

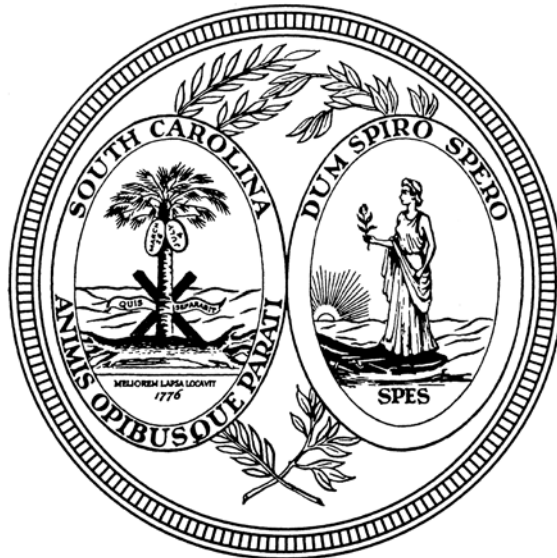


SOUTH CAROLINA GENERAL ASSEMBLY

Legislative Audit Council

October 2014

A REVIEW OF THE SOUTH CAROLINA EDUCATION LOTTERY



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Contents

Chapter 1 Introduction

Audit Objectives	1
Scope and Methodology	1
Background.....	2

Chapter 2 Lottery Operations

Instant Game Closing Procedures	5
Internal Controls Over Fraud With Retailer Accounts	8
Unclaimed Prizes	9

Chapter 3 Follow-Up

Implementation of Recommendations in LAC Lottery Audits	13
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Appendix

Agency Comments	21
-----------------------	----

Contents

Introduction

Audit Objectives

Sections 59-150-30(B) and 2-15-63(A) of the South Carolina Code of Laws require the Legislative Audit Council to conduct a management audit of the South Carolina Education Lottery (SCEL) every three years. Previous audits of the lottery have been published in 2003, 2005, and 2010. We reviewed the controls at the lottery, as well as followed up on recommendations in the previous audit reports.

We also reviewed controls to ensure that lottery proceeds transferred to the Education Lottery Account are spent as the General Assembly intended. That review has been separately published. Our audit objectives were to:

- Determine the adequacy of the lottery's internal controls over its operations.
- Determine the status of recommendations made in the previous LAC lottery audits.

Scope and Methodology

This audit focused on the operations of the S.C. Education Lottery relevant to our audit objectives. The period of review was generally from FY 10-11 to FY 12-13 with earlier or later time periods as noted in the report.

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

- Accounting and financial records.
- Contracts and procurement records.
- Policies and procedures.
- Reports from auditors, consultants, and other external sources.

Criteria used to measure performance included state laws, agency policies, and general criteria for the establishment of appropriate internal controls.

We reviewed internal controls over some of the lottery's operations, as discussed in the report. When addressing some of our objectives, we relied on computerized data maintained by the lottery. We reviewed external reports on these systems to confirm that the data is valid and reliable.

We conducted this performance audit in accordance with generally accepted government auditing standards from 2007. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The S.C. Education Lottery (SCEL) was established in 2001 and began selling tickets in January 2002. The mission of the lottery is “to provide, with integrity, entertainment options to adults to support education in South Carolina.” SCEL sells two types of games.

Instant Games — A lottery ticket that requires the player to remove a latex coating to determine if the ticket is a winner. In FY 13-14, the lottery introduced 72 instant ticket games.

Terminal Games — Tickets are purchased at a retailer through a network of computer terminals. The lottery currently has 6 terminal games including Powerball, Mega Millions, Palmetto Cash 5, Pick 4, Pick 3, and Add-A-Play.

There were 3,805 retailers licensed by the lottery to sell tickets as of June 30, 2014.

The lottery is governed by a nine-member board who serve three-year terms. Three members are appointed by the Governor, three by the President Pro Tempore of the Senate, and three by the Speaker of the House of Representatives. The lottery had 112 full-time and 6 part-time employees as of June 16, 2014.

The SCEL does not receive state appropriations and is funded through the sale of lottery game tickets. For FY 13-14, the revenues earned from the sale of lottery tickets and other retailer fees are shown in Table 1.1.

Table 1.1: FY 13-14 Lottery Revenues

REVENUES	AMOUNT	PERCENT
Instant Games	\$875,532,259	69%
Terminal Games	388,904,509	30%
Retailer Fees and Other	3,689,437	<1%
TOTAL	\$1,268,126,205	100%

Source: SC Education Lottery

The funds received by the lottery are used to pay prizes, retailer commissions, and administrative expenses. The remaining funds are transferred to the Education Lottery Account. The lottery does not determine how the funds in the Education Lottery Account are spent. Those funds are appropriated by the General Assembly and distributed to the agencies receiving those funds.

Table 1.2: FY 13-14 Lottery Expenditures

EXPENDITURES	AMOUNT	PERCENT
Prizes	\$811,055,368	64%
Education Lottery Account (including unclaimed prizes)	330,703,203	26%
Retailer Commissions	89,234,224	7%
Operating Expenses	37,079,537	3%
TOTAL	\$1,268,072,332	100%

Source: SC Education Lottery

Chapter 1
Introduction

Lottery Operations

Instant Game Closing Procedures

The lottery has not amended its regulations, as recommended in previous audits, to reflect the change in its end-of-game procedures to end sales immediately after the last top prize is claimed. Our analysis of instant ticket sales showed that ending the game sales earlier has not adversely affected the sales of instant tickets.

An instant game is a lottery ticket that requires the player to remove a latex coating to determine if the ticket is a winner. The lottery offers a variety of instant games with tickets ranging in price from \$1 to \$10. Tickets are sold by licensed lottery retailers throughout the state. For FY 13-14, the lottery earned over \$800 million in revenues from instant tickets and paid out over \$600 million in prizes. Table 2.1 shows the revenues earned and prizes paid by ticket prices for FY 12-13 and FY 13-14.

Table 2.1: Instant Game Revenues and Prizes

INSTANT GAME TICKETS	FY 13-14	FY 12-13
Revenue		
\$1	\$43,611,511	\$43,178,609
\$2	81,456,132	80,846,344
\$3	28,732,245	30,630,669
\$5	166,714,325	170,494,365
\$10	552,470,944	478,334,578
TOTAL	\$872,985,157	\$803,484,565
Prizes		
\$1	\$24,985,802	\$25,147,502
\$2	52,281,872	51,631,150
\$3	19,012,394	20,305,818
\$5	116,888,443	119,935,974
\$10	415,027,135	360,075,252
TOTAL	\$628,195,646	\$577,095,696

Source: S.C. Education Lottery

End-of-Game Regulations

In the 2005 LAC audit of the S.C. Education Lottery (SCEL), we found that the lottery had sold \$19.9 million in instant tickets for FY 04-05 after all the top prizes for those games had been claimed. We recommended that the lottery discontinue the practice of selling tickets when the top prizes are no longer available. In 2009, the lottery revised its game closing procedures to require that tickets cannot be sold after the last top prize in a game is claimed. However, the lottery has not amended its regulations, as recommended, to reflect the change in procedure. S.C. Reg. 44-40.10, which concerns instant games, includes the official end-of-game requirements including that a “lottery retailer may continue to sell tickets for each instant game up to ninety (90) days after the official end of that game.” If an earlier date has not already been set, the official end of the game is set when there is one unclaimed top prize remaining, usually in 90 days as allowed by regulation. However, if the remaining top prize is claimed before the official end of the game, sales of that game must end immediately. This policy has not been included in the regulation.

Recommendation

1. The South Carolina Education Lottery should submit a proposed regulation to the General Assembly to amend S.C. Reg. 44-40.10C.(2) to state that once a retailer has been notified that the last top prize of an instant game has been claimed, sales of those game tickets must be discontinued immediately.

Effect of End-of-Game Procedures

There was concern that ending the game sales earlier had adversely affected the instant game ticket process and sales. The inability to set a closing date for the game as well as the possibility that the top prizes may be claimed early in the selling period could affect the lottery’s planning and projected sales. We reviewed data on the sale of instant tickets from October 2007 to March 2014 and compared statistics between sales started before May 2009, when the new procedure was implemented, to sales after May 2009. Our analysis of instant ticket sales showed that ending the game sales earlier has not adversely affected the sales of instant tickets. The sales of instant tickets are usually the highest during the first few weeks that a game is introduced. If the top prizes in a game are claimed earlier than expected, the majority of the ticket sales have already occurred. As shown in Table 2.2, we did find that the number of days that a game was active has decreased, but the percentage of tickets sold has increased since ending games sales earlier, with the exception of the \$1 and \$10 tickets.

Table 2.2: Sales of Instant Games Before and After Policy Change in May 2009

INSTANT GAME	START OF GAME	AVERAGE NUMBER OF DAYS	AVERAGE % TICKETS SOLD
\$1 Tickets	Before	182	91
	After	300	88
\$2 Tickets	Before	229	87
	After	200	91
\$3 Tickets	Before	246	84
	After	208	90
\$5 Tickets	Before	295	86
	After	226	87
\$10 Tickets	Before	197	95
	After	175	94

Source: S.C. Education Lottery

The profit that the lottery has earned from the instant games has also increased since the policy change for all of the tickets except the \$5 tickets. Table 2.3 shows the average profit per game before the policy change in May 2009 and after the change and the percentage change in the profit.

Table 2.3: Profits from Instant Games Before and After Policy Change in May 2009

INSTANT GAME	START OF GAME	AVERAGE PROFIT	% CHANGE
\$1 Tickets	Before	\$755,867	15%
	After	\$867,848	
\$2 Tickets	Before	\$1,091,274	6%
	After	\$1,161,745	
\$3 Tickets	Before	\$1,373,557	8%
	After	\$1,489,292	
\$5 Tickets	Before	\$2,555,335	-14%
	After	\$2,206,229	
\$10 Tickets	Before	\$4,087,036	19%
	After	\$4,844,218	

Source: SC Education Lottery

Having to end a game when the last top prize has been claimed creates unplanned tasks to be completed in a shorter amount of time for the information technology gaming staff and the marketing sales representatives. While there may be costs associated with these tasks, the ticket sales and the profits from the games do not appear to be adversely affected.

Internal Controls Over Fraud With Retailer Accounts

We reviewed SCEL's internal controls to prevent and detect retailer account fraud to determine if the controls are adequate. A lottery employee had embezzled \$226,439 from retailer accounts from 2010 to 2012. We found that SCEL had policies to detect and prevent this type of fraud which were not followed and has implemented additional controls to detect and prevent this in the future.

In 2012, the lottery began investigating a retailer's complaints that the lottery had charged it more than the retailer owed. During the course of the investigation, it was discovered that a lottery employee had changed bank account numbers and e-mail accounts to direct retailers to wire funds due the lottery into his personal bank account. He would then bill other retailers the amount of those funds so that the lottery's accounts would be balanced. He would change the lottery's information back to the original information so that the changes would not be detected when retailers complained. The employee was terminated, charged with embezzlement, and indicted. He has not been convicted or sentenced. All of the retailers fraudulently charged have been reimbursed and the lottery has received \$216,439 from its insurance company. Any restitution will be paid to the insurance company.

The employee had the authority to change the bank account numbers but should have filed written change forms and obtained approval signatures. All of the changes made were recorded in the system audit logs, but management did not review the logs. Additionally, since the employee was authorized to make the changes and only made them sporadically, it may not have alerted management to the fraud. Retailer complaints are also an indication of possible fraud. In this instance, the retailers were complaining to the person who was committing the fraud. It was only when complaints were made to other lottery employees that the investigation began.

SCEL has implemented a policy that precludes accountants from making changes to the bank accounts for the retailers for which they are responsible. A primary processor who does not have responsibility for any accounts has been named to make any required changes. The Chief Financial Officer is required to approve any changes to bank information prior to entry in the computer system.

The lottery's financial auditor and internal auditor recommended in 2010 that two separate user names be issued to the employees with authority to make changes to bank account information. One user name would be used for day-to-day responsibilities. The other user name would be required to make changes to bank accounts. In 2013, separate user names were issued to employees with backup responsibilities for retailer bank account numbers.

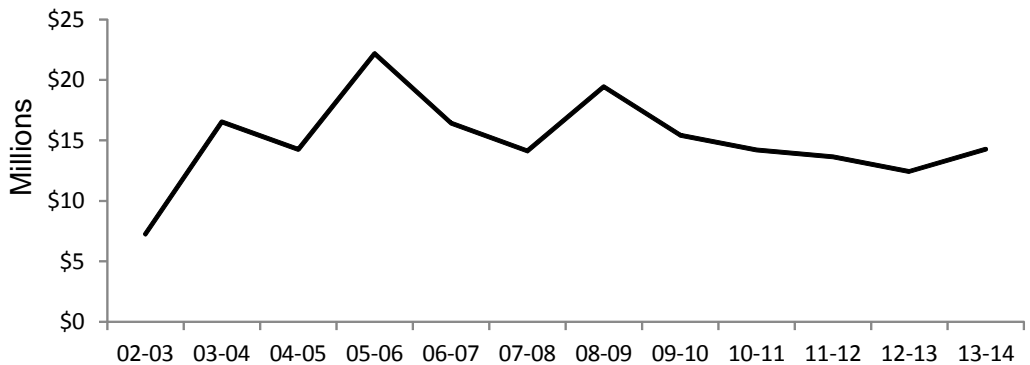
Unclaimed Prizes

We found that the lottery could use additional methods to better estimate the amount of unclaimed prizes. An unclaimed prize is a prize on a winning ticket that has not been claimed within the applicable time period for the lottery game. For instant games, the winner has 90 days after the end of the game to claim a prize. For online games, the winner has 180 days after the drawing is held to claim a prize. Unclaimed prize money must be deposited into the Education Lottery Account each year. The General Assembly determines the allocation of unclaimed prize money among agencies. Appropriations from the Education Lottery Account must be for educational purposes and programs as specified in S.C. Code §59-150-350(D).

Actuals and Estimates of Unclaimed Prizes

The lottery deposits unclaimed prize money once a month in the Education Lottery Account. Unclaimed prize funds have been decreasing in recent years as shown in Chart 2.4.

Chart 2.4: Education Lottery Deposits



Source: SC Education Lottery and State Budget Office

However, the unclaimed prize amount increased from over \$12 million transferred in FY 12-13 to \$14,265,225 in FY 13-14.

The SCEL Commission provides an estimate of the expected amount of unclaimed prizes to the Board of Economic Advisors (BEA), which is then used as the basis for the General Assembly’s appropriation of those funds. According to a lottery official, the estimates are based on historical trends of unclaimed prizes. There is no formula used in the process. Table 2.5 shows the latest unclaimed prizes estimate available to the General Assembly during the appropriations process, the actual amount of the transfer, and the difference.

Table 2.5: Unclaimed Prize Estimates and Actual Revenue: FY 07-08 Through FY 13-14

FISCAL YEAR	DATE	ESTIMATE	ACTUAL	DIFFERENCE
07-08	12/14/2006	\$8,400,000	\$14,128,271	\$5,728,271
08-09	11/08/2007	\$8,400,000	\$19,437,827	\$11,037,827
09-10	11/07/2008	\$8,400,000	\$15,427,686	\$7,027,686
10-11	11/10/2009	\$8,400,000	\$14,209,819	\$5,809,819
11-12	11/10/2010	\$12,400,000	\$13,653,581	\$1,253,581
12-13	11/10/2011	\$12,400,000	\$12,436,933	\$36,933
13-14	05/09/2013	\$8,000,000	\$14,265,225	\$6,265,225

Source: SC Education Lottery and Board of Economic Advisors

For the last three fiscal years, the lottery has revised its estimates of unclaimed prize revenue throughout the fiscal year which has resulted in more accurate estimates. The lottery reviews and revises its estimates of unclaimed prize revenue for the current and upcoming fiscal years three times during the fiscal year. For example, for FY 13-14, the lottery revised its estimate of \$8 million in May 2013 to \$11 million in February 2014 and to \$12 million in May 2014.

Other States' Unclaimed Prizes

We reviewed how the lotteries in Georgia and Tennessee estimate unclaimed prizes to determine if they have a method that could be used in South Carolina. According to a Georgia lottery official, Georgia does not estimate its unclaimed prizes each year. According to a Tennessee lottery official, the lottery estimates unclaimed prizes based on historical claim experience which has been that unclaimed prizes are about 1.9% of the gross prize expense. If South Carolina used a similar method as an additional way to estimate unclaimed prizes, the average over the last five years is 2% of the gross prize expense. A more conservative method could be to use the lowest ratio over the last five years which is 1.6%. By using additional methods to estimate unclaimed prizes, the lottery and the BEA could provide the General Assembly with more accurate estimates to plan the appropriation of lottery funds.

Recommendation

2. The South Carolina Education Lottery and the Board of Economic Advisors should consider the results of additional methods when estimating unclaimed prizes for use by the General Assembly during the appropriations process.

Allocation of Unclaimed Prizes

The General Assembly appropriates unclaimed prize funds in the proviso that allocates the funding from the Education Lottery Account. For FY 13-14, unclaimed prizes totaling \$8 million were appropriated as shown in Table 2.6.

Table 2.6: FY 13-14 Unclaimed Prize Appropriations

AGENCY	PURPOSE	AMOUNT
CHE	Higher Education Excellence Enhancement Program	\$2,950,000
SDE	New School Buses	\$1,700,000
CHE and Tech Board	Tuition Assistance Two-Year Institutions	\$1,700,000
SDE	K-5 Reading, Math, Science & Social Studies	\$1,600,000
DAODAS	Gambling Addiction Services	\$50,000

Source: FY 13-14 appropriations act

If the revenue from unclaimed prizes is less than the amount appropriated, the appropriations for each program will be reduced on a pro rata basis. The General Assembly also includes additional appropriations in the proviso if the unclaimed prize funds exceed the estimate. For FY 13-14, an additional \$18 million was appropriated to be distributed in the following order.

Table 2.7: FY 13-14 Excess Unclaimed Prize Appropriations

PRIORITY	AGENCY	PURPOSE	AMOUNT
1	SDE	New School Buses	\$3,300,000
2	CHE	Partnership Among S.C. Academic Libraries (PASCAL) Program	\$1,500,000
3	CHE	Technology: Public Four-Year Universities, Two-Year Institutions, and State Technical Colleges	\$5,470,093
4	State Library	Aid to County Libraries	\$2,000,000
5	CHE	Higher Education Excellence Enhancement Program	\$1,000,000
6	Tech Board	Allied Health Initiative	\$4,000,000
7	CHE	Critical Needs Nursing Program	\$1,000,000

Source: FY 13-14 appropriations act

Any additional remaining funds are appropriated to CHE for LIFE, HOPE, and Palmetto Fellows scholarships.

Many of the programs receiving unclaimed prize funds also receive funds from the Education Lottery Account. We reviewed the controls on how agencies spend these funds in *A Review of the State's Use of South Carolina Education Lottery Proceeds*.

Follow-Up

Implementation of Recommendations in LAC Lottery Audits

The Legislative Audit Council has published three audit reports of the South Carolina Education Lottery.

A REVIEW OF THE S.C. EDUCATION LOTTERY AND THE STATE'S USE OF LOTTERY PROCEEDS (DECEMBER 2003)

A REVIEW AND FOLLOW-UP REPORT OF THE SOUTH CAROLINA EDUCATION LOTTERY (DECEMBER 2005)

AN AUDIT OF THE S.C. EDUCATION LOTTERY (FEBRUARY 2010)

We reviewed 18 of the recommendations from these reports. These recommendations were reviewed because either they had not previously been followed up on, or previous follow-up reviews showed them to be partially implemented or not implemented. Other recommendations were also reviewed as part of the audit but are included in other sections of the report.

Of these 18 recommendations, we found that 8 had been implemented, 2 had been partially implemented, and 8 had not been implemented. Of the 10 recommendations directed to SCEL, we found that 6 had been implemented, 2 had been partially implemented, and 2 had not been implemented.

LAC RECOMMENDATIONS	
Implemented	8
Partially Implemented	2
Not Implemented	8
TOTAL	18

Below, we discuss the recommendations from each previous audit that had not previously been followed up on, or previous follow-up reviews showed them to be partially implemented or not implemented.

DECEMBER 2003

Recommendation 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.

NOT IMPLEMENTED

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. In 2003, based on an analysis of lottery profits and state advertising spending, we concluded that South Carolina would probably have higher per capita profits if it had higher per capita advertising expenditures.

S.C. Code §59-150-60(A)(15) prevents the lottery from entering into an advertising contract if the commission exceeds 3%. In 2003, we found that the standard advertising contract commission is 15%. This disparity causes circumstances that may prevent the lottery from obtaining the most high-quality and cost-effective advertising services.

There were no bills introduced in the 2007-2008 through 2013-2014 sessions which addressed this section of the law.

DECEMBER 2003

Recommendation 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.

NOT IMPLEMENTED

In 2003, we found that the lottery purchased promotional items because S.C. Code §59-150-60(H) prevents it from giving away tickets for promotional purposes. Because the items purchased cost significantly more than promotional tickets would have, we concluded that the lottery should be allowed to give tickets away for promotional purposes as long as its commission promulgates regulations concerning ticket use and requiring the cost to be included as administrative expenditures. There were no bills introduced in the 2005-2006 through 2013-2014 sessions which amended this section of the law.

DECEMBER 2003

Recommendation 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.

NOT IMPLEMENTED

In 2003, we found that the lottery is restricted from competitively procuring communication services because S.C. Code §59-150-60(A)(9) requires it to use services provided by the Budget and Control Board. A lottery official stated that without this requirement, the lottery could procure services at lower rates and pass the savings on to retailers, which could attract more retailers to sell tickets. There were no bills introduced in the 2005-2006 through 2013-2014 sessions which amended this section of the law.

DECEMBER 2005

Recommendation 6

When the South Carolina Education Lottery advertises a top prize for any of its games, it should include the odds of winning a top prize.

IMPLEMENTED

In our 2010 audit, we determined that SCEL had partially implemented this recommendation. We found that it did not communicate the odds on its billboards, but it did communicate the odds verbally on radio ads and in writing on its television ads.

SCEL has improved its communication of the odds of winning a top prize since the 2010 audit. We reviewed a sample of 116 television, radio, print, and digital ads, including billboards and PIDs (monitors that show SCEL advertisements at lottery retail locations), from 2013. We found that SCEL has implemented this recommendation because:

- SCEL’s advertisements on television and radio all communicated top prizes and the odds of winning a top prize.
- All of the television ads included written, but not verbal, statements of the odds of winning (see the following Recommendation 7).
- Of the 63 print and digital ads we reviewed, 61 (97%) stated the odds of winning a top prize.

DECEMBER 2005

Recommendation 7

When the South Carolina Education Lottery advertises a top prize for any of its games on television or radio, it should verbally communicate in the ad the odds of winning a top prize.

PARTIALLY IMPLEMENTED

In our 2010 audit, we determined that SCEL had partially implemented this recommendation. We found that none of the television ads reviewed included a verbal statement of the odds of winning, although 80% included a written statement of the odds. We also found that 75% of radio ads reviewed included a verbal statement of the odds of winning.

We reviewed nine television ads aired during 2013 and found that all advertised top prizes and communicated the odds of winning a top prize in writing. However, none of these verbally communicated the odds of winning a top prize. Our follow-up review also included 32 radio ads aired during 2013. All 32 advertised top prizes, and verbally communicated the odds of winning a top prize.

DECEMBER 2005

Recommendation 8

When the South Carolina Education Lottery prints a top prize on a lottery ticket or number selection form, it should also print on the ticket or form the odds of winning the top prize.

IMPLEMENTED

In our 2010 audit, we determined that SCEL had partially implemented this recommendation. We found that none of the instant (“scratch-off”) tickets sampled communicated the odds of winning a top prize, but that all of the number selection forms did indicate these odds. During this audit, but after we reviewed these tickets, SCEL officials stated that, after ticket sales were completed for games contracted through March 16, 2009, all instant tickets citing a top prize would include the odds of winning a top prize.

We reviewed all 144 instant tickets and 6 number selection forms used in 2013. All of these tickets and forms communicated the odds of winning a top prize.

DECEMBER 2005

Recommendation 9

The South Carolina Education Lottery should obtain and follow advice from reading/literacy experts to ensure that written communications to lottery customers can be read by persons with moderate reading skills.

PARTIALLY IMPLEMENTED

Literacy experts recommend careful use of language and avoidance of italics, small print, and all capital letters to increase the readability of printed materials. In our 2010 audit, we determined that SCEL had partially implemented this recommendation. In July 2009, it consulted with literacy experts regarding marketing material used at its retail play stations, but not regarding the language printed on its lottery tickets or number selection forms.

SCEL has not taken further action to implement this recommendation since that time. SCEL officials indicated that it was difficult and time-consuming to obtain the expert advice in 2009. We identified free online guides and tools from which SCEL could obtain expert guidance to increase the readability of its documents.

DECEMBER 2005

Recommendation 12

The South Carolina Education Lottery should submit a request to the General Assembly to amend Regulation 44-40.10 (C)(2), so that lottery retailers are required to discontinue the sale of scratch-off lottery tickets immediately after being notified that a game has been officially ended.

NOT IMPLEMENTED

The S.C. Education Lottery has not submitted any regulations to the General Assembly from 2010 through January 2014. See *Instant Game Closing Procedures* for a further discussion of this recommendation.

DECEMBER 2005

Recommendation 13

The General Assembly should approve a request from the South Carolina Education Lottery to amend Regulation 44-40.10(C)(2), so that lottery retailers are required to discontinue the sale of scratch-off lottery tickets immediately after being notified that a game has been officially ended.

NOT IMPLEMENTED

The S.C. Education Lottery has not introduced any regulations from 2010 through January 2014, so the General Assembly has not had any regulations to approve. See *Instant Game Closing Procedures* for a further discussion of this recommendation.

DECEMBER 2005

Recommendation 14

The General Assembly should amend §59-150-210 (E) of the South Carolina Code of Laws to repeal the prohibition against lottery ticket sales on primary and general election days.

IMPLEMENTED

In 2005, we found that the effect of this prohibition in 2004 was a loss of approximately \$1.8 million in sales and \$600,000 in net proceeds available for education. While S.C. Code §59-150-210(E) has not been repealed, a proviso has been included in the appropriations acts in FY 11-12, FY 12-13, and FY 13-14 which suspends the provisions of S.C. Code §59-150-210(E) so lottery tickets are allowed to be sold on primary and general election days.

DECEMBER 2005

Recommendation 18

The General Assembly should amend state law to authorize the South Carolina Education Lottery to deny, suspend, revoke, or terminate the contracts of lottery retailers or applicants who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction.

NOT IMPLEMENTED

In 2005, we found that the authority of the lottery to respond to illegal gaming by lottery retailers may be limited by state law to cases in which a retailer has been criminally convicted. In 2011, SCEL revised its contracts with lottery retailers to put in place an automatic, non-appealable six-month suspension if a magistrate determines an illegal gaming device was present at a retail outlet. There was no legislation introduced during the 2009-2010 through 2013-2014 legislative sessions to amend state law to penalize retailers who allow illegal gambling on their premises.

DECEMBER 2005

Recommendation 19

The General Assembly should amend state law to authorize the South Carolina Education Lottery to impose administrative fines against lottery retailers who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction.

NOT IMPLEMENTED

In 2005, we found that the authority of the lottery to respond to illegal gambling by lottery retailers may be limited by state law to cases in which a retailer has been criminally convicted. In 2011, SCEL revised its contracts with lottery retailers to put in place an automatic, non-appealable six-month suspension if a magistrate determines an illegal gaming device was present at a retail outlet. There was no legislation introduced during the 2009-2010 through 2013-2014 legislative sessions to amend state law to penalize retailers who allow illegal gambling on their premises.

DECEMBER 2005

Recommendation 20

The South Carolina Education Lottery should continue to reduce the number of cell phones provided to employees.

IMPLEMENTED

SCEL has slightly decreased the number of cell phones provided to its employees from our 2005 and 2010 audits (see table below). In addition, SCEL continues to monitor its cell phone plans to identify areas where costs can be reduced. Since 2010, it has reduced its data plan associated with the phones by approximately \$6,600 per year.

LAC AUDIT	CELL PHONES ASSIGNED TO SCEL EMPLOYEES	APPROXIMATE NUMBER OF SCEL EMPLOYEES
2003 [03-5]	86	130
2005 [SCEL-05]	84	150
2010 [SCEL-08]	86	140
2014 [SCEL-13]	77	118

Source: S.C. Education Lottery

DECEMBER 2005

Recommendation 21

The South Carolina Education Lottery should maintain data on the status of its performance measures.

IMPLEMENTED

We reviewed documentation on the operations of departments throughout the agency, including goals, weekly reports of change over time and change compared to previous time frames, and current conditions compared with goals. SCEL has demonstrated that it has been consistently maintaining and analyzing data to determine the status of its performance measures.

DECEMBER 2010

Recommendation 1

The Materials Management Office of the Budget and Control Board and the South Carolina Education Lottery should ensure that evaluators provide clear, unambiguous explanations of their scoring of future lottery contract proposals to comply with S.C. Code §11-35-1530(9).

IMPLEMENTED

In 2010, we found that some SCEL procurement records did not clearly state the reasons for assigning points to vendors that submitted contract proposals. These points were used to determine which companies were awarded contracts.

We reviewed evaluation documents from the Budget and Control Board for six contracts currently in use by SCEL. These documents included clear explanations of evaluators' scores, as required by S.C. Code §11-35-1530(9).

DECEMBER 2010

Recommendation 2

The South Carolina Education Lottery should comply with §11-35-1210(1) of the South Carolina Code of Laws and S.C. Regulation 19-445.2020.A.(1) when purchasing additional goods and services from companies with lottery contracts.

IMPLEMENTED

In 2010, we found that SCEL paid a contracted vendor approximately \$806,000 for extra services without a contract change order authorized by the Budget and Control Board, as required by state law and regulation.

We reviewed payment information from FY 13-14 for seven vendors with SCEL contracts. There were no payments to three of those vendors during this time. SCEL provided two properly authorized change orders for two of the vendors that did receive payments. We did not find any instance of noncompliance in the payment information we reviewed.

DECEMBER 2010

Recommendation 3

When reporting the results of demographic surveys of its lottery players, the South Carolina Education Lottery should include monthly per capita expenditures by demographic group.

IMPLEMENTED

SCEL has reported the results of its 2014 demographic survey of its players to its Board of Commissioners, including monthly per capita expenditures by demographic group. Below are examples from the 2014 survey results of demographic groups that spend the most and the least, on average, for all SCEL games combined.

	HIGHEST MONTHLY PER CAPITA SPENDING		LOWEST MONTHLY PER CAPITA SPENDING	
	AVERAGE SPENDING	DEMOGRAPHIC GROUP	AVERAGE SPENDING	DEMOGRAPHIC GROUP
Education	\$23.20	High School or Less	\$11.30	Four-Year Degree
Employment	\$22.30	Temporarily Unemployed	\$4.85	Student
Type of Job	\$23.62	Service Occupation	\$13.81	Education
Marital Status	\$22.69	Other	\$13.94	Widowed/ Divorced
Household Income	\$21.11	Under \$35,000	\$10.34	\$100,000 to \$150,000
Age	\$20.18	55 to 64	\$15.09	45 to 54
Residential Area	\$19.90	Urban	\$15.60	Small Town
Gender	\$19.54	Male	\$13.89	Female
Ethnicity	\$18.80	African American	\$10.45	Other

Source: S.C. Education Lottery

DECEMBER 2010

Recommendation 4

The South Carolina Education Lottery should contract with the Department of Alcohol and Other Drug Abuse Services to conduct periodic checks of retailers' compliance with S.C. Code §59-150-210 (D).

NOT IMPLEMENTED

In 2010, we found that compliance checks of lottery retailers to deter the illegal sale of lottery tickets to minors had not been conducted on a regular basis. SCEL has not contracted with the Department of Alcohol and Other Drug Abuse Services to conduct compliance checks of the state law prohibiting lottery ticket sales to minors.

Agency Comments



October 22, 2014

Perry K. Simpson, Director
South Carolina Legislative Audit Council
1331 Elmwood Avenue, Suite 315
Columbia, South Carolina 29201

Dear Mr. Simpson:

We appreciate the professional and courteous manner in which the auditors conducted themselves under the leadership of Andrea Truitt.

Following are the South Carolina Education Lottery's (SCEL) written responses to Legislative Audit Council (LAC) observations.

Chapter 2, Lottery Operations:

Instant Game Closing Procedures:

S.C. Reg. 44-40.10C.(1) states that "SCEL shall announce the official end of each game." The South Carolina Education Lottery enforces the end of game process through system controls, policies and procedures designed to pick up games from the retailer when they are ended, and through the retailer contract, retailer training, and announcements to customers in the retail location. As reported by the LAC in its 2010 audit, SCEL had implemented sound end-of-game procedures.

While it is true the Commission has not submitted updated regulations changing S.C. Reg. 44-40.10C.(2) to explicitly state that once a retailer has been notified that the last top prize of an instant game has been claimed sales of tickets must be discontinued immediately, we continue to believe that the current wording of the regulation that "SCEL shall announce the official end of each game" and a "lottery retailer *may* continue to sell tickets for each instant game *up to* ninety (90) days after the official end of that game...." (emphasis added) is permissive and covers current procedures.

Unclaimed Prizes:

We believe SCEL uses a sound methodology of conservatively estimating unclaimed prizes each year based on analysis of historical trends. As acknowledged in the LAC report, SCEL also "reviews and revises its estimates on unclaimed prize revenue for the current and upcoming fiscal years three times during the fiscal year."

The Commission is always open to improvement, however, and will consider the results of any and all additional methods available whose methodology is considered valid when estimating unclaimed prizes for use by the General Assembly during the appropriations process.

Chapter 3, Follow-Up:

Implementation of Recommendations in LAC Lottery Audits:

To the extent SCEL could legally implement recommendations, and the recommendations positively enhanced business operations or promoted public policy, SCEL implemented prior recommendations. We would like to point out that the LAC table does not fully represent the number of recommendations implemented by SCEL as a result of prior LAC audits.

During prior audits, the LAC presented several recommendation items to SCEL. As shown in the table below, of 31 prior audit recommendations under the control of SCEL only two have not been implemented.

Audit Year	Recommendations	Implemented	Partially Implemented	Not Implemented
2003	9	9	0	0
2005	18	15	2	1
2010	4	3	0	1
Total	31	27	2	2
Percentage	100.0%	87.1%	6.5%	6.5%

In those two cases the LAC recommended SCEL: 1) Submit a request to the General Assembly to amend regulations requiring lottery retailers to discontinue ticket sales after a game has officially ended, and 2) Establish a contract with DAODAS to conduct periodic checks of retailers' compliance with S.C. Code §59-150-210(D) prohibiting the sale of lottery products to minors. We discuss our reasons for not implementing these recommendations below.

December 2003, Recommendation 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."

SCEL appreciates the spirit of the 2003 LAC recommendation trying to ease potential constraints. SCEL now has more than thirteen successful years of generating funds for education with a downward trend in advertising expenses. SCEL successfully operates well within all statutory restrictions on spending and currently sees no need to request a statutory change for more flexibility.

December 2003, Recommendation 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."

The Commission respectfully submits that printing tickets to give away for promotional purposes opens the lottery up to potential fraud.

In fact, in November 2012, an Arkansas Lottery Security employee was fired and charged after taking lottery tickets, using security credentials to manipulate the system to reassign them as promotional tickets, cashing the tickets at a retail location, then using security credentials to mark the ticket "void by Security" so no record of them existed. The employee received approximately \$477,893 from the scheme.

On February 7, 2014, a Kentucky Lottery Corporation regional manager was charged with three counts of fraudulent use of a lottery ticket, a Class C felony. The regional manager is accused of having stolen 1,800 promotional lottery tickets and fraudulently cashing them.

The Commission believes that offering promotional tickets unnecessarily increases the risk that the lottery will be subject to potential fraud and abuse. SCEL does not want to assume this risk. The Commission therefore respectfully requests this recommendation be removed from future reports and the General Assembly not implement the recommendation.

December 2003, Recommendation 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."

The recommendation may no longer be necessary. As with most technology, the cost for these communication services is lower now than it was in 2003.

December 2005, Recommendation 7. "When the South Carolina Education Lottery advertises a top prize for any of its games on television or radio, it should verbally communicate in the ad the odds of winning a top prize."

As indicated in the 2014 LAC report: all television ads reviewed by the LAC which aired in 2013 communicated the odds of winning a top prize in writing; all 32 radio ads reviewed by the LAC which aired in 2013 advertised top prizes and verbally communicated the odds of winning a top prize; and all of the 144 instant tickets and 6 play slips reviewed by the LAC communicated the odds of winning a top prize.

In addition to the above methods, there are numerous other ways, particularly in retail locations at the point of sale, that SCEL advertises the odds of all games.

SCEL understands the importance of effectively communicating game odds, and will continue to communicate top prize odds to players.

We submit SCEL has in fact implemented the full spirit and intent of this recommendation.

December 2005, Recommendation 9. "The South Carolina Education Lottery should obtain and follow advice from reading /literacy experts to ensure that written communications to lottery customers can be read by persons with moderate reading skills."

SCEL believes it has sufficiently addressed the concern raised by this recommendation. SCEL researched and identified a site www.readabilityscore.com to address these subjects. SCEL added this process to its quality control checklist completed when finalizing promotional pieces.

December 2005, Recommendation 12: "The South Carolina Education Lottery should submit a request to the General Assembly to amend Regulation 44-40.10 (C)(2), so that lottery retailers are required to discontinue the sale of scratch-off lottery tickets immediately after being notified that a game has been officially ended." and 13: "The General Assembly should approve a request from the South Carolina Education Lottery to amend Regulation 44-40.10 (C)(2), so that lottery retailers are required to discontinue the sale of scratch-off lottery tickets immediately after being notified that a game has been officially ended."

See comments to 2014 LAC Report Recommendation Number 1 herein.

December 2005, Recommendation 18: "The General Assembly should amend state law to authorize the South Carolina Education Lottery to deny, suspend, revoke, or terminate the contracts of lottery retailers or applicants who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction" and 19: "The General Assembly should amend state law to authorize the South Carolina Education Lottery to impose administrative fines against lottery retailers who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction."

While these recommendations are made to the General Assembly and not to SCEL, the gravity of the subject merits comment by SCEL. SCEL has taken steps to effectively address this concern. As indicated in the LAC 2014 Report, SCEL added a provision to its retailer contract in July 2011 whereby the retailer voluntarily agrees to a six-month license suspension if a gaming machine in the retailer outlet is found to be illegal by a local judge. SCEL has implemented a process to obtain information regarding illegal machines and has issued more than thirty-five suspensions to date. The Executive Director has

also denied a license for any location where the owner(s) has pending gambling or certain other offenses until the pending charge(s) is resolved since July 1, 2011.

In our opinion, implementing a simple fine could adversely affect the integrity and reputation of this lottery. Based on our experience, disabling or removing a sales terminal for a length of time, thereby denying offending retailers income that their competitors --who in good faith comply with law and contract-- are receiving, is much more effective than a one-time fine that could lead to a mindset that noncompliance is merely "a cost of doing business" or one where "money can make the problem go away". Consequently, SCEL believes the suggested amendment(s) to state law would weaken, not strengthen, SCEL business operations and the public policy against illegal gambling.

February 2010, Recommendation 4. "The South Carolina Education Lottery should contract with the Department of Alcohol and Other Drug Abuse Services to conduct periodic checks of retailers' compliance with S.C. Code §59-150-210(D).":

SLED previously performed sting operations on behalf of the lottery with no violations detected. In addition, of only 690 complaints SCEL has received since the lottery's first ticket sale in 2002, only two have been related to potential sale of lottery products to underage individuals. SLED agents contracted by SCEL acted on each complaint at the time of the complaint.

Therefore, based upon the results of prior SLED sting operations and the immaterial number of complaints received by SCEL Security, we submit that the cost of contracting with DAODAS would exceed the benefit and we believe this recommendation is unnecessary.

Thank you again for this opportunity to comment. We sincerely appreciate the opportunity to work with you for the benefit of the State, and we look forward to your continued assistance.

Respectfully,



Paula Harper Bethea
Executive Director

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