

DEPARTMENT OF THE LOTTERY
GAMES ADMINISTRATION

Operational Audit



SECRETARY OF THE DEPARTMENT OF THE LOTTERY

Pursuant to Section 20.317(1)(a), Florida Statutes, the Secretary of the Department of the Lottery is appointed by the Governor with confirmation by the Senate. Leo DiBenigno served as the Secretary during the period of audit. Cynthia F. O'Connell was appointed by the Governor as the Secretary on February 9, 2011.

The audit team leader was Jon M. Bardin and the audit was supervised by Kathryn D. Walker, CPA. Please address inquiries regarding this report to Kathryn D. Walker, CPA, Audit Manager, by e-mail at kathrynwalker@aud.state.fl.us or by telephone at (850) 487-9085.

This report and other reports prepared by the Auditor General can be obtained on our Web site at www.myflorida.com/audgen; by telephone at (850) 487-9175; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

DEPARTMENT OF THE LOTTERY
Games Administration

SUMMARY

This operational audit of the Department of the Lottery (Department) focused on games administration issues primarily related to product development and management. Our audit disclosed the following areas where improvements should be made:

Finding No. 1: Although our tests disclosed no instances in which significant game development processes had been omitted, the Department’s game management controls could be improved by implementing written procedures describing the steps to be performed when selecting, launching, advertising, monitoring, and closing lottery games.

Finding No. 2: The Department did not utilize a methodology, such as the completion of a checklist, to document the accomplishment of game management milestones.

Finding No. 3: The Department did not always document that all appropriate divisions approved a game’s working papers prior to the contracting for the game.

Finding No. 4: The Department should consider tracking in one system all applicable costs for each game, including license fees, research costs, and advertising costs.

BACKGROUND

State law authorizes the Department of the Lottery (Department) operate lottery games so as to maximize revenues in a manner consonant with the dignity of the State and the welfare of its citizens. The net proceeds of lottery games are to benefit public education.¹ Specifically, revenues from the sale of lottery tickets, less prizes paid to winning ticket holders, retailer commissions and fees, gaming vendor fees, and administrative costs, are to be transferred to the Educational Enhancement Trust Fund managed by the Florida Department of Education.² The Department generates revenue by selling two types of products, online games and scratch-off games. Scratch-off games are considered instant games because the customers can immediately determine if they are a winner by scratching off the latex covering of the ticket. Online games are generally games in which winning numbers are selected or drawn at a designated time. The Department releases about 40 new scratch-off games each fiscal year, but only released one new online game during the period July 2009 through November 2010. The Department typically makes available approximately 50 scratch-off games and 7 online games at any one time.

A game is created based on a concept developed internally or by a gaming vendor. The game concept is presented to Department management who decide whether the game will fit into the Department’s mix of products. Games are to be launched at a strategic point in time to ensure the mix of products remains well-balanced. For each game, the Department is to monitor on a regular basis the sales of tickets and number of prizes claimed. Various groups and systems accumulate for each game the associated specific costs which include research, licenses, advertising, and promotional items.

¹ Section 15, Article X of the State Constitution of Florida; Sections 24.102 and 24.104, Florida Statutes.

² Section 24.121, Florida Statutes.

Scratch-off and online games can be purchased at any one of nearly 13,200 retail establishments and 9 district offices throughout Florida. Through sales of these game tickets, the Department has in recent years, generated approximately \$4 billion in annual sales.

FINDINGS AND RECOMMENDATIONS

Games Administration

Finding No. 1: Game Procedures

The process of rolling out a game from conception to launch is a complicated and carefully timed progression of steps involving several Department organizational units, the printing vendor, and, in some instances, several other contract vendors. To successfully launch the game, many of these steps must be performed in chronological order. Also, because of printing, advertising, or seasonal issues, deadlines must be established for each step, including a final launch date deadline. Decisions must also be made as to how much and what kind of advertising should be committed to each new game. Following the launch of a game, the Department is responsible for periodically monitoring the game to determine remaining top prizes, timing of tasks, geographic data from sales, and player acceptance. The Department also periodically monitors all game prize-level payments to ensure that the prizes are being claimed as expected and on course with the game’s prize structure.

Because of the many critical steps required to roll out, monitor, and then determine the optimal date for a game’s termination, comprehensive written procedures describing the associated processes and identifying the responsible individuals or organizational units and contractors involved are necessary to ensure the efficient and effective management of games. Our audit disclosed that the Department’s Games Administration Section had several comprehensive written procedures addressing, among other things, retailer hotline call handling, online game draws, and determination of top scratch-off prizes remaining. However, no written procedures were available for the Department’s Product Development or Advertising Sections. With respect to the Product Development Section, written procedures should be established for such processes as game creation, game launch, game monitoring, and game closure. The Advertising Section’s written procedures should reasonably ensure the accomplishment of marketing objectives and describe related processes such as communications with Product Development, the selection of games for advertisement, and the development and approval of the marketing tools and strategies that are to be employed.

Our tests disclosed no instances in which significant game development processes had been omitted. However, the adoption of written procedures would provide Department management with additional assurance that game management objectives will be accomplished. By establishing written procedures, the Department would also have a basis for providing guidelines for the consistent and timely performance of the games administration processes. By not including intricate details in the procedures, the procedures may be applied to most, if not all, game development situations.

Recommendation: We recommend that the Department establish written procedures to describe the steps necessary, along with the timing of those steps, for game creation, game launch, advertising decisions, game monitoring, and game closure.

Finding No. 2: Documenting Milestones

As mentioned in finding No. 1, there are a number of tasks that take place as games are researched, selected, launched, monitored, and closed. Some of these tasks must be completed before others can be started and the completion of groups of related tasks are considered by the Department to be milestones. For example, for the game launch milestone, the game must be printed by the ticket vendor and submitted to the Department along with an electronic validation file so that the Department can adequately test the game using quality control standards. These tasks are the responsibility of various Department organizational units and contractors and require various levels of input and approval.

To ensure that each milestone is completed timely and correctly, there should be a methodology, such as a form or checklist, to document the accomplishment of each task as it is completed and then approved. Although the Department's planning documents did indicate when specific tasks should be performed, and we were advised that Department staff sometimes relied on verbal affirmation that the tasks were performed, no documentary evidence existed to show that the tasks were, in fact, performed. For 18 games, we examined final game approval documents (working papers) that were to be reviewed by management as the final step before game launch and found that these documents did not evidence the completion of interim steps or approvals.

The execution of a checklist, as each game task is completed, would provide Department management additional assurance that games are appropriately researched, selected, launched, monitored, and closed.

Recommendation: We recommend that the Department develop a methodology for documenting the timely completion and approval of game management tasks.

In response to this finding, the Department referred to the "Status of Games in Progress" report, product briefs, and timeline documents. These documents, considered during the course of our audit, address the timing of game management milestones. As indicated in our findings, we believe the Department would further benefit from the development of a methodology for documenting the completion and approval of the various tasks which must be performed in order to complete each milestone.

Finding No. 3: Game Working Paper Approval

The last step in the game development process is the approval of the working papers (game details) by Department managers representing each division and the Department Secretary. The working papers document, usually prepared by the game's printing vendor, contains game rules and instructions, prize structure, ticket print quantities, ticket images showing colors and layout, game odds, and security specifications. The approval process includes an event called a "page turning," during which Department managers are to examine each page of the working papers document to ensure that all requirements have been properly incorporated into the game. A routing sheet is used at the event to obtain the approval signatures of management staff representing each applicable division. If any revisions are necessary, the working papers are to be sent back to the printing vendor for amendment. Once the working papers document is approved, it becomes the contract with the printing vendor, with the last page of the document containing the signatures of the Department Secretary and the printing vendor representative.

We examined the working papers for 18 games and noted that for 2 games, the routing sheet did not contain signatures indicating approval by the Security Division. Department staff explained that, in some instances, not all divisions are able to be present at a game's page turning. In these instances, approval is usually obtained after the

meeting via email. In response to our audit inquiry, the Security Division indicated that the 2 games’ working papers were approved by the Security Division prior to the games’ page turning events and finalization of the game contract; however, documentation of those approvals was not provided for our review.

Documentation of the approval by each applicable division is important to ensure that each aspect of the game meets legal, security, finance, and information resource technology requirements and that a game is not printed and launched with defects.

Recommendation: We recommend that the Department ensure that all appropriate divisions review and approve each game’s working papers and document approvals either at the game’s page turning event or prior to the finalization of the game contract.

Finding No. 4: Tracking of License Fees, Research Costs, and Advertising Costs

In addition to general advertising and promotion costs, the Department incurs substantial costs associated with the research, advertisement, and license fees associated with each new lottery game. During the research process, the Department contracts with companies to conduct player research and verify game odds. The Department also contracts with an advertising agency to plan, develop, and purchase advertising for games. Additionally, the Department must obtain permission from licensors for games that have licensed logos, names, or methods of play. Generally, a licensor charges a flat fee which the Department must pay before any tickets are sold, or a percentage-of-sales fee. Also, a licensor may require the Department to advertise the game in association with an upcoming product release in lieu of a license fee.

Game costs, including research costs, advertising costs, and license fees, were not identified, allocated, and recorded in the Department’s general ledger accounting records in a manner which would allow a summarization of cost for each game. In response to our audit inquiry, Department staff indicated that options were being explored to create this functionality in a new accounting system. During the period covered by our audit, to determine the costs for individual games, Department staff had to access and accumulate cost information from various systems.

To perform a proper post-game analysis and determine whether proper planning decisions were made, and to assist in the planning of future games, the Department would benefit by having a readily available means to capture all costs associated with each game.

Recommendation: We recommend that the Department consider tracking in one system all applicable costs related to each game, including research costs, advertising costs, and license fees. We also recommend that this information be used in the analyses of games after they are closed and that the reviews be documented.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Auditor General conducts operational audits of governmental entities to provide the Legislature, Florida’s citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

We conducted this operational audit from August 2010 to June 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient,

appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This operational audit focused on games administration, including product development and management. The overall objectives of our audit were:

- To evaluate the effectiveness of established internal controls in achieving management's control objectives in the categories of compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the validity and reliability of records and reports; and the safeguarding of assets.
- To evaluate management's performance in achieving compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the validity and reliability of records and reports; and the safeguarding of assets.
- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to section 11.45(7)(h), Florida Statutes.

In conducting our audit we:

- Obtained an understanding of the internal controls over game research and development, creation of prize structures, advertising decisions, monitoring of sales and remaining prizes, and determining when games should be closed.
- Obtained an understanding of other relevant internal controls and tested key processes and procedures.
- Interviewed Department management and staff.
- Examined Department documentation related to 30 lottery games (27 scratch-off games, 3 online games) to determine whether during the period July 2009 through November 2010 the Department:
 - Followed established criteria in determining the need for new lottery games.
 - Relied upon research and performed cost-profit analyses in making game selections and end of game analyses.
 - Ensured that each active game had sufficient legal authority through law or rule (game details were completely described) for the game's methodology, prize structure, prize payment, and other provisions.
 - Associated applicable game-specific revenues, expenses, and contracts to specific games.
 - Provided a valid public purpose for expenses and contracts for specific games that either directly or indirectly supported those games.
 - Employed effective procedures for determining the continued profitability of active games as well as when to continue or close certain games.
 - Effectively disposed of any funds, prizes, tickets, promotional items, or other assets that were surplus and not usable in new games.
 - Informed the public about the closing of games.
 - Provided a navigable Web site that disseminated information to the general public about current games, availability of prizes, how to play, how to collect on winning tickets, and how long games will run.
 - Kept adequate records on the scratch-off tickets to determine whether all prize payouts had been made on all claimed and unclaimed scratch-off tickets.

- Tested 15 retailer hotline calls to determine whether the Department had effective policies and procedures for managing and resolving lottery retailer issues that may arise due to unique game rules, problems, or processes associated with specific games.
- Reviewed applicable policies, procedures, and tested records utilized in game research, planning, and development for 30 games.
- Tested 10 online game draws to determine whether the Department kept sufficient records of all online draws to evidence that the draws were properly made in compliance with all Department procedures.
- Performed various other auditing procedures, including analytical procedures and walkthroughs, as necessary, to accomplish the objectives of the audit.
- Prepared and submitted for management response the findings and recommendations that are included in this report and which describe those matters requiring corrective actions.

AUTHORITY

Section 11.45, Florida Statutes, requires that the Auditor General conduct audits as directed by law, concurrent resolution of the Legislature, or as directed by the Legislative Auditing Committee. Pursuant to the Legislative Auditing Committee’s direction, we have conducted an operational audit of the Department, and this report has been prepared to present the results thereof.



David W. Martin, CPA
Auditor General

MANAGEMENT’S RESPONSE

In a response letter dated August 30, 2011, the Secretary of the Department provided a response to our audit findings and recommendations. The Secretary’s response is included as **EXHIBIT A**.

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EXHIBIT A
 MANAGEMENT'S RESPONSE

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

FLORIDA LOTTERY

August 30, 2011

David W. Martin, CPA
 Auditor General
 G74 Claude Pepper Building
 111 West Madison Street
 Tallahassee, Florida 32399-1450

Dear Mr. Martin:

The Lottery has received your July 26, 2011 report of preliminary and tentative findings and recommendations resulting from your audit of the Lottery's Games Administration for the fiscal year ended June 30, 2011. The staff has discussed your recommendations and responds as follows:

1. Recommendation: We recommend that the Department establish written procedures to describe the steps necessary, along with the timing of those steps, for game creation, game launch, advertising decisions, game monitoring, and game closure.

Response: The audit tests "disclosed no instances in which significant game development processes has been omitted" but felt that "written procedures would provide Department management with additional assurance that game management objectives will be accomplished." The audit report further states that "by not including intricate details in the procedures, the procedures may be applied to most, if not all, game development situations."

We concur in the general thrust of the finding and will develop appropriately high-level written procedures in a standardized Lottery format by March 1, 2012. However, we cannot fully agree with the audit's assertion that "no written procedures were available for the Department's Product Development or Advertising Sections." For example:

- Since 1996, the Lottery has used industry standard project management tools and workflow reports to track its product development and management process. These tools also provide Lottery managers with detailed procedures for the purpose of ending games and troubleshooting ticket defects.



EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

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August 30, 2011
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- The Florida Lottery Advertising Workflow process has been in use since our current general market advertising agency was selected two years ago. This tool is used to ensure communication among Product Development, Marketing (including Advertising) and other units of the Lottery to ensure the coordinated development of creative strategies, marketing tools and budgets for new game introductions and promotions. In February 2011, with the involvement of a new Lottery Secretary, the Lottery developed a new flow chart for the On-line game and Scratch-off game Lifecycle. This overview document illustrates the intricate process of planning, developing, launching, monitoring and closing games. From this document, we will further identify critical processes that may warrant the development of more detailed procedures following a consistent Lottery product format.
2. Recommendation: We recommend that the Department develop a methodology for documenting the timely completion and approval of game management tasks.

Response: Here too, we concur with the intention underlying the audit recommendation. We will examine our existing processes and determine if there are other areas in which checklists, approval forms, or similar documents would genuinely benefit the efficient and effective business operations, particularly in regard to conveying the necessary process steps to new employees.

At the same time, we must respectfully disagree with some of the statements that "the Department did not utilize a methodology such as completion of a checklist to document accomplishment of management milestones" and that "no documentary evidence existed to show that tasks were performed." Both the Scratch-off and On-line game launches processes rely heavily on cross-functional teams and the use of forms and checklists and for the most critical stages of development. For example:

- The "Status of Games in Progress" report (copy enclosed) is reviewed in weekly meetings with our vendor to follow the progress of Scratch-off game launches from art concepts, prize structure development, working paper development, ticket printing, shipping and sending validation tapes. With over 40 new games being launched each year with varying degrees of complexity, the creative process used to select games might be difficult to document via a "one size fits all" checklist.

**EXHIBIT A
MANAGEMENT’S RESPONSE (CONTINUED)**

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- For every On-line game launch and major Scratch-Off or On-line promotion, timelines are developed to follow the process from the development of the Product Brief through software development, marketing support development and sales performance monitoring. These customized timelines list the specific tasks required for the project identifying due dates, milestones, and responsible divisions. These timelines are discussed in detail in weekly cross-functional team meetings beginning 4-6 weeks before games launch. Additionally, a Product Brief is developed for every On-line game launch and major promotion. This document summarizes the product objectives, game research and analysis used to make the product recommendations, and provides pertinent information to other divisions that becomes the basis for the development of advertising, software and contracts.

3. Recommendation: We recommend that the Department ensure that all appropriate divisions review and approve each game’s working papers and document approvals either at the game’s page-turning event or prior to the finalization of the game contract.

Response: During the audit process, Working Paper routing sheets did not contain signatures indicating approval by the Security Division in two of the 18 Scratch-off games that were examined. We concur with this finding, and corrective action was taken immediately. The Working Paper review team was reminded of the importance of signing the routing sheet if they cannot attend the page-turning meeting, and the Scratch-off product manager now takes extra care to ensure that all critical area signatures are obtained before the working papers are executed.

4. Recommendation: We recommend that the Department consider tracking in one system all applicable costs related to each game, including research costs, advertising costs, and license fees. We also recommend that this information be used in the analyses of games after they are closed and that the reviews be documented.

Response: We concur with this recommendation. While the Lottery does a considerable amount of game and cost analysis already, a project is underway to greatly strengthen our capabilities in this regard by putting in place a new financial accounting system.

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

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The Lottery currently relies on a collection of custom-built financial sub-systems, external data feeds and manual procedures that must be supplemented with numerous spreadsheets to conduct financial business. Over the last twelve months, the Lottery purchased the JD Edwards Financial software package which is being configured for Lottery specific use. The system has been renamed "BLAST" and will allow financial data to be recorded in one accounting system and will produce profit and loss data on games. Any financial record may be recorded with an associated game number in order to link all transactions for a specific game for reporting purposes. Although the general ledger functionality was implemented July 1, 2011, it will be next fiscal year before the system capabilities are maximized to accomplish the task recommended.

I would like to thank your staff for their diligent efforts on behalf of the Lottery and look forward to receiving your final report.

Sincerely,


Cynthia O'Connell
Secretary

cc: Dennis Harmon, Deputy Secretary
David Bishop, Deputy Secretary
Marcy Jackson, Chief Financial Officer
Andy Mompeller, Inspector General

**EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)**

Florida Lottery Status Report
Week Beginning 8/30/2011

Status of Games in Progress:																		
Game Number	Game Name	Price Point	Quantity (Millions)	Received Art Concept	Final Art Approved	Final P/S Approved	WPS Sent to Lottery	Received from Lottery	WPS sent to Lottery	Status	Required Execution Date*	Execution Date	Contract Delivery Date	Press	Tentative Press Date	Launch Date	Shipped	Validation Files Sent
FL-1120	Crossword	\$3	15.12M	6/21/11	6/29/11	6/28/11	7/20/11	7/21/11	7/21/11	Exec	6/9/11	7/21/11	8/22/11	P3	8/14/11	8/23/11	8/22/11	8/22/11
FL-1121	Wild Number Bingo	\$3	15.12M	6/21/11	6/23/11	6/23/11	7/13/11	7/19/11	7/19/11	Exec	6/19/11	7/19/11	8/22/11	P3	8/16/11	9/2/11	8/22/11	8/23/11
FL-1116	What's Your Number?	\$1	15.36M	4/29/11	5/3/11	5/5/11	5/16/11	5/23/11	5/23/11	Exec	6/23/11	5/23/11	6/20/11	P3	8/5/11	9/6/11	8/11/11	8/11/11
FL-1117	Lots of Green	\$2	10.8M	4/29/11	5/11/11	5/12/11	5/20/11	5/23/11	5/24/11	Exec	6/23/11	5/24/11	6/21/11	P3	8/6/11	9/6/11	8/15/11	8/15/11
FL-1118	Wheel of Fortune	\$5	7.2M	6/10/11	7/22/11	7/15/11	7/21/11	7/21/11	7/22/11	Exec	6/23/11	7/22/11	8/31/11	P6	8/5/11	9/6/11	8/15/11	8/15/11
FL-1119	Gold Rush Tripler	\$20	15.12M	4/29/11	5/4/11	6/10/11	6/29/11	6/30/11	7/1/11	Exec	6/23/11	7/1/11	8/15/11	P6	8/1/11	9/6/11	8/10/11	8/10/11
FL-5003	Season's Greetings (Gtech)	\$1	11.34								7/21/11					10/4/11		
FL-1122	Holiday Gold	\$2	9.3M	6/28/11	7/11/11	7/12/11	7/19/11	7/20/11	7/20/11	Exec	7/21/11	7/20/11	8/17/11	P3	9/3/11	10/4/11		
FL-1123	Winter Bucks - Metallic	\$5	5.28M	6/28/11	7/6/11	7/7/11	7/15/11	7/19/11	7/19/11	Exec	7/21/11	7/19/11	8/23/11	P6	9/4/11	10/4/11		
FL-1124	Million Dollar Holiday - FOIL	\$10	3.96M	6/28/11	7/11/11	7/12/11	7/21/11	7/21/11	7/21/11	Exec	7/21/11	7/21/11	8/25/11	P6	8/22/11	10/4/11	8/29/11	
FL-5004	Holiday Cheer (Gtech)	\$1	10.08								8/11/11					10/25/11		
FL-1125	Peppermint Payout - Scented	\$2	7.56M	6/28/11	7/11/11	7/13/11	7/19/11	7/20/11	7/20/11	Exec	8/11/11	7/20/11	8/17/11	P2	8/8/11	10/25/11	8/16/11	8/15/11
FL-1126	Triple Your Money	\$2	10.80M	6/28/11	7/11/11	7/13/11	8/1/11	8/3/11	8/3/11	Exec	8/11/11	8/3/11	8/31/11	P3	8/30/11	10/25/11		
FL-1127	Diamond 7's	\$5	7.2M	6/28/11	7/12/11	7/14/11	8/3/11	8/8/11	8/8/11	Exec	8/11/11	8/8/11	9/19/11	P3	9/7/11	10/25/11		
FL-1128	Dueces Wild	\$1	12.0M	8/16/11	8/17/11	8/17/11	8/29/11				9/15/11			P2		11/29/11		
FL-1129	10X the Money	\$2	12.24M	8/16/11	8/17/11	8/17/11	8/29/11				9/15/11			P6		11/29/11		
FL-1130	Winning Resolution	\$5	7.2M	8/16/11	8/18/11	8/17/11					9/15/11			P3		11/29/11		
FL-1131	TBD	\$1	12M								10/27/11					1/10/12		
FL-1132	TBD	\$2	12.24M								10/27/11					1/10/12		
FL-1133	TBD	\$2	5.4M								10/27/11					1/10/12		
FL-1134	TBD	\$5	7.2M								10/27/11					1/10/12		

SGI/MDI

1. None

Florida Lottery

1. Provide direction for January Games

Validation Files to be loaded:

1. None

*Launch date subject to change if Required Execution Date is not met.

**Game name has a trademark issue and will require licensing agreement.

= Denotes game is behind schedule.

= Denotes game is being produced by another vendor.