Carolina, and there are 26 states that participate in this online game.

Table 1.1 and Chart 1.2 show the sales generated by each type of game for FY 02-03.

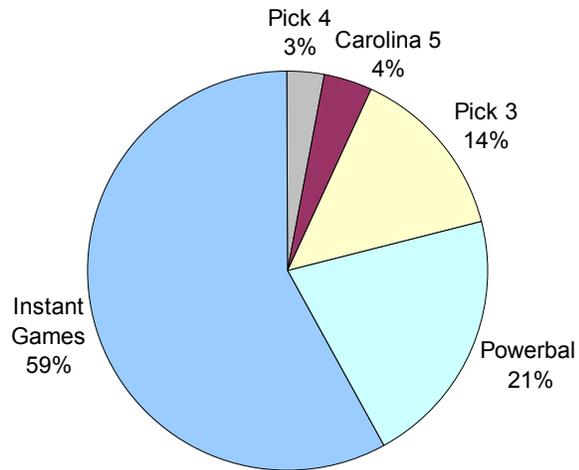
Table 1.1: FY 02-03 Lottery Game Sales

GAME	SALES	PERCENT
Instant Games	\$426,311,967	59%
Powerball	153,849,870	21%
Pick 3	99,076,360	14%
Carolina 5	25,584,634	4%
Pick 4	19,490,444	3%
TOTAL	\$724,313,275	100%

Source: South Carolina Education Lottery

Most (80%) of the lottery's revenue comes from instant tickets and Powerball.

Chart 1.2: FY 02-03 Lottery Game Sales as Percent of Total Sales



Source: South Carolina Education Lottery

The lottery has estimated its sales from games for FY 03-04 will be \$709 million, a 2% decrease from the \$724 million in sales in FY 02-03. According to a lottery official, they do not include revenues from potential large Powerball jackpots in their projections, because these events are unpredictable. The proceeds from lottery games are used to supplement education funds, pay for prizes, retailer commissions, and the operating expenses of the lottery. Table 1.3 and Chart 1.4 show the distribution of these funds for FY 02-03.

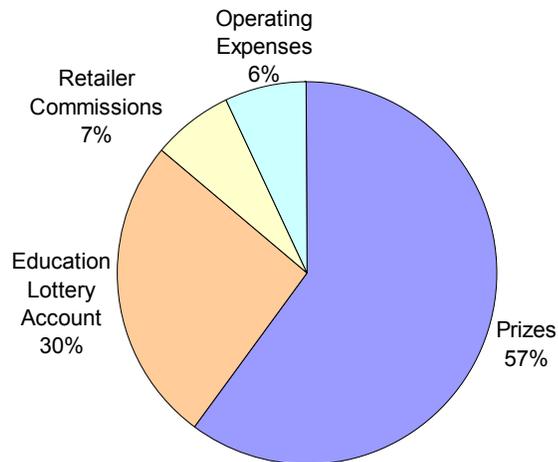
Table 1.3: FY 02-03 Lottery Expenditures

LOTTERY EXPENDITURES	AMOUNT	PERCENT
Prizes	\$415,717,255	57%
Education Lottery Account (including unclaimed prizes)	\$220,056,527	30%
Retailer Commissions	\$51,136,250	7%
Operating Expenses	\$40,990,341	6%
TOTAL	\$727,900,373	100%

Source: South Carolina Education Lottery

Once it transfers funds to the education lottery account, SCEL is not responsible for distributing them. This responsibility belongs to the state. The General Assembly determines exactly how the funds are to be used in its annual appropriations (see p. 31). Of the amount allocated for prizes, \$7,261,823 was unclaimed, so it was transferred to the education lottery account as required by law.

Chart 1.4: FY 02-03 Lottery Expenditures



Source: South Carolina Education Lottery

Chapter 1
Introduction

Administrative Management

Administrative Expenses

S.C. Code §59-150-350(A) states that the South Carolina Education Lottery's (SCEL) annual administrative expenditures should not exceed 15% of total revenues. The law defines administrative expenditures to include all costs of doing business except for prizes and the retailer fidelity fund (see p. 22). Commissions to retailers, 7% of revenues, are included in administrative expenditures, which leaves 8% for other expenses. These expenses include advertising, the costs associated with the operation of games, employees' salaries and benefits, office equipment, and leased space. For FY 01-02, the lottery's administrative expenditures (\$49,177,752) were 14.6% of total revenues, and in FY 02-03 SCEL's administrative expenditures (\$92,126,591) were 12.6% of total revenues. Expenditures in both fiscal years were less than the 15% allowed by law.

Overall, we found that the SCEL has made appropriate efforts to control administrative costs. We identified two areas, cell phones and vehicle use, where the lottery could further cut costs, resulting in more revenues for education.

Lottery Cost Controls

We determined how the lottery decided what to purchase and sampled vouchers in several areas:

- Travel.
- Equipment.
- Supplies.
- Promotional expenses.
- Dues and memberships.
- Education and training.
- Employee recognition.
- Miscellaneous expenditures.

The lottery has not yet completed its job classification and compensation study and, as recently as April 2003, implemented staff reorganization. Therefore, we did not perform a detailed review of SCEL salaries in this audit.

For some types of expenses, such as office space and salaries, the lottery's board obtained a report from a consultant and data from other states to help establish its level of staffing and office space needs and to estimate other start-up costs. The SCEL performed cost analyses to determine the most cost-effective way to administer payroll and whether to lease or purchase office equipment.

We found that SCEL often asked employees to document and justify expenditures:

- The lottery has adopted state travel regulations for its employee travel. To limit travel costs, the lottery requires all staff to submit justifications for travel prior to the trip. The employee must fill out a form explaining why the trip is necessary and provide a detailed estimate of travel costs.
- The marketing department has kept an informal record of promotional events so they will know exactly what was used and distributed at these events.

We found other evidence that the lottery has attempted to control administrative costs:

- The majority of the furnishings at the lottery were purchased through the Department of Corrections' prison industries program. In one instance, the executive director asked that the SCEL return some expensive office furniture that was purchased from a local retailer.
- During our audit the lottery decided to stop the coffee and water service which provided refreshments to employees and visitors free of charge. The lottery had spent \$116 per month for this service.
- The lottery is a member of the state's training consortium, which is a group of state agencies that share training resources to minimize costs. As of April 2003, SCEL employees have attended 120 training courses through the consortium; 77 of these were conducted at the lottery.

In addition, lottery controls were tested when its staff identified a problem with the use of gift certificates as incentives for retailers (see p. 23). In August 2003, a lottery employee was charged with taking gift certificates for personal use.

Cell Phones

The lottery could reduce the number of cell phones provided to employees. SCEL has 86 active cell phones purchased through one provider. The lottery pays \$67.50 per cell phone each month for access, which totals approximately \$5,800 per month. The lottery also pays fees for roaming and a directory assistance service.

Usage

For some employees, such as the 38 marketing and sales representatives (MSRs) who visit retailers all around the state, the use of a cell phone could improve job efficiency and performance. However, the lottery has issued cell phones to many employees who have administrative desk jobs in the main office. We could not determine any reason why these employees would need a cell phone to perform their jobs. One official noted that the cell phones are beneficial because if there were an emergency, staff could be contacted during a weekend. However, other agencies have ways to contact staff in the case of emergencies without providing a cell phone.

We also found that many of the phones were not frequently used. From November 2002 through March 2003, there were eight phones that had less than 100 minutes used each month, including four that averaged 0 minutes per month. We estimate that the lottery could reduce the number of cell phones by at least 30, which would yield an annual savings of more than \$24,000. The lottery should reevaluate its employees' need for cell phones.

Policies and Procedures

The lottery's policies and procedures did not address personal use of cell phones, reimbursement to the state for personal calls, or the use of optional services such as directory assistance. State-owned cellular phones should be used to conduct work-related business only. Furthermore, personal use should be restricted to emergencies, and in the cases where it is necessary, should be reimbursed. The directory assistance service costs \$1.25 per call. According to a staff member, the lottery tells employees to limit use of this service to emergencies only. We found an instance where one employee accrued \$34 in directory assistance charges in one month. Therefore, if employees abuse this service it could become costly for the agency.

As of October 2003, the SCEL updated its policy and procedures manual to address the problems we identified.

Recommendations

1. The South Carolina Education Lottery should reduce the number of cell phones provided to employees.
2. The South Carolina Education Lottery should continue to monitor the use and costs associated with its cell phones.

Leased Cars

The South Carolina Education Lottery could obtain additional savings from re-evaluating its use of vehicles. In some cases, the lottery reimburses employees that travel frequently for the use of their personal cars when it would be more cost-effective to provide a leased vehicle for them. In other cases, the lottery leases vehicles for staff located primarily in the main office, and the usage of these cars has been low. It would be more cost-effective to reimburse these employees for using their personal automobiles rather than assigning them a leased car.

The lottery should consider providing its marketing and sales representatives (MSRs) with leased cars to reduce administrative costs. These employees work primarily from their cars and submit mileage which the lottery reimburses. In FY 01-02 the lottery spent approximately \$207,000 to reimburse the MSRs for use of their personally-owned vehicles. Based on a standard developed by the Budget and Control Board, an SCEL analysis found that it would be more cost-effective to provide 26 lottery employees with leased cars. Agency officials decided that since several MSRs had purchased new cars to perform their duties, they would wait three years before assigning state-owned vehicles to the employees. The lottery reserved the right to supply leased cars for those employees who had not purchased new cars, but as of May 2003, none had been provided.

From January 2002 through March 2003, SCEL leased 12 state-owned cars from the Budget and Control Board for a cost of \$97,773. The lottery spent an average of 41¢ per mile for the 12 cars it leased, with 10 of these cars costing more per mile than the 34.5¢ the state reimburses employees for using their personal automobiles. The lottery spent as much as 92¢ to \$1 per mile for two of these cars. SCEL spent approximately \$16,000 more for the leased vehicles than if it reimbursed employees. The lottery should only lease vehicles when the cost of doing so is less than reimbursing employees for the use of their own vehicles.

Recommendations

3. The South Carolina Education Lottery should consider providing state-owned leased cars to employees when it would be more cost-effective.
4. The South Carolina Education Lottery should not provide state vehicles to its employees when it would be less expensive to reimburse them for use of their own vehicles.

Other States' Administrative Costs

We compared the SCEL's administrative expenses to those of 19 other southeastern states and those whose lottery expenditures are similar to South Carolina's. We found that the 20 states averaged 14.9% in administrative expenditures for FY 01-02. Table 2.1 shows that all of the states with smaller percentages for administrative costs had more revenues than South Carolina. According to an SCEL official, lotteries with high revenues generally have a lower percentage of administrative costs because of fixed costs and economies of scale. Furthermore, some states' retailer commissions were lower than South Carolina's rate of 7%, which allowed these states more funds for other expenses (see p. 27).

Table 2.1: Comparing Other States' Lotteries' Administrative Expenditures to the South Carolina Education Lottery's Administrative Expenditures, FY 01-02

STATE	FY 01-02 LOTTERY REVENUES (MILLIONS)	ADMINISTRATIVE EXPENSES AS % OF TOTAL REVENUES	RETAILER COMMISSIONS AS % OF TOTAL REVENUES	TOTAL ADMINISTRATIVE EXPENDITURES AS % OF TOTAL REVENUES
NEW MEXICO	\$134.0	13.7%	7.1%	20.8%
IOWA	\$181.2	14.1%	6.3%	20.4%
MINNESOTA	\$377.4	13.2%	6.3%	19.5%
KANSAS	\$190.1	11.7%	5.7%	17.4%
OREGON*	\$816.9	8.3%	8.8%	17.1%
WEST VIRGINIA*	\$848.6	10.5%	5.8%	16.3%
ARIZONA	\$294.8	9.4%	6.8%	16.2%
COLORADO	\$408.0	7.8%	7.4%	15.2%
LOUISIANA	\$311.6	9.8%	5.1%	14.9%
WISCONSIN	\$427.6	7.8%	7.0%	14.8%
SOUTH CAROLINA**	\$337.2	7.6%	7.0%	14.6%
INDIANA	\$626.3	7.4%	6.9%	14.3%
KENTUCKY	\$638.7	7.4%	6.2%	13.6%
MISSOURI	\$585.2	7.3%	6.3%	13.6%
WASHINGTON	\$438.6	7.5%	5.9%	13.4%
GEORGIA	\$2,449.4	5.7%	7.0%	12.7%
VIRGINIA	\$1,108.1	6.7%	5.6%	12.3%
FLORIDA	\$2,330.4	5.1%	5.5%	10.6%
MARYLAND	\$1,306.6	3.8%	6.5%	10.3%
CONNECTICUT	\$907.9	4.3%	5.7%	10.0%
AVERAGE	\$735.1	8.5%	6.4%	14.9%

* Oregon and West Virginia have Video Lottery Terminals, player-activated lottery games, but we only include data about their traditional lottery.
 ** Includes SCEL start-up costs (ticket sales began in January 2002).

Source: National Association of State and Provincial Lotteries, La Fleur's 2003 World Lottery Almanac, and SCEL

Contracts

We reviewed the lottery’s management of its contracts to ensure that there are adequate controls for cost-effective vendor performance. We found that the lottery had adequate controls over its contracts. However, in one case, the South Carolina Law Enforcement Division (SLED) has provided services to the lottery without an agreement where a written contract is needed.

Our review focused on the lottery’s primary contracts, those concerning the main functions of the lottery — gaming and advertising (see Table 2.2). We did not find material problems with the procurement or administration of these contracts.

Table 2.2: Lottery Contracts Reviewed by LAC

CONTRACTOR	TYPE OF CONTRACT	INITIAL TERM	AMOUNT SPENT FROM 8/01–3/03
Scientific Games	Instant Tickets*	3 years	\$35.2 million
	Online Games	5 years	
Chernoff Newman Silver Gregory	Advertising and Marketing Services	2 years	\$11.9 million
Battelle Memorial Institute	Gaming Consultant	1 year beginning 1/1/03	\$190,000

* Includes warehousing and distribution of tickets.

Source: South Carolina Education Lottery

Advertising and Marketing Services Contract

S.C. Code §59-150-60(A)(18) authorizes the SCEL to “advertise and promote the lottery and lottery games...” From January 2003 through June 2003, the lottery budgeted approximately \$3.4 million for advertising expenses. Table 2.3 shows how these funds had been spent as of June 2003.

Table 2.3: Advertising Expenses From January 2003 – June 2003

ITEM	EXPENDITURES	PERCENT
Media Placement of Advertising	\$1,866,399	56%
Production of Advertising	677,125	20%
Monthly Retainer	495,000	15%
Special Events, Sponsorships, Research	231,400	7%
Media Commission	49,532	2%
TOTAL	\$3,319,456	100%

Source: South Carolina Education Lottery

The lottery is required by law to follow the state procurement code and used the procurement process to contract for advertising and marketing services. Chernoff Newman Silver Gregory (CNSG) was selected as the advertising agency. The primary responsibility of CNSG is to develop advertising programs and provide marketing services for the lottery. The services provided by the agency include:

- Creation, production, and purchase of all advertising materials for print, broadcast, Internet, and other media.
- Collaboration with the lottery to develop comprehensive plans to promote all lottery products.
- Purchase of goods and services associated with advertising programs and marketing services.

The advertising agency is paid a monthly retainer of \$82,500 and a 2.7% commission on media placements. Also, the lottery pays CNSG for the cost of goods and services related to advertising that it has procured on behalf of the lottery.

We reviewed invoices paid to CNSG which represented approximately 10% of the \$11.9 million paid to the agency from August 2001 through March 2003. We did not identify any expenditures related to the advertising contract that were inappropriate. However, some of the costs associated with advertising are substantial. Some of the items paid for included:

- \$173,800 for fees and expenses for an actor to participate in six days of lottery ad production.
- \$74,844 for American Express gift checks to give as promotions to lottery retailers.
- \$2,023 for a first-class plane ticket from Los Angeles to Columbia for a lottery game show host.

Scientific Games Contracts

The lottery has two contracts with Scientific Games International, Inc. (Sci Games) — instant tickets and online games. We identified no inappropriate expenditures under the contract. The three-year contract for instant tickets includes the manufacture of instant tickets, warehousing and distribution of the tickets, and marketing support services. The cost of the tickets is based on the size and number of tickets ordered. The lottery pays \$104,500 per month for warehousing services in the Columbia area. The charges to deliver tickets to retailers vary based on the size of the delivery.

The online contract requires a validation system for the instant tickets, a system with equipment for the online games, and various support functions. The five-year contract requires a subcontractor to provide an internal control system to monitor the games and ensure their integrity. The lottery pays the following for Sci Games services:

- Monthly administrative fees ranging from \$450,000 to \$590,000.
- Paper costs estimated to be \$88,148 per month.
- Telecommunication costs estimated in the contract at \$207,144 per month.
- Computer system and SCEL terminals for \$5,287,938 (one-time).
- 3235 Extrema retailer terminals for \$5,270,000 (one-time).

We reviewed a sample of invoices paid to Sci Games for both contracts. The lottery investigated several of the charges and verified their accuracy before paying them.

The Sci Games contracts allow the lottery to receive damages for specific instances of performance failure. As of June 2003, the lottery has exercised this option once during the contract term. Sci Games was charged \$2,000 for a delay in the availability of an online game for testing. Additionally the lottery's information technology staff has audited Sci Games' compliance with the contract and maintains a log of any incidents that occur along with their resolutions.

Battelle Contract

Battelle Memorial Institute is a non-profit entity that provides testing, evaluating, and consulting for online gaming systems. The lottery contracts with Battelle to test most of its online games before they are launched to the public. The current contract with Battelle provides that its staff will be paid an hourly rate plus expenses. The total amount of the contract is not to exceed \$144,500. We reviewed a sample of invoices paid to Battelle and identified no inappropriate expenditures.

SLED Services

We also reviewed other expenditures of the lottery to determine if the services should have been obtained under contract. We found that the lottery has received services from SLED based on an unwritten agreement. SLED has assigned three officers to investigate crimes associated with the lottery. A lieutenant supervises these officers, but his services are provided at no charge to the lottery. However, the lottery does pay for his cell phone (see p. 8). SLED bills the lottery quarterly for these officers' salaries and expenses. The

recurring costs are approximately \$45,000 every three months. The expenses include gas, beepers, radio service, and a clothing allowance. The lottery also paid more than \$36,000 for the equipment for the officers (see Table 2.4).

Table 2.4: One-Time Expenses for Equipment for SLED Officers in May 2002

ITEM	TOTAL COST
Mobile and hand-held radios	\$30,000
Greens, boots, rain gear, protective gloves	2,040
Protective vest and cover	1,800
Glock, duty belt, holster	1,725
Shotgun	750
TOTAL	\$36,315

Source: South Carolina Education Lottery

From August 2001 through March 2003, the lottery paid SLED \$399,274. This includes the cost of criminal record background checks on lottery retailers and investigations of lottery vendors. The lottery is required by state law to conduct these checks. However, we could not identify any requirement in state law that the lottery pay SLED to investigate violations of the lottery's laws. Without an agreement concerning the duties of the officers and costs of the services, the lottery has no control over these expenditures or the quality of these services.

Recommendation

5. The South Carolina Education Lottery should have a formal written contract with the State Law Enforcement Division to provide investigative services.

Performance Measures

We reviewed performance measures at the South Carolina Education Lottery and found that it does not have a formal system of measuring results throughout the organization. The lottery measures its performance by meeting or exceeding its internally developed revenue goal. While revenue is a key indicator of the lottery's performance, it is not the only area in the organization that should be monitored for results.

For FY 02-03, the SCEL had a goal of \$615 million in total sales. The lottery achieved sales of \$724 million and exceeded its goal by \$109 million (18%). According to SCEL officials, this is the main performance measure for the lottery, and all strategies and objectives lead back to this goal. The lottery

does have strategic business plans that lay out strategies for development and improvement of the lottery. However, these plans do not provide a way to measure results throughout the organization.

Many successful South Carolina companies systematically measure their performance. These companies and other organizations measure and monitor their performance in many areas, including the following:

- Customer satisfaction.
- Mission accomplishment.
- Employee satisfaction, involvement, and development.
- Supplier/contractor/partner performance.
- Regulatory/legal compliance.
- Financial performance.

State agencies are required by state law to produce annual accountability reports that detail their performance in many of these categories. The SCEL is required by S.C. Code §59-150-320(1) to publish an annual report. This report should include measures of performance throughout the organization.

Performance Measures in Other States

We found that both the Texas and Florida lotteries have formal outcome and output performance standards. These lotteries have revenue goals and additional measures used by different departments. Some of the key measures reviewed by these states include:

- State revenue received per advertising dollar expended.
- Number of retailer business locations licensed.
- Average cost per retailer location license issued.
- Number of lottery complaints resolved.
- Average cost per complaint resolved.
- Total revenue transferred to the state.
- Level of operating expenses.

The SCEL could use these lotteries as benchmarks in developing its own performance measures.

Performance measures are an integral part of a strong accountability system. This system enables managers, the General Assembly, and the public to assess the organization's performance. The measures allow management to modify practices and improve outcomes if problems are noted.

Recommendation

6. The South Carolina Education Lottery should develop performance measures for all departments and include these measures in its annual report.
-

Recommended Statutory Changes

We reviewed the South Carolina Education Lottery Act and the operations of the lottery to identify any amendments to the statutes that could be beneficial to the state. We found that some of the advertising restrictions could be changed to reduce costs and increase lottery sales. We also identified an unnecessary restriction in procurement that may result in higher costs.

In February 2003, the lottery conducted an internal review of its legislation to identify areas where changes would be desirable. The lottery staff recommended substantive changes discussed below, as well as several technical changes to “clean up” the wording or eliminate outdated provisions. The staff recommendations were approved unanimously by the lottery commission in February 2003 and forwarded to the Lottery Oversight Committee. S.C. Code §59-150-325(A)(2) gives the committee the authority to propose changes to state law “to rectify undesirable conditions in connection with the administration or operation of the lottery.” However, the amendments were not proposed to the General Assembly during the 2003 session.

Advertising Restrictions

S.C. Code §59-150-60(A)(18) requires that the amount spent on advertising each year not exceed 1% of the previous year’s gross sales. For FY 02-03, the lottery spent \$6.6 million on advertising which was .91% of its gross sales for that year. Only 10 of the 38 states with lotteries restrict lottery expenditures for advertising with a cap or allowing only funds appropriated for advertising to be spent. Five of the six states with a specified percentage can spend 3% or more of their revenues on advertising. An analysis conducted by the Tennessee Comptroller of the Treasury found that restrictions on advertising spending are likely to reduce lottery profits. The analysis found that states with higher per capita advertising expenditures generally had higher per capita profits, which in South Carolina, would mean more funds for education.

S.C. Code §59-150-60(A)(15) prevents the lottery from entering into an advertising contract if the commission exceeds 3%. The standard commission for advertising contracts is 15%. In order to compensate for this restriction,

the lottery has structured its advertising contract to include a 2.7% commission and a monthly retainer for the ad agency of \$82,500. The amount of compensation may deter advertising agencies from bidding on the contract. In addition, the lottery cannot control costs because it must pay the retainer regardless of how much time the agency spent or what services were provided to the lottery. As a result, the lottery may be prevented from obtaining the most high-quality and cost-effective advertising services.

S.C. Code §59-150-60(H) prevents the lottery from giving away tickets for promotional purposes. Due to this restriction, the lottery purchased items to give away to promote the games. From January through June 2003, the lottery spent approximately \$131,000 on promotional items. Some of the items purchased included hats, towels, and T-shirts. Promotional tickets would be included in the ticket order for an insignificant cost. In order to ensure adequate controls over promotional tickets, the commission should be required to promulgate regulations concerning their use and specify that their cost be included as administrative expenditures. For example, the Texas Lottery Commission offers promotional tickets to retailers and players. The Texas lottery's regulations give the executive director the authority to determine the bonus programs and the criteria must be included in the procedures for the game.

If the cap on advertising expenditures were removed, the advertising expenses would remain as part of the lottery's administrative expenses cap of 15%. The lottery would have more flexibility in budgeting for advertising but would still have a limit on how much it could spend for administration.

Telephone System

The lottery is restricted from competitively procuring communication services. S.C. Code §59-150-60(A)(9) requires the lottery to use the telecommunications network service of the Budget and Control Board's Office of Information Resources (OIR). Generally the use of a competitive procurement method helps to ensure that the providers selected are cost-effective and of high quality.

The lottery uses telecommunication services to link its online retailers to the lottery's computer system. The charges for this service are passed on to the retailers. As of July 2003, the annual charges are \$780, which the retailer pays in weekly fees of \$15. According to a lottery official, if the lottery did not have to go through OIR, it could procure services at lower rates. These savings would be passed on to the retailers which would allow them to earn more profits and consequently attract more retailers to participate in selling lottery tickets.

Recommendations

7. The General Assembly should consider amending S.C. Code §59-150-60(A)(15) and (18) to allow the lottery more flexibility in its marketing efforts. These expenses should remain as administrative expenses and be subject to the 15% cap.
8. The General Assembly should consider amending S.C. Code §59-150-60(H) to allow the lottery to give tickets away for promotional purposes. The lottery should be required to promulgate regulations to govern the use and number of these tickets.
9. The General Assembly should consider amending S.C. Code §59-150-60(A)(9) to eliminate the requirement that the lottery use the telecommunications network services of the Budget and Control Board's Office of Information Resources.

Chapter 2
Administrative Management

Lottery Operations

Licensing Procedures

We reviewed a sample of 100 licensed retailer files and found that the SCEL has appropriate controls over the licensing process; however, the policies and procedures should be updated regularly. As of March 2003, the SCEL had more than 3,400 licensed retailer locations and had denied licensure to 211 retailers. In 98% of the denials, the reason was failure to pay taxes owed to the Department of Revenue (DOR).

Retailers must comply with the requirements of the S.C. Education Lottery Act in order to be licensed. The act and regulations promulgated by the SCEL have several requirements for the licensing of retailers and the renewal of retailer licenses (see Table 3.1).

Licensing staff have used checklists as a control in their review of applicant files. The SCEL legal department also reviews each file for completeness. Although we found that SCEL generally ensured that applicants met all requirements, there were a few exceptions. We found two instances where all SLED checks had not been completed on license renewals. Also, lottery staff could not locate one file.

The SCEL tracks licensing information on a database created by the staff. The database, which was implemented in 2003, is referred to as the lottery command console (LCC). This system is used to capture all information in a licensing file except for signature pages of a contract. It is used by staff in all departments with responsibilities relating to licensing, including legal, finance, and marketing. Each department is responsible for different procedures in the licensing process, and no license can be issued without all departments completing the required sections.

Table 3.1: Retailer Licensing Requirements

REQUIREMENTS FOR LICENSURE AS A LOTTERY RETAILER	LICENSE RENEWAL REQUIREMENTS
A complete application and licensure fee (\$210).	A complete renewal application and renewal fee* (\$135).
The applicant must be over 21 years of age.	Renewal must take place within one year**.
The applicant must set up an electronic funds transfer (EFT) account solely for lottery funds.	The retailer must pass a DOR check.
The business may not be a foreign business not registered in S.C. All principals of the organization including operational managers must pass a SLED check.	All principals of the organization must pass SLED checks.
The retailer must pass a DOR check to determine if he is current in all filings and payment of taxes.	The percentage of lottery sales must be less than 60% of the retailer's gross sales.

* The renewal fee varies based on the type of terminal (Sci Scan \$100 and Extrema \$135).

** The first renewal dates were staggered, allowing completion within 16 months.

Policies and Procedures

The SCEL has written policies and procedures for the licensing process; however, the policies were incomplete and had not been updated. Although officials stated that they were in the process of updating the policies, at the time of our review there were sections that were incomplete. For example, the section about the approval process requires that appropriate information be entered into a computer system; however, the details of what information is required were omitted. Other policy sections had notations of unanswered questions. Also, the amount of the licensing fee, which changed effective January 1, 2003, was not updated to the new amount.

In October 2003, the SCEL provided the LAC with updated licensing policies.

Low Incidence of Retailer Debts

The SCEL has experienced a low percentage of outstanding debt by retailers. The SCEL has a staff member responsible for collecting debts from retailers who have been terminated from the lottery program and have past due accounts. As of April 2003, 114 accounts with a total debt of \$386,000 had been turned over for collection. This represents 4/100 of 1% of the total gross earnings of the SCEL.

The SCEL drafts funds owed the lottery from each retailer's electronic funds transfer (EFT) account weekly. A retailer can have delinquent payments three times before being terminated from the program. According to officials, in most cases these funds are collected within a few days. Any accounts over 30 days old are referred for collection. If attempts to collect the debts are not successful, they are turned over to the legal department for further action. Before turning over the debt to the legal staff, SCEL phones the retailer and sends two certified letters. The SCEL also submits names of debtors to the Department of Revenue's setoff debt program.

Section 59-150-170(A) of the S.C. Code of Laws requires that the lottery establish a fidelity fund by assessing each retailer a one-time fee (\$75) that may be used to cover losses. As of June 2003, the fidelity fund balance was \$361,733; however, the SCEL has not yet used this fund to cover losses. According to an official, at this time the lottery does not consider any debt uncollectible; however, he stated the SCEL may use the fidelity fund in the future but would still pursue the retailer for the debt. The lottery has not established a policy to use the fidelity fund for debts considered uncollectible.

Inspections of Retailers

Section 59-150-240 requires that the lottery commission "...inspect, at times determined solely by the commission, the facilities or operations of a lottery vendor or lottery retailer to determine the integrity of the lottery vendor's product or compliance by the lottery retailer or lottery vendor with its contract." According to officials, the lottery complies with this section through visits by marketing sales representatives (MSR) to the retailers on a biweekly basis.

The MSR completes a checklist during each retailer visit. This checklist requires that the MSR review the inventory of tickets, displays, and the training of employees. The checklists are reviewed by the regional sales managers. We reviewed a sample of checklists from two MSRs and found that there were few problems noted. Officials stated that the low incidence of problems noted on the checklist is due to the lottery encouraging the MSRs to handle any problems or issues at the time of the visit.

Recommendations

10. The South Carolina Education Lottery should update licensing policies and procedures on a regular basis.
11. The South Carolina Education Lottery should implement a written policy on the use of the fidelity fund to pay retailer debts.

Retailer Compensation

We reviewed lottery retailer compensation and retention to determine the adequacy of provisions for lottery retailers. While we did not find any problems in this area, the General Assembly might use the following information to determine whether current provisions are in accord with its intent.

Retailer Earnings

S.C. Code §59-150-150(A) establishes lottery retailer commissions at "...not less than seven percent of gross proceeds." Retailers receive the 7% commission for each ticket they sell. Since October 2002, retailers have also earned a bonus of 1% of the prize amount for selling winning tickets of \$10,000 or more, with a cap of \$50,000. The SCEL has also awarded other incentives to retailers, such as gift certificates and cash bonuses, for excelling in sales of particular games.

We obtained information on the amounts retailers earned in commissions and selling bonuses during the period March 2002 through February 2003, essentially the lottery's first year (see Table 3.2). More than 90% of retailers earned less than \$25,000 from lottery operations.

Table 3.2: Retailer Commissions and Selling Bonuses, March 2002 Through February 2003

AMOUNT EARNED	NUMBER OF RETAILERS	PERCENT
More than \$100,000	6	0.2%
\$50,000 – \$99,999	26	0.6%
\$25,000 – \$49,999	268	6.5%
\$15,000 – \$24,999	816	19.8%
\$10,000 – \$14,999	826	20.0%
\$5,000 – \$9,999	782	19.0%
\$1,000 – \$4,999	826	20.0%
\$1 – \$999	571	13.9%
TOTAL	4,121	100.0%

Source: South Carolina Education Lottery

The lottery also assesses some costs to retailers.

- Initial license fee of \$225 (\$210 beginning January 2003).
- Annual renewal fee (\$100 to \$135).
- Line charges of \$720 annually for retailers who sell online games (\$13.85 weekly, will be \$15 beginning in July 2003).

Retailers must also have an electronic funds transfer (EFT) account dedicated to lottery financial transactions. Also, sometimes they may hire additional staff to handle lottery transactions.

Retailer Recruitment and Retention

According to *La Fleur's 2003 World Lottery Almanac*, the average number of residents per retailer for state lotteries was 1,405. South Carolina had more retailers than average with 1,178 residents per retailer. Most (76%) of the 3,487 retailers selling lottery tickets in South Carolina in FY 01-02 were convenience stores or gas stations. These retailers accounted for 89% of sales.

The SCEL does not reject any applicants for retailer licensure based on potential sales; those who meet the qualifications can become licensed (see p. 21). However, not every licensed retailer can sell online games. The

lottery has a limited number of Extrema terminals (3,450), which are used for the online games, and it assigns them to retailers with the most potential for sales. Other retailers receive SciScan terminals and can only sell the instant ticket games. According to a lottery official, they consider such factors as customer count, the population base, and proximity to the North Carolina border in determining which type of terminal to assign.

From March 2002 through early April 2003, approximately 983 retailers terminated their participation in the lottery. Although this number seems large, it does not appear to present a problem. We obtained information about retailer terminations to determine why they stopped participating in the lottery. The lottery does not have detailed information on the reasons for terminations, but conclusions can be drawn from the information that is available. As shown in Table 3.3, most of the terminations have been at retailer request.

**Table 3.3: Retailer Terminations,
March 2002 Through April 2003**

REASON	TOTAL	PERCENT
Retailer Request	703	72%
Ownership Change	196	20%
Lottery Request	63	6%
Other/Unknown	21	2%
TOTAL	983	100%

Source: South Carolina Education Lottery.

According to lottery officials, retailer request for termination is a very broad category which includes many reasons. For example, this category includes all retailers who have gone out of business and many that couldn't pay what they owed the lottery. We reviewed the delinquent retailer accounts that had been referred to the lottery's collection agent (see p. 22) and found that 74 had terminated at "retailer request."

Although the lottery does not track detailed reasons for termination, the termination form includes a space for the reason. We analyzed 104 of the forms where the retailer had indicated a specific reason for leaving the lottery (see Table 3.4).

Table 3.4: Reasons for Retailer Request Terminations

REASONS FOR RETAILER TERMINATIONS	TOTAL *	PERCENT
Low sales, lack of profit	54	47.8%
Capacity issues (trouble handling lottery)	14	12.4%
Wanted Extrema (online) terminal	11	9.7%
Interference with business, suitability issues	11	9.7%
Other	7	6.2%
Outside pressure (customer, landlord, etc.)	6	5.3%
Security issues (theft)	6	5.3%
Equipment/lottery complaints	4	3.5%
TOTAL	113	100.0%

* The 104 retailer terminations forms gave 113 reasons for termination.

Most of the terminations were because the retailer was not making anticipated profits. According to lottery officials, it is normal at the beginning of a lottery for retailers to leave when expectations did not match performance. They said that they are not really concerned about terminations when sales are increasing. Also, the lottery has had a steady stream of new retailers. From July 2002 through April 2003, an average of 57 new retailers were licensed each month.

Other States' Retailer Compensation

The rate of compensation paid to lottery retailers in South Carolina (7%) is higher than average, ranking 7th out of 39 lotteries (see Table 3.5).

Lottery Retailer Advisory Board

The lottery retailer advisory board, established by S.C. Code §59-150-110, has not been active. The advisory board is to "...advise the lottery board on retail aspects of the lottery and to present the concerns of lottery retailers throughout the State." The board is to be composed of ten lottery retailers appointed by the Governor, with the chair serving coterminous with the Governor. According to board members, who were appointed by the previous Governor, the board has met only one time. According to a lottery official, it would be beneficial for the board to provide another communication channel between retailers and the lottery.

Chapter 3
Lottery Operations

Table 3.5: Retailer Commissions, FY 01-02

	STATE	COMMISSIONS (MILLIONS)	TICKET SALES (MILLIONS)	COMMISSIONS AS A PERCENT OF SALES
1	RHODE ISLAND	\$25.76	\$235.65	10.93%
2	OREGON	29.58	336.86	8.78%
3	COLORADO	30.74	407.97	7.53%
4	MICHIGAN	120.72	1,688.06	7.15%
5	GEORGIA	163.63	2,321.95	7.05%
6	WISCONSIN	30.12	427.55	7.04%
7	SOUTH CAROLINA	23.49	335.49	7.00%
8	MAINE	10.99	157.91	6.96%
9	INDIANA	43.31	626.31	6.92%
10	NEW MEXICO	9.24	133.97	6.90%
11	CALIFORNIA	198.06	2,896.37	6.84%
12	ARIZONA	19.99	294.82	6.78%
13	MARYLAND	85.36	1,306.54	6.53%
14	IOWA	11.68	181.31	6.44%
15	OHIO	126.60	1,983.10	6.38%
16	MINNESOTA	23.95	377.13	6.35%
17	DELAWARE	7.44	117.22	6.35%
18	WEST VIRGINIA	12.94	206.90	6.25%
19	KENTUCKY	39.84	638.73	6.24%
20	WASHINGTON	27.13	438.60	6.19%
21	DC	12.81	211.15	6.07%
22	NEW YORK	284.34	4,753.62	5.98%
23	MONTANA	1.98	33.63	5.89%
24	NEBRASKA	4.27	73.96	5.77%
25	IDAHO	5.35	92.67	5.77%
26	KANSAS	10.97	190.08	5.77%
27	VERMONT	4.73	81.98	5.77%
28	MASSACHUSETTS	239.45	4,193.83	5.71%
29	CONNECTICUT	51.68	907.90	5.69%
30	FLORIDA	132.35	2,330.37	5.68%
31	VIRGINIA	62.24	1,108.07	5.62%
32	SOUTH DAKOTA	1.45	26.28	5.52%
33	NEW JERSEY	113.44	2,068.51	5.48%
34	NEW HAMPSHIRE	11.47	212.83	5.39%
35	MISSOURI	31.21	585.19	5.33%
36	PENNSYLVANIA	100.05	1,934.16	5.17%
37	LOUISIANA	15.88	311.62	5.10%
38	ILLINOIS	79.34	1,566.67	5.06%
39	TEXAS	148.36	2,966.26	5.00%
	TOTAL	\$2,351.94	\$38,761.22	6.07%*

*Average

Source: *La Fleur's 2003 World Lottery Almanac*

Controls Over Prize Payments

We found that the SCEL has a good system of controls over prize payments; however, an independent review of policy compliance would strengthen these controls. Individuals who win prizes over \$500 may go to a claims center or mail in a winning ticket to receive the payment. The lottery has claims offices in three cities — Columbia, Greenville, and Mt. Pleasant. Mail-in prize claims are processed by the Columbia office.

We reviewed all 1,275 mail-in and walk-in prize claims submitted to the Columbia claims center for May 2003. We found 38 files (3%) in which documentation required by SCEL policy was missing.

The S.C. Education Lottery Act, lottery regulations, and claims policy manual have requirements that are intended to ensure the eligibility of those claiming prizes. The requirements in the claims policy manual are shown in Table 3.6.

Table 3.6: Prize Claim Requirements

TYPE OF CLAIM	FILE REQUIREMENTS
\$500 or less	Copies of the person's ID and the check issued should be enclosed in the file. For mail-in claims, no ID is required.
\$501 – \$4,999	A copy of the ID, the check issued, the W-2G*, and a claim form must be filed with the ticket.
\$5,000 or more	All of the above items and documentation that DOR and DSS were contacted to identify any outstanding debts.

* W-2G is a federal reporting form for gambling winnings.

Source: South Carolina Education Lottery

The S.C. Education Lottery Act requires that the SCEL withhold debts submitted by other agencies from winnings of \$5,000 or more. The claims office has access to the Department of Social Services' (DSS) list of child support enforcement debtors, and calls the Department of Revenue (DOR) to check for tax and other debts. Staff implemented a contact sheet to document that these checks were completed. Since its inception, the lottery has collected over \$68,000 in child support and delinquent taxes; however, the most frequent problem found in our review was the absence of evidence that DSS and DOR were contacted (21 files).

Other problems found during the claims review included:

- No ID copy for walk-in claims (6 files).
- No W2-G for a claim over \$500 (1 file).
- No claim form for a claim over \$500 (1 file).
- No copy of a check issued (1 file).

Claim Reviews

In April 2003, Columbia claims staff performed a brief review of their own files, recording discrepancies identified. According to staff, they conducted a similar review at the Mt. Pleasant office in February 2003, and there were plans to conduct a review at the Greenville office. However, there are no written policies requiring staff to conduct these reviews or stating how to use the findings to improve the documentation. An independent review of the files by an entity such as SCEL internal audit would help to ensure that appropriate controls were implemented.

Added Controls Over Daily Balancing

Increased documentation was needed to ensure that daily balancing activities were completed as required. According to staff, each day a register listing all checks issued is printed and filed with the winning tickets. Two staff members balance the amount of checks issued with the total entries on the claim logs. Other than adding tapes, there was no evidence that the balancing was completed.

During our review, SCEL staff created a form to track that the totals are balanced each day and identify the employees who performed the balancing. The requirements for the form were added to the revised policy manual.

Debt Examination Threshold

The S.C. Education Lottery Act allows any state or local agency to submit to the lottery a list of names of persons owing debts to the agency in excess of \$100. In addition, SCEL must withhold the debts owed from any prize payment of \$5,000 or more. Currently the only agencies to submit debts are DSS for child support and DOR for delinquent taxes and debts reported to DOR by other agencies. We obtained information on the number of prizes in excess of \$600 (the amount of winnings which must be reported to the IRS) paid to winners to determine the potential for the lottery to increase its role in debt collection. We found that of those prizes over \$600, 13.2 % were over \$5,000; however more than twice that percentage, 28.7%, were over \$2,500

(see Table 3.7). If the threshold for debt examination is reduced, there is a potential to increase collection of debts owed the state.

Table 3.7: Percentage of Prize Payments Over \$2,500, \$3,500, and \$5,000, Inception Through June 2003

PRIZES EQUAL TO OR OVER	NUMBER OF PRIZE PAYMENTS	PERCENT OF TOTAL CLAIMS OVER \$600
\$2,500	2,723	28.7%
\$3,500	1,444	15.2%
\$5,000	1,255	13.2%

Source: South Carolina Education Lottery

Recommendations

12. The South Carolina Education Lottery should periodically conduct internal audits to review compliance with policies for prize payments.
13. The General Assembly should consider lowering the threshold for debt examination in S.C. Code §59-150-330(F) from \$5,000 to \$2,500.

The State's Use of Lottery Proceeds

We reviewed the use of lottery funds by various state agencies and found that generally the funds were used as required by law; however, in some cases the General Assembly released agencies from the statutory requirements, due to the state's budget situation. In 2003, the General Assembly passed two joint resolutions that lifted the restrictions on some agencies' use of lottery funds. Both the local school districts and South Carolina State University were able to use lottery funds not for the original stated purpose, but for general operating expenses.

We also reviewed the agencies' controls to ensure the funds are used appropriately. We found that controls are uneven and still being established. The State Auditor's office is charged with ensuring that controls are adequate (see p. 39).

Background — Distribution of Funds

The SCCEL is required by state law to deposit monthly all net proceeds from lottery activities into an education lottery account. These funds are distributed through the Budget and Control Board's office of the state budget. The Education Lottery Act and subsequent appropriations acts govern how the proceeds are to be used.

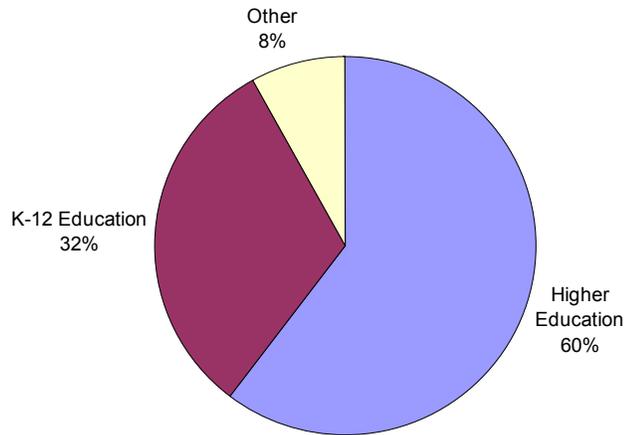
Although the lottery earned revenues in FY 01-02, the legislation distributing the funds was not in effect until FY 02-03. Therefore, earnings from both years were distributed in FY 02-03. The General Assembly appropriated a total of \$252 million for this two-year period (see Table 4.1 and Chart 4.2). The law states that the appropriations must be used to supplement and not supplant existing funds for education.

**Table 4.1: Appropriations from
FY 01-02 and FY 02-03 Lottery
Proceeds**

AGENCY	FY 01-02	FY 02-03	TOTAL
COMMISSION ON HIGHER EDUCATION	\$18,596,317	\$127,584,100	\$146,180,417
DEPARTMENT OF EDUCATION	38,903,683	40,915,900	79,819,583
SC EDUCATIONAL TELEVISION	18,500,000	0	18,500,000
HIGHER EDUCATION TUITION GRANTS COMMISSION	3,000,000	0	3,000,000
SOUTH CAROLINA STATE UNIVERSITY	1,000,000	2,000,000	3,000,000
STATE LIBRARY	0	1,500,000	1,500,000
TOTAL	\$80,000,000	\$172,000,000	\$252,000,000

Source: S.C. Code §59-150-355

Chart 4.2: Distribution of Lottery Proceeds FY 01-02 Through FY 02-03



Source: S.C. Code §59-150-355

Unclaimed prize money was also distributed by the General Assembly. When prizes are not claimed within a certain period, the lottery transfers those funds to the education lottery account. For FY 01-02 and FY 02-03, the first \$1 million of unclaimed prize money was distributed to the Budget and Control Board to contract for services assisting in the prevention and treatment of gambling disorders (see p. 40). Any revenue in excess of this \$1 million was to be appropriated to the State Department of Education for the purchase and repair of school buses.

For FY 03-04, the appropriations act distributed lottery funds projected at \$215 million (see Table 4.3).

Table 4.3: Lottery Funds Appropriations FY 03-04

AGENCY	AMOUNT	PERCENT
COMMISSION ON HIGHER EDUCATION	\$137,000,000	63.7%
DEPARTMENT OF EDUCATION	70,503,683*	32.8%
HIGHER EDUCATION TUITION GRANTS COMMISSION	3,000,000	1.4%
SOUTH CAROLINA STATE UNIVERSITY	3,000,000	1.4%
STATE LIBRARY	1,500,000	0.7%
TOTAL	\$215,003,683	100.0%

* Includes \$8 million in unclaimed prize funds for school buses.

Source: FY 03-04 Appropriations Act

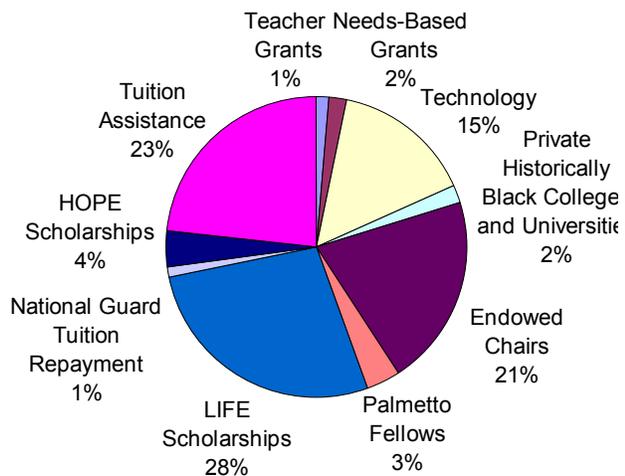
Use of Lottery Proceeds

As shown in Chart 4.2, higher education has been the primary recipient of lottery funds. However, the funds have been distributed to a wide variety of programs. The following program descriptions show how lottery proceeds have been used.

Commission on Higher Education

The Commission on Higher Education (CHE) receives the largest amount of lottery funds. It is to use these appropriations to fund 10 programs specified by the General Assembly (see Chart 4.4). Some of the funds are “flow-through” funds, and others are distributed directly by the CHE. The State Board for Technical and Comprehensive Education is involved in distributing some of these funds. The CHE is also allocated \$192,817 in lottery proceeds to administer the funds. The CHE administers the LIFE, HOPE, and Palmetto Fellows scholarships (\$50,787,600), which accounted for 39% of CHE’s FY 02-03 appropriation. These scholarships are distributed by institutions of higher education to students who meet eligibility requirements.

Chart 4.4: Lottery Funds Distributed by the Commission on Higher Education, FY 01-02 Through FY 02-03



Source: S.C. Code §59-150-355

In addition to scholarships, the CHE administers several other lottery-funded programs. These programs are listed below with the amount appropriated from FY 01-02 and FY 02-03 lottery proceeds.

TUITION ASSISTANCE (\$34 million)

Provides tuition assistance to S.C. residents attending a two-year public or independent institution of higher learning. The college where the student is enrolled notifies the student of the award amount based upon the number of eligible recipients and available funding each academic year.

ENDOWED CHAIRS (\$30 million)

This funding is distributed based on grants to the state's three research institutions through a competitive application process. A 12-member board is responsible for awarding matching funds, for oversight and operation of the fund, and for various accountability requirements established in statute for the program. According to a CHE official, as of late August 2003, most of the funds had been awarded; however, none of these funds had been distributed. Each recipient is required to match the lottery funds on a one-to-one basis and has five years to match and request disbursement of these funds. An additional \$30 million is appropriated for FY 03-04, which, according to the official, the CHE plans to award in March or April 2004.

TECHNOLOGY FUNDING (\$21.7 million)

Grants awarded to institutions supporting the development of technology and/or technology infrastructure. Half of the funds are awarded to the state's four-year teaching universities and the other half to the state's two-year and technical institutions.

PRIVATE HISTORICALLY BLACK COLLEGES AND UNIVERSITIES (\$3 million)

Equal amounts were given to each of the six institutions for construction and renovation projects.

NEEDS-BASED GRANTS (\$3 million)

Grants for students which must be applied directly towards the cost of attendance at the college for a maximum of eight terms. Students may receive up to \$2,500 annually if enrolled full-time and up to \$1,250 annually if enrolled part-time. This program is administered by the financial aid office on each public college campus. The S.C. Higher Education Tuition Grants Commission administers the program for private colleges and universities as part of its tuition grants program.

TEACHER GRANTS (\$2 million)

Grants awarded to public school teachers not to exceed \$1,000 per year, to attend institutions of higher learning for the purposes of upgrading existing content area skills or obtaining a master's degree. As of August 2003, no grants had been awarded in this program.

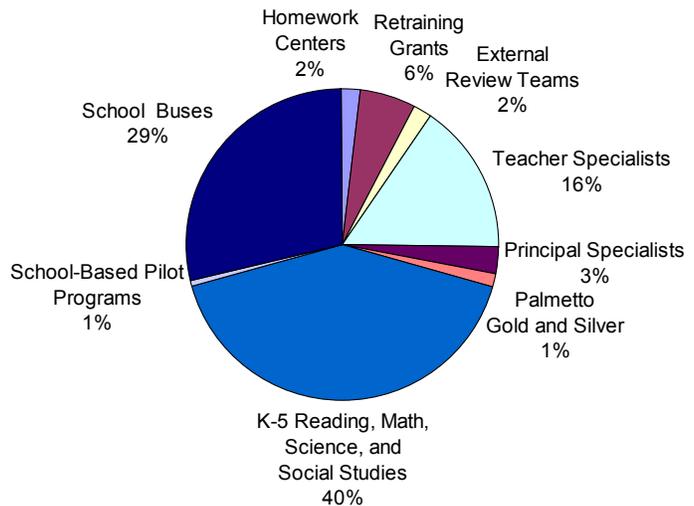
NATIONAL GUARD STUDENT LOAN REPAYMENT PROGRAM (\$ 1.5 million)

A loan repayment program which provides incentives for enlisting or remaining in both the S.C. Army and Air National Guards (SCNG) in areas of critical need. CHE has promulgated regulations containing the terms of the program.

State Department of
Education

Lottery funding for K-12 education is distributed by the State Department of Education (SDE). SDE has been appropriated funding in eight program areas (see Chart 4.5). In FY 02-03, the majority (76%) of these funds were allocated directly to the school districts to administer these programs. The funds for teacher/principal specialist, pilot programs, Palmetto Gold and Silver, and homework centers were allocated directly to the school districts. In FY 02-03 a joint resolution allowed the districts to use lottery funds to provide any direct classroom instructional programs or for essential operating costs. SDE's lottery-funded programs are described briefly below with the amount of FY 01-02 and FY 02-03 lottery proceeds appropriated.

Chart 4.5: K-12 Lottery
Appropriations FY 01-02 and
FY 02-03



Source: S.C. Code §59-150-355

K-5 READING, MATH, SCIENCE, AND SOCIAL STUDIES PROGRAM (\$32.9 million)

For this program all K-5 schools had to develop their own plan. They could submit the program for the improvement of these core subjects or use one from a list of programs. In FY 02-03, each K-5 school received a \$30,000 base amount plus \$80 per K-5 child. In addition, all unsatisfactory and below average schools (as designated on the November 2001 report card) received some additional funds.

BUSES (\$23 million)

Funds were used for the purchase, repair, and maintenance of state-owned school buses. According to an official, buses are distributed so that the average age of the buses around the state will be the same. In FY 02-03, SDE purchased 250 buses for a total of \$15.5 million.

TEACHER/PRINCIPAL SPECIALIST (\$14.9 million)

Those schools that score below average on the PACT test can get a teacher specialist in certain areas. The teacher receives a supplement of \$19,775 per year to teach at a low scoring school. The teacher's previous job is held for three years. The principal specialist program is similar with a \$24,719 annual supplement for participants.

RETRAINING GRANTS (\$4.6 million)

Schools that are on the "unsatisfactory" list based on the school report card may receive professional development funds. These schools must submit a "school renewal plan" to the department.

HOMEWORK CENTERS (\$1.5 million)

Schools on the "unsatisfactory" list are given grants to operate homework centers.

EXTERNAL REVIEW TEAMS (\$1.5 million)

A team comprised of educators and other community representatives conducts an audit of school districts found unsatisfactory and makes recommendations for change. Funds are used to supply the teams and purchase necessary supplies for the schools based on problems found. For example, if the school has no microscopes, SDE can purchase them using lottery funds.

PALMETTO GOLD AND SILVER AWARDS PROGRAM (\$1 million)

These are grants given to schools that do well on the school report card, and they may use the funds at their discretion. The award is based on a dollar amount per student with a minimum of \$1,500 for the gold award.

SCHOOL-BASED PILOT PROGRAMS (\$400,000)

Funds were used to fund the helping one student to succeed program in four school districts.

SDE Direct Expenditures,
FY 02-03

Although most (\$49 million) of the funds given to SDE were sent directly to the school districts, we found that SDE directly expended \$15.1 million for external review teams, retraining grants, school buses, and the K-5 reading, math, science, and social studies program. We reviewed a limited sample of vouchers from these programs to determine the nature of some SDE expenditures. In our voucher review, we found the following:

- The K-5 program expended over \$13,000 for meals and refreshments for USC, SDE, and school district employees. According to documentation and SDE staff, these funds were used to provide breakfast and lunches to the reading and math coaches selection committee meetings, the monthly reading initiatives coaches meeting, and training sessions for coaches.
- The external review team expended over \$370,000 on data processing equipment. Staff informed us that this purchase was for laptop computers and accessories for the teacher specialists.
- There were also several vouchers from external review team funds for the purchase of equipment for the schools, such as microscopes and calculators.

While we did not find any violations of state law with the vouchers reviewed, SDE's provision of meals and refreshments to public employees reduced the amount of funds available for other educational purposes. SDE should ensure that its expenditures are appropriately prioritized.

Other Agencies
Receiving Lottery Funds

South Carolina State University

SCSU was originally awarded \$3 million from FY 01-02 through FY 02-03 for a research and technology grant. This grant was to support basic and applied research in information technology outreach opportunities for S.C.'s rural and urban citizens. However, in FY 02-03 a joint resolution allowed these funds to be used for instructional and essential operating purposes, if a CPA certified that all other cost-saving methods had been exhausted. This certification was made, and an SCSU official stated that the university used all of the lottery funds to support general operating needs.

For FY 03-04, SCSU is appropriated \$3 million in lottery funds; however, the use of the funds is not stipulated. An SCSU official stated that they plan to use the funds for general operating purposes.

Higher Education Tuition Grants Commission

The Higher Education Tuition Grants Commission provides needs-based grants to S.C. residents attending 20 private colleges in the state. The lottery funds (\$3 million) account for 11% of the commission's total funding. Although lottery funds are held in a separate account, they are used in the same manner as all other funding for needs-based grants.

SC State Library

The State Library distributes funds (\$1.5 million) to local libraries on a per capita basis. These funds are to be used for educational technology delivery, upgrade, and maintenance.

SC Educational Television Commission

SCETV received an allocation of \$18.5 million in FY 02-03. These funds were to be used for the digitalization project which is required of all television stations by the Federal Communications Commission (FCC). We reviewed a sample of vouchers at SCETV and found no problems with the expenditures; however, we did note that all of the funds for the project had not been expended. According to officials the project is not completed, and all funds will be used upon completion.

Full Controls Not Yet Implemented

We found that agency controls to ensure that lottery funds are spent as intended vary widely. Some agencies already have a system of audits into which the lottery funds can be incorporated. Examples of agency procedures are as follows.

Higher Education Tuition Grants Commission

The Higher Education Tuition Grants Commission requires each institution to have a yearly program review by an independent auditor. Any recurring or excessive problems found in these reviews require a corrective action plan by the college or university's administration. The commission has incorporated its lottery-funded grants into the review process.

Commission on Higher Education

CHE already conducts audits of the HOPE, LIFE and Palmetto Fellows scholarship programs. According to officials, the CHE plans to conduct reviews of its other lottery -funded programs in the future. The CHE will not start the review of these funds until January 2004.

State Board for Technical and Comprehensive Education

The State Board for Technical and Comprehensive Education has required that a review of tuition assistance funds awarded by the technical colleges be included in the financial statement audits of the colleges for FY 02-03. The board issues funds designated for technology on a reimbursement basis, after reviewing technology purchases made by the technical colleges.

State Department of Education

SDE has not yet reviewed the use of lottery funds by the districts. Officials stated that in the future district auditing services will include the lottery funds in the audit plan; however, they are currently auditing FY 01-02 in which no lottery funds were received. According to an official, the internal audit department has also been requested to conduct an audit of lottery funds; however, as of September 2003, no audits have been conducted.

SC State Library

The State Library requires that the local libraries report on how the lottery funds were used by category. This information is self-reported and varies in format. The state library has set guidelines for next year's reporting; however, there are no plans to audit the use of these funds.

In the FY 03-04 appropriations act, the State Auditor's office is charged with ensuring that state agencies receiving lottery funds have procedures in place to monitor expenditures and that they are working effectively. According to an official, the State Auditor's office will include procedures in its appropriations act work program to review the agency's monitoring procedures when they audit the agencies. The specific type of audits conducted at those agencies receiving lottery funds vary. While many of the agencies receive annual audits of their financial statements, others receive more limited "agreed upon procedures" reviews.

The State Library, Commission on Higher Education, State Department of Education, and the Higher Education Tuition Grants Commission all have agreed upon procedures audits. The State Auditor's office has no authority to audit the private historically black colleges and universities which receive lottery funds.

Unused Lottery Funds

We noted that lottery funds for some programs have not yet been used. Although agencies are allowed to carry forward lottery funds, we could not always determine the reasons for delays. In some cases the General Assembly may reconsider the amount of the appropriations. It may be possible to shift funds to areas where more support is needed. To maximize the use of lottery funds, funding could be suspended for some programs until the program can be fully established.

Gambling Contract

The S.C. Education Lottery Act provides that "...the first \$1,000,000 of unclaimed prize money is appropriated to the Budget and Control Board to contract for services assisting in the prevention and treatment of gambling disorders." However, as of August 2003, these contracts had not yet been awarded. The board issued two requests for proposal (RFPs) in July 2003 for these services. Information provided by the lottery indicated that the unclaimed prize money exceeded \$1 million in November 2002. According to a Budget and Control Board official, the contract required specific expertise for which they had obtained assistance. Also, according to a board official, due to staff reductions, they were not able to start working on the proposal full time until shortly before it was issued.

Commission on Higher Education

We reviewed the expenditures of the CHE (see Table 4.6) and found that funds in several programs had not been fully expended. In most cases the amount not expended was less than 5% of the total appropriated; however, in both the teacher grants and national guard funds over 80% of the appropriated amount went unused. The teacher grants funds were used to develop a website where teachers can apply online. The website was completed in late May 2003, and CHE began the process of issuing grants in August 2003. The National Guard funds are being held in trust for those that meet the requirements for future use; benefits could not be awarded until an eligible loan is at least one year old. According to a CHE official, they plan to carry forward these funds and use them as required. For FY 03-04 another \$1.5 million was appropriated for National Guard Tuition repayment and another \$2 million for teacher grants. Also, although \$29.9 million has been awarded for the endowed chairs program, as of August 2003, no funds have been distributed.

Table 4.6: Commission on Higher Education Expenditures of Lottery Funds

PROGRAM	FY 01-02 AND FY 02-03 APPROPRIATIONS	FY 02-03 EXPENDITURES	FUNDS REMAINING
LIFE	\$50,493,270	\$52,610,067 (104%)	(\$2,116,797)
HBCUs	3,000,000	3,000,000 (100%)	0
Needs-Based	3,000,000	3,000,000 (100%)	0
Tuition Assistance	34,000,000	33,524,185 (99%)	475,815
Technology (2yr)	10,850,000	10,596,317 (98%)	253,683
Palmetto Fellows	9,051,040	8,804,882 (97%)	246,159
HOPE	5,787,600	5,507,637 (95%)	279,963
Technology (4yr)	10,850,000	10,227,077 (94%)	622,923
Administration	192,817	168,201 (87%)	24,616
National Guard	1,500,000	154,227 (10%)	1,345,773
Teacher Grants	2,000,000	15,000 (1%)	1,985,000
Endowed Chairs*	30,000,000	0 (0%)	30,000,000
TOTAL	\$160,724,727	\$127,607,593 (79%)	\$33,117,134

*\$29,937,365.41 has been awarded but none has been disbursed.

Source: Commission on Higher Education

Recommendations

14. All agencies administering lottery funds should establish appropriate controls to ensure that lottery funds are used as intended.
15. All agencies allocated lottery funds should ensure that administrative costs incurred are minimal.
16. The General Assembly should consider whether previously appropriated lottery funds have been spent when deciding on future appropriations of lottery funds.

Chapter 4
The State's Use of Lottery Proceeds

Agency Comments

**Appendix
Agency Comments**



November 21, 2003

Mr. George L. Schroeder, Director
South Carolina Legislative Audit Council
1331 Elmwood Avenue, Suite 315
Columbia, South Carolina 29201

Dear Mr. Schroeder:

Please find attached the South Carolina Education Lottery's (SCEL) responses to the Legislative Audit Council report. SCEL is a recognized leader in our industry, as evidenced by our sales statistics, cost containment measures and numerous awards and accolades. We will review and adopt any system or tool which will help us be better stewards of public funds and provide additional proceeds for the enhancement of South Carolina's education system. Accordingly, we welcome your valuable input, concur with your recommendations as they relate to SCEL, and, in fact, have already implemented them. In addition, we stand ready to assist members of the General Assembly with information and research that will assist them in discharging their legislative and oversight responsibilities.

We very much appreciate the opportunity to work with both you and your fine staff for the benefit of our State and look forward to your continued assistance. We also appreciate the professional and courteous manner in which the auditors conducted themselves, under the capable leadership of Ms. Jane Thesing.

Thank you again for your valuable input and please do not hesitate to contact us if you need any further information in the future.

Respectfully,

A handwritten signature in black ink, appearing to read "John C.B. Smith, Jr.", with a long, sweeping underline that extends to the right.

John C.B. Smith, Jr.
Commission Chairman

Regarding Recommendations 1 and 2, Cell Phones, on page 9:

The SCEL strives to aggressively pursue all possible cost saving measures and agrees it should continuously monitor the use and costs associated with cell phones. Therefore, we constantly reevaluate cell phone needs for the minimum number of minutes needed to conduct SCEL business, the related cost of those total minutes and the phones distributed. Likewise, we continue to monitor the assignment of cell phones and to restrict cell phone use to the minimum essential business requirements. Since start-up, we have twice changed cell phone providers to achieve additional cost reductions resulting in overall annual savings of \$58,344. During that process we progressively reduced the number of cell phones needed during start-up. We would like to note that, during our repeated analysis, we have determined that total mobile phone cost savings are actually achieved by negotiating the number or allocation of minutes, as opposed to the number of phones and phone numbers the provider is willing to provide for those minutes.

We agree we should continue to monitor the use and costs associated with cell phones. We constantly reevaluate cell phone needs for the minimum number of minutes needed to conduct SCEL business, the related cost of those total minutes and the phones distributed and will continue to aggressively pursue all possible cost savings measures in this area.

Regarding Recommendations 3 and 4, Leased Cars, on page 10:

The SCEL strives to aggressively pursue all possible cost saving measures and agrees it should assign leased vehicles when a continuing cost savings appears probable. Our decision to defer a forced transition to leased cars was to avoid placing individual employees at a disadvantage with respect to personal financial obligations undertaken when they were initially hired as Marketing Sales Representatives (MSRs). We have not provided leased cars to individual MSRs in the interim because this would create two distinct classes of employee, with concomitant inequities, prior to a general transition to leased cars.

Break even analysis calculations currently indicate the use of leased cars would not be generally cost effective at this time. To date, the average monthly mileage is below the level at which State-owned leased cars would be cost effective. This average appears to be decreasing as we move further out of start-up mode.

The Commission will continue to monitor this issue and will consider providing State-owned leased cars to employees when it would be more cost effective. The Commission agrees it should assign leased vehicles when a continuing cost savings appears probable and will do so. We agree SCEL should not provide state vehicles to its employees when it would be less expensive to reimburse them for use of their own vehicles. We will continue to monitor this issue and will take action where necessary.

Regarding Table 2.1, "Other States' Administrative Costs", on page 11:

As noted in your footnote, total expenditures include start up costs. To provide specifics, total expenditures during the start up period of 1/1/01 through 12/31/01 were \$3,804,555. Removal of start up costs from the numerator in expense percentages would render "Administrative Expenses as % of Total Revenues" 6.5% vs. 7.6%; and "Total Administrative Expenses" 13.5% vs. 14.6%. In addition, as noted in your introduction to this section on page 7, audited data for State FY03 yields 5.6% for administrative expenses/total revenue, and 12.6% for total administrative expenses (+ commissions)/total revenue.

Regarding Recommendation 5, SLED Services, on page 15:

We agree with the recommendation and will develop a formal written contract with the State Law Enforcement Division to provide investigative services.

Regarding Recommendation 6, Performance Measures, on page 17:

We concur with this recommendation. SCEL is a leader in our industry as evidenced by our sales statistics and awards. We will review and adopt any system or tool which will help us to improve, generate more revenue, and become the benchmark by which other lotteries are measured.

We have taken initial steps towards an approach which suits our business needs and is appropriate for our environment. In our recent strategic planning session November 20, 2003, we incorporated a session to identify and strengthen our performance measurement process.

We are currently developing formal outcome and output performance standards at the agency, department and employee levels and will track these performance measures in the SCEL strategic plan as well as through the employee performance appraisal system. We will also publish them in our annual report as well as other reports to stakeholders.

Regarding Recommendations 7, 8 and 9, Statutory Changes, on page 19:

The Commission will gladly offer any research, data and/or other assistance requested at such time as the General Assembly wishes to consider these issues.

Regarding Recommendation 10, Licensing Procedures, on page 23:

The Commission agrees it is important to consistently update policies and procedures. Licensing policies and procedures have been completed as part of a process improvement exercise performed with the guidance of IT, Legal, Internal Audit and Security personnel. We will continue to update licensing and all other policies and procedures on a consistent basis.

Regarding Recommendation 11, Fidelity Fund Procedures, on page 23:

The Commission concurs and will continue to maintain and utilize the fidelity fund as required by S.C. Code Ann. §59-150-170(A). Commission staff created an *Aide-Mémoire* to reflect procedures followed for accounting for bad debts in accordance with GAAP. We recently amended this *Aide-Mémoire* to include recommended procedures.

Regarding Recommendation 12, Prize Payment Audits, on page 30:

The Commission agrees the Claims area is an important area for audit. The previous Internal Auditor audited the Claims Office (although it had not operated long at the time) and the current Internal Auditor has assisted the office in tax and other policy-related research, as well as a process improvement exercise. The SCEL Internal Auditor has ensured the Claims Office will be audited on a systematic basis now that the LAC has completed its review.

Regarding Recommendation 13, Debt Set-off Threshold, on page 30:

The Commission will gladly offer any research, data and/or other assistance requested at such time as the General Assembly wishes to consider this issue.

**Appendix
Agency Comments**

In addition to the SCEL, the agencies listed below reviewed Chapter 4, “The State’s Use of Lottery Proceeds.”

Budget and Control Board
State Department of Education
Commission on Higher Education
Higher Education Tuition Grants Commission
SC Educational Television Commission
SC State Library
South Carolina State University
Office of the State Auditor

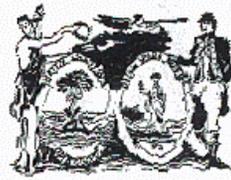
Comments received from the Budget and Control Board and the Department of Education follow.

STATE OF SOUTH CAROLINA
State Budget and Control Board
OFFICE OF EXECUTIVE DIRECTOR

MARK SANFORD, CHAIRMAN
GOVERNOR

GRADY L. PATTERSON, JR.
STATE TREASURER

RICHARD ECKSTROM
COMPTROLLER GENERAL



HUGH K. LEATHERMAN, SR.
CHAIRMAN, SENATE FINANCE COMMITTEE

ROBERT W. HARRELL, JR.
CHAIRMAN, WAYS AND MEANS COMMITTEE

FRANK W. FUSCO
EXECUTIVE DIRECTOR

P.O. Box 12444
COLUMBIA, SOUTH CAROLINA 29211
(803) 734-2320

November 24, 2003

George L. Schroeder
Director
South Carolina Legislative Audit Council
1331 Elmwood Ave., Suite 315
Columbia, S.C. 29201

Dear Mr. Schroeder:

Please allow me to provide you with updated information concerning contracts for the services assisting in the prevention and treatment of gambling disorders. The contract for treatment of gambling disorders has been awarded to the Department of Alcohol and Other Drug Abuse Services.

We are also working to award a contract to DAODAS for operation of a hotline for individuals seeking help with gambling problems. The Board's Materials Management Office issued a solicitation for this contract earlier this year. While five companies responded to the solicitation, none met the criteria of the S.C. Education Lottery Act, specifically that these firms must be non-profit organizations and an affiliate of the National Council on Problem Gambling. DAODAS indicates that they will be able to implement this part of the program in addition to the treatment component.

Sincerely,

Frank W. Fusco



STATE OF SOUTH CAROLINA
DEPARTMENT OF EDUCATION

INEZ MOORE TENENBAUM
STATE SUPERINTENDENT OF EDUCATION

November 25, 2003

George L. Schroeder, Director
Legislative Audit Council
1331 Elmwood Avenue, Suite 315
Columbia, South Carolina 20201

Dear Mr. Schroeder:

Thank you for the opportunity to review Chapter 4, "The State's Use of Lottery Proceeds" (pp. 31-41) of the final draft report, *A Review of the S. C. Education Lottery and the State's Use of Lottery Proceeds*. We appreciate the cooperation of your staff in the manner in which this audit was conducted.

Under the heading SDE Direct Expenditures, the report identifies three areas of expenditures that require further comments. The funds expended for meals and refreshments were for the training of the literacy coaches for the monthly and summer study sessions of the South Carolina Reading Initiative (SCRI). The provision of meals at these training sessions increased the effectiveness of the sessions, since it reduced the amount of time for a lunch break and maintains the focus on the training. Working lunches allow for lunch breaks of no more than thirty minutes instead of an hour. Many of the lunch periods were spent with the coaches working in small groups on various projects. The literacy coaches travel to Columbia for this training, and we try to maximize the use of their time to achieve the objectives set for the training sessions. The literacy coaches are entitled to reimbursement for lunch in accordance with the state procedures.

The other direct expenditures referenced in the report were the purchase of laptop computers for the teacher specialists and the purchase of instructional materials and equipment for schools, such as microscopes and calculators. The laptop computers are used by the teacher specialists in performing their duties by assisting in data analysis, reporting and communication to the Department, and preparation and development of instructional resources. The purchase of instructional materials for schools is needed to provide the necessary resources that are needed for improving instruction.

George L. Schroeder, Director
Page 2
November 25, 2003

The Department of Education has procedures for the accountability on the use of all funds, including lottery, allocated to school districts. The Office of District Auditing and Field Services publishes The Funding Manual, the Financial Accounting Handbook, and the Single Audit Guide, which provide the guidelines for all programs and document the use of the funds.

I appreciate the cooperation and assistance of you and your staff and look forward to working with you in the future.

Very truly yours,



Inez M. Tenenbaum
State Superintendent of Education