



Mary Taylor, CPA  
Auditor of State

OHIO LOTTERY COMMISSION  
PERFORMANCE AUDIT

AUGUST 31, 2010



# Mary Taylor, CPA

## Auditor of State

To the Ohio Lottery Commission, Governor, speakers of the House and Senate, and Residents of the State of Ohio:

Based on recent substantial changes in OLC operations and management; the passage of Issue 3 in November 2009, permitting the operation of casinos in four Ohio cities; and the State's projected financial deficit in the 2011-2012 biennium, which increases reliance on revenue from the Ohio Lottery Profits Education Fund (LPEF), a performance audit of the Ohio Lottery Commission (OLC) was initiated in January 2010. The four areas assessed in the performance audit were agency governance, organization and staffing, financial planning and management, and lottery operations. These areas were selected because they are important components of OLC's operations that support its mission of generating revenue for education. Improvements in these areas can assist OLC in maintaining its performance and contributions to the LPEF.

The performance audit contains recommendations that identify the potential for cost savings and efficiency improvements. The performance audit also provides an independent assessment of the Ohio Lottery Commission. While the recommendations contained in the audit report are resources intended to assist in improving business operations, the OLC is also encouraged to independently assess its operations and develop alternatives to supplement those contained in the performance audit report.

An executive summary has been prepared which includes the project history; an overview of the Ohio Lottery Commission; the scope, objectives and methodology of the performance audit; and a summary of noteworthy accomplishments, recommendations, and financial implications. This report has been provided to Lottery Commission members and OLC executive management and its contents have been discussed with them. The Ohio Lottery Commission has been encouraged to use the results of the performance audit as a resource in further improving Lottery operations, service delivery, and the stability of its financial contributions to Ohio education funding.

Additional copies of this report can be requested by calling the Clerk of the Bureau at (614) 466-2310 or toll free at (800) 282-0370. In addition, this performance audit can be accessed online through the Auditor of State of Ohio website at <http://www.auditor.state.oh.us/> by choosing the "Search" option.

Sincerely,

A handwritten signature in cursive script that reads "Mary Taylor".

Mary Taylor, CPA  
Auditor of State

August 31, 2010



# Executive Summary

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## Project History

On January 7, 2010, the Auditor of State's Office (AOS) commenced an audit of the Ohio Lottery Commission (OLC or Agency) to evaluate the Agency's performance in the areas of governance, planning, budgeting, and financial management, human resources management, and lottery operations. The initiation of the audit was prompted by risks identified by auditors, including recent substantial changes in OLC operations and management; the passage of Issue 3 in November 2009, which permits the operation of casinos in four Ohio cities; and the State's projected shortfall in the 2011-2012 biennium, which increase its reliance on revenue from the Ohio Lottery Profits Education Fund (LPEF).

Ohio Revised Code § 117.11(B) states:

“In addition to the annual or biennial audit provided for in division (A) of this section, the auditor of state may conduct an audit of a public office at any time when so requested by the public office or upon the auditor of state's own initiative if the auditor of state has reasonable cause to believe that an additional audit is in the public interest.”

As described in the engagement letter to OLC, the Auditor of State has reasonable cause to believe this additional audit of lottery operations is in the public interest. Specifically, the Ohio Lottery is a \$2.4 billion per year operation and a significant component of the State's contribution to education funding and the State budget in general. The uncertain nature of gaming revenue from month to month and venue to venue results in additional financial risk even as the State contemplates an increasing reliance on these funds as a means for balancing its budget. Further, the addition of Keno combined with the recent passage of Issue 3 has added complexity to Lottery operations and created an environment of heightened risk.

The performance audit was designed to identify opportunities for enhanced performance of OLC in relation to its transfers to the LPEF. Assessments were based on leading and recommended practices, industry standards, comparisons with similar sized lotteries (peers) and leading practices. Recommendations were developed to address risks associated with changes in operations and management (**R2.1**, **R2.2**, **R3.1**, **R4.1**, and **R5.10**); the introduction of other types of gaming in Ohio (**R2.3**, **R4.2**, and **R5.1**); and uncertain revenue in relation to State-level transfer expectations (**R2.5**, **R4.3**, **R4.4**, **R5.2**, **R5.3**, and **R5.7**).

## Agency Overview

### *Purpose and Operation*

OLC was established through passage of State Issue 1, a measure that was approved by voters in May 1973. The constitutional amendment permitted the General Assembly to authorize a lottery, run by a State agency (Art. 15, § 06 of the Ohio Constitution). Initially, lottery profits were included in the State's General Revenue Fund, so they were used for a variety of State government purposes. However, in November 1987, the Constitution was amended to specify that lottery profits are to be used solely for the support of elementary, secondary, vocational, and special education programs. Subsequently, the General Assembly created the Lottery Profits Education Fund (LPEF).

OLC operates as a State business enterprise, subject to State laws and regulations. It is self-sustaining, generating most of its revenue through ticket sales, and funded through the State Lottery Fund. OLC's LPEF transfer obligation is included in the State's biennial budget, and the budgeted transfer amounts for State Fiscal Year (SFY) 2010 and SFY 2011 are \$705.0 million and \$711.0 million, respectively. The LPEF transfers are appropriated for public education and are used to both supplement and partially offset the State's General Revenue Fund obligation to education. In SFY 2009, LPEF transfers accounted for approximately 6.3 percent of education funding.<sup>1</sup>

In SFY 2005, total revenue was approximately \$2.1 billion, which increased to \$2.4 billion by SFY 2009. OLC's main expenditures consist of prize payouts, retailer bonuses and commissions, operating expenses, and transfers. In SFY 2009, prize payouts represented 60.3 percent of OLC's total sales. Bonuses and commissions were 6.2 percent of sales. Operating expenses totaled 5.1 percent of sales. Lastly, LPEF transfers were 29.0 percent of total sales.

Chapter 3770 of the Ohio Revised Code (ORC) sets forth the requirements for the Ohio Lottery Commission, as it relates to the actual operation of the lottery. The lottery is administered by an Executive Director, who is appointed by and serves at the pleasure of the Governor. The Ohio Lottery Commission is comprised of nine members, all appointed by the Governor with advice and consent from the Senate.

Pursuant to ORC § 3770.03, the Commission is responsible for promulgating rules under which a Statewide lottery may be conducted.<sup>2</sup> The Commission approves the rules that govern all games (instant tickets and online games) as part of the administrative rule-making process. The Commission also has to approve existing rules that require review/re-approval every five years.

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<sup>1</sup> Net General Revenue Fund and LPEF transfers.

<sup>2</sup> Rules are promulgated under Chapter 119 of the ORC with the exception of instant games, which are promulgated under ORC § 111.15.

The Commission also periodically takes formal positions on promotions or initiatives that are being implemented by OLC but do not legally require the approval of the Commission or administrative rules. ORC § 3770.03 also requires the Commission to meet at least one each month.

The Executive Director is responsible for Agency policy-setting and the day-to-day operations of OLC. She delegates primary operational oversight to 14 deputy directors of specific offices within the Agency.<sup>3</sup> The offices and their respective bureaus comprise the major functions of OLC, including Communications, Finance, Operations, General Services, Human Resources, Information Technology, Internal Audit, Charitable Gaming, Legal Counsel, Marketing Services, Product Development, Sales Management, Security, and Executive Management. OLC also operates nine regional sales offices, which recruit, train, and provide support for lottery retailers; as well as provide customer service including claiming and validation for winning tickets. As of May 2010, OLC employed 352 individuals who comprise 291.03 full-time equivalent (FTE) employees.

### *Games*

OLC markets two types of games—instant tickets and online games. Instant tickets (also called scratch-off tickets) can be purchased for \$1 - \$20 from a lottery retailer. Most instant games are priced from \$1 to \$5 and are designed to last 20-25 weeks, or until all the major prizes have been won. “Spotlight games” with price points of \$10 or \$20 can last up to a year or more. At the time of the audit, OLC offered 57 instant ticket games. Each instant ticket game consists of 5-30 million tickets. OLC generally expects to sell about 80 percent of the game tickets before all the major prizes are gone. When a game is closed the Lottery will collect unsold tickets from its retailers, reconcile the game ticket inventory, and destroy the unsold tickets. Instant ticket design and printing is contracted out to Scientific Games International and Pollard Banknote, while the warehousing, distribution, and management functions are contracted to Intralot.

Online game tickets are purchased through a network of computer terminals located at retail outlets. The terminals are linked to a central computer that records the wagers. At the time of the audit, OLC offered the following nine online games: Pick 3, Pick 4, Rolling Cash 5, Classic Lotto, Kicker, Mega Millions, Ten-OH!, Keno, and Powerball. Winning number combinations are randomly drawn at specified times during the week. Some games select their winning numbers through drawings of balls, while others use computerized random number generators to select the numbers. Several OLC games have drawings twice daily (Pick 3, Pick 4, Ten OH!), while other games have drawings either daily (Rolling Cash 5) or on certain days of the week (Classic Lotto, Mega Millions, and Powerball). Mega Millions (introduced in 2002) and Powerball (introduced in 2010) are both multi-state lotteries with many states participating in

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<sup>3</sup> In April 2010, OLC created a new Office of Government and Community Relations.

selling tickets and generating funds for the jackpots. Drawings for both games take place in other states.

In addition, OLC offers a series of EZ Play games, which are a combination of the two categories in that they play like instant ticket games, but are generated through terminals. OLC also produces an instant ticket/live game show game called Cash Explosion. Cash Explosion is a \$1 instant ticket game, and one of the prizes allows the player to submit the ticket for an opportunity to appear on the game show. Contestants are selected through drawings of tickets submitted. Ohio is the only state in the country that hosts a televised game show.<sup>4</sup> Finally, OLC conducts infrequent raffle ticket games in which players purchase tickets over specific periods of time and winners are selected through drawings.

In addition to the instant and online games discussed above, significant discussion in recent years has been focused on expanding the lottery to include video lottery terminals (VLTs). VLTs are similar to slot machines, and discussions about placing VLTs at Ohio racetracks date back to at least 2000, when the idea was proposed to the Lottery Profit Review Commission. In June 2009, VLTs were proposed by Governor Ted Strickland as part of the solution to balance the State's biennial budget, and he ultimately issued a directive to OLC to promulgate rules for the implementation of VLTs. These rules were put on hold after a September 2009 decision by the Ohio Supreme Court that the VLT-related language enacted in the budget bill was subject to a Statewide referendum. However, during the course of the audit, the organization that had initiated the referendum withdrew the VLT issue from the Statewide ballot, and the Commission voted to replace previously-approved rules and to adopt a legal strategy to allow for implementation of VLTs. Details about the VLT plan, timelines, and the legal strategy were not available at the time of the audit. See additional discussion of VLTs in the **agency governance** section.

For its existing games, OLC's prize payouts as a percentage of total sales are comparable to the peer average. Instant ticket game payouts range from 61 percent for \$1 tickets to 75 percent for \$20 tickets.<sup>5</sup> Payouts are slightly higher for holiday games (about 71 percent). Online game payouts range from 49 percent for Pick 4 to 64 percent for Keno.<sup>6</sup> Since SFY 2005, game sales have increased about 2.9 percent annually, overall.

On July 1, 2009, the Ohio Lottery successfully completed its conversion to a new online gaming system vendor, Intralot. The contract award was for two years, with up to four two-year

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<sup>4</sup> The California Lottery also produced a game show, "Make Me a Millionaire," but it was cancelled during the course of the performance audit, with a final airing date of July 3, 2010.

<sup>5</sup> Instant ticket payout rates: \$1 – 61 percent, \$2 – 63 percent, \$3 – 66 percent, \$5 – 69 percent, \$10 – 73 percent, \$20 – 75 percent.

<sup>6</sup> Online game payout rates: Pick 3 – 50 percent, Pick 4 – 49 percent, Classic Lotto – 55 percent, Mega Millions – 50 percent, Rolling Cash 5 – 52.4 percent, Ten OH! – 51 percent, Kicker - 41.5 percent, Keno – overall odds 64.28 percent.

renewals. The Ohio Lottery noted in the 2007-08 Comprehensive Annual Financial Report (CAFR) that it projects savings of up to \$200 million over the ten-year contract period, as compared with the preceding contract.

### *Financial History/Performance*

As described above, nearly all OLC revenue is generated through game sales. Expenses consist primarily of prize payouts, bonuses and commissions to retailers, operating expenses, and LPEF transfers. **Table 1-1** shows historical trends in these broad revenue and expenditure categories.

**Table 1-1: OLC Historical Sales and Expenses**

State Fiscal Year	Total Ticket Sales	Prizes	Prizes as % of Total Sales	Bonuses/Commissions	Bonuses/Comm. % of Total Sales	Operating Expenses	Operating Expenses % of Total Sales	Transfers to Education	Transfers to Education % of Total Sales
1999	\$2,144.7	\$1,259.8	58.7%	\$134.6	6.3%	\$88.9	4.1%	\$696.3	32.5%
2000	\$2,150.4	\$1,275.0	59.3%	\$135.0	6.3%	\$103.9	4.8%	\$686.0	31.9%
2001	\$1,919.9	\$1,112.8	58.0%	\$120.2	6.3%	\$107.8	5.6%	\$637.0	33.2%
2002	\$1,983.1	\$1,148.1	57.9%	\$126.6	6.4%	\$103.3	5.2%	\$635.2	32.0%
2003	\$2,078.2	\$1,208.2	58.1%	\$137.0	6.6%	\$100.8	4.9%	\$641.4	30.9%
2004	\$2,154.7	\$1,276.0	59.2%	\$132.8	6.2%	\$97.7	4.5%	\$655.6	30.4%
2005	\$2,159.1	\$1,280.8	59.3%	\$133.8	6.2%	\$97.7	4.5%	\$645.1	29.9%
2006	\$2,220.9	\$1,311.2	59.0%	\$139.8	6.3%	\$109.8	4.9%	\$646.3	29.1%
2007	\$2,259.4	\$1,338.4	59.2%	\$140.0	6.2%	\$109.8	4.9%	\$669.3	29.6%
2008	\$2,325.1	\$1,397.0	60.1%	\$143.9	6.2%	\$110.3	4.7%	\$672.2	28.9%
2009	\$2,417.7	\$1,459.0	60.3%	\$150.1	6.2%	\$124.3	5.1%	\$702.3	29.0%

**Source:** Ohio Lottery Commission SFY 2009 comprehensive annual financial report

**Note:** Total ticket sales does not include other revenues.

Prior to SFY 2008, OLC experienced its top year of sales in SFY 1996, when it generated \$2.3 billion in sales, but it experienced three consecutive years of sales decreases in SFYs 1997-1999. **Table 1-1** shows that after some continued instability in the late 1990s and early 2000s, OLC has experienced eight consecutive years of growth since SFY 2001, with an overall increase in sales of 25.9 percent. During the same time period, transfers to education experienced two years of decrease (SFYs 2002 and 2005), but overall increased by 10.3 percent. The lottery's top year in terms of transfers to education, amounting to \$748.5 million, occurred in SFY 1997.<sup>7</sup>

In 2008, the Ohio Lottery was the 10th largest lottery in the U.S. by sales, and it grew to the 9th largest lottery in 2009. As shown in **Table 1-2** below, Ohio generated lottery sales of \$202 per

<sup>7</sup> During the course of the audit, OLC completed SFY 2010, which produced a ninth consecutive year of sales growth and a record \$2.486 billion in sales.



resident, which ranks 13th among U.S. lotteries and 7th when compared with the peer states selected for this performance audit.

In general, auditors found OLC's performance and management practices to be consistent with other U.S. lotteries. Overall, the Lottery has performed well and has generated significant revenue for the State through its game sales. During the historical period examined by the AOS, OLC met or exceeded its transfer obligations for public education, which are established during the State's biennial budget process (although it did require using a portion of its prior cash balance in SFY 2009 to exceed the initially projected LPEF transfer).<sup>8</sup> OLC staff are well-informed about its games, operations, and the practices of other states.

However, auditors also found opportunities to improve operations and ultimately increase transfers to education. Specifically, despite having access to volumes of data and research on its own operations and the lottery industry as a whole, OLC does relatively little in the way of performance measurement and management, long-term planning, or formal documentation of processes or standards for decision-making. While these types of recommendations may not represent wholesale changes to OLC operations or reflect major failures in management, they do present opportunities for OLC to become more transparent and accountable, to become a leader in the lottery industry in terms of performance and innovation, and although it is too difficult to quantify within the scope of this performance audit, to generate more dollars for education.

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<sup>8</sup> In SFY 2009, the OLC exceeded the initially-projected LPEF transfer amount (\$667,900,000) by 5.1 percent, transferring a total of \$702,291,000.

## Comparative Statistics

Table 1-2 shows OLC in comparison with the ten peer states used in this performance audit. Key measures are analyzed in more detail in specific sections of the report.

**Table 1-2: Key Statistics, OLC and Peers**

	Ohio	Florida	Georgia	Illinois	Indiana	Kentucky	Michigan	New Jersey	New York	Pennsylvania	Texas	Peer Average
<b>Governance Type</b>	Stand Alone State Agency	Stand Alone State Agency	Public Corp.	Dept. of Revenue	Corp.	Corp.	Stand Alone State Agency	Dept. of Treasury	Dept. of Finance and Taxation	Dept. of Revenue	Indep. Comm.	N/A
<b>Public Purpose</b>	K-12 Ed.	K-12 Ed.	Preschool/Scholarships	K-12 Ed.	Various	Various Ed.	K-12 Ed.	Various	K-12 Ed. <sup>1</sup>	Various	K-12 Ed.	N/A
<b>Operating Revenues (in Millions)<sup>2</sup></b>	\$2,332.9	\$4,182.5	\$3,276.4	\$2,089.1	\$822.8	\$778.2	\$2,351.1	\$2,579.3	\$6,673.2	\$3,088.9	\$3,716.5	<b>\$2,955.8</b>
<b>Total Operating Expenses (in Millions)<sup>3</sup></b>	\$1,651.2	\$2,866.2	\$2,417.6	\$1,439.0	\$612.9	\$589.7	\$1,605.9	\$1,690.6	\$4,606.8	\$2,175.4	\$2,634.4	<b>\$2,063.8</b>
<b>Transfers (in Millions)</b>	\$672.2	\$1,283.4	\$867.7	\$648.5	\$217.1	\$192.1	\$740.7	\$882.1	\$2,043.1	N/A <sup>4</sup>	\$1,034.9	<b>\$878.8</b>
<b>Avg. Prize Payout %</b>	60.3%	59.3%	62.6%	59.6%	61.2%	63.4%	56.8%	57.9%	59.2%	59.7%	62.1%	<b>59.9%</b>
<b>Population (in Millions)</b>	11.49	18.33	9.69	12.90	6.38	4.27	10.00	8.68	19.49	12.45	24.33	<b>12.65</b>
<b>Per Capita Sales</b>	\$202	\$228	\$338	\$159	\$129	\$182	\$233	\$292	\$342	\$248	\$151	<b>\$230</b>
<b>Per Capita Net Income</b>	\$62	\$74	\$91	\$50	\$34	\$46	\$76	\$103	\$109	\$75	\$46	<b>\$70</b>
<b>Residents per Retailer</b>	1,393	1,444	1,251	1,702	1,607	1,488	981	1,422	1,226	1,454	N/A	<b>1,390</b>
<b>Retailer Commissions as % of Ticket Sales</b>	6.2%	5.6%	7.1%	5.1%	7.2%	6.4%	7.4%	5.6%	6.0%	5.5%	5.1%	<b>6.1%</b>
<b>Employees (in FTEs)</b>	291.03	412.00	-- <sup>5</sup>	105.28	163.31	165.50	181.45	108.36	-- <sup>5</sup>	238.19	260.25	<b>218.01</b>
<b>Retailers per LSR</b>	83.3	113.3	104.6	114.9	68.4	89.7	170.2	152.7	138.9	91.1	N/A	<b>115.9</b>

Source: *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009) and OLC SFY 2009 comprehensive annual financial report.

<sup>1</sup> New York also allocated a small portion of lottery profits to higher education.

<sup>2</sup> Includes ticket sales and other revenue.

<sup>3</sup> Include prizes, retailer commissions, and administrative/operational expenses.

<sup>4</sup> The Pennsylvania Lottery is excluded from the peer average for transfers. The Pennsylvania Lottery does not report transfers in its annual financial statements, nor did it provide this financial information to AOS.

<sup>5</sup> Georgia and New York did not provide sufficient information for auditors to use in the analysis. (see **methodology and scope** for additional detail)

## **Methodology and Scope**

Performance audits are defined as engagements that provide assurance or conclusions based on evaluations of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision-making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that AOS plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives.

Audit work was conducted between February 1, 2010 and May 28, 2010, and data was drawn from SFYs 2005 to 2010. To complete this report, the auditors gathered a significant amount of data pertaining to OLC, conducted interviews with numerous individuals associated internally and externally with the various offices and bureaus within OLC, and reviewed and assessed available information. Peer data and other information used for comparison purposes were not tested for reliability, although the information was reviewed for reasonableness. In certain sections of the report, detailed information was omitted from the public document for security reasons, particularly in **lottery operations**.

The performance audit process involved significant information-sharing with OLC, including preliminary drafts of findings and proposed recommendations related to the identified audit areas. Furthermore, periodic status meetings were held throughout the engagement to inform OLC of key issues impacting selected areas, and share proposed recommendations to improve or enhance operations. Throughout the audit process, input from the Agency was solicited and considered when assessing the selected areas and framing recommendations. Finally, OLC provided verbal and written comments in response to various recommendations, which were taken into consideration during the reporting process. Where warranted, AOS modified the report based on the Agency's comments.

In addition, several other state lotteries were selected to provide benchmark comparisons for the areas assessed in the performance audit. The lotteries of Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, New Jersey, New York, Pennsylvania, and Texas were used in the applicable sections of the performance audit. These lotteries were selected based upon demographic and operational data. In its response to the draft audit report, OLC expressed concerns about using larger states – specifically Texas, New York, and Florida – as peers, due to their abilities to realize greater economies of scale in their operations. However, using the

average of ten peer states, some of which are larger and some of which are smaller, is in part intended to mitigate any advantages an individual state may have due to its size.

With regard to staffing comparisons in **Table 1-2** and the **organization, staffing, and management** section, auditors engaged in significant discussions with OLC and the peer states to group employees by functions, rather than by job title or division name, to assess OLC's staffing levels dedicated to each function. These functional comparisons were the basis for the staffing recommendations made in this report. AOS was unable to obtain detailed staffing data from the peer states of New York and Georgia. As a result, data about total FTEs may be available for these states but it was not subject to the data testing and verification performed by auditors for Ohio and the other peer states. Consequently, it was determined that Georgia and New York would not be included in the staffing comparisons performed in this audit.

Additional state lotteries, such as Connecticut, Iowa, Louisiana, Nebraska, New Mexico, North Dakota, North Carolina, Oklahoma, South Carolina, and Tennessee were included for informational purposes in specific recommendations. Furthermore, external organizations and sources were used to provide comparative information and benchmarks, such as the following:

- *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009);
- North American Association of State and Provincial Lotteries (NASPL);
- Government Finance Officers Association (GFOA);
- National State Auditors Association (NSAA);
- The Society for Human Resources Management (SHRM); and
- The American Marketing Association (AMA).

Specifically, a significant portion of the peer data was taken from the *La Fleur's 2009 World Lottery Almanac* and from NASPL. This data is largely self-reported by the various lotteries. Although the AOS did not test the data for reliability, these resources are widely cited within the industry, and thus were determined to be reasonable for the comparisons used in this audit.

The Auditor of State and staff express appreciation to OLC and representatives of the Florida Lottery, Georgia Lottery, Illinois Lottery, Indiana Lottery, Kentucky Lottery, Michigan Lottery, New Jersey Lottery, New York Lottery, Pennsylvania Lottery, and Texas Lottery, as well as the staff of NASPL, for their cooperation and assistance throughout this audit.

## Noteworthy Accomplishments

Noteworthy accomplishments acknowledge significant accomplishments or exemplary practices. The following summarizes OLC's noteworthy accomplishments identified throughout the course of the audit. Additional detail pertaining to these accomplishments is presented in each section of the report.

**Vendor Performance Evaluations:** OLC’s process for conducting vendor performance evaluations every six months is a noteworthy accomplishment. Completion of the vendor performance evaluations provides OLC with a formal record of vendor performance for use in evaluating the extension of contracts. This allows OLC to maximize the effectiveness of its resources by targeting them toward vendors who perform in accordance with the contract deliverables and in a manner consistent with OLC’s expectations. However, OLC should augment the process to ensure that all vendor performance evaluations are completed in a manner that provides clear and consistent evaluative information.

**Lottery Gaming System Conversion:** In July 2009, OLC switched its online gaming system vendor from GTECH, which had held the contract since 1985, to Intralot. The process of planning and implementing the new gaming system took months and according to OLC, constituted the largest gaming system conversion in U.S. history. An online gaming system serves as the nerve center of a lottery’s operation, providing the computer system that processes all online games, recording sales at the retailer level, and providing the equipment that retailers use to sell tickets for the online lottery games. As such, the conversion to Intralot was essentially a massive information technology (IT) project.

According to a 2009 report from the Standish Group, which has historically tracked the success rate of IT projects, only 32 percent of all IT projects succeed (meaning they are delivered on time, on budget, and with required features and functions). In contrast to this low success rate, OLC’s gaming system conversion took place as planned on July 1, 2009, with only minimal problems and no significant disruptions to the Statewide sale of lottery tickets. According to OLC, while there have been normal implementation issues to work through, the new vendor has substantially complied with the requirements of the contract and with OLC’s performance expectations. At the same time, the new gaming system contract is expected to save OLC between \$15 and \$20 million per year over the 10-year life of the contract. Consequently, the success of OLC’s gaming system conversion constitutes a noteworthy accomplishment.

**Employee Engagement – Agency Mission:** In the survey distributed to OLC employees by AOS (see **appendix 3-B**), respondents rated OLC very high on the following questions related to OLC’s mission:

**Table 1-3: OLC Employee Survey – Mission & Values**

Employee Survey Question	Percentage Who Agree/Strongly Agree
Do you understand the mission & vision of the Lottery?	93.0%
What is your level of agreement with the mission & vision of the Lottery?	90.0%
Do you understand the values & goals of the Lottery?	91.5%
What is your level of agreement with the values and goals of the Lottery?	87.9%
I understand the impact my position has upon the success of the Ohio Lottery	92.6%

**Source:** AOS survey of OLC employees

As demonstrated in **Table 1-3**, OLC employees expressed a strong awareness of and alignment with the Agency's mission. Moreover, nearly 93 percent of employees understand how their individual roles contribute to the success of OLC. These response rates are extremely high and reflect that OLC has had success in defining, communicating, and achieving employee buy-in for its mission and values. These specific responses provide a strong foundation for organizational success.

**Financial Reporting:** OLC has demonstrated consistent achievement in its financial reporting. In SFY 2009, OLC was awarded its 13th consecutive Certificate of Excellence in Financial Reporting by the Government Finance Officers Association. Moreover, OLC earned three consecutive Making Your Tax Dollars Count Award from AOS for SFYs 2005, 2006, and 2007. The award is presented to Ohio governments that meet the following criteria:

- The entity must complete and submit a Comprehensive Annual Financial Report (CAFR).
- There must be no findings or issues present in the audit report.
- There must be no other financial concerns involving the entity.

OLC's track record of success in financial reporting constitutes a noteworthy accomplishment, as it serves as the basis for accountability in its use and management of public dollars.

## Subsequent Events

The following key events have occurred since the conclusion of audit fieldwork:

- In August 2010, OLC contracted with Delahanty Consulting LLC of Verona, Wisconsin to provide a three- to five-year strategic plan (see **R4.1**). The contract is structured to not exceed about 136 hours with a total cost of \$24,973 (although it provides for additional hours to be negotiated if needed). According to OLC, the contract will also include an assessment of the potential impact of casinos on lottery sales (see **R4.2**). Also as part of the plan, OLC indicated that a workforce plan has been identified as a strategic goal and will lead to the development of an Agency-wide staffing plan (see **R3.1**) and a training and development program (see **R3.10**).
- According to OLC, since the completion of fieldwork on this performance audit, it has engaged the services of one of its marketing vendors to modernize and update its web site (see **R5.9**). It has also begun delivering some content via social media outlets Twitter and WordPress (see discussions of social media in **R2.4** and **R5.8**).
- According to OLC, during the course of the audit it commenced an Agency-wide update of its employee job descriptions. All OLC managers are required to review the job

descriptions of assigned staff and submit revisions. OLC expected the project to be complete by the end of 2010 (see **R3.11**).

## Conclusions and Key Recommendations

Each section of the audit report contains recommendations that are intended to provide OLC with options to enhance its operational efficiency and improve its long-term financial performance. In order to obtain a full understanding of the assessed areas, the reader is encouraged to review the recommendations in their entirety. The following summarizes the key recommendations from the performance audit report.

*In the area of Agency Governance, OLC should:*

- Be given the authority and flexibility in its administrative operations to fulfill its mission. Such authority should include the ability of OLC to develop processes for procurement and contracting that are consistent with the goals of accountability and transparency, while also more appropriate to a business enterprise.

*In the area of Agency Governance, the Governor and General Assembly should:*

- Enact legislation to reorganize the Ohio Lottery Commission and its Agency as a quasi-public corporation. If the State does not adopt a corporate style of governance for OLC, the Governor or the General Assembly should consider adopting individual characteristics of such an organization.
- Provide OLC with at least a modicum of exemption from the Ohio Administrative Procedures Act for its day-to-day operations. Such an exemption would allow OLC to react to a changing market and implement legislatively-authorized online and instant games in a more timely fashion. Such exemptions would not allow OLC to implement gaming that has not been authorized by the General Assembly.
- Within the constitutional designation of Lottery profits for education purposes, examine the possibility of refining the public purpose of and more clearly targeting the State's lottery profits to be more specific and transparent. By designating lottery profits to a more specific purpose, OLC may be more successful in marketing lottery products, communicating the purpose of lottery profits, and sustaining higher levels of public support.
- Expand the duties and roles of the Commission to include the appointment and oversight of the OLC chief executive and budgetary control if Ohio adopts a corporate, quasi-public model for OLC. If the Ohio Lottery does not convert to a quasi-public corporation,

the Commission should be eliminated, as it is duplicative in nature and does not help maximize the efficiency of the lottery or its mission of generating revenue for public education.

*In the area of Organization, Staffing and Management, OLC should:*

- Develop a formal staffing plan that coincides with the goals and objectives identified in the Agency's strategic plan. The staffing plan should take into consideration vacancies, Agency operations and workloads, and the number of employees needed during the coming year, as well as the cost of hiring new employees, and what value the individuals will bring to customers and the organization.
- Conduct an overall examination of its organizational structure in order to better align offices and bureaus and improve communication and collaboration. In addition, it should evaluate its organizational structure and seek to optimize the arrangement of offices and supervisory/management structure.
- Consider eliminating staff in the following offices, bureaus, or functional areas:<sup>9</sup>
  - 1.5 FTEs within its Office of Human Resources,
  - 4.0 FTEs within the Bureau of Strategic Planning,<sup>10</sup>
  - 1.0 FTE within the Marketing and Product Development functions,
  - 3.0 administrative assistant FTEs within the Office of Communications, and
  - 4.0 FTEs in the Office of Information Technology (as well as leaving 4.0 FTE vacancies in this Office unfilled).
- Improve the efficiency and effectiveness of its Drawings Bureau through the use of relevant performance measures and a work review of the composition and responsibilities of the draw staff. OLC should also determine the feasibility of increasing the use of part-time staff to cover the drawings and reducing the number of full-time personnel needed. Taking these actions would ensure that the draw staff is working productively and help eliminate the long periods of downtime experienced in between drawings.

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<sup>9</sup> Staffing reductions are also recommended in the classification of Lottery Sales Representatives and associated regional office positions; however, these are addressed in **lottery operations**.

<sup>10</sup> OLC does not have a strategic plan and generally uses performance and statistical information compiled by NASPL and La Fleur's, as well as the research provided by its gaming and marketing vendors. Texas and Florida have strategic plans and only Texas has a specific individual assigned to planning. Based on auditors' recommendations to develop a strategic plan (**R4.1**) and performance measures, OLC could likely benefit from an individual with the task of coordinating planning and internal measurement efforts but the current staffing of 5.0 FTEs in the Bureau of Strategic Planning significantly exceeds the peers.



- Consider reorganizing the Office of General Services to ensure that the ratio of supervisors to employees is fairly allocated among supervisors. As a component of the reorganization, the Agency should eliminate all vacancies from its organizational charts, particularly in General Services where a large number of vacancies exist. Finally, OLC should closely examine workload measures for these employees, set performance benchmarks, and tailor its staff accordingly.
- Conduct a survey or complete a competency study, task analysis, or performance analysis study to identify the skills and knowledge employees need to improve their performance. Once those skills have been identified, OLC can target those issues precisely in its training program.
- Work with the Department of Administrative Services Office of Collective Bargaining to renegotiate blanket and Lottery-specific provisions within the Ohio Civil Service Employees Association (OCSEA) collective bargaining agreement that limit the Agency's ability to function efficiently. Specifically, the Lottery should review
  - Opportunities to increase flexibility when filling job openings for highly technical and specialized positions (such as IT and sales) to ensure it fills the position with the most qualified candidate.
  - Job descriptions and classifications as appropriate for the Agency.
  - Drive-time provisions within the Agency-specific language of the OCSEA collective bargaining agreement.

*In the area of Planning, Budgeting and Financial Management, OLC should:*

- Develop a comprehensive strategic plan that incorporates the long-term needs and objectives of the Agency. In preparing the plan, OLC should include detailed goals, objectives, benchmarks, timeframes, performance measures, and cost estimates. In addition, OLC should link the strategic plan to the Agency-wide budget and to each office's budget.
- Assess the potential impact that the emergence of casinos or other forms of gaming could have on game sales, revenues, and ultimately on the Agency's ability to sustain transfers to the (LPEF). The assessment of this potential risk to OLC's stability should be taken into account in all Agency planning efforts including the development of a strategic plan, future marketing plans, and future revenue and expenditure projections.
- Expand its current two-year fiscal planning cycle (which coincides with the State budget cycle) to include five fiscal years when projecting revenues, expenditures, and the

transfers to the LPEF. In order to best depict its changing environment, OLC should consider using rolling forecasts.

- Establish an internal budget reserve policy which clearly identifies dedicated and available funds contributing to the ending fund balance within regular operations. Any reserve should be based on identified benchmarks, leading practices, and known risks in order to support OLC's ability to meet its financial obligations to the LPEF. Once its budget reserve policies and benchmarks are established, OLC should work with the General Assembly and the Ohio Office of Budget and Management (OBM) to formally adopt a budget reserve fund and expectations for the size of the fund and the manner in which reserve funds will be used.
- Formally review all areas of expenditure to determine if there are non-essential, non-revenue generating expenditures that could be reduced.
- Enhance the six-month vendor performance evaluation process by ensuring that all evaluations address standard vendor performance areas in addition to specific vendor performance areas unique to each contract. The level of detail should be consistent and the areas of evaluation should be clearly delineated.

*In the area of Lottery Operations, OLC should:*

- Ensure that game decisions (adding, eliminating, or refreshing a game) are based on sound performance data and formally documented. Also, it should update, and establish a process of continued, formal updates, for the Cash Explosion profitability analysis.
- Develop indicators to measure the performance of its retailer network and set specific performance targets for its licensed retailers. OLC should also build a retailer support strategy to help its retailers improve performance and meet the stated goals or target its performance management system and strategic plan. Finally, OLC should consider establishing policies and procedures for addressing low-performing retailers, as well as incentives to improve retailer performance.
- Develop a formal strategy for recruiting, retaining, and improving traditional retailers that includes specific strategies and goals, similar to recent efforts to recruit Keno retailers.
- Adopt Agency rules under Chapter 119 of the Revised Code (if OLC is not exempted from the State's rule-making requirement (see **R2.3**)), and corresponding internal policies and procedures, defining the bonding requirements and licensing and renewal fees for retailers. OLC should use its statutory authority and the examples provided in other states

to develop more flexible bonding requirements for retailers while ensuring its exposure to losses is minimized.

- Develop and implement a set of performance indicators to formally measure the efficiency and effectiveness of its Lottery Sales Representative (LSR) positions and regional sales offices. It should establish specific targets for its LSR positions and regional sales offices then regularly monitor their performance. Furthermore, OLC should enforce its swipe card and Order Pad System procedures to ensure all LSRs use the technology correctly and consistently so that the Agency can better track relevant data for performance measurement.
- Eliminate 10.0 LSR1 positions and eliminate two regional sales offices (and the additional 8.0 FTEs associated with the management of those offices) to bring the efficiency indicators more in line with the averages of the peer state lotteries.
- Review its marketing allocation as part of its biennial budget planning, and base the amount of funding it requests for marketing on a formal determination of its needs. If OLC establishes a corporate-style organizational model, it should develop an internal process for determining the appropriate level of funding for marketing.
- Evaluate its marketing plan and consistently incorporate the elements of a marketing plan recommended by the American Marketing Association (AMA). Incorporating recommended elements will help transform the marketing plan into a more dynamic tool for decision-making and for short- and long-term planning.
- Modernize and update its web site, focusing specifically on the usability and utility of the site. Improving the utility and appeal of the web site would provide an opportunity for the Agency to expand its reach by offering access to information, promotional messages, and other lottery-related content.
- Implement improved contracting, scoring, and service revision processes during the next round of RFP scoring and contract awards for the cooperative services program (CSP) contract and instant ticket products and services contract. OLC should clearly document the rationale behind scoring criteria used on the evaluation form and the scores given for each component of the proposals. Additionally, OLC should ensure it meets with each of its vendors shortly after awarding the contract to discuss and formally agree on the coordinating services and products to be provided and how the services are to be implemented. Furthermore, particularly for contracts of this magnitude, OLC should develop a formal process to document agreed-upon services to reduce the number of differences between what was proposed by the vendor and what is actually provided.

## Summary of Financial Implications

The following table summarizes the performance audit recommendations that contain financial implications. Detailed information concerning the financial implications, including assumptions, is contained within the individual sections of the performance audit.

**Table 1-4: Summary of Financial Implications**

<b>Recommendation</b>	<b>Annual Cost Savings</b>
<b>R3.3</b> Eliminate 1.5 FTEs from the Office of Human Resources	\$83,000
<b>R3.4</b> Eliminate 4.0 FTEs from the Bureau of Strategic Planning and 1.0 FTE from Marketing/Product Development	\$292,000
<b>R3.6</b> Eliminate 3.0 FTEs from the Office of Communications	\$184,000
<b>R3.7</b> Eliminate 4.0 FTEs from the Office of Information Technology and do not fill the 4.0 FTE vacancies	\$317,000
<b>R5.6</b> Eliminate 10.0 LSR1 FTEs	\$500,000
<b>R5.6</b> Close two regional offices (including the elimination of 2.0 FTE regional managers, 2.0 FTE assistant managers, 2.0 FTE executive secretaries, and 2.0 FTE LSR2s)	\$633,000
<b>Total</b>	<b>\$2,009,000</b>

This audit also includes several recommendations that will result in cost savings, but the magnitude or amount could not be quantified. These include **R3.5** on improving the efficiency and effectiveness of drawing staff, **R3.9** on reorganizing its Office of General Services, **R3.10** on renegotiating collective bargaining agreements that do not take into the account the uniqueness of lottery operations, **R4.5** on reviewing discretionary expenditures to reduce administrative and operational costs, and **R5.5** on managing Lottery Sales Representative performance. Readers are encouraged to examine the full text of the recommendations to obtain a full understanding of the potential financial and performance implications of these and the other recommendations contained in this report.

## **Audit Objectives**

The following assessments were conducted in this performance audit:

### **Governance**

- Do the reporting and oversight relationships among lottery administrators, the OLC, and central state government maximize the effectiveness of lottery operations?
- How does Ohio's statutory and constitutional framework impact the OLC's ability to operate effectively and efficiently?
- Would an alternative organizational governance model allow for more effective lottery operations?

### **Organization Staffing and Management**

- How do the organizational hierarchy and span of control within the OLC compare with recommended/leading practices and/or peer states?
- How do OLC's staffing levels and mix of staff compare with similar lotteries? How do staffing levels compare on a workload basis? How does the use of pay classifications impact the Lottery's staffing and flexibility in personnel deployment?
- How do OLC's human resource management practices compare with leading practices?
- How does OLC ensure consistent understanding of its personnel policies?
- How do OLC employees rate the organizational climate?
- How does the OCSEA collective bargaining agreement affect OLC's management of certain classes of employees? How does the use of unionized labor compare with lotteries in other strong labor states?

### **Planning, Budgeting, and Financial Management**

- Do OLC's long-term planning and budgeting practices meet leading and/or recommended practices?
- Do OLC's revenue and expenditure projection practices meet leading and/or recommended practices?
- What steps has OLC taken to evaluate and reduce or eliminate unnecessary expenditures?
- Does OLC manage its contracts consistent with leading and/or recommended practices?

**Lottery Operations**

- What steps has the OLC taken to improve its retailer recruiting, retention, and performance?
- How can lottery sales representatives become more efficient and effective?
- What are the key contractual arrangements in place with the game vendors associated with each type of game?
- What steps has OLC taken to improve the performance of its games?
- Do OLC's marketing efforts meet leading practices and maximize returns?

## Appendix 1-A: Acronyms

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### Agency Governance

CEO – Chief Executive Officer  
DAS – Department of Administrative Services  
GRF – General Revenue Fund  
HB – House Bill  
HOPE – Helping Outstanding Pupils Educationally  
JCARR – Joint Committee on Agency Rule Review  
KLC – Kentucky Lottery Corporation  
LPEF – Lottery Profits Education Fund  
LPRC – Lottery Profit Review Commission  
LSC – Legislative Service Commission  
MUSL – Multi-State Lottery Association  
NASPL – North American Association of State and Provincial Lotteries  
OAC – Ohio Administrative Code  
OBM – Office of Budget and Management  
ODE – Ohio Department of Education  
OEBM – Ohio Evidence Based Model  
OLC – Ohio Lottery Commission  
ORC – Ohio Revised Code  
SB – Senate Bill  
SFY – State Fiscal Year  
VLTs – Video Lottery Terminals

### Organization, Staffing, and Management

AG – Attorney General  
AOS – Auditor of State  
EEO – Equal Employment Opportunity  
EI – Employee Involvement  
FTE – Full-time Equivalents  
GAO – Government Accountability Office  
HR – Human Resources  
IT – Information Technology  
ITVM – Instant Ticket Vending Machine  
LSR – Lottery Sales Representatives  
OCSEA – Ohio Civil Services Employee Association  
PAT – Professional, Administrative, and Technical

PDM – Participative Decision Making  
R&D – Research and Development  
SHRM – Society of Human Resource Management

**Planning, Budgeting, and Financial Management**

CAFR – Comprehensive Annual Financial Report  
EETF – Educational Enhancement Trust Fund  
GASB – Governmental Accounting Standards Board  
GFOA – Government Finance Officers Association  
NSAA – National State Auditors Association  
OAKS – Ohio Administrative Knowledge System  
RFP – Request for Proposal

**Lottery Operations**

AMA – American Marketing Association  
BOS – Back Office System  
CSP – Cooperative Services Program  
CTV – Complaint to Vendor  
IAD – Interactive Agent Database  
ITB – Instant Ticket Bureau  
MOU – Memorandum of Understanding  
LPRC – Lottery Profit Review Commission  
OPPAGA – Office of Program Policy Analysis and Government Accountability  
PDC – Primary Data Center  
ROI – Return on Investment  
ROO – Return on Objective  
SDC – Secondary Data Center  
SGI – Scientific Games International  
TSRs – Telemarketing Sales Representatives



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# Agency Governance

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## Background

This section of the performance audit focuses on the agency governance of the Ohio Lottery Commission (OLC or the Agency).<sup>1</sup> The objective of this section is to assess OLC's operating environment, reporting and oversight relationships, and governing structure compared with leading or recommended practices, industry standards, and selected peer state lotteries.<sup>2</sup>

### *Enabling Legislation*

In May 1973, Ohio voters approved State Issue 1, a constitutional amendment proposed by the General Assembly, which authorized the State to conduct lotteries. In response to the newly-approved Article 15, § 6 of the Constitution, the General Assembly passed House Bill (HB) 990 to create a State Lottery Commission. Lottery profits were initially used for a variety of purposes and were categorized as a component of the State's General Revenue Fund. Over time, however, the General Assembly began dedicating lottery profits to public education within the State budget, and voters ultimately approved a second constitutional amendment in November 1987 that required lottery profits to be used solely for support of elementary, secondary, vocational, and special education programs. Pursuant to the 1987 amendment, the General Assembly created the Lottery Profits Education Fund (LPEF) to keep the lottery profits separate from the General Revenue Fund.

The composition and statutory responsibilities of the Ohio Lottery Commission, laid out in Chapter 3770 of the Ohio Revised Code (ORC), have changed over the course of the Commission's history. As it was created in HB 990, the Commission was composed of five members with 4-year terms. While HB 990 allowed for the gubernatorial appointment of the Executive Director who served at the pleasure of the governor, the Commission was required to approve the hiring of personnel, contracts for the operation or promotion of the lottery, and the promulgation of administrative rules. Finally, lottery profits (i.e., transfers into the General Revenue Fund) were required by statute to equal at least 30 percent of total revenues.

During its first several years, OLC's operations were under heightened scrutiny due to a series of incidents and apparent mismanagement. By May 1978, the OLC Executive Director had resigned, making him the fourth director to depart the agency in four years. Governor James Rhodes ordered an investigation by the Ohio Highway Patrol, which concluded that scandals and

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<sup>1</sup> Throughout this report, *Ohio Lottery Commission* or *Commission* refers to the nine-member appointed oversight body. *OLC* or *Agency* refers to the State Agency formed to carry out lottery operations.

<sup>2</sup> See **executive summary** for a list of the peer state lotteries and an explanation of the peer selection methodology.

missteps experienced by OLC were the result of acts that were “more foolish than criminal.” By the end of the decade, some legislators began calling for a review and possible end to the State-run lottery.

In January 1980, the General Assembly passed a comprehensive lottery reorganization bill. Senate Bill (SB) 139 reduced the role of the Commission and increased the Commission size from five to nine members, appointed for three-year terms. SB 139 included provisions that Commission members should represent the various geographic regions of the State, and have prior experience or education in business administration, management, sales, marketing, or advertising. Finally, the legislation removed the Commission’s authority to approve staffing decisions and contractual agreements for the operation of the Agency.

The next major change in the statute occurred following a 2000 report by the Lottery Profit Review Commission (LPRC). The LPRC was created as a temporary commission in response to three consecutive years of declining lottery sales. The LPRC made recommendations to help improve OLC’s long-term fiscal commitment to education. Some of the major recommendations included enacting legislation to permit participation in multi-state lottery games, and repealing or reducing the 30 percent profit requirement. The legislature responded by authorizing the State to join multi-state lottery games, with the formal approval of the Governor, and removing the requirement for a 30 percent profit transfer from statute. Eliminating the 30 percent profit transfer requirement was seen as a means to offer higher prize payouts to customers and generate additional revenues, with the understanding that such a strategy may yield a larger profit transfer, but one that may not equal 30 percent of total revenue. The change in this requirement allowed the Agency greater latitude in the strategies pursued to generate profits for the State (see **planning and financial management** for more discussion on the LPEF).

### *Reporting Relationships*

Under current law, OLC is led by an Executive Director who is appointed by the Governor, confirmed by the Ohio Senate, and serves at the pleasure of the Governor. The Executive Director is responsible for day-to-day operations and has the authority to appoint staff and enter into contracts for the operation or promotion of the lottery, within the State processes governing these functions.

The Governor also appoints the nine members of the Ohio Lottery Commission to staggered three-year terms, with the advice and consent of the Ohio Senate. ORC § 3770.01 requires that one member of the Commission represent an organization that deals with problem gambling and assists recovering gambling addicts, and that other Commission members have prior experience or education in business administration, management, sales, marketing, or advertising. Moreover, no more than five of the nine members of the Commission can be from the same political party, and the members of the Commission should represent the various geographic regions of the State. The Commission’s primary function is that of a rule-making body, promulgating rules for

the operation of a Statewide lottery and for all instant ticket and online games according to Ohio's administrative rule-making procedures. Other areas where the Commission is required to approve administrative rules include the locations and manner in which lottery tickets may be sold, as well as the requirements for and compensation paid to lottery retailers.

Monthly meetings allow Commission members to serve in an advisory capacity as well. The Executive Director and deputy directors provide Commission members with written reports updating them of the activities of the prior month, including a monthly financial statement detailing lottery revenues, disbursements, and transfers to the Lottery Profits Education Fund. On occasion, the Commission will propose and pass a resolution taking a position on an action taken by OLC, even though it does not require the Commission's approval.

State law also includes provisions for the General Assembly and Governor to serve in an oversight capacity of OLC. Minutes of each month's Commission meeting are provided to the Governor and leadership of the Senate and House of Representatives. Additionally, the Commission is required to prepare an annual report for the Governor and General Assembly detailing lottery revenues, prize disbursements, and operating expenses for the preceding fiscal year. The General Assembly also retains control over the enabling legislation of OLC, as the Ohio Constitution permits the General Assembly to authorize a lottery operated by an agency of the State. Moreover, the State biennial budget, which includes OLC's appropriations, is enacted through legislation in the General Assembly. The legislature also provides oversight of OLC's administrative rule-making and its spending through the Joint Committee on Agency Rule Review (JCARR) and the Controlling Board, respectively. OLC seeks approval from the Controlling Board when it requests a waiver of competitive selection for a contract, an increase in a particular appropriation, or a transfer of funds between line items.

OLC is assigned an executive assistant in the Governor's office who serves as a liaison between the Agency and the Governor's Office. The OLC Executive Director meets with members of the Governor's staff, when necessary, in order to ensure that the Governor remains abreast of operations and major initiatives. OLC's appropriations are set in the State's biennial budget, as described above, and OLC staff work with the Governor and the Office of Budget and Management (OBM) to develop the appropriation levels that are included in the Governor's executive budget, which is submitted in each odd-numbered year to the General Assembly for action. Finally, the ORC requires the Governor's approval for OLC to join a multi-state lottery game, such as Mega Millions or Powerball.

## *Operating Environment*

OLC periodically prepares a revenue alternatives document,<sup>3</sup> which discusses options that could be used to generate additional profits. This document is generally prepared when the State's financial condition justifies a need for additional revenue and is used for internal planning purposes and shared with OBM. When the Governor announces a Lottery-related initiative, information generally originates from a version of the revenue alternatives document. Such revenue enhancement opportunities are not pursued without the approval of the Governor, regardless of whether or not they fall under OLC's existing legal authority. This is because the Executive Director yields to the Governor's decision on matters of policy, especially when a change in lottery operations could be considered an expansion of gambling. In this way, the role of the Executive Director is similar to any other member of the Governor's cabinet.

The oversight and reporting relationships between the Executive Director, Commission, Governor, and General Assembly can best be examined through some of OLC's recent initiatives. These case studies show the decision-making process and illuminate inconsistencies in the approach to new game initiatives. Moreover, the examples below show that decisions do not always originate within the Agency based on its ability to maximize revenue, but rather, are sometimes determined by parties outside OLC.

### **Mega Millions - 2002**

Then-Governor Bob Taft announced plans for Ohio to participate in a multi-state game in January 2001, as part of the biennial budget process. Although the multi-state game was not included in the final version of the budget bill, by December 2001 legislation was needed to fill a \$1.5 billion shortfall in the State budget. As part of this legislation, the General Assembly authorized OLC to enter into a multi-state game. The new revenue from the prospective multi-state game was intended to offset GRF support for public education. In this case, the multi-state lottery game was projected to generate \$41 million in additional transfers for education in State Fiscal Year (SFY) 2003, and an identical reduction of GRF payments to education was planned.

According to OLC staff, the addition of multi-state games was an option on the revenue alternatives document at the time it was proposed by the Governor. It had also been a specific recommendation of the Lottery Profit Review Commission's March 2000 report. After studying the multi-state games in place at the time, OLC chose to join The Big Game, which was ultimately restructured and renamed Mega Millions. Mega Millions sales began in Ohio in May 2002. The implementation of Mega Millions had a positive impact on lottery revenues and transfers to the LPEF, reversing a six-year trend of declining transfers.

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<sup>3</sup> As part of the audit, AOS requested but never received copies of these revenue alternatives documents. As a result, any information about the frequency or content of these documents is based solely on interviews with OLC staff.

**Keno - 2008**

Planning for Keno began following Governor Ted Strickland's announcement in January 2008 that OLC would begin offering the game. Game rules for Keno were presented to the Commission in February 2008. According to OLC staff, Keno had been on the Agency's agenda for years, and was included on the revenue alternatives document as far back as 2001, when Mega Millions was implemented. However, until OLC was notified in 2008 that the Governor intended to announce a broad budget balancing plan, there had not been recent discussion with the administration about Keno. At that point, OLC staff worked with the administration to quickly develop a timeline and projections for Keno implementation. However, the projections did not account for specific factors OLC faced during implementation. Such variables included partial-year implementation of the game (reducing revenue projections), the Statewide smoking ban in place that impacted the operations of liquor establishments, and OLC's conversion to a new gaming system at the same time. OLC cites these factors as contributing to Keno's failure to meet its sales projections to date.

In addition, the timing of the Keno decision created other implementation issues for OLC. Specifically, OLC went before the State Controlling Board on May 5, 2008 seeking approval to spend approximately \$18 million to purchase new terminals and other equipment for the operation of Keno from GTECH (the gaming system vendor at the time). At the same time, OLC was finalizing the process by which it would choose Intralot as its new gaming system vendor, effective July 1, 2009 (see **operations**). At the Controlling Board hearing, the former Executive Director stated directly that the Keno implementation had delayed the RFP process for the new gaming system. Moreover, despite the fact that one week later, on May 12, 2008, the Executive Director would announce Intralot as the successful vendor for the gaming system contract, this information was not shared with the Controlling Board, which granted OLC the authority to purchase the equipment from GTECH. He would also later acknowledge that OLC had doubts whether the equipment could be reused after the conversion, but that the need to implement Keno quickly drove the Agency's approach before the Controlling Board.

Ultimately, OLC spent \$11.2 million specifically on Keno equipment. However, during the gaming system conversion, Intralot opted to replace the Keno equipment rather than try to adapt the GTECH equipment to its new system. In its FY 2008-09 financial statement, OLC wrote off the \$11.2 million in equipment as a loss, a portion of which it characterized as a business expense.<sup>4</sup> After the conversion, OLC sold the Keno equipment back to GTECH for approximately \$1.7 million, and the amount will appear as a miscellaneous revenue on its FY 2009-10 financial statement. Additionally, OLC planned to penalize GTECH for Keno equipment failures that occurred in May 2009, near the end of its contract period. The original estimated penalty was about \$972,000 but OLC reduced this amount to actual damages of

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<sup>4</sup> The Director of Finance clarified that this equipment would have been depreciated over a five-year time horizon and, therefore, the loss was less than \$11 million.

\$35,400 through negotiations with GTECH. The contract between OLC and GTECH memorializing the final damages and the equipment repurchase was signed in November 2009.

### **Video Lottery Terminals (VLTs) - 2009**

Video lottery terminals (VLTs)<sup>5</sup> are similar to slot machines, and depending on the actual machine specifications, they might be identical. Generally, the primary difference is that a slot machine produces a completely random combination of symbols, which corresponds to a table of payouts. In other words, although slot machines are programmed with a specific payout percentage, there is no predetermined number of winning games. In contrast, VLTs often use depleting prize pools similar to instant ticket games, meaning that there are a known number of winning prizes, which are randomly selected by the player.

Discussions about placing VLTs at Ohio racetracks date back to at least 2000, when the idea was proposed to the Lottery Profit Review Commission. The next year, VLTs were proposed as a potential funding mechanism to overhaul Ohio's school funding system. Since that time, numerous VLT proposals have been considered in the General Assembly, although according to OLC officials, the proposals were never initiated by OLC, there was no internal planning for VLTs, and they were never included in OLC's revenue alternatives documents.

In June 2009, VLTs were proposed by Governor Strickland as part of the solution to balance the State's biennial budget.<sup>6</sup> VLTs had not been discussed with OLC officials or Commissioners prior to the Governor's announcement. On July 13, 2009, the Governor issued a directive to OLC to promulgate rules for the implementation of VLTs. Estimates of potential revenue from VLTs came from the OBM rather than OLC. Emergency rules were presented at the Commission meeting in August. Following ORC Chapter 119 procedures, the Commission approved both emergency rules as well as regular proposed rules. Emergency rules were filed pursuant to the Governor's directive in order to ensure that applications and licensing of Ohio's seven racetracks could begin immediately and racetracks could start generating revenue from VLTs by May 2010. In drafting rules governing VLTs, OLC's Chief Legal Counsel consulted the Governor's directive in addition to existing frameworks for VLT operations in other states. The Governor's directive specified the manner in which VLTs could be offered and the general specifications of the product. Input was also received from the Governor's executive assistant, Commissioners, interest groups, and other interested parties.

Ultimately, the VLT rules passed by the Commission were put on hold after a September 2009 decision by the Ohio Supreme Court that the VLT-related language enacted in the budget bill

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<sup>5</sup> ORC 3770.21 defines "video lottery terminal" as "any electronic device approved by the state lottery commission that provides immediate prize determinations for participants on an electronic display."

<sup>6</sup> Per the Governor's July 13, 2009 directive, increasing the amount of Lottery transfers to education by implementation of VLTs would "allow the State to dedicate scarce general revenue funds to critical programs benefiting the health, safety, and welfare of Ohio's citizens, avoiding devastating cuts to those programs."



was subject to a Statewide referendum. The Executive Director indicated that the rules would remain on hold pending action by the Governor or Legislature. In the meantime, OLC started including VLTs in its internal planning in order to be prepared should the issue move forward.

During the course of the audit, the organization that had initiated the referendum withdrew the VLT issue from the Statewide ballot, citing the recent approval of casino gaming and the Governor's announced intention to seek a court ruling on the OLC's authority to implement VLTs. Subsequently, on July 19, 2010, the Commission adopted a two-pronged strategy for VLTs. First, it withdrew the VLT rules that had been adopted pursuant to the Governor's July 13, 2009 directive, and voted to replace them with new rules. The Commission also voted to authorize the OLC to adopt a legal strategy to allow for implementation of VLTs. Details about the VLT plan, timelines, and the legal strategy were not available at the time of the audit.

### **Powerball – 2010**

After years of discussion, an agreement in principle to allow Powerball/Mega Millions states to cross-sell their games was reached at the October meeting of the North American Association of State and Provincial Lotteries (NASPL). The agreement allowed the Mega Millions consortium of states to enter into an agreement with the Multi-State Lottery Association (MUSL), which operates the multi-state jackpot game Powerball, to offer customers in each group of states the opportunity to purchase both games. Following this tentative decision, the Lottery received projections of Powerball profits that ranged from \$6-\$40 million. Yet since cross-selling had never occurred before, there were no good indicators of how much profit the addition of Powerball would generate in Ohio. For example, there was no way to know how much Powerball sales would impact existing Mega Millions sales or how jackpot levels would be affected by having more people playing both games. Given these unknowns, the Lottery determined that a \$10 million profit was most reasonable. The potential loss of revenue from out-of-state players coming to Ohio to purchase Mega Millions tickets, should Ohio decide not to sell both games when all of the surrounding states decided to sell both, was determined to be the most significant benefit of cross-selling.

According to statute, the Governor must personally sign any agreement or designate an authorized signatory in order for OLC to participate in a multi-state game. However, without a physical agreement, the Agency had to wait for the Powerball and Mega Millions states to reach a formal agreement. The final agreement was reached on December 31, 2009, and a memo with a request for authority to sign the agreement was sent to the Governor on January 6, 2010. Final authority was received on January 29, 2010, and the Executive Director signed the agreement. OLC's Chief Legal Counsel worked to draft rules for Powerball, with input from various OLC offices and bureaus to review the language.

Nine of the ten peer lotteries began cross-selling Powerball and Mega Millions on January 31, 2010.<sup>7</sup> Ohio began selling Powerball tickets on April 16, 2010. Although there were states that began even later, 36 states began cross-selling the two multi-state games before Ohio.

The Ohio Lottery Commission approved proposed game rules at the January 25, 2010 meeting. OLC staff had discussed internally the use of emergency rules to achieve an earlier implementation date, closer to when the majority of other state lotteries were implementing the games. However, the Agency determined that the need to implement cross-selling was not an emergency or a necessity, since it would not generate significant revenues. Consequently, the Commission moved forward with the standard rule-making process. Following approval from the Commission, the proposed rules were filed with JCARR. They went through a public comment session (with no public responses or concerns expressed), went before JCARR, and were subsequently approved by the Commission at its April 6, 2010 meeting (which had been moved up from April 19 to allow for earlier implementation of the game). As described above, the rule as approved by the Commission took effect on April 16, 2010 and OLC became the 44th state lottery to sell Powerball tickets.

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<sup>7</sup> The only exception was Florida, which at the time of the audit, was not planning to offer Mega Millions.

## Recommendations

**R2.1 The Governor and the General Assembly should consider enacting legislation to reorganize the Ohio Lottery Commission and its Agency as a quasi-public corporation. The operation of a lottery is a unique function of government, and the agency charged with administering it should be organized in a way that allows for operational effectiveness and an ability to maximize profits within the legal framework of the lottery. The state lotteries that have organized in similar fashions operate in environments that allow for improved business practices, and they are better positioned to react to changing market conditions.**

**In recommending OLC reorganize as a quasi-public corporation, it is important to note that while the optimal form of agency governance would include all of the characteristics listed below (R2.2-R2.4), they are not mutually exclusive. The rejection of a corporate style of governance does not preclude the Governor or the General Assembly from adopting individual characteristics of such an organization.**

**As discussed under *Reporting Relationships* in the background, the Ohio Constitution requires that a State agency administer the lottery, but the language does not specify the manner in which that agency is to be organized and governed, the reporting relationships between the agency and the Governor, or the need for a Commission to oversee the agency.**

Unlike virtually every other State agency and commission, the purpose of the Ohio Lottery is not to provide a service, but to generate a profit. This mission, to generate revenues which support education, is achieved through promoting a product in the marketplace and is more similar to a business enterprise than a government agency. However, OLC's status as a cabinet-level State agency, hampers its ability to operate most effectively.

To some degree, State policymakers recognized this fact when the lottery was first enacted by establishing a State Lottery Commission to help oversee the operations of the lottery. Over time, the statutes were changed and the only formal authority left with the Commission was approval of Agency rules (which are still subject to the legislative rule review process). The case studies in the background of this section describing recent lottery initiatives demonstrate that the Commission, as currently configured, plays very little role in lottery decision-making. Instead, policy decisions often originate outside the OLC, and may or may not further the lottery's short- or long-term goals.

In addition, according to OLC staff, it is often a challenge to follow guidelines issued by the Department of Administrative Services and operate under the requirements imposed by general State government when the needs of OLC do not always fit within the

framework of a State agency. Most recently, OLC has been subject to the directives and restrictions put in place by the Governor to limit general government spending (see **planning and financial management**). However, some of these requirements actually impede the Agency's ability to operate effectively. Many of the State-required business processes to which OLC is subject slow the speed in which OLC staff can respond to changing market conditions, introduce new products, or promote the lottery. Specific requirements include the rule-making process for instant and online games, purchasing and contracting constraints and requirements, and limitations on new technologies in social media, marketing, and web site promotion.

An example of how increased flexibility may benefit an enterprise like the lottery is the provision, included in the initial legislation creating the lottery, that required the OLC to transfer at least 30 percent of its total revenue. In 2000, the Lottery Profit Review Commission (LPRC) suggested eliminating this provision on the theory that requiring a certain *percentage* to be transferred may actually reduce the *amount* available to transfer. In other words, allowing the OLC to spend more in revenue-generating areas such as prizes and marketing would increase sales and make more dollars available for education. The 30 percent requirement was subsequently removed from statute, and since that time game sales and transfers have increased steadily (reversing the trend at the time of the LPRC report) despite the fact that since 2005, profit transfers have been less than 30 percent of sales. While a number of factors have contributed to the lottery's recent revenue increases, the increased flexibility in this area appears to be one such factor.

According to the Executive Director of NASPL, one of the challenges facing older lotteries is the enabling legislation under which they were organized. While many of these lotteries are structured like Ohio and are subject to the same regulations that state agencies must follow, newer lotteries have identified the obstacles encountered by existing lotteries and have largely organized using some type of corporate model.

In 1989, the Kentucky Lottery became the first lottery in the United States to organize under a corporate model. In passing the statute creating the Kentucky Lottery Corporation (KLC), the Kentucky General Assembly recognized "that the operations of a lottery are unique activities for state government and that a corporate structure will best enable the lottery to be managed in an entrepreneurial and business-like manner." Since the inception of the KLC, nine of the 11 new lotteries have organized as corporations or as independent commissions with many of the same characteristics.<sup>8</sup>

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<sup>8</sup> The 11 newer lotteries are Georgia (1993), Indiana (1989), Louisiana (1991), Nebraska (1993), New Mexico (1996), North Carolina (2006), North Dakota (2004), Oklahoma (2005), South Carolina (2002), Tennessee (2004), and Texas (1992). All but Nebraska and North Dakota have organized as corporations or independent commissions.

While each state has taken a slightly different approach to the corporate model and the specific provisions relating to the organization of the lottery, the following are commonalities identified in these corporate-style lotteries:

- An independent board of directors, appointed by the governor, with authority to govern the operation of the lottery;
- A CEO, appointed by the board of directors or governor, who serves a set term or at the pleasure of the board of directors, rather than the governor;
- Authority by the board of directors to approve and modify the organization's budget independent of the annual (or biennial) legislative budgeting process;
- Greater flexibility, as determined by the board of directors, in the areas of procurement and contracting;
- Exemptions to the administrative rule-making requirements imposed on other state agencies;
- Other exemptions from general administrative and/or bureaucratic requirements with regard to human resource management; and
- Oversight, transparency, and accountability through a system of regular reports and audits.

According to the KLC, one of the greatest benefits of the lottery's organization is the ability to respond and implement games in a more timely fashion. Additionally, with the President of the Corporation serving at the pleasure of the Board of Directors, KLC has found the corporate model allows for a more experienced work force, greater continuity in operations, and a commitment to strategic planning. The KLC noted the current President has served since 1993, which covers the terms of four different governors.

In addition to the newer state lotteries that have organized as quasi-public corporations, two states with existing lotteries – Connecticut and Iowa – have *reorganized* under corporate styles of governance. In 1996, the Connecticut Lottery Corporation was created by the General Assembly; the first time a lottery operated by a state agency was transferred to a quasi-public corporation. The conversion to a corporation was intended to allow the lottery to:

- Operate in an entrepreneurial and business-like manner, free from the budgetary and other constraints that affect state agencies;
- Provide continuing and increased revenue to the people of the state through the lottery by being responsive to market forces and acting generally as a corporation engaged in entrepreneurial pursuits; and
- Ensure that the lottery continues to be operated with integrity and for the public good.

In 2003, Iowa joined Connecticut by replacing the Division of the Iowa Department of Revenue and Finance with the Iowa Lottery Authority. The conversion was proposed as a response to the Iowa Governors challenge for state agencies to identify opportunities for greater efficiency and effectiveness.

According to the CEO of the Iowa Lottery Authority at the time, “sometimes the constraints of our old bureaucratic structure made it difficult to operate like a business and rise to our potential. Our new structure gives us greater flexibility and speed in deciding and implementing day-to-day decisions.”

According to the Iowa Lottery, some of the perceived benefits experienced after adopting a corporate-style lottery included greater flexibility in day-to-day business decisions, enabling the lottery to bring products brought to market more quickly with effective advertising for each project, and improved coordination of product introductions, linked to a budgeting process more appropriate for the organization. Additionally, the corporate-style lottery allowed for custom-tailored job descriptions for better flexibility, speed, and control in hiring for key positions (see **human resources**). The claim by the Iowa Lottery Authority that greater flexibility and speed in guiding operations allows for greater efficiency has translated into an average profit transfer that is 19.7 percent higher than before the conversion. While the conversion is not the sole reason for increased profit transfers, the increases do provide support for the perceived benefits the corporate model affords.

Conversely, the Superintendent of the Illinois Lottery indicated it is very difficult to run the marketing and retailing aspects of the lottery under the confines of the operating environment of state government. The State of Illinois has a very structured state procurement process which, according to the Superintendent, does not suit the needs and unique nature of the lottery. As a result, the Illinois Lottery is restricted in its ability to make changes to the marketing or retail operations, which ultimately affect the profits that can be generated to support the Common School Fund, the State’s designated recipient of lottery profits.

In speaking with OLC officials, they acknowledged difficulties operating the lottery under the guise of a state agency with a rule-making commission. However, each indicated the Agency had made the decision to work to maximize efficiency within the existing operating environment, rather than advocate for an operating environment that allowed for greater flexibility.

As described in **R2.2**, establishing a more independent governance structure would not exempt a lottery from the oversight or accountability expected of public bodies. States that have adopted corporate-style lotteries have been able to incorporate oversight requirements to ensure that the cultures, traditions, and public expectations of their

specific states are maintained. Moreover, while any legislation establishing a corporate-style governance structure should provide OLC with flexibility in its day-to-day operations, it should also include detailed language outlining what OLC is and is not allowed to do. Specifically, the legal framework should be clear about the types of gaming that are authorized and the types that are not, and OLC should not have authority to offer gaming choices that have not been approved through the legislative process.

OLC is considered a more mature lottery, having been in operation since 1974. The more recent trend has been for lotteries to organize or reorganize as corporations or independent commissions, realizing that operating as entrepreneurial enterprises provides opportunities for lotteries to be more flexible, more innovative, and more responsive to market conditions. Adopting a similar approach in Ohio could allow OLC to make decisions (see *operating environment* in the background) and restructure operations to increase its ability to generate revenue for education. Specific options under a corporate-style governance structure are discussed in **R2.2**, **R2.3**, and **R2.4**.

**R2.2 If Ohio proceeds with adoption of a corporate model of governance, the duties and roles of the Commission should be expanded to include the appointment and oversight of the OLC executive director and budgetary control. The Executive Director should report to and serve at the pleasure of the Ohio Lottery Commission. Further, the Commission should be afforded additional responsibilities, including approval of the Lottery's internal budget. In making these two changes in the role of the commission, more defined requirements for Commission members should also be implemented as has been done in other states and in the recently-enacted Ohio Casino Control Commission statutes to license and regulate the State's casinos.<sup>9</sup> Moreover, systems currently in place to ensure oversight by the Governor and General Assembly should be reinforced.**

**If the Ohio Lottery does not convert to a quasi-public corporation, the Commission should be eliminated. The limited role of the Commission is duplicative in nature and does not help maximize the efficiency of the lottery or its mission of generating revenue for public education. Instead, it adds a layer of bureaucratic oversight and is an additional expense to the State.**

Despite the Commission's responsibility for adopting rules for games that are consistent with the Lottery's statutory authority, the Executive Director indicated that in practice, she defers to the Governor's judgment for major policy decisions, especially those which could be viewed as expanding the Lottery in any way (including the addition of new

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<sup>9</sup> The amendment to the constitution, approved in November 2009, notes that the Ohio Casino Control Commission shall license and regulate casino operators, management companies retained by such casino operators, key employees of such casino operators and such management companies, and gaming-related vendors to ensure the integrity of casino gaming.

types of games, additional drawings, or the types of venues in which lottery tickets can be sold). In its response to a draft version of this performance audit, OLC noted that the Executive Director's deference to the Governor on matters of policy is not inconsistent with the Commission's rule-making authority.

Moreover, while the members of the Commission ask questions regarding lottery operations, they typically respect the knowledge and expertise of OLC staff and defer to their recommendations for proposed administrative rules. While the Commission is able to serve as a check on actions proposed by OLC staff, auditors were unable to identify a time in recent history when the Commission did not approve proposed administrative rules presented by Agency staff. However, as noted by OLC in its response to the draft version of this performance audit, Commissioners did propose and approve three amendments to the VLT rules it approved in August 2009.

In comparing the governance of the Ohio Lottery with the peer lotteries, Ohio operates with a duplication of oversight responsibilities. Ohio's lottery can be classified as an agency or arm of government, due to the fact that OLC is subject to the same regulations as other State agencies and that the Director of OLC reports to and serves at the pleasure of the Governor. Of the ten peer lotteries, six are organized in this fashion,<sup>10</sup> while four are organized in the corporate/commission style of governance.<sup>11</sup> Of the peers who are also organized as arms of government, only two (New Jersey and Illinois) have lottery commissions. Moreover, the role of the Illinois Lottery Control Board is limited to reviewing the Lottery's advertising policies. In fact, the Florida Legislature voted in 2001 to abolish its State Lottery Commission, which had served as an advisory commission to the Governor and the Secretary of the Lottery. While the role of the Florida Lottery Commission did not include the rule-making authority held by the Ohio Lottery Commission, Florida's Lottery staff and commissioners agreed that a lottery commission did not significantly enhance the Lottery's mission of maximizing profit transfers to support public education.

Under a corporate style of governance, the director of the lottery is somewhat insulated from the political process and is able to operate the lottery in a manner more similar to a business, maximizing profits. Most lotteries under this form of governance have directors who are appointed by and report to the state lottery board of directors. There are a few exceptions to this, including Kentucky, whose President/CEO is appointed by the Governor, but then reports to and can only be removed by the Board of Directors. The Iowa Governor appoints its Lottery Director for a set term, which is staggered from the Governor's term of office. So even when appointed by the Governor in Kentucky and Iowa, the Director is afforded a degree of independence and stability that provides a greater level of continuity in the lottery's business practices.

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<sup>10</sup> Florida, Illinois, Michigan, New Jersey, New York, and Pennsylvania.

<sup>11</sup> Texas, Kentucky, Georgia, and Indiana.



Additionally, under a corporate style of governance, the board of directors is granted much greater authority over the operations of the lottery. Common responsibilities under a corporate model typically include approval of an annual budget (though overall appropriations may still be determined by the state's legislature), major lottery procurements, and policies and procedures related to the conduct of lottery games. Additionally, the Board serves as a resource to the CEO/Director. The Georgia and Kentucky statutes both state, "the Board of Directors shall provide the chief executive officer with private-sector perspectives of a large marketing enterprise." Moreover, the Georgia statute – as well as those in Iowa, North Carolina, New Mexico, and Oklahoma – require that the lottery commission include representation from professions such as attorneys, accountants, and law enforcement officers, as well as persons with experience in marketing. Some boards of directors – including those in Kentucky, Iowa, and Connecticut – include the State Treasurer as an ex-officio member of the Board. Of the peer lotteries with appointed boards, the average term was 4.5 years.

Despite the independence and flexibility afforded by a corporate style of governance, states with quasi-public corporations seek to promote transparency and integrity of their lotteries' operations through systems of audits and reports to their legislatures and to the public. For example, in Georgia, the lottery is required to submit quarterly and annual reports to the Governor, state auditor, state accounting officer, and a joint legislative oversight committee. Reports disclose revenues, prize disbursements, operating expenses, and administrative expenses, as well as a summary of the functions and activities performed by each division of the lottery. The Georgia Lottery Corporation is also required to adopt a system of internal audits, maintain weekly records of lottery transactions, receive an annual audit of the operation, and submit an annual budget to the Georgia Office of Planning and Budget using the same fiscal year used by state government. Additionally, a joint legislative oversight committee has the authority to inquire into and review lottery operations, as well as review and evaluate the success of operations. If necessary, the committee has the authority to conduct an independent audit or investigation of the lottery.

Furthermore, the classification of a lottery as a quasi-public corporation does not exclude it from public records statutes. The Kentucky Lottery Corporation's enabling statute explicitly states that all meetings of the Board of Directors shall be open and that all records of the KLC are open records and subject to public inspection. Moreover, it should be noted that in no instance does a corporate-style lottery have independent authority to establish new types of gaming. Instead, in all states, the types of gaming allowed are established in statute by the state legislatures.

The current structure of the Ohio Lottery Commission leads to a duplication of duties. The Executive Director, as an at-will employee of the Governor, does not make significant decisions about lottery policy, without approval from the Governor.

Moreover, the primary formal role of the Commission is to approve games rules, which are already subject to oversight through the State rule-making process (JCARR).<sup>12</sup> OLC staff correctly noted that the Commission's statutory requirement to hold monthly public meetings does provide an element of accountability to the lottery's operations and decision-making. However, Ohio's Commission members serve shorter terms than the peer average and, outside of a Commission member who is required to represent an organization that deals with problem gambling, the statute does not require board members to represent specific professions (attorney, accountant, law enforcement, or marketing),<sup>13</sup> which could result in the appointment of a Commission without sufficient relevant experience. As a result, the Commission, while inquiring into the operation of the lottery, typically defers to the judgment, experience, and knowledge of OLC staff. Ultimately, the Commission, by virtue of its current design, does not substantively contribute to the efficiency of OLC or its ability to generate profits for public education.

Converting to a quasi-public corporation would grant the Commission greater authority and promote improved continuity of operations. Increasing the statutory authority of the Commission and instituting more lottery-relevant requirements for members would create a Commission that is more dynamic, has greater outside expertise, and is more directly involved in helping OLC maximize the efficiency of operations and generate greater profits. Additionally, the Governor, General Assembly, and public could ensure sufficient oversight of Lottery operations through regular reports and audits.

Conversely, if the Ohio Lottery does not convert to a quasi-public corporation, the General Assembly should consider eliminating the duplicative role of the Commission. The Commission, while providing some level of review, is not currently in the position to add substantive value to the operation of the Lottery or the profits generated.

**R2.3 The Governor and General Assembly should provide OLC with at least a modicum of exemption from the Ohio Administrative Procedures Act with respect to the Agency's day-to-day operations. As a quasi-public corporation, it should be the prerogative of the Commission/Board of Directors to approve rules, including those for legislatively-authorized online and instant games, which govern OLC operations. Such an exemption would allow OLC to react to a changing market and implement online and instant games in a more timely fashion. If the Governor and General Assembly choose to retain the current lottery structure, the Agency should be provided exemptions from procedures in a manner similar to those in other states.**

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<sup>12</sup> The Commission does approve internal rules regarding operations of OLC, which may not require the oversight of JCARR.

<sup>13</sup> ORC § 3770.01 requires Commission members to "have prior experience or education in business administration, management, sales, marketing, or advertising".

**As described in R2.2, any exemptions from Ohio’s administrative rule-making requirements would not authorize OLC to approve or otherwise implement lottery games that have not been authorized by the General Assembly.**

The primary function of the Commission is to promulgate rules under which a Statewide lottery may be conducted. The process to promulgate rules is outlined in OAC § 3770:1-2-03 and further defined by the procedures which are in place for all State agencies and outlined in ORC Chapter 119 or ORC § 111.15, depending on the type of rule. Ohio’s rule-making process is intended to allow State agencies to develop rules through which the agency administers the laws enacted by the General Assembly. In other words, OLC can only authorize games through rules that are consistent with its statutory authority.

General administrative rules and rules that govern the play of online games are promulgated pursuant to ORC Chapter 119 processes. For these rules, the Commission must first approve proposed rules prepared by OLC staff. Following approval from the Commission, the proposed rules are submitted to the Secretary of State, the Legislative Service Commission (LSC), and the Joint Committee on Agency Rule Review (JCARR).

The Ohio Lottery Commission is then required to give notice of and hold a public hearing on the proposed rules, accepting comments before and after the hearing date. JCARR is an oversight committee established to ensure that agencies are not exceeding their legislative authority in the rule-making process. JCARR has jurisdiction for 65 days and holds a hearing regarding the proposed rule after the 40th day from when the rule was filed. JCARR does not approve the proposed rule, but can recommend a resolution to the General Assembly to invalidate the rule if the rule is outside the scope of the Ohio Lottery’s statutory authority, if it conflicts with an existing rule, or if the rule conflicts with the legislative intent of the statute. Following the public hearing and expiration of JCARR’s jurisdiction, the Lottery Commission must vote to approve the rule in final form. Upon passage, the rule is filed in final form with the Secretary of State, LSC, and JCARR. The rule is then effective on the tenth day after it is filed with each of the aforementioned. Using the Ohio Lottery Commission’s scheduled meetings from 2010 as an example, the earliest an online game approved in proposed form at the July 19 meeting could take effect would be October 28, 101 days later. In the case of Powerball, the Agency began selling tickets the day the rule went into effect (April 16, 2010), 81 days after the Commission had approved it in proposed form.

While the process to promulgate a rule for an instant ticket does not take as long, instant ticket rules are still classified as administrative rules. The Commission is required to approve the rules for each instant ticket, but is not required to hold a public hearing or allow 65 days for JCARR to review the rule. Once the rule is approved by the Commission, the rule may be filed and become effective 10 days after the filing date. While the statute only requires the Commission to approve the rule for instant tickets

once, it is the Commission's practice to approve rules in proposed form and then again in final form. According to OLC's Chief Legal Counsel, this allows the Commission to review the game twice, ensures ample time for public comment on the proposed rule, and permits OLC staff to perform a second review of the rule. Consequently, an instant ticket proposed at the July 19 meeting could be sold no sooner than August 26, 38 days following approval in proposed form by the Commission.

OLC and the Commission have the ability to enact emergency rules. However, an emergency rule requires the Governor to issue an executive order allowing an exemption from Chapter 119 requirements. While OLC used emergency rules to begin the implementation of VLTs before the initiative was halted (see discussion on VLTs in the background), it chose not to use emergency rules to implement Powerball. The decision not to pursue emergency rules for Powerball contributed to the delay in beginning to cross-sell the multi-state games in Ohio (see discussion on Powerball in the background).

While Ohio adopts all online and instant games through administrative rules, in all of the 10 peer states, rules regarding game play are to some degree exempted from the administrative procedures process or allowed to be filed under emergency rule procedures. Texas and New York have exempted instant ticket game play rules from their administrative rule-making procedures requirements. An additional five states – Kentucky, Illinois, Michigan, New Jersey, and Pennsylvania – exempt both instant and online ticket game play from their normal rule-making processes. Rather, in these states, game play rules are published in a register or public notice. In Florida and Indiana, rather than exempting lottery games from administrative procedure requirements, the statutes in those two states allow the lotteries to promulgate rules under emergency rule-making procedures. In Florida, the statute explains, "The unique nature of state lottery operations requires, from time to time, that the department respond as quickly as is practicable to changes in the marketplace."

The Georgia Lottery, which operates as a quasi-public corporation, has the least restrictive process, exempting all lottery rules from the Georgia Administrative Procedures Act. In Georgia, approval by the lottery commission is the only action required to enact a new instant or online game, as well as general administrative rules. Newer state lotteries, such as North Carolina, New Mexico, and Tennessee have also exempted their lotteries from following the same administrative procedures an agency of the state would be required to follow.

Officials from state lotteries with exemptions to the standard administrative rule-making process remarked on the efficiencies gained through the exemptions. A representative of the Florida Lottery commented that with emergency rule-making authority, new lottery products move to market more quickly. She noted that if the legislature would determine it is no longer appropriate for the lottery to continue using emergency rule-making

provisions, the process to implement instant and online games would take much longer, and as a result, the lottery would have more difficulty in operating as an entrepreneurial business enterprise. The Superintendent of the Illinois Lottery also described a streamlined approach to implementing new games. The lottery's product development department determines the specifications and financial impact of each new online or instant game and the Superintendent seeks the informal approval of the Director of the Department of Revenue (the agency in which the lottery is operated), as well as the Governor, when necessary. Without the requirement to go through the administrative rule process, the Superintendent noted a quick turnaround time from when the lottery decides to implement a game and when that game can be distributed to retailers.

Compared with peer states, Ohio has the most lengthy and cumbersome process for promulgating rules concerning instant and online games. While peer state lotteries all operate with different levels of independence from the administrative rule-making procedures, the only permanent exemption the statute allows the Ohio Lottery is to forego a 65-day review window and public hearing for instant tickets. Providing the Commission with the authority to approve rules would maintain the accountability that currently exists in the rule-making process while allowing OLC the flexibility it needs to respond in a timelier manner to a changing marketplace. Any flexibility or exemption in OLC's rule-making authority would not allow it to implement gaming that has not been approved by the General Assembly.

**R2.4 Whether the General Assembly and Governor choose to transition OLC to a quasi-public corporation charged with generating revenue for public education or retain the current State agency structure, OLC should be given a level of authority and flexibility in its administrative operations to fulfill its mission. Such authority should include the ability of OLC to develop processes for procurement and contracting that are consistent with the goals of accountability and transparency, while also more appropriate to a business enterprise. With appropriate checks and balances, such authority would assist OLC in responding to changing environments, increasing efficiency, and maximizing profits.**

As a State lottery organized as an arm of government, OLC is required to follow directives, administrative procedures, and statutes regarding purchasing, personnel, and other general government regulations that are identical to those required of other State agencies. OLC has followed the Governor's restrictions to limit travel, meals, and discretionary spending and to control hiring. In SFY 2010, employees were also required to take 10 unpaid leave days (furlough days) to help mitigate the State's budget shortfall, because of the State of Ohio's collective bargaining agreement and a directive from the Governor. These requirements were put in place to limit general government (i.e., General Revenue Fund) spending, and OLC does not receive any General Revenue Funds.

The Department of Administrative Services (DAS) policies that OLC is required to follow in the areas of contracting and procurement also act as constraints on its ability to operate like a business and to maximize revenue. Because OLC uses DAS for its marketing contracts, there are elements of the process that restrict the Agency's flexibility and ability to get maximum performance out of its contracts. OLC is challenged both to set minimum standards that contractors can meet but also create contracts that provide enough flexibility in an area where marketing mediums and games change quickly, and where advertising firms with specific expertise could be used on a limited basis for very specific projects.

Providing OLC with additional flexibility would also promote innovative marketing strategies in areas such as social media and other emerging technologies. OLC staff noted that after developing ideas to expand lottery marketing into social media outlets, it had to wait months for rules from DAS regarding the use of social media by all State agencies. Similarly, the Agency has encountered difficulty in following directives regarding how State agencies structure their web sites (see **R5.9**). When staff began exploring the idea of putting an advertising banner on the OLC web site, DAS sought to issue uniform State regulations, which at the time of the audit, had yet to be completed.

Other states have recognized the unique contracting and procurement needs of a state lottery. Of the peer lotteries, five have the ability to generate their own policies and rules that govern the procurement and contracting processes. All four of the peers organized as quasi-public corporations have such provisions. Moreover, Connecticut and Iowa, the two corporate-model state lotteries that previously operated as state agencies, specifically provided this exemption as part of their conversions, to allow for greater flexibility and responsiveness. In the case of the Iowa Lottery, its purchasing authority has allowed it to more quickly introduce and promote new lottery products, and has provided a framework for more business-like operations. However, it is still able to use state contracts for purchases when advantageous to its operations. The procurement process also allows the lottery to procure specialized products in a more timely fashion, which is important in the unique and specialized lottery industry. While the Iowa Lottery still goes through a bidding process, it is not subject to the general requirements of its Department of Administrative Services.

As the OLC staff has indicated, the mission and needs of OLC do not always fit within the State agency framework of providing traditional government services rather than generating profits. By failing to modify bureaucratic processes in recognition of the unique nature of a lottery, the constraints described above impact OLC's ability to be flexible, innovative, and responsive to real-time changes in the marketplace in order to maximize revenue and LPEF transfers. Changes to administrative processes can occur through exemptions to DAS requirements or through a recognition that DAS requirements should be modified to fit OLC's business model.

Other states have recognized that their lotteries are enterprises that do not perform the traditional functions or fit within the traditional structures of state government. As such, these states have granted their lotteries more authority to promote the efficient operation of such organizations. Similar authority for Ohio's lottery – whether inside or outside of the DAS process – would provide OLC with additional tools to help it operate as efficiently as possible and maximize profits.

- R2.5 Within the constitutional designation of Lottery profits for education purposes, the Governor and General Assembly should examine the possibility of refining the public purpose of and more clearly targeting the State's lottery profits. While profits generated by the lottery support education, the State lacks the ability to point to a tangible and identifiable purpose. The general purpose use of lottery profits may impede OLC's ability to maximize profits and diminish public support. By appropriating lottery profits to a more specific purpose, OLC may be more successful in marketing lottery products, communicating the purpose of lottery profits, and sustaining higher levels of public support.**

**As the Ohio Department of Education (ODE) implements the Ohio Evidence Based Model (OEBM) and its various reporting requirements, OLC and ODE may be able to use cost data to identify specific areas of study or operations that could be funded with LPEF monies. There are a variety of ways this could be accomplished without divesting lottery profits from the purview of ODE. For example, OLC could work with ODE to determine a specific program to fund, such as all-day kindergarten, class size reductions, or other programs specified in the OEBM. OLC could also work with ODE to communicate how lottery profits comprise total state aid by including such information on school district report cards or other informational materials. Regardless, such information should be easily communicated to the public. Using this approach, the State would not need to compensate for diverted LPEF funds, but stakeholders would be able to clearly identify where LPEF funds are directed.**

In 1987, voters approved a constitutional amendment earmarking lottery profits for educational purposes. Since then, all lottery profits have been accounted for in a separate fund, the Lottery Profits Education Fund (LPEF), which is used to support elementary, secondary, vocational, and special education. While lottery profits had supported education prior to SFY 1988, proceeds from the lottery had been deposited in the General Revenue Fund. At present, the LPEF is a part of the total expenditures made by the State for foundation payments to Ohio school districts. However, the general nature in which profits are directed does not lend itself to allowing OLC and stakeholders to highlight or identify the tangible way in which profits are benefiting education programs in Ohio. Moreover, increases in profit transfers to the LPEF do not necessarily translate to increases in State funding for education. Recent proposals to expand the lottery, including

VLTs and Mega Millions, have been made with the understanding that additional funds from the LPEF would be offset by decreases in General Revenue Fund support of education.

In interviews with Ohio convenience store owners, some of whom are licensed as lottery retailers, it was noted that the public purpose of the lottery is an important factor in selling tickets. If potential customers better understood and supported the cause funded by lottery profits, retailers believe they would sell more lottery products. They remarked that people either do not appear to understand that lottery profits represent a part of education funding, or they are cynical about the continued presence of local levies and debate at the State level about school funding.

The Lottery Profit Review Commission, charged with making recommendations that would aid OLC in reversing a trend of declining sales and profit transfers, took up the issue of specifically earmarking lottery profits for a specific purpose. In its 2000 report, the Commission recommended the Governor and General Assembly consider more specific earmarking of lottery profits, particularly for future increases in profits. The Commission noted that while lottery profits are dedicated to the support of education through the LPEF, lottery profits are used to support basic aid of education, and evidence of the impact of lottery profits on education is difficult for many citizens to discern. The Commission cited the programs the Georgia Lottery supports with profits and noted that if lottery profits were earmarked for easily identifiable items or programs in the State's education budget, public support for the lottery could be strengthened.

According to OLC, efforts have been made to communicate and reinforce an understanding of how lottery profits are used. However, in a survey administered by auditors, Agency employees identified communicating the public purpose of the lottery as an area that could use improvement. The question – “The public understands the importance of the Ohio Lottery” – was the only question in which more employees disagreed with the statement than agreed. In previous years, OLC has requested that the General Assembly devote profits to a specific program or programs within education, in order to strengthen the association between the lottery and a more specific purpose. However, since lottery profits are embedded with the State foundation formula, the General Assembly has been unwilling to make this change.

Many states have earmarked lottery profits to support primary, secondary, and/or higher education. Of the ten peer states, seven direct their profits to support these causes, with four peers allocating funds to K-12 education in a manner similar to Ohio. Georgia and Kentucky are two examples of lotteries that direct their lottery profits to specific and identifiable programs.



According to the Executive Director of NASPL, even though Ohio's profits are constitutionally designated for primary and secondary education, there is not a tangible connection between lottery revenues and education. Moreover, lottery profits have been used, at least in part, to offset General Revenue Fund spending on education, and General Revenue Funds have been diverted to other uses. He concluded that this lack of a clear purpose for lottery revenue undermines the public's support of the lottery and compounds the misperception that the lottery was implemented to singlehandedly fund education.

The Georgia Lottery has established a well-publicized connection between lottery profits and the HOPE (Helping Outstanding Pupils Educationally) Scholarship Program, which provides scholarships for Georgia high school students to attend Georgia colleges and universities, and the Georgia Pre-K Program, which provides funding for preschool programs. Since inception, Georgia lottery profits have benefited more than 1.2 million HOPE Scholarship recipients and 1 million four-year-olds in the Pre-K program throughout the state.

The Executive Director of NASPL indicated the programs the Georgia lottery supports are excellent examples of a lottery that has identified and directed profits to a targeted program. Specifically, the HOPE Scholarship has been linked to higher high school and college graduation rates. In the same way, the Pre-K Program allows families to send their children to an early childhood education program they may otherwise not be able to afford, and the children to be more prepared for academic success upon entering kindergarten. The Executive Director of NASPL indicated these types of programs help to remove some of the stigma typically associated with playing the lottery. As a result of these programs, he stated that the Georgia Lottery has benefited from a much higher level of public support and respect.

The Superintendent of the Illinois Lottery echoed the NASPL concerns about transferring lottery profits to more general causes. In Illinois, lottery profits are directed to the Common School Fund and public perceptions about the use of profits in education funding are similar to those found in Ohio. Without the benefit of having its lottery profits tied to a tangible or specific purpose, it is difficult for Illinois residents to connect to a specific benefit that lottery profits provide. The Superintendent believed the Illinois Lottery would have greater public support and could be more effective in marketing lottery products if profits were earmarked for identifiable projects or initiatives in the way other lotteries have done.

The difficulty in modifying the method in which lottery profits are directed toward education is most recently illustrated through the biennial budget passed in July 2009. The Governor had proposed resolving a budget shortfall through the installation of VLTs at the State's seven horseracing tracks. This initiative was projected to generate \$933 million for the LPEF. In his directive to OLC, the Governor stated, "Increased lottery

revenues allow the State to dedicate scarce general revenue funds to critical programs benefiting the health, safety and welfare of Ohio's citizens, avoiding devastating cuts to those programs." In fact, when the implementation of VLTs was suspended pending a Statewide referendum on the relevant provision in the budget bill (see discussion on VLTs in the background), the General Assembly ultimately voted to delay a planned income tax cut, generating additional General Revenue Funds to cover the loss of revenue anticipated from the LPEF.

While the use of lottery profits is entrenched in the budget process in Ohio, other existing lotteries have worked to better define the public purpose of lottery profits. In SFY 1999, the Kentucky Lottery began directing profits toward the Kentucky Education Excellence Scholarship, the College Access Program, and the Kentucky Tuition Grants Program. Prior to this specific earmark, the Lottery's profits were directed to the General Fund, with no specific earmark for the funds.

Through meetings with OLC staff, interviews with stakeholders, and review of other states' public purposes for lottery profits, the current use of lottery profits presents a challenge in conveying the benefits of playing the lottery and hampers OLC's ability to identify any tangible or specific programs that the lottery profits directly support. Lottery profit transfers to the LPEF accounted for 6.3 percent of spending on primary and secondary education in SFY 2009, and directing lottery profits to a specific program may help OLC more effectively market lottery products and increase public support for the lottery.<sup>14</sup>

Because of the budgetary constraints facing Ohio in the next biennium, OLC should consider working with ODE, using the new information generated through the Evidence Based Model reporting requirements, to identify specific areas of school operations that could be fully funded with LPEF dollars. Using data on Ohio school district expenditures and the new data that will be produced in the next few fiscal years, OLC and ODE could target programs for funding that would illustrate the importance of lottery profits and ensure no diminution of LPEF dollars being used for education in Ohio.

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<sup>14</sup> Figure represents GRF and LPEF spending for primary and secondary education.

**ORGANIZATION STAFFING  
AND MANAGEMENT**

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# Organization, Staffing, and Management

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## Background

This section of the performance audit focuses on the Ohio Lottery Commission's (OLC or the Agency) human resource operations. The objective is to assess OLC's organizational hierarchy, staffing levels, and human resource management practices against leading or recommended practices, industry benchmarks, and selected peer lotteries.<sup>1</sup> Sources of leading or recommended practices include the Government Accountability Office (GAO) and the Society of Human Resource Management (SHRM). Sources of industry standards include *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009).

### *Organizational Structure*

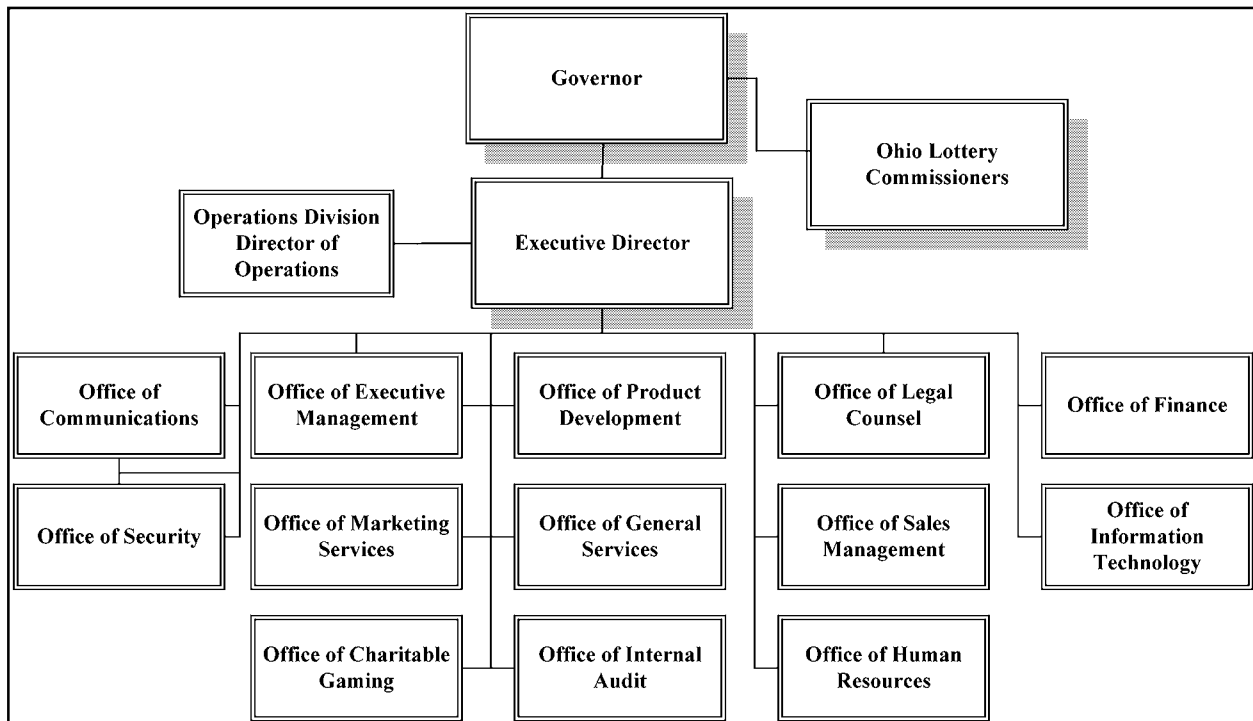
Pursuant to Ohio Revised Code (ORC) § 3770.02, the Executive Director of OLC is appointed by the Governor, confirmed by the Ohio Senate, and serves at the pleasure of the Governor. The Executive Director is required to devote full time to the duties of the office and is not permitted under the ORC to hold other office or employment. The Executive Director also must meet all the requirements for appointment as a member of the Commission and must, by experience and training, possess management skills that equip him or her to administer an enterprise of the nature of a state lottery.

The ORC authorizes the Executive Director to appoint an assistant director, deputy directors of marketing, operations, sales, finance, public relations, security, and administration; and as many regional managers as are required. The Executive Director may also appoint necessary professional, technical, and clerical assistants. Regional managers and assistant regional managers, sales representatives, and any lottery executive account representatives remain in the unclassified service.

OLC consists of 14 offices, and within each office, there are various bureaus. The offices are depicted in **Chart 3-1**.

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<sup>1</sup> See the **executive summary** for a list of the peer lotteries and an explanation of selection methodology.

**Chart 3-1: OLC Organizational Structure State Fiscal Year (SFY) 2009**

Source: OLC 2008 and 2009 CAFR

The offices shown in **Chart 3-1** are described below:<sup>2</sup>

- Executive Management:** The Office of Executive Management consists of the Executive Director and her staff. Executive Management oversees the operations of OLC. The Executive Director is responsible for administering instant and online lottery game products through a Statewide network of licensed retailers. In addition, the Executive Director, via a memorandum of understanding with the Ohio Attorney General, oversees the administration of Ohio's charitable bingo licensing and monitoring. The Office of Executive Management consists of 5.5 full-time equivalent employees (FTEs).<sup>3</sup>
- Operations:** The Office of Operations oversees the production of the daily drawings and weekly Cash Explosion game show, the vending solution group (instant ticket vending

<sup>2</sup> In April 2010, OLC created a new Office of Government and Community Affairs (replacing the Legislative Bureau previously housed under the Office of Operations). For this new Office, OLC hired a Deputy Director and a Junior Legislative Liaison, and transferred one employee (Public Information Officer 2) from the Office of Communications to Government and Community Affairs. For the staffing comparisons in this section, the new Office was grouped with the Office of Legal Counsel based on their work functions to ensure a "like" comparison with the peers.

<sup>3</sup> The Executive Management Office consists of the Executive Director, an Administrative Assistant 3, the Deputy Director of Operations, two Administrative Assistant 4s, and two temporary college interns.

machine employees), and agency strategic research and planning. The Office of Operations is comprised of the Game Show Bureau, Strategic Planning Bureau, and Legislative Bureau.<sup>4</sup> The Office of Operations employs 9.0 FTEs.<sup>5</sup>

- **Charitable Gaming:** The Office of Charitable Gaming is responsible for the licensing and regulatory compliance of charitable organizations, including investigations, audits, and site inspections. In SFY 2005, OLC and the Ohio Attorney General’s Office (AG) signed a Memorandum of Understanding between the two agencies transferring the administration and monitoring of charitable bingo licensing to OLC. The Office of Charitable Gaming is comprised of the Licensing Bureau and Site Inspectors Bureau. There are currently 17.0 FTEs employed in the Office of Charitable Gaming.
- **Internal Audit:** The Office of Internal Audit conducts internal audits of OLC. In addition, the Office of Internal Audit is responsible for testing the consistency and integrity of new products (i.e., games). The Office of Internal Audit employs 4.0 FTEs.
- **Information Technology:** The Office of Information Technology is responsible for overseeing the Lottery’s servers, network, telecommunications, and information security. In addition, the Office of Information Technology is responsible for computer operations, programming, software development, gaming network, applications, and the technical side of the nightly drawings. The Office of Information Technology is comprised of the Applications Development Bureau, Network Information Systems Bureau, and IT Operations Bureau. There are currently 38.5 FTEs employed in the Office of Information Technology.
- **Human Resources:** The Office of Human Resources is responsible for overseeing the following activities/operations: benefits, compensation and classifications, Equal Employment Opportunity (EEO), new hires, training and development, employment processing, employee performance measures, and labor relations. The Office of Human Resources is comprised of the following bureaus: Personnel Management, Labor Relations, and Benefits/EEO. There are currently 6.9 FTEs employed in the Office of Human Resources.
- **Legal Counsel:** The Office of Legal Counsel oversees all legal matters that come before the Agency, including public record requests, game rules, and contract management. In addition, the Office of Legal Counsel is the liaison with the AG’s Office. The Office of Legal Counsel currently consists of 4.2 FTEs.

<sup>4</sup> During the course of the audit, the Legislative Bureau was replaced by a new Office of Government and Community Relations.

<sup>5</sup> The Strategic Planning staff (5.0 FTEs) are grouped with the Product Development Office FTEs in **Table 3-1** to ensure the comparison includes “like” services and functions” among Ohio and the peers. The Game Show staff (4.0 FTEs) are excluded from **Table 3-1** as no peers operate a game show.

- **Finance:** The Office of Finance is responsible for budgeting, accounts payable, agent receivables, general accounting, claims, purchasing, and payroll. The Office of Finance is comprised of the following bureaus: Agent Accounts, Accounts Payable, Claims, Purchasing, and General Accounting. There are currently 26.5 FTEs employed in the Office of Finance.<sup>6</sup>
- **Sales Management:** The Office of Sales Management is responsible for selling lottery tickets and consists of lottery sales representatives who are responsible for dealing with the retailers. There are nine sales regions throughout the State. The Office of Sales Management is broken down into the following regions (see **lottery operations** for a map of OLC regions): Region 1 – Cleveland, Region 2 – Toledo, Region 3 – Dayton, Region 4 – Cincinnati, Region 5 – Columbus, Region 6 – Athens, Region 7 – Canton, Region 8 – Youngstown, and Region 9 – Lorain. There are currently 141.3 FTEs employed in the Office of Sales Management.
- **Product Development:** The Office of Product Development oversees the online and instant ticket games. In addition, the Office of Product Development manages new game and promotion launches, researches new product offerings and sales performance, conducts marketing focus groups, oversees management of the cooperative services program (see **lottery operations**), and establishes open and close dates for all games. The Office of Product Development is comprised of the Instant Ticket Bureau and Online Games Bureau. There are currently 7.0 FTEs employed in the Office of Product Development.
- **Security:** The Office of Security is responsible for securing the safety and security of the Agency’s employees, game products and drawings. In addition, the Office of Security investigates stolen ticket incidents and initiates background checks for employees, vendors, and retailers, and provides general security needs to protect the safety and reputation of the Agency. The Office of Security includes a bureau dedicated to drawing security. There are currently 16.5 FTEs employed in the Office of Security.
- **Communications:** The Office of Communications oversees all aspects of OLC’s communications and public relations efforts and serves as the Agency’s spokesperson. The Office of Communications produces internal and external documents and publications, manages the Agency’s response to public records requests, develops and maintains OLC’s online presence (web site and social media), and manages any

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<sup>6</sup> OLC’s Claims staff are reviewed separately based on their job functions to ensure a “like” comparison to the peers (see **Table 3-1**).

videography projects. The Office of Communications also includes a graphics bureau.<sup>7</sup> There are currently 10.9 FTEs employed in the Office of Communications.<sup>8</sup>

- **Marketing Services:** The Office of Marketing Services oversees all aspects of OLC's marketing efforts, including advertising, promotions, sponsorships, point-of-purchase, and merchandising. The Office of Marketing Services is comprised of the following bureaus: Sponsorships, Advertising/Creative Services, and Promotions. There are currently 11.0 FTEs employed in the Office of Marketing Services.
- **General Services:** The Office of General Services oversees a variety of Agency support functions, including agent licensing, vehicle fleet administration, office services, warehouse operations, and the customer call center. The Office of General Services is comprised of the following bureaus: Office Services, Retailer Services, Inventory, Warehouse, Vehicle Section, Mail Services, Call Center, and Licensing & Bonding. There are currently 27.7 FTEs employed in the Office of General Services.

### *Staffing*

In May 2010, OLC employed 333.8 FTEs. **Table 3-1** illustrates staffing levels at OLC and the peers for State Fiscal Year (SFY) 2010. All positions are shown as full-time equivalents (FTEs), and staffing levels are compared on a per capita basis and per sales basis for all classifications. In addition, the Sales staff is compared on a per retailer basis. See **appendix 3-A** for additional detail on Ohio and the peers.

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<sup>7</sup> In its response to a draft of this performance audit, OLC noted that the Office of Communications has two additional bureaus – Media Relations and Website/Video – that were not included in the initial organizational charts provided to auditors.

<sup>8</sup> During the course of the audit, OLC transferred one employee (Public Information Officer 2) from the Office of Communications to Government and Community Affairs.



**Table 3-1: OLC and Peer Staffing Levels<sup>9</sup>**

	Ohio	Peer Average <sup>1</sup>	Difference	Percentage Difference
<b>Executive Management/Gaming Services<sup>2</sup></b>				
FTEs	5.54	5.64	(0.10)	(1.8%)
FTEs per capita	0.48	0.48	0.00	0.0%
FTEs per sales	0.0024	0.0024	0.0000	0.0%
<b>Human Resources</b>				
FTEs	6.86	4.60	2.26	49.1%
FTEs per capita	0.60	0.42	0.18	42.9%
FTEs per sales	0.0030	0.0024	0.0006	25.0%
<b>Product Development / Marketing/Strategic Planning<sup>3</sup></b>				
FTEs	23.00	13.36	9.64	72.2%
FTEs per capita	2.00	1.34	0.66	49.3%
FTEs per sales	0.0099	0.0074	0.0025	33.8%
<b>Security</b>				
FTEs	11.84	11.74	0.10	0.9%
FTEs per capita	1.03	1.07	(0.04)	(3.7%)
FTEs per sales	0.0051	0.0057	(0.0006)	(10.5%)
<b>Drawings</b>				
FTEs	4.64	4.68	(0.04)	(0.9%)
FTEs per capita	0.40	0.36	0.04	11.1%
FTEs per sales	0.0020	0.0017	0.0003	17.6%
<b>Communications<sup>4</sup></b>				
FTEs	10.89	6.12	4.77	77.9%
FTEs per capita	0.95	0.58	0.37	63.8%
FTEs per sales	0.0047	0.0033	0.0014	42.4%
<b>Finance / Purchasing<sup>5</sup></b>				
FTEs	21.89	18.39	3.50	19.0%
FTEs per capita	1.91	1.80	0.11	6.1%
FTEs per sales	0.0094	0.0093	0.0001	1.1%
<b>Claims</b>				
FTEs	4.65	14.37	(9.72)	(67.6%)
FTEs per capita	0.40	0.98	(0.58)	(59.2%)
FTEs per sales	0.0020	0.0058	(0.0038)	(65.5%)
<b>Internal Audit</b>				
FTEs	4.00	3.95	0.05	1.3%
FTEs per capita	0.35	0.44	(0.09)	(20.5%)
FTEs per sales	0.0017	0.0025	(0.0008)	(32.0%)

<sup>9</sup> The FTE figures for Ohio and the peers do not include vacant positions that the lotteries are planning to fill. Georgia and New York are excluded from the peer average, as these states did not provide sufficient information for auditors to use in the analysis.

<b>Legal/Governmental Community Affairs<sup>6</sup></b>				
FTEs	7.19	8.44	(1.25)	(14.8%)
FTEs per capita	0.63	0.62	0.01	1.6%
FTEs per sales	0.0031	0.0037	(0.0006)	(16.2%)
<b>Information Technology</b>				
FTEs	38.55	27.83 <sup>7</sup>	10.72	38.5%
FTEs per capita	3.36	2.70	0.66	24.4%
FTEs per sales	0.0166	0.0147	0.0019	12.9%
<b>Warehouse / Facilities</b>				
FTEs	4.00	11.57	(7.57)	(65.4%)
FTEs per capita	0.35	1.45	(1.10)	(75.9%)
FTEs per sales	0.0017	0.0083	(0.0066)	(79.5%)
<b>Licensing / Bonding</b>				
FTEs	6.73	10.81	(4.08)	(37.7%)
FTEs per capita	0.59	0.76	(0.17)	(22.4%)
FTEs per sales	0.0029	0.0037	(0.0008)	(21.6%)
<b>Sales</b>				
FTEs	141.25 <sup>8</sup>	97.59	43.66	44.7%
FTEs per capita	12.29	9.55	2.74	28.7%
FTEs per sales	0.0607	0.0499	0.0108	21.6%
FTEs per retailer	0.0171	0.0137	0.0034	24.8%
<b>Total</b>				
FTEs	291.03 <sup>9</sup>	217.77	73.26	33.6%
FTEs per capita	25.33	20.91	4.42	21.1%
FTEs per sales	0.1252	0.1105	0.0147	13.3%

Source: OLC and peer organizational charts and interviews

Note 1: Totals may vary from actual due to rounding

Note 2: The FTEs for Ohio and the peers are based on 2010 staffing figures. However, the total population, total sales, and total retailers are based on SFY 2008 information.

Note 3: See Table 3-B in appendix 3-B for a state-by-state comparison of Ohio and the peers, as well as additional notes on the peers.

Note 4: The FTEs per capita and FTEs per sales are shown on a per million basis.

<sup>1</sup> The Illinois Lottery was merged with the Illinois Department of Revenue in 2003. As a result of the merger, a variety of support functions are provided to the Lottery by other operational areas within the Department of Revenue. Functions provided by the Department of Revenue to the Lottery were excluded from this analysis.

<sup>2</sup> The Executive Management category includes Executive Staff and Gaming Services. Ohio, Florida, and Michigan were the only entities with staff devoted to Gaming Services. Ohio has 3.54 FTEs devoted to Gaming Services, while Florida and Michigan have 19.0 and 3.0 FTEs, respectively.

<sup>3</sup> Ohio, Illinois, Kentucky, and New Jersey operate separate product development and marketing divisions, while the remaining peers combine these functions into one division. Therefore, these two divisions were combined for comparison purposes. In addition, the majority of the peers do not have a strategic planning division, so OLC's and Texas's strategic planning FTEs were included in Product Development/Marketing.

<sup>4</sup> OLC includes the graphic design employees in the Office of Communications. As a result, when the peers' graphic designers, were not a part of the Communications Division, they were added to the staffing in this category for comparison purposes.

<sup>5</sup> OLC includes purchasing employees in the Office of Finance. As a result, when the peers' purchasing employees were not a part of the Finance Division, they were included in the Finance/Purchasing category for comparison purposes.

<sup>6</sup> Governmental and Community Affairs employees were included in the Legal category for staffing comparison purposes.

<sup>7</sup> This peer average includes New Jersey. However, auditors conducted a secondary analysis in the **recommendations** because New Jersey appears to be an extreme outlier in this category.

<sup>8</sup> OLC Sales FTEs do not include the addition of the 12.0 LSR1 and 1.0 LSR2 FTEs the Agency recently hired.

<sup>9</sup> Total OLC FTEs does not include the following bureaus: Game Show (4.0 FTEs) as no peers host a game show, and Office Services (6.0 FTEs), Mail Services (1.0 FTE), and Call Center (10.0 FTEs) as OLC is the only Agency with a separate Office of General Services. The peer general service employees are scattered throughout a variety of divisions. In order to ensure a consistent staffing comparison, these OLC employees were excluded from the staffing analysis.

**Table 3-1** shows that OLC employs more FTEs per capita and per sales when compared with the peer averages in human resources (see **R3.3**), product development/marketing/strategic planning (see **R3.4**), drawings (see **R3.5**), communications (see **R3.6**), finance/purchasing, information technology (see **R3.7**), and sales (see **R3.8**). However, Ohio's finance and purchasing FTEs per sales (0.0094) are comparable to the peer average (0.0093) and no recommendations were made in this area.

Staffing levels were comparable in the areas of executive management (specifically when compared with peers that include gaming staff) and legal. Staffing levels were below the peers in the areas of security (excluding the drawing staff), claims (OLC is significantly lower than the peer average), internal audit, warehouse/facilities (OLC is significantly lower than the peer average), and licensing/bonding.

### *Collective Bargaining*

OLC has a collective bargaining agreement with the Ohio Civil Services Employee Association (OCSEA) that covers 199 employees. The OCSEA agreement covers a variety of government agencies throughout the State, including the Ohio Lottery Commission, and is set to expire on February 29, 2012. The majority of the employees in the following offices and/or bureaus are covered under the OCSEA agreement: Security (including drawings), Finance, Internal Audit, Information Technology, Licensing/Bonding, Call Center, and Sales. Of the remaining 153 employees, 59 are classified, which means that they have civil service protection, and 94 unclassified employees serve at the pleasure of the Executive Director.

Most of the OCSEA contract is negotiated for Statewide application by the Department of Administrative Services Office of Collective Bargaining. OLC does not have any seats at the bargaining table for the overall contract, which applies to all OCSEA members. However, there is a section within the contract that pertains directly to OLC. OLC and its representatives of the collective bargaining unit negotiate the Agency-specific language that is stipulated in the OCSEA agreement. A review of the Agency's contract showed there were a number of provisions that might warrant discussion or renegotiation during the next round of collective bargaining (see **R3.11**).

### *Employee Survey*

An employee survey was distributed by email to OLC employees during the course of this audit. The purpose of the survey was to obtain employee feedback on a variety of subjects and to gauge perceptions of the Agency's organizational climate. As part of OLC's rebranding initiative, an employee satisfaction survey had been conducted in December 2007. That survey was divided into four categories: Employment Characteristics, Company Culture, Commitment, and Communication. At OLC's request, AOS incorporated several of the Agency's original survey questions into the AOS-developed survey in order to track progress. OLC had a survey response

rate of 93.2 percent. In general, respondents indicated they were satisfied with the Agency's operations. See **appendix 3-B** for the results of the employee survey. See also *noteworthy accomplishments* in the **executive summary**.

### *Hiring Practices*

As a component of this audit, AOS examined the hiring practices used by OLC.<sup>10</sup> OLC has a structured hiring process that outlines the steps to take, what order to take them in, and what needs to be accomplished with each step. During an interview with a Regional Sales manager, the manager commented that recent changes in selection of sales staff had improved the quality of candidates.

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<sup>10</sup> AOS did not test the hiring practices for all applicants.

## Recommendations

### *Staffing and Organization*

**R3.1 OLC should develop a formal staffing plan that is aligned with the goals and objectives identified in the Agency’s strategic plan (see R4.1). OLC should review the Texas Lottery Commission’s workforce plan to identify areas for inclusion in its own staffing plan. The staffing plan should take into consideration vacancies, Agency operations and workloads, and the number of employees needed during the coming year, as well as the cost of hiring new employees, and what value the individuals will bring to customers and the organization.**

**As a component of developing the staffing plan, OLC should undertake regular reviews and updates of its job descriptions. When modifications are needed, it should process the changes through the Department of Administrative Services (DAS) using standard State methods. The Office of Human Resources should be designated as having primary responsibility for reviewing and updating job descriptions.**

The Deputy Director of Human Resources noted that the Agency does not have a staffing plan or operational benchmarks and workload measures to guide staffing. Rather, the Deputy Director of Human Resources bases the Agency’s staffing on the needs and unique demands of each Office.

The Deputy Director of Human Resources meets with each deputy director periodically to determine the staffing needs of each Office. If staff is needed, the Deputy Director of Human Resources verifies the budget and pay range of the classification and fills out a form that lists the job duties of the position. The request is forwarded to the Office of Finance for approval and then sent to the Executive Director for her approval. Once the Executive Director approves the addition of the position(s), the Deputy Director of Human Resources writes a justification to the Office of Budget Management (OBM) for its approval. Lastly, the Deputy Director of Human Resources develops a job description and posts the job both internally and externally.

The Deputy Director of Human Resources indicated that some of the Agency’s job descriptions are outdated. The Agency’s practice is to reassess job descriptions annually during employees’ performance reviews. However, the Deputy Director of Human Resources noted that the practice is not enforced. Additionally, she noted that OLC is in the process of sending out job descriptions to management in each respective office to ensure that job descriptions are accurate.

According to the publication, *Staffing Best Practices: Creating a Staffing System* (Shamis, Managing Partner of Selecting Winners, Inc., n.d.), all companies should have a staffing plan, but especially those on fast growth tracks. Organizations should consider the following when developing staffing plans:

- Plan staffing requirements based on the strategic or business plan;
- Hire proactively based on planned needs and expected attrition;
- Maximize the organization's existing resources; and
- Determine the gaps in current resources and develop strategies to fill them.

A staffing plan provides order and discipline to a process that too often feels rushed and chaotic. While preparing a staffing plan, organizations should ask themselves these key questions:

- How many new employees will be needed during the coming year?
- Why will those employees be needed?
- When will they be needed?
- How long will they be needed?
- How much will it cost the company to hire new employees? and
- What value will they bring to customers and the organization?

*Job Descriptions – An Overview* (Society of Human Resource Management (SHRM), 2002) states that job descriptions have the potential to become the subject of contention, including grievances or litigation. Accordingly, it is critical that accuracy be maintained in job descriptions. To ensure this, the employer should designate one party (for example, the supervisor or the HR department) as having primary responsibility for keeping them current. In addition, the employer should have a plan for reviewing them regularly. A plan of this type should reflect the personnel resources available to do the review and the character of the job content. Some jobs are dynamic, changing rapidly and extensively (due to technological or organizational considerations); these job descriptions should be reviewed often. Other jobs change very little over long periods of time; these job descriptions need not be reviewed as often.

The Texas Lottery Commission, as part of its strategic plan, has developed a workforce plan for SFYs 2009-2013. The workforce plan outlines the critical workforce skills that are important to the agency's ability to operate, the workforce demographics, employee turnover rates, and the number of state employees who are eligible for retirement. In addition, the workforce plan has a section that focuses on the future workforce profile of the Texas Lottery Commission. This section outlines expected workforce changes, future critical functions, and anticipated staffing changes needed to continue to perform the work of the Lottery.

By developing a staffing plan and using key workload measures to regulate staffing, OLC will be better able to ensure it has the critical skills needed to maintain operations while being efficient in staffing its operations. Additionally, it will help the Agency determine what positions may need to be created, removed from the organizational chart, or expanded/reduced. As noted in **Table 3-1**, there are a few staffing areas in which the Agency was below the peer average. AOS did not identify inefficiencies or performance gaps related to the lower staffing in those areas. Likewise, OLC is higher in some areas that are addressed in subsequent recommendations where workload and other analyses indicated potential inefficiencies. In both instances, a staffing plan would help OLC determine the most appropriate level of staffing needed to meet the Agency's goals and objectives. Using a staffing plan will also help assure stakeholders that OLC is operating in a lean manner, consistent with its mission to support education funding in Ohio. Furthermore, regularly updating job descriptions ensures that the job descriptions accurately reflect the responsibilities of each position. By regularly updating job descriptions, OLC can ensure that changes in environment are accurately reflected in its job descriptions.

**R3.2 OLC should conduct an overall examination of its organizational structure in order to better align offices and bureaus and improve communication and collaboration. The Agency should specifically consider combining the Office of Marketing Services and the Office of Product Development as this would help ensure the two offices communicate to develop the most effective promotional campaigns to support the sale of instant and online games. In addition, OLC should evaluate its organizational structure and seek to optimize the arrangement of offices and supervisory/management structure. Examining communication channels and identifying offices and bureaus that routinely work together may aid the Agency in consolidating some offices and bureaus and reducing the potential for redundancy and silos.**

Prior to SFY 2008, OLC was organized by clusters. This arrangement functioned as follows:

- The Executive Director was responsible for overseeing offices predominantly related to executive and management-level functions and Agency operations:
  - The Office of Communications,
  - The Office of Legal Counsel,
  - Legislation,
  - The Office of Marketing Services, and
  - The Office of Security.

- The Chief of Staff in the Division of Gaming Services was responsible for overseeing offices related to the direct business functions of the Agency:
  - The Office of Charitable Gaming,
  - The Office of Product Development,
  - The Office of Sales Management, and
  - The Office of Strategic Planning.
- The Assistant Director was responsible for overseeing offices completing Agency management functions like financial and HR management:
  - The Office of Finance,
  - The Office of General Services,
  - The Office of Human Resources,
  - The Office of Information Technology, and
  - The Office of Internal Audit.

Beginning in SFY 2008, this organizational structure was modified and the clusters were eliminated. Instead, each Office within OLC reported directly to the Executive Director. **Table 3-2** compares the organizational structure for OLC divisions with the peers.

**Table 3-2: OLC and Peer Organizational Structures**

Divisions	Ohio	New York	Illinois <sup>1</sup>	Florida	Pennsylvania	Indiana	New Jersey	Texas	Kentucky	Michigan
Executive Management	X	X	X	X	X	X	X	X	X	X
Operations	X	X	X		X	X	X	X	X	X
General Services	X			X						
Marketing Services	X	X <sup>2</sup>	X	X	X	X	X	X	X	X
Communications	X	X	X	X		X	X	X	X	X
Security	X	X		X	X	X	X	X	X	X
Product Development	X		X	X			X	X		
Sales	X	X <sup>2</sup>	X	X	X	X	X		X	X
Finance	X	X	X	X	X	X	X	X	X	X
Internal Audit	X	X		X		X		X	X	X
Legal Counsel	X	X	X	X		X		X	X	
Human Resources	X	X		X		X		X	X	X
Information Technology	X	X		X	X	X	X	X	X	X
Charitable Gaming	X							X		X
Legislative Affairs				X				X		

Source: OLC and peers organizational charts

<sup>1</sup> The Illinois Lottery was merged with the Department of Revenue in 2003. As a result, the Department of Revenue provides the Lottery with a variety of support functions, including security, information technology, finance, planning, etc.

<sup>2</sup> New York's Sales and Marketing are combined into one division.



As shown in **Table 3-2**, OLC is comprised of 14 offices. Each Office is managed by a Deputy Director, who reports directly to the Executive Director. In addition, **Table 3-2** shows that although there are some similarities in OLC and the peers' organizational structures, there are some notable differences as well, which are described below.

**Executive Management:** OLC's Executive Management Office is comparable to the peers, with no significant differences in functions or organizational structure.

**Operations:** The majority of the peer entities have operations divisions, but there are some differences in how this function is deployed by the peers. For instance, Florida does not have an operations division, while Indiana and Kentucky's operations divisions are housed under their Administrative Services Divisions. In addition, there are some notable differences in the day-to-day functions of OLC's Operations Office compared with the peers. For example,

- OLC's Operations Office is responsible for overseeing the production of the daily drawings and weekly Cash Explosion game show, managing the instant ticket vending machines, and Agency strategic research and planning.
- The operations divisions in Illinois, Pennsylvania, Indiana, and Kentucky are also responsible for warehouse management (i.e., the storage and distribution of lottery tickets).
- New York's Operations Division is comprised of a variety of functions, including gaming services, financial management, computer services, human resources, mail room, drawings, and prize payments.
- New Jersey's Operations and Organizational Support Division is responsible for overseeing information processing, validations drawings, warehouse/facilities, and human resources.
- Similarly, Michigan's Planning and Operations Division oversees information technology and gaming control.
- Lastly, Texas's Operations Division is responsible for overseeing retailer services, security, drawings, and the advertising and promotion of products.

**General Services:** OLC's Office of General Services oversees a variety of areas including inventory/warehouse, vehicles, office services, mail services, licensing and bonding, and the Lottery's Call Center. While the majority of the peers perform similar general services functions, Ohio is the only entity whose General Services Office is in its own separate office.

**Marketing Services/Product Development:** Similar to Ohio, Illinois, Florida, and New Jersey all have separate Marketing and Product Development divisions. Although the marketing and product development functions in Texas are separated, both functions are housed within the Operations Division. In contrast, Pennsylvania, Indiana, Michigan, and

Kentucky combined their marketing and product development functions into a single division. Lastly, New York's marketing and product development are combined with the Sales Division.

**Communications:** OLC's Office of Communications is comparable to the peers, with no significant differences in functions or organizational structure, with the exception of Pennsylvania<sup>11</sup>.

**Security:** While all of the peers have security divisions, with the exception of Illinois, there are some differences in the organizational structure. Ohio, Kentucky, Indiana, and Florida house their drawing employees within their security divisions. New Jersey and Texas house their drawing employees in their operations divisions. In contrast, Pennsylvania's drawing employees are housed under the Consumer Marketing Division.

**Sales:** OLC's Office of Sales Management is comparable to the peers, with no significant differences in organizational structure or functions, with the exception of Texas. The Senior Internal Auditor of the Texas Lottery noted that GTECH, its gaming contractor, distributes lottery tickets to retailers, while the Lottery is responsible for providing licenses to the retailers.

**Finance:** While all of the peers have finance divisions, there are a few differences in the organizational structures and functions. OLC's Office of Finance and the Kentucky' Lottery Finance Division are responsible for both purchasing and claims. In contrast, the finance divisions in Indiana and Florida process claims, and the administrative divisions manage purchasing functions. Conversely, the Finance Division in New Jersey manages purchasing, but claims are processed by its Operations Division. Lastly, in Texas, the Finance Division is not responsible for either function—purchasing is managed by the Administrative Division and claims are processed by the Operations Division.

**Internal Audit:** OLC's Office of Internal Audit is comparable to the peers, with no significant differences in organizational structure or functions, with the exception of Illinois and New Jersey, whose internal audit functions are supported by other agencies.

**Legal Counsel:** OLC's Office of Legal Counsel is comparable to the peers, with no significant differences in organizational structure or functions, with the exception of New Jersey, Pennsylvania, and Michigan, in which legal functions are performed by other agencies.

**Human Resources:** OLC's Office of Human Resources is comparable to the peers, with no significant differences in organizational structure or functions, with the exception of

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<sup>11</sup> AOS was unable to identify communications staff within Pennsylvania's organizational chart and was unable to obtain further clarification from Pennsylvania.

Illinois, New Jersey, and Pennsylvania, in which human resources functions are performed by other agencies.

**Information Technology:** OLC’s Information Technology Office is comparable to the peers, with no significant differences in functions or organizational structure.

**Charitable Gaming:** OLC’s Office of Charitable Gaming is responsible for the licensing and regulatory compliance of charitable organizations, including investigations, audits and site inspections. Texas and Michigan are the only peers who also have a charitable gaming divisions. Ohio’s Charitable Gaming Office appears to be comparable to these peers, with no significant differences in functions or organizational structure.

A closer examination of OLC’s organizational structure, compared with its prior structure and those of the peers, reveals that the large number of independent offices, each reporting to the Executive Director, lends itself toward creating silo effects, with each Office operating as its own organization. While this creates some organizational independence, it hampers the ability of certain interdependent offices to function collectively. Based on the results of the employee survey conducted by auditors, only 37.2 percent of staff rated communication between departments as being effective (see **appendix 3-B**). Additionally, OLC personnel noted that opportunities may exist to improve the organizational structure. For example, the Deputy Director of Human Resources indicated that if the instant ticket vending machine (ITVM) staff and the drawing staff operated under the same division, the structure might better serve OLC operations.

The effect of operational silos was particularly noted in two areas, game promotion and the evaluation of marketing campaigns. The Deputy Director of Marketing Services noted that the Offices of Marketing Services, Product Development, and Sales – which must collaborate on a number of issues related to game deployment – partner in an attempt to avoid the organizational silo effect. Regular meetings are scheduled to discuss product development plans and games being offered, but the organizational structure requires additional efforts to coordinate. The success of efforts to enhance communication is the result of individual efforts and office management, rather than the organizational structure.

However, the Office of Marketing Services is not heavily involved in the initial decision-making about upcoming games or promotions. For example, during the audit period, OLC employees expressed concern that a national campaign for PowerBall and “10-X” drawings (occurring throughout the month of April) and promoted by the Office of Marketing might conflict or cause confusion with a Ten-Oh! promotion planned by the Office of Product Development to be running concurrently. The simultaneous campaigns with similar titles could cause confusion for players and could be less effective on an

individual basis. Although the difference was ultimately resolved, the overlap was attributed to coordination and communication issues between the Office of Marketing Services and the Office of Product Development.

In the area of measuring the performance of promotions, the Bureau Chief of Advertising/Creative Services indicated that the process for performance measurement of campaigns/promotions works differently for instant vs. online games. In both cases, Marketing and Product Development work closely together to identify the games that are being promoted, the timing of the launches and/or promotions, and objectives. In the case of instant games, the Office of Marketing Services largely drives the promotion, while in the case of online games, the Office of Product Development drives the promotion and Marketing's role is more limited. There does not appear to be an operational reason for this different approach to online games. Instead, it is a function of tradition and the division in Product Development between instant and online games. By combining the Marketing and Product Development Offices, the Lottery may experience more consistency amongst game promotions.

According to SHRM (2002), organization structure can be defined as the formal interrelating of individuals and groupings in allocation of tasks, responsibilities and authority to achieve the goals of the organization. There are a variety of organizational structures entities can use, including:

**Functional Organization Structures:** Most organizations start with this form. The organization forms departments and each department has a separate function and specializes in that and only that area. Management from above must centrally coordinate the different specialized departments. It is a hierarchical, usually vertically-integrated organizational structure. It emphasizes standardization in organization and processes for specialized employees in relatively narrow jobs. The advantage of this structure is that the organization develops experts in their areas. However, the disadvantage centers on coordination. People are in their own specialized silos and often fail to coordinate with other departments. OLC is currently using the functional organization structure, and as noted above, Agency officials have expressed concern about the development of silos.

**Product Organization Structure:** This form is often used after a functional one ceases to be effective. As the organization sees a need to develop new products and services, it may change to a product organization structure. Each product or group of products becomes a separate division or cost center. The advantage of this product or divisional organization focus on what is needed to produce those specialized products for that division while still using knowledge gained from other different, but related, divisions. The disadvantages of this decentralization relate to duplication of functions. Each division often has its own units that could be helping each other but may not under this structure.

**Matrix/Project Organization Structures:** Matrix organization structures are a combination of the functional and product organization structures. They have grown out of project structures where employees from different functions formed teams to work on a project until it was completed; then they reverted to their own functions again. Advantages of the matrix structure include a wide range of skills focusing on a specific project or product and moving quickly for results. As an example, since the manufacturing and marketing people may also be involved with the design people in developing a product, it can be designed quicker, and produced and sold with fewer problems along the way. Communication across groups not normally communicating is enhanced to the organization's betterment. Disadvantages of matrix organizations include many employees reporting to more than one boss at a time. This can be confusing and create conflict for employees raised with the assumption of only one boss. This type of organization requires greater communication skills and adaptability of employees.

*Assessing Your Organizational Structure*, (Texas State Classification Office, 2003) notes that the restructuring process should include:

- Project planning;
- Data collection;
- Structural analysis;
- Staffing needs analysis;
- Span of control analysis; and
- Development of recommendations

When evaluating the organizational structure, it is extremely important to consider all the factors that affect the organization and to consider what "non-organizational" changes might be implemented, both to improve operations and to reduce management and supervisory needs. The Deputy Director of Human Resources noted that due to the turnover in the executive director position since 2007 (three executive directors) and different viewpoint of the Agency as articulated by each executive director, restructuring the Agency's organizational structure was less of priority during transition periods. However, having a strategic plan and staffing plan (see **R4.1** and **R3.1**) in place would provide OLC with direction and guidance to identify the most effective organizational structure for the Agency, regardless of recent turnover in executive management.

By restructuring the organizational structure and combining offices that work closely together, the Lottery could realize more consistency amongst divisions and improve communication amongst its offices. Improving consistency and communication can produce additional efficiencies in operations or enhance the effectiveness of processes across the organization. In addition, the Agency could optimize its arrangement of offices and its supervisory/management structure, helping to reduce the number of supervisors who are supervising minimal numbers of employees (see **R3.9**).

**R3.3 OLC should consider eliminating 1.5 FTEs within its Office of Human Resources. To facilitate these reductions, the Agency should review the organizational charts of the peers to determine potential areas/positions that could be consolidated or eliminated. Reducing the number of Office of Human Resources FTEs would more closely align OLC's Human Resources staffing levels and practices with the peers.**

Table 3-1 shows that OLC employs slightly more FTEs per capita and FTEs per sales than the peer average. Auditors attribute the higher staffing levels primarily to the fact that OLC employs a full-time Labor Relations Officer, a position that is not included in the peer HR departments. The OLC Labor Relations Officer is responsible for coordinating and monitoring all aspects of labor relations for the Agency, including the following:

- Reviewing collective bargaining information and union contracts on a continuous basis,
- Participating in the contract negotiation process and administration of union contracts on behalf of the Executive Director,
- Attending meetings, seminars, and workshops to keep updated on all new labor relation issues and trends, and
- Investigating employee grievances and disciplinary charges.

OLC, in its response to a draft of this performance audit, asserted that other State agencies in Ohio employ labor relations officers, and that this is a better comparison because not all lotteries are covered by collective bargaining agreements. However, the Chief Administrative Officer and the HR Director for Florida and Michigan respectively handle all labor relation tasks for their agencies. The remaining peer lotteries do not work under collective bargaining agreements; therefore, they have no staff members dedicated to collective bargaining issues. Furthermore, agencies within Ohio often incorporate labor relations activities into other HR functions; a separate position is not required or often necessary.

Since most of the OCSEA contract is negotiated for Statewide application by the Office of Collective Bargaining and OLC does not have a seat at the main bargaining table, the OLC Labor Relations Officer is mainly responsible for handling the negotiations for the Agency-specific language that pertains to OLC. Given the fact that the Agency-specific language for OLC is minimal and only covers a small number of specific provisions, and based on the number of other Human Resources employees, the Office of Human Resources is equipped to fulfill the negotiation function. If OLC were to eliminate the full-time Labor Relations Officer, the Office of Legal Counsel could handle the investigations of grievances and disciplinary charges.

OLC would need to eliminate 2.0 FTEs to achieve the peer average for human resources FTEs per capita or 1.3 FTEs to achieve a comparable number of human resources FTEs per sales. Combining duties and streamlining functions among HR personnel (see also **R3.11**) would help OLC achieve a staffing level similar to the peers and more appropriate for an agency of its size.

*Financial Implication:* Eliminating 1.5 human resources FTE positions would result in savings of approximately \$83,000 annually in salaries and benefits based on the average of the two lowest salaried employees within the Office of Human Resources and benefits at 31 percent.<sup>12</sup>

**R3.4 OLC should consider eliminating 4.0 FTEs within the Bureau of Strategic Planning and 1.0 FTE within the Marketing and Product Development functions. To facilitate these reductions, the Lottery should consolidate the Office of Marketing Services and Office of Product Development into a single Office (see R3.2). In addition, the Agency should examine the organizational charts of the peers, specifically the peers whose product development and marketing functions are combined, to identify areas where OLC can realize additional efficiencies through combining and reorganizing duties. Reducing the number of FTEs dedicated to Marketing, Product Development, and Strategic Planning would better align OLC staffing with the peers based on workload, and would increase the efficiency of these functions.**

**Table 3-1** shows that OLC employs 0.66 more FTEs per capita and slightly more FTEs per sales (.003) than the peer average. The higher staffing levels are attributed to the staffing and organization of OLC's Product Development and Marketing offices.

In addition, OLC has a Bureau of Strategic Planning that consists of 5.0 FTEs. Only Ohio and Texas have staff specifically assigned to separate bureaus of strategic planning.<sup>13</sup> The Bureau of Strategic Planning is responsible for the development of the Agency's strategic plan, the creation of performance measures, and research of industry trends, government initiatives, and other lotteries. However, OLC does not have a strategic plan (see **R4.1**), and auditors identified numerous examples where it has not instituted performance measures. Though data collection and analysis is important to OLC operations, OLC also uses the information compiled by NASPL and La Fleurs, as well as the research provided by its gaming and marketing vendors, to help identify industry trends. In contrast, both Texas and Florida have strategic plans. Texas has only one specific individual assigned to planning, while Florida does not have any employees assigned specifically to planning. Based on auditors' recommendations to develop a strategic plan (**R4.1**) and performance measures, OLC could likely benefit from an individual with the task of coordinating

<sup>12</sup> Benefits were calculated as a percentage of salaries based on actual expenditures from OLC financial reports.

<sup>13</sup> For the purposes of analysis, the strategic planning FTEs were included in the Product Development/Marketing category for Ohio and Texas in the data presented in **Table 3-1**.

planning and internal measurement efforts. The tasks currently performed by 5.0 FTEs in the Bureau of Strategic Planning could be distributed to other bureaus that could perform research tasks internally.

Although the additional strategic planning FTEs are primarily responsible for OLC's higher staffing levels in this area, OLC's FTEs per capita and FTEs per sales are significantly higher than Texas's, the only other state with dedicated strategic planning staff. Moreover, even when the strategic planning FTEs are removed from the comparison, OLC's staffing levels in the combined Marketing/Product Development category still exceed the peer average. Reducing 1.0 FTE in this area would bring Ohio more in line with the peers.

One way to accomplish the reduction in Marketing/Product Development is through consolidating the two offices (see **R3.2**). Ohio, Florida, Illinois, Kentucky, and New Jersey operate separate product development and marketing divisions. In contrast, Indiana, Michigan, Pennsylvania, and Texas combined these two functions into single divisions. When examining only the peers that have combined product development and marketing divisions, the peer average FTEs per capita is 1.29. In contrast, the peer average FTEs per capita for the four peers who operate separate product development and marketing divisions is 1.39. An examination of peer department staffing levels and mix revealed that the higher staffing levels for the peers who operate separate marketing and product development divisions is related to the additional administrative leadership and administrative assistants. Peers with single marketing and product development divisions only employ one director and typically fewer administrative assistants.

OLC noted that there is no industry standard or best practice that would require it to combine the Marketing and Product Development functions. While this is true, combining the two offices would produce additional efficiency that would help address OLC's higher staffing level in this area. Moreover, as discussed in **lottery operations**, the division of these two offices does create some duplication of functions, inconsistent processes, and opportunities for communication failures. Combining the two offices would help resolve these issues that were identified by OLC staff.

*Financial Implication:* Eliminating 4.0 FTE positions within the Bureau of Strategic Planning and 1.0 FTE position within the Office of Marketing Services and Office of Product Development would result in savings of approximately \$292,000 annually in salaries and benefits.

**R3.5 OLC should improve the efficiency and effectiveness of its Drawings Bureau using relevant performance measures (FTEs per capita and FTEs per sales) and workload information. In addition, the Lottery should conduct a work review of the composition and responsibilities of the draw staff to determine the feasibility of**



**increasing the use of part-time staff to cover the drawings and reduce the number of full-time personnel needed. Taking these actions would ensure that the draw staff is working productively and help eliminate the long periods of downtime experienced between drawings.**

The Drawings Bureau is responsible for the proper operation, set-up, and verification of drawing equipment to certify midday and nightly drawings, and for all OLC drawings. As of 2010, the Drawings Bureau consists of one Administrative Assistant 3, three full-time lottery game security specialist, and two part-time lottery game security specialist. **Table 3-1** shows that OLC's drawing FTEs per capita and per sales are slightly higher than the peer averages.

During observations of midday drawings and conversations with OLC staff, it was noted that Agency drawing staff experience long periods of downtime between drawings. When the drawing staff is not conducting a drawing, some of the staff members are asked to assist in other activities, such as covering the security desk or assisting in an administrative capacity. However, this does not consistently occur nor is it applied to all drawing staff. In other words, OLC has not assigned drawing staff additional duties that they may complete during their work hours and between drawings. As such, some employees engage in non-work related tasks, such as reading novels and newspapers, during paid work hours when they are not engaged in drawings.

The slightly higher staffing levels are explained by Indiana and Kentucky's use of part-time employees for drawings. Indiana uses two part-time drawing managers to conduct weekend, holiday, and nightly drawings, while Kentucky employs five part-time drawing security officers. However, because of the limited assigned hours, Indiana's two employees and Kentucky's five employees only equal a full-time equivalent of 0.75 FTEs and 0.50 FTEs, respectively. This practice provides Indiana and Kentucky with sufficient staff to handle the drawings without incurring the additional costs of employing full-time draw staff employees.

By comparison, OLC employs three full-time lottery game security specialists and two part-time lottery game security specialists, for a total of 3.6 FTEs. The Lottery would need to reduce 0.50 and 0.69 FTEs in order to achieve the peer average for FTEs per capita and FTEs per sales, respectively. However, when Indiana and Kentucky are excluded from the peer average, OLC's draw staff ratios are comparable to the peers (0.40 FTEs per capita and 0.0019 FTEs per sales).

Though it is likely that other states experience staff downtime as well, OLC could better use its full-time drawing staff by examining the periods of downtime and making appropriate Lottery-related work assignments so that each employee's time is fully used.

OLC may potentially need to overcome issues related to classifications and cross training to fully use its drawing staff throughout the workday.

Through a work analysis of drawing staff activities, OLC will be able to determine the feasibility of increasing the use of part-time staff or adding to the responsibilities of the draw staff. Options for more fully using drawing staff during regularly assigned work hours include making permanent assignments to assist in security-related activities and/or conducting clerical and general services-related tasks. Assigning additional duties during downtime would permit OLC to more fully use its full-time staff and may enhance its ability to reduce staff in other areas.

In its response to a draft of this audit, OLC noted that it had recently assigned draw staff to validate high-tier prizes associated with Powerball. Auditors requested a description of the general duties and volume of work associated with this task and the number of hours that would be used in this regard each week. OLC cited its Multi-State Lottery Association (MUSL) confidentially requirements and did not provide a description of the job function. Lottery officials stated that this task requires about 1.5 to 2 hours per verification and there are usually between five and ten verifications per week.

**R3.6 OLC should eliminate 3.0 FTEs positions within the Office of Communications. Based on the staffing used in peer lotteries, OLC should examine its administrative staffing levels for possible reduction. Eliminating the 3.0 administrative assistant FTEs would more closely align OLC's Communication staffing levels and practices with the peers.**

The Office of Communications is responsible for developing and implementing policies governing all facets of OLC Communications programs (e.g., Electronic Design/Graphics, Publications, and Media Relations). In addition, the Office of Communications formulates, coordinates, and implements policies and procedures for Agency community service and fundraising initiatives. In the beginning of the year, the Office of Communications consisted of 11.89 FTEs. However, in May 2010, OLC transferred one Public Information Officer 2 (1.0 FTE) from Communications to Governmental and Community Affairs.

**Table 3-1** shows that OLC employs 0.37 more FTEs per capita and 0.0014 more FTEs per sales than the peer averages. An examination of peer department staffing levels and mix revealed that higher staffing levels in OLC are related to its four administrative assistants within its communications functions. The peers employ between zero and one administrative assistant. The only peers who have administrative assistants in this function are Texas and Florida.

In its response to the draft of this audit, OLC asserted that the administrative assistant positions in Communications are not duplicative and noted that one employee is responsible for constituent correspondence, customer service, and an employee newsletter; another is involved in social media initiatives, maintaining a Keno retailer blog, and maintaining web-based tracking initiatives. Still, OLC's staffing level in this area significantly exceeds the peers, indicating that administrative assistants in these peer lotteries manage multiple job duties, or that the duties are spread among other staff.

The Lottery would need to eliminate 4.2 FTEs to achieve the peer average for communication FTEs per capita. By comparison, the Lottery would need to reduce approximately 3.2 FTEs to achieve a comparable number of communication FTEs per sales.

*Financial Implication:* Eliminating 3.0 communication FTEs positions would result in savings of approximately \$184,000 annually in salaries and benefits.

**R3.7 OLC should review its Office of Information Technology staffing levels in conjunction with relevant performance measures before filling any vacant positions within the Office of Information Technology. Based on the analysis in Table 3-1, the Lottery should also consider eliminating 4.0 FTEs to better align its staffing and workload with peer lottery operations. Using service tickets and other IT-related workload measures will help OLC identify the appropriate positions for elimination.**

The Office of Information Technology consists of three bureaus: Network Information System, Applications Development, and IT Operations. The Network Information System oversees OLC's servers, network, telecommunications, and information security. Applications Development works closely with the gaming system vendor and helped design the specifications and test the software for the gaming system. The Bureau of IT Operations is responsible for computer operations, programming, software development, gaming network, applications, and the technical aspect of nightly drawings.

**Table 3-1** shows that OLC employs more IT FTEs per capita than all but two peers. Similarly, OLC's IT staffing levels per sales (0.0166) are higher than the peer average (0.0147). However, because of concerns raised by OLC in their response to the draft audit report, auditors recalculated the IT staffing data omitting New Jersey because of its extreme outlier status. Omitting this peer brought OLC's IT staffing per sales in line with the peers but its staffing per capita remained above the peers by 3.78 FTEs. Reviewing additional performance measures, such as service tickets per FTE, would provide OLC with additional data upon which to base a determination on the adequacy of staffing levels in each bureau of the Office of Information Technology. Based on the peer data, OLC could reduce up to 4.0 FTEs in various IT classifications and bring its staffing more in line with the peers on a per capita basis, and exceed peer efficiency on per sales basis.

In its response to a draft of this audit, OLC noted that some of the peer lotteries, particularly Illinois, New Jersey and Pennsylvania are housed within larger agencies and therefore do not have comparable IT staff, and OLC requested these peers be removed from the comparison. For this reason, auditors contacted each of these states for additional descriptions of the work performed by their IT departments. Because of the significant difference in IT staffing arrangements, Illinois was excluded from the peers. New Jersey did not respond to the request for additional information and was also excluded from the analysis. However, Pennsylvania uses its IT staff in a similar manner, had comparable positions, and received similar levels of vendor and outside support as OLC and were therefore retained. For example, Pennsylvania employs 3 FTEs<sup>14</sup> to support what it calls its Administrative System. This encompasses both internal programs (accounting) and the gaming system. OLC employs 13 FTEs (including 2.0 FTE administrative assistants) in a similar bureau to accomplish like functions. In addition to the high staffing on a ratio basis, auditors noted examples of OLC IT employees engaged in non-lottery related activities during the workday, indicating significant down-time. These indicators, taken together, point to an opportunity to improve the efficiency of the IT division through staffing reductions.

In addition to its current staff, OLC is planning on posting four vacant positions within the Office of Information Technology and seeking applicants to fill the positions. Because OLC has not conducted internal workload studies to determine if additional employees are needed, it should consider refraining from posting the positions until it has demonstrated a need to fill the vacancies. Furthermore, the Agency should examine the periods of downtime experienced by the IT staff to ensure that each IT employee's time is fully used before filling vacancies. Understanding the unique technical skills associated with different types of IT functions, OLC should ensure it has the correct mix of staff in its Office of Information Technology to appropriately and efficiently fulfill its duties.

*During the course of the audit, OLC filled the four IT vacancies discussed in this recommendation. Consequently, in reviewing its staffing levels in this area, OLC should treat these as filled positions and consider a higher number of reductions. This change does not affect the financial implication of this recommendation, discussed below.*

*In its response to the draft of this audit, OLC provided documentation stating it had added two of these four positions to support 24/7 operations required for Powerball. However, Pennsylvania offer the same game but has not increased staff significantly to accommodate on-site computer operator work required under the Multi-State Lottery. OLC should carefully consider its staffing requirements and schedule to ensure optimal IT staff use, and then make reductions accordingly.*

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<sup>14</sup> Pennsylvania also employs 4 FTEs to serve as its information interface with retailers, customers, and vendors, and another 4 FTEs to support its office network and PC terminals

*Financial Implication:* Eliminating 4.0 FTE positions within the Office of Information Technology would result in savings of approximately \$158,000 annually in salaries and benefits. In addition, OLC could realize another \$158,000 in cost avoidance by not filling the four vacant positions within the Office of Information Technology.

**R3.8 OLC should consider making reductions in its sales staffing levels in order to improve the efficiency and effectiveness of this function. Relevant performance measures indicate that OLC employs a much higher level of staffing in this category than the peers (see also R5.6 for further information).**

The Office of Sales Management is responsible for increasing Statewide sales in order to maximize OLC's annual transfer to the Lottery Profits Education Fund. This is accomplished by OLC selling its products through licensed lottery retail agents (retailers). The Office of Sales Management is comprised of nine sales regions located throughout the State. Each sales region is comprised of a Regional Sales Manager, an Assistant Regional Sales Manager,<sup>15</sup> an Executive Secretary, a Management Analyst, and several Lottery Sales Representatives (LSRs). In addition to the nine sales regions, there are approximately 12.3 additional FTEs in Sales Management.

As shown in **Table 3-1**, OLC's sales staffing levels are higher than the peer averages on a per capita, per sales, and per retailer basis. Specifically, OLC employs 2.70 more FTEs per capita, 0.0107 more FTEs per sales, and 0.0034 more FTEs per retailer than the peers. Additionally, the Deputy Director of Human Resources indicated that the Agency recently hired 13 Lottery Sales Representatives (12 LSR1s, and 1 LSR2). When including the additional LSRs, OLC's FTEs per capita, FTEs per sales, and FTEs per retailer increases to 13.42, 0.0663, and 0.0187, respectively.

A detailed comparison of staffing level and mix amongst OLC and the peers indicates that the higher staffing levels are driven by the LSR positions. In the analysis of **lottery operations**, auditors developed performance indicators to gauge both the efficiency and effectiveness of LSRs and regional sales offices. When compared with the peer averages, the performance of OLC was significantly lower in all efficiency and effectiveness indicators (see **R5.5** and **R5.6** for additional information). Because of the disparity in workload and efficiency, OLC should closely examine its staffing deployment in this area.

**R3.9 OLC should consider reorganizing the Office of General Services to ensure that the ratio of supervisors to employees is fairly allocated among supervisors. The Lottery should also conduct similar span of control analyses in the other Offices to ensure**

<sup>15</sup> The Cleveland sales region has historically employed two Assistant Regional Managers, although during the course of the performance audit, one of these employees left OLC, and the position had not been filled at the time of the audit's release.

that its supervisory structure is efficient and effective. As a component of the reorganization, the Lottery should eliminate all vacancies from its organizational charts, particularly in General Services where a large number of vacancies exist. This would ensure that OLC is able to clearly analyze the actual staff-to-supervisor ratios within its organization. Finally, because OLC is the only lottery among the peers to employ a General Services division, it should closely examine workload measures for these employees, set performance benchmarks (e.g., calls per customer service assistant FTE), and tailor its staff accordingly.

OLC is the only lottery among the peers to employ its own Office of General Services.<sup>16</sup> As a result, the staffing analysis compiled positions within the peer lotteries that conduct similar functions for the purposes of analysis. OLC is also the only lottery to employ its own staff in a call center. A more detailed examination of OLC's Office of General Services staffing revealed a number of areas where staffing adjustments might improve efficiency or effectiveness. These areas included small spans of control, a high number of unfilled vacancies, and the absence of relevant workload measures to guide staff levels and performance. These areas are discussed in more detail below.

**Span of Control:** The Deputy Director is responsible for overseeing the Office of General Services. However, in addition to the Deputy Director, OLC employs nine supervisors in the Office, each of whom oversees specific support functions. **Table 3-3** illustrates the number of supervisors and the total number of subordinates for whom each supervisor is responsible within the Office of General Services.

**Table 3-3: Office of General Services Span of Control**

Position	# of Positions Supervised	# of Employees Supervised
Deputy Director 5	5	4
Inventory Control Manager	5	4
Business Administrator 2	10	9
Management Analyst Supervisor	0	0
Inventory Control Supervisor	6	2
Motor Fleet Coordinator Supervisor <sup>1</sup>	0	0
Administrative Assistant 3	3	1
Mail Center Manager	2	0
Public Inquiry Supervisor	4	2
Public Inquiry Supervisor	6	6

**Source:** OLC organizational chart

<sup>1</sup> The Motor Fleet Coordinator Supervisor position was vacant at the time of the audit. However, the Lottery was planning to fill this vacancy.

<sup>16</sup> ORC § 3770.02 requires the Executive Director to appoint deputy directors in several areas, including administration. According to OLC, the Office of General Services was previously known as the Office of Administration and continues to serve the function contemplated by this ORC provision.

**Table 3-3** shows that there is a large variance in the ratio of employees to supervisors within the Bureaus that make up the Office of General Services. For instance, the Business Administrator 2 is responsible for supervising nine employees, while the Administrative Assistant 3 is responsible for supervising one employee. In addition, there are a few instances where supervisors do not oversee any employees, due to vacancies that were not filled. Lastly, **Table 3-3** illustrates that there is also a large variance in the ratio of supervisors to employees within several bureaus. For example, OLC's Call Center has two Public Inquiry Supervisors. However, one Public Inquiry Supervisor is responsible for overseeing two employees, while the other Public Inquiry Supervisor oversees six employees.

*Assessing Your Organizational Structure* (Texas State Classification Office, 2003) identifies span of control as the number of subordinates who report directly to a single manager or supervisor. A narrow span of control is ideal for an organization where high levels of diversity and complexity of work are performed, there is a large amount of change in the work environment, and coordination and interdependence is important between employees and groups. A wide span of control is ideal for employees who can function with little supervision and monitor their own performance. Organizations should take the following steps before reorganizing their span of control:

- *Review Organizational Charts:* Count the total number of layers from the lowest individual contributor to the Executive Director. The target range should be four to six layers, smaller agencies (less than 500 employees) should have fewer layers.
- *Use Analytical Tools:* An activity analysis can illustrate how much time middle managers actually spend on management and supervisory activities. In addition, an organization can develop decision/responsibility matrices to understand who is responsible for making decisions and what positions have overlapping or redundant responsibilities. Lastly, a conceptual map can help indicate what functions and services are helpful in order to identify duplicate services.
- *Identify Employees who Supervise a Limited Number of Employees (1-3):* Once these employees have been identified, organizations should ask: Can those employees being supervised be moved under another supervisor? Can the current supervisor be a team leader? If that position were to not supervise, would it be needed? What value does this position create? Management and supervisory positions that do not add value commensurate with their costs should be eliminated or restructured.
- *Identify Employees who can Work in Self-Managed Teams:* Highly developed teams can control functions once reserved for management, such as designing

work processes, establishing production schedules, setting goals and performance measures, and maintaining quality control.

- *Identify “Technical” Supervisors:* Organizations should consider these questions: Do these employees work in high-level technical or very specialized jobs? Does the employee need to write performance evaluations or have the authority to hire and fire? Can the employee oversee work assignments and work more as a team leader? Can supervisory duties be taken from the job without substantially reducing the employee’s workload?

**Number of Vacancies:** OLC has a significant number of vacant positions in the Office of General Services. The Deputy Director of Human Resources indicated that the Agency does not intend to fill some of the vacancies. However, due to the process required by The Department of Administrative Services (DAS) to add positions, OLC retains the vacancies and plans to reclassify the positions to fit the Agency’s needs as applicable. In order to ensure that OLC takes into account the impact vacant positions have on the ratio of supervisors to employees, it should eliminate the vacant positions that will not be filled from its organizational chart.

**Workload Measures:** The Office of General Services is responsible for a variety of support functions including agent licensing, vehicle fleet administration, office services, warehouse operations, and the customer call center. The Office of General Services consists of 29 employees, or 27.73 FTEs. OLC indicated that it has developed a number of workload measures for the functions performed by the Office of General Services. Reviewing these workload measures – such as calls per customer service assistant FTEs – in the context of a staffing analysis would provide the Lottery with additional information to use in making a determination on the adequacy of the staffing levels. From the workload measures, OLC can determine the most appropriate level and mix of staff in this office.

Through a closer examination of the Office of General Services staffing levels, mix and span of control, OLC may be able to realize significant savings or improvements in efficiency through redesigning the Office’s organization and establishing performance targets. Though General Services provides critical support functions necessary for the achievement of OLC’s core mission, improving the efficiency of its functions will help the Agency redirect operational resources to its LPEF commitments.

### *Human Resource Management and Collective Bargaining*

**R3.10 As the Office of Human Resources begins to work on developing goals for OLC’s training program, the Agency should consider conducting a survey or completing a competency study, task analysis, or performance analysis study to identify the skills**



**and knowledge employees need to improve their performance. Once those skills have been identified, OLC can target those issues precisely in their training program.**

The Deputy Director of Human Resources noted that OLC does not have a formal training program. However, the Office of Human Resources is in the beginning stages of developing a training program for the Agency. The Deputy Director of Human Resources noted that they are hoping to have the training program finalized by the beginning of 2011. The Office of Human Resources plans work with the Executive Director and the Office of Finance to finalize the training program.

Though OLC does not have a formal training program, the Deputy Director of Human Resources noted that employees have funds available to them for training through the DAS exempt professional development fund and the union education trust fund, depending on the employee's classification status. If employees wish to attend training, they can apply for professional development funds. All training requests are approved by the employee's immediate supervisor and/or the Deputy Director.

Business and Legal Reports, Inc. (Special Report – Training 2001) notes that all employees at all levels in an organization need training – from entry-level workers to supervisors to top managers. The purpose of training is to improve the performance of individual workers, and as a result, improve the performance of the entire organization. The appropriate training given to the right employees at the right time in the proper way can help an organization improve performance in every aspect of operation: productivity, quality, sales, customer service, safety, and cost control. A number of tools can be used to decide what kind of training is needed to improve performance. Each tool tries to determine the key skills and knowledge required to perform a job competently. Although each method approaches the training needs issue from a slightly different angle, they all end up with the same goal—identifying what employees need to learn to improve their performance.

- **Surveys:** Ask key employees what knowledge and skills they think are necessary to perform their jobs well. Ask these employees to indicate where they think inadequacies currently exist. List all their suggestions and prioritize them to develop a training plan of action.
- **Competency studies:** Examine each job to determine what a competent employee needs to know to be able to do the job. Once again, ask key people to provide their opinions concerning the competencies necessary to meet performance standards. Try to identify areas where competency requirements are not currently being met. Then outline the skills and knowledge required to be competent in the job, and prioritize the list to plan the training.

- **Task analysis:** Analyze all the tasks involved in performing a particular job. Make a list of all the skills and knowledge required for an employee to perform each task correctly. Look for areas where tasks are not being performed correctly by all employees, and try to determine the skills and knowledge that are lacking. Develop a master list of required skills and knowledge and use it as a basis for the training initiative.
- **Performance Analysis:** With this method, start with performance. Decide what level of performance is required for each job. Then examine what an employee must do to deliver this level of performance. In other words, what must an employee actually accomplish to do the job successfully? Next, examine which tasks contribute to this accomplishment, and determine the skills and knowledge necessary to perform each task. Then try to determine if and where critical tasks are not being performed adequately. Finally, use this data to compile a prioritized list of skills and knowledge that the training program will teach employees.

Developing a skills inventory, obtaining a survey or analysis of performance and tasks, and prioritizing its training plan will help OLC more effectively target its training efforts to organizational needs. Improved training coordination will raise the skill levels of key personnel and assist the Agency in maximizing the efforts of its workforce, improving overall performance while increasing efficiency and effectiveness.

**R3.11 OLC should work with the DAS Office of Collective Bargaining to renegotiate blanket and Lottery-specific provisions within the OCSEA collective bargaining agreement that limit the Agency's ability to function efficiently. Specifically, OLC should seek a greater degree of flexibility when filling job openings for highly technical and specialized positions (such as IT and sales) and ensure the most qualified and appropriate candidate is placed in the position. In addition, OLC should work with DAS to update job descriptions and classifications as appropriate for the Agency when additional needs arise (see R3.1).**

**Lastly, OLC should work with its bargaining unit to renegotiate the drive-time provision within the Agency-specific language of the OCSEA collective bargaining agreement. Specifically, the Lottery should consider establishing mileage exemptions for the Lottery Sales Representatives. Additionally, the Lottery should adopt a provision similar to Florida where employees who voluntarily agree to transfer to another sales region do not qualify for additional drive time.**

As discussed in the *background*, OLC bargaining unit members are covered under the State's OCSEA negotiated agreement. The majority of the OCSEA contract is negotiated Statewide by the Office of Collective Bargaining. OLC does not have any seats at the main bargaining table, although it does negotiate with its collective bargaining unit the

section within the OCSEA contract that pertains specifically to OLC. Examples of Agency-specific language include drive-time for sales representatives, random drug testing, and other provisions. Once the two sides have reached an agreement, the main contract is presented to the union for ratification. The contract is negotiated every three years.

The Lottery's negotiation team consists of the Deputy Director of Human Resources, the Labor Relations Officer, one or two other Deputy Directors (generally Sales and General Services), and a Labor Relationship Specialist from the Department of Administrative Services. The Deputy Director of Human Resources indicated that the other Deputy Directors are chosen based on which offices have the largest interest in the issues being negotiated. The collective bargaining unit is represented by the Chapter President, a staff representative, and two or three union members (depending on the issues being negotiated). The Chapter President noted that the collective bargaining unit is broken into communities of interest. The Chapter President represents a conglomerate of employees of different agencies (which include OLC) who reside within Cuyahoga County.

OLC employees covered by the OCSEA agreement are represented by eight bargaining units and each classification of employees covered by the agreement is assigned to a bargaining unit. Furthermore, each position within the bargaining unit is assigned a classification number and a pay range. The pay classifications fall under the jurisdiction of DAS.

Both the Deputy Director of Human Resources and the Chapter President noted that the overall relationship between OLC and the collective bargaining unit has been positive. However, the Deputy Director of Human Resources indicated that there are a few stipulations within the agreement that negatively impact OLC operations. A summary description of the stipulations includes the following:

### **Pay Classifications**

The Deputy Director of Human Resources noted that pay classifications are very limiting in terms of staff flexibility. For instance, the OCSEA contract stipulates that new employees shall be provided a copy of their position description. When position descriptions are changed, employees shall be furnished a copy. If an employee or the bargaining unit believes that he/she has been assigned duties not within his/her current classification, the employee or the bargaining unit may file a *working out of class* grievance with the Agency Director or designee. The Agency Director or designee investigates and issues a decision after review and approval by the Office of Collective Bargaining, within 35 calendar days. If the Director or designee determines that the employee is performing duties which meet the classification concept and which constitute a substantial portion of the duties (i.e., 20 percent or more of the employee's time if to a

higher classification or 80 percent of the employee's if to a lower classification) specified in another classification specification, the Executive Director orders the immediate discontinuance of the inappropriate duties being performed by the employee, unless the parties agree to the reclassification of the person and position.

If the duties are determined to be those contained in a classification with a lower pay range than the employee's current classification, no monetary award will be issued. If the duties are determined to be those contained in a classification with a higher pay range than that of the employee's current classification, the Executive Director or designee shall issue an award of monetary relief, provided that the employee has performed the duties as previously specified for a period of four or more working days. The amount of the monetary award shall be the difference between the employee's regular hourly rate of pay, and the hourly rate of pay at the applicable step of the higher pay range for the new classification.

Although the pay classification issue has a larger impact on bargaining unit employees, the Deputy Director of Human Resources indicated that pay classifications can also impact exempt employees. Employees who are exempt can request job audits through DAS if they believe that they are performing duties outside of their job descriptions. The Chapter President noted that over the course of time jobs evolve and that a change in job duties is necessary. The bargaining unit has the ability to approach OLC to discuss the additional job duties and upgrade the positions as appropriate.

During the audit, Office representatives noted that the restrictive nature of the pay classifications limit OLC's ability to cross train or to fully utilize its employees in some cases. Furthermore, multiple OLC deputy directors noted that the use of pay classifications makes it more difficult to motivate staff. Bargaining unit employees are paid on the State salary schedule and receive pay increases based on satisfactory evaluation ratings.<sup>17</sup> However, when employees reach the last step of their position-specific salary schedule and no longer receive step increases, and may not have opportunities for promotion, the ability to motivate high performance is limited. However, the Chapter President noted that this structure also provides job security to employees.

Illinois and New York both noted that pay classifications make it hard to motivate staff. For instance, the Illinois Lottery indicated that pay classifications prevent the Lottery from offering incentive pay to staff to optimize staff performance. Employees cannot move up into higher classifications unless management is willing to assign employees to a higher pay scale.

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<sup>17</sup> Per the OCSEA contract, there is currently a freeze on step movements until June 21, 2011. After June 21, 2011, subsequent step increases shall occur after one year and successful completion of probation, provided the employee receives an overall rating of satisfactory.

In contrast, employees in Indiana and Kentucky do not belong to collective bargaining units. As a result, neither state is locked into pay classifications; instead, both states use pay grades (or pay bands). For instance, Indiana uses pay grades by job category, such as Professional, Administrative, and Technical (PAT). Within the categories, there are four pay grade ranges. A representative of General Counsel noted that this system provides the Lottery with flexibility to hire new associates at the appropriate competitive salary. The pay grades still apply but there is flexibility because the ranges are designed based upon a broad, band approach.

### **Cross Training**

The Deputy Director of Human Resources noted that it is difficult to cross train employees due to the possibility that the additional duties may be outside of the employee's current job classification (i.e., working out of class). Therefore, OLC does not globally cross train employees. The Deputy Director of Human Resources indicated that cross training is unique to each individual Office. Similarly, New York and Illinois noted that cross training does not occur at their respective Lotteries due to the possibility of employees working outside of their specified job duties.

According to the Society of Human Resource Management (SHRM), cross training historically focused on broadening employees' skills to reduce costs and provide job coverage. Today, the reasons organizations implement cross training go beyond these traditional needs. It has many more benefits for employees and organizations. Along with improving productivity, it increases employee commitment and motivation. However, cross training is not for every organization. There are impediments and costs associated with implementation. If an organization is unionized, it may be more difficult to implement a cross training program. Unions typically protect job jurisdiction and fight strategies that broaden jobs or enrich them. However, many unions have begun to recognize the need to rethink their positions and collaborate with organizations to create more flexible and cost-effective workforces to compete in the global economy. Improved cross training could help OLC make more effective use of underutilized employees (see **R3.5**).

### **Seniority**

Per the OCSEA contract, all vacancies within the bargaining units that the Agency intends to fill must be posted in a conspicuous manner throughout the region, district, or state. If the Agency plans to fill the vacant position by promotion, transfer, or demotion, the job will be awarded to the qualified employee with the most State seniority, unless the Agency can show that a junior employee is demonstrably superior to the senior employee.

The Chapter President indicated that this helps level out the playing field for job openings. However, the Deputy Director of Information Technology (IT) indicated that this provision requires the Lottery to fill open positions internally based on seniority rather than strictly on qualifications. This is a significant issue in the Office of IT due to specific areas of technical skill that employees need to possess. For example, the Director of IT noted that the majority of the technical staff (i.e., gaming systems, network information systems, network support, etc.) are covered by the union. As such, a position that requires technical skill may be filled by a person that has the most seniority rather than the most technically skilled employee.<sup>18</sup>

The seniority provision also impacts the Office of Sales Management. When a sales representative position opens up, OLC may be required to award the job to an employee who lives outside of the sales region because that person had the most seniority. This could result in a reduction of the amount of time the sales representative has to spend in the region due to drive time.

Similar to Ohio, the peer lotteries that are covered under collective bargaining agreements also award open positions based on seniority. In contrast, Kentucky and Indiana noted that their job openings are filled based strictly on the qualifications of the applicants.

### **Drive Time**

The Agency-specific language within the OCSEA agreement states that LSRs are compensated at their base rate of pay for all time after reaching their first assignment, excluding meal periods, until arriving at their residences.<sup>19</sup> In other words, the sales representatives pay for the drive to work, while the Lottery pays for their drive home. The Chapter President noted that the bargaining unit believes that this arrangement is fair. However, a member of the administration noted that this arrangement has some drawbacks. Specifically, LSRs are able to set their own routes and, as a result, maximize the drive time for which OLC pays. For example, the LSRs may start at the retailers closest to their homes and progress further from their home as the day progresses, thus limiting the amount of drive time for which the employees are responsible and increasing the amount of drive time for which the Lottery is responsible. Lastly, the seniority stipulation within the contract can also result in increased drive time costs for the Agency if an open position is awarded to a sales representative who lives outside of the region.

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<sup>18</sup> In its response to the draft of the audit, OLC indicated that as a result of Statewide contract negotiations in 2009, management and labor agreed to language specifically designed to address issues with IT staffing. As a result, OLC began a process of transitioning and reclassifying IT staff in August 2010.

<sup>19</sup> This provision does not apply when the first and/or last assignment of the day is the LSR's regional office.

**PLANNING, BUDGETING  
AND FINANCIAL  
MANAGEMENT**

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# Planning, Budgeting and Financial Management

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## Background

This section of the performance audit focuses on the Ohio Lottery Commission's (OLC or the Agency) planning, budgeting, and financial and contract management practices. The objective of this section is to compare OLC's planning and financial operations with leading or recommended practices, industry standards, and selected peer state lotteries.<sup>1</sup> Sources of leading or recommended practices include the Government Finance Officers Association (GFOA) and the National State Auditors Association (NSAA). Sources of industry standards include *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009)<sup>2</sup> and data collected by the North American Association of State and Provincial Lotteries (NASPL).

### *Agency Purpose and Relationship to State Budget*

OLC operates as a State business enterprise, subject to State laws and regulations. OLC is self-sustaining and funded through the State Lottery Fund (referred to throughout this report as the Operating Fund).<sup>3</sup> OLC operates to provide funding, in the form of transfers to the Lottery Profits Education Fund (LPEF), for primary, secondary, vocational, and special education programs. OLC's LPEF transfer obligation is included in the State's biennial budget, and the budgeted transfer amounts for the State Fiscal Year (SFY) 2010 and SFY 2011 biennium are \$705.0 million and \$711.0 million, respectively. The LPEF transfer is used to supplement and partially offset the State's General Revenue Fund obligation to education (see **R2.5** in **agency governance** for additional discussion about the public purpose of lottery profits). In SFY 2009, LPEF transfers accounted for approximately 6.3 percent of education funding.<sup>4</sup>

OLC's LPEF transfer obligation is developed jointly by representatives from OLC, the Office of Budget and Management (OBM), and the Ohio Department of Education (ODE) during the biennial budget development process. OBM includes in the biennial budget an LPEF transfer obligation that is based on OLC's historical performance and achievable future performance.<sup>5</sup>

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<sup>1</sup> See **executive summary** for a list of the peer state lotteries and an explanation of the peer selection methodology.

<sup>2</sup> Much of the peer state data used in this report is taken from the *La Fleur's 2009 World Lottery Almanac*, which provides SFY 2008 data. As such, this report includes some SFY 2009 information for the Ohio Lottery for context, but comparisons are based on SFY 2008 data.

<sup>3</sup> OLC revenue is primarily generated from lottery ticket sales, and it does not receive General Revenue Fund appropriations.

<sup>4</sup> Net General Revenue Fund and LPEF transfers.

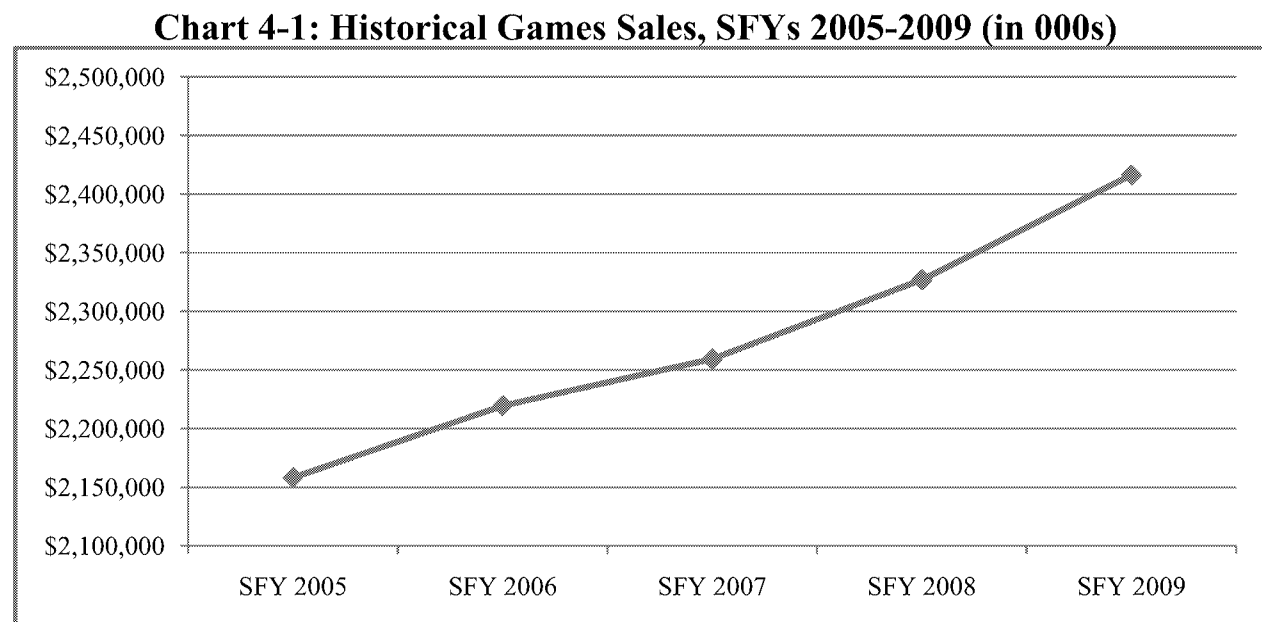
<sup>5</sup> Increases in achievable future performance can be directly associated with expected performance of new games. For example, OLC's SFY 2008 LPEF transfer obligation was \$657.9 million, while the SFY 2009 LPEF transfer obligation was \$667.9 million; in contrast, the SFY 2010 LPEF transfer obligation is \$705.0 million. This significant increase is primarily attributable to the launch of Keno during SFY 2009.



Once the LPEF transfer obligation is established, OLC is expected to meet the obligation and the LPEF transfer obligation has historically been an achievable target for the Agency to meet. In fact, in many years, OLC has been able to transfer funds in excess of the LPEF transfer obligations included in the State biennial budgets.<sup>6</sup> However, OLC's practice of exceeding LPEF transfer obligations is more a function of setting easily achievable targets rather than the Agency fully maximizing its transfers to the LPEF (see **R4.5**).

### Financial History

OLC's revenues consist of games sales, other revenues,<sup>7</sup> and net non-operating revenues/loss.<sup>8</sup> Games sales represented 99.7 percent of OLC's total operating revenue in SFY 2009.<sup>9</sup> The remaining revenues consisted mostly of other revenues and interest income, which made up 0.3 percent of total revenues in SFY 2009. **Chart 4-1** shows the historical sales consisting of instant and online games from SFY 2005 to SFY 2009.



**Source:** The Ohio Lottery Commission's audited year-end comprehensive annual financial reports.

<sup>6</sup> For example: in SFY 2005, the LPEF obligation was \$637.9 million, while the actual transfer was \$645.1 million; in SFY 2006, the LPEF obligation was \$637.9 million, while the actual transfer was \$646.3 million; in SFY 2007, the LPEF obligation was \$637.9 million, while the actual transfer was \$669.3 million; and in SFY 2008, the LPEF obligation was \$657.9 million, while the actual transfer was \$672.2 million.

<sup>7</sup> Other revenue includes adjustments made for GASB reporting.

<sup>8</sup> Net non-operating revenues/loss could have a positive or negative effect on OLC ending available cash and include items such as interest income equipment disposal, and capital leases.

<sup>9</sup> Total operating revenue includes the State Lottery Fund, but excludes the Deferred Prizes Trust Fund and the Charitable Gaming Oversight Fund.

As **Chart 4-1** illustrates, total game sales increased by an average of 2.9 percent per year, with the largest increase (3.8 percent) occurring in SFY 2009 and the smallest increase (1.8 percent) in SFY 2007. Of the total games sales, Pick 3 averaged 16.7 percent, followed by Mega Millions at 8.7 percent and Pick 4 at 8.2 percent. The smallest average games sales were reported by the Raffle (0.5 percent), which is expected because of the seasonality of the game (see **Appendix 4-A** for additional detail). During the five-year period depicted, OLC's sales increased a total of 11.97 percent while the peer states' sales increased an average of 11.99 percent.

On a per-game basis, Pick 4 increased at the fastest rate between SFY 2005 and SFY 2009, an average of 4.9 percent, versus Rolling Cash 5 (formerly Buckeye 5), which decreased by an average of 2.6 percent. Instant ticket sales have also been volatile in recent years, with an increase of 4.6 percent from SFY 2005 to SFY 2006 and decreases of as much as 1.4 percent from SFY 2008 to SFY 2009 (see **Appendix 4-B** for additional detail).<sup>10</sup>

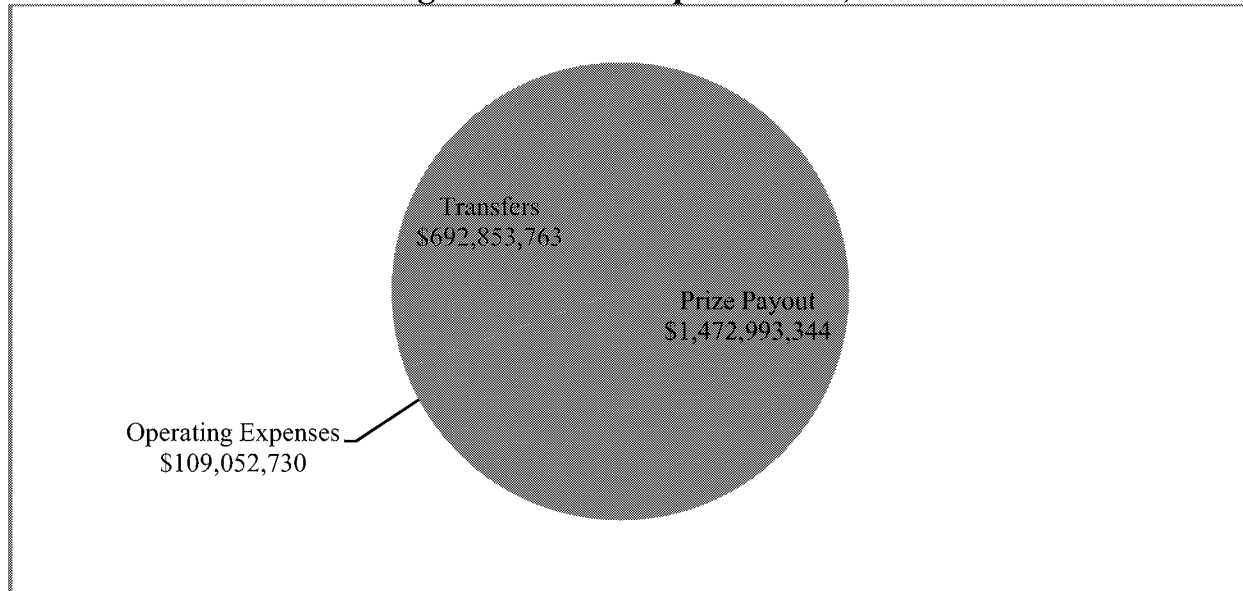
While the overall average increases in total games sales have been relatively consistent, per-game sales tend to be unpredictable due to several factors including sizes of the jackpots and the introduction of new online games. This was evident with the launch of Keno in SFY 2009, which had total sales of approximately \$100 million. While OLC received additional revenue in SFY 2009 from Keno, other games such as Pick 3 decreased by 1.3 percent, Rolling Cash 5 by 4.7 percent, Mega Millions by 4.0 percent, and Ten-OH! by 38.7 percent.

OLC's main expenditures consist of prize payouts, bonuses and commissions, operating expenses, and transfers.<sup>11</sup> Prize payouts consist of prizes paid to winners, and bonuses and commissions that are paid to retailers. In SFY 2009, prize payouts represented 64.7 percent of OLC's total expenses. Operating expenses consist of personal services, maintenance, depreciation, and other expenses, which totaled 5.0 percent of total expenses in SFY 2009. Lastly, transfers made up 30.3 percent of total operating expenses in SFY 2009; this includes transfers to the Lottery Profits Education Fund (LPEF) and the Deferred Prizes Trust Fund. **Chart 4-2** shows the average expenses per category from SFY 2005 to SFY 2009.

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<sup>10</sup> To report an accurate historical trend, only games that had been in existence since SFY 2005 were reported. These games include Pick 3, Pick 4, Rolling Cash 5, Kicker, Mega Millions, and instant tickets (see **Appendix 4-B**, for additional information).

<sup>11</sup> For the purposes of this report, prizes, bonuses, and commissions are depicted in aggregate in **Chart 4-2**. The lottery industry typically shows these as separate line items

**Chart 4-2: Average Historical Expenditures, SFYs 2005-2009**

**Source:** The Ohio Lottery Commission's audited year-end comprehensive annual financial reports (SFY 2005 through SFY 2009).

As shown in **Chart 4-2**, prize payouts<sup>12</sup> represent OLC's largest expense and have increased by an average 3.0 percent over the past five fiscal years. The largest increase occurred in SFY 2007 (4.0 percent), compared with a decrease of 0.7 percent in SFY 2006. Operating expenses increased by an average of 6.0 percent from SFY 2005 to SFY 2009. However, the largest increase occurred in SFY 2009 (12.8 percent). Transfers increased at a rate of 2.7 percent during the five fiscal years represented in **Chart 4-2**. However, transfers to the Deferred Prizes Trust Fund can vary significantly depending upon whether a prize winner receives a lump sum payment or elects to have payments distributed in future years.

The largest LPEF transfer increase of 4.5 percent (approximately \$30 million) occurred in SFY 2009. The smallest transfer increase occurred in SFY 2006 and was 0.2 percent (\$1.1 million). **Table 4-1** illustrates the revenue and expenditure history of OLC's regular Operating Fund for SFY 2005 through SFY 2009.

<sup>12</sup> The Prize Payout category includes: prizes (less expired prizes) and bonuses and commissions as reported in a similar manner in **Table 4-2**.

**Table 4-1: Historical Financial Performance SFYs 2005-2009 (in 000s)**

	SFY 2005	SFY 2006	Percent Change	SFY 2007	Percent Change	SFY 2008	Percent Change	SFY 2009	Percent Change
<b>Revenue</b>									
Game Sales	\$2,159,129	\$2,220,927	2.9%	\$2,259,396	1.7%	\$2,325,140	2.9%	\$2,417,678	4.0%
Other Revenues	\$5,374	\$5,022	(6.6%)	\$5,170	3.0%	\$5,162	(0.2%)	\$5,486	6.3%
<i>Subtotal Revenue</i>	\$2,164,503	\$2,225,949	2.8%	\$2,264,566	1.7%	\$2,330,302	2.9%	\$2,423,165	4.0%
<b>Net Non-Operating Revenue / Loss</b>									
Interest Income	\$1,296	\$3,180	145.2%	\$4,751	49.4%	\$4,462	(6.1%)	\$2,007	(55.0%)
Gain (Loss) on Equipment Disposal	(\$21)	\$67	(408.7%)	\$42	(36.9%)	\$38	(8.5%)	\$19	(49.3%)
Interest Expense on Capital Leases	(\$1,417)	(\$511)	(63.9%)	\$0	(100.0%)	\$0	0.0%	\$0	0.0%
<i>Subtotal Net Non- operating Revenue/Loss</i>	<i>(\$142)</i>	<i>\$2,735</i>	<i>(2,018.6%)</i>	<i>\$4,794</i>	<i>75.2%</i>	<i>\$4,501</i>	<i>(6.1%)</i>	<i>\$2,026</i>	<i>(55.0%)</i>
<b>TOTAL REVENUE</b>	<b>\$2,164,360</b>	<b>\$2,228,685</b>	<b>3.0%</b>	<b>\$2,269,361</b>	<b>1.8%</b>	<b>\$2,334,803</b>	<b>2.9%</b>	<b>\$2,425,192</b>	<b>3.9%</b>
<b>Prize Payout</b>									
Prizes (Less Expired Prizes)	\$1,264,304	\$1,267,996	0.3%	\$1,323,524	4.4%	\$1,376,865	4.0%	\$1,424,645	3.5%
Bonuses and Commissions	\$133,841	\$139,840	4.5%	\$139,960	0.1%	\$143,926	2.8%	\$150,061	4.3%
<i>Subtotal Prize Payout</i>	<i>\$1,398,145</i>	<i>\$1,407,837</i>	<b>0.7%</b>	<i>\$1,463,485</i>	<b>4.0%</b>	<i>\$1,520,791</i>	3.9%	<i>\$1,574,706</i>	3.5%
<b>Operating Expenses</b>									
Personal Services	\$66,471	\$75,946	14.3%	\$90,395	19.0%	\$73,318	(18.9%)	\$74,376	1.4%
Maintenance	\$16,568	\$18,183	9.8%	\$16,704	(8.1%)	\$34,073	104.0%	\$46,144	35.4%
Depreciation	\$14,624	\$14,663	0.3%	\$821	(94.4%)	\$1,028	25.1%	\$1,821	77.1%
Other Expenses	\$26	\$30	14.8%	\$37	22.3%	\$15	-57.3%	\$12	(22.9%)
<i>Subtotal Operating Expenses</i>	<i>\$97,688</i>	<i>\$108,824</i>	11.4%	<i>\$107,958</i>	(0.8%)	<i>\$108,436</i>	0.4%	<i>\$122,355</i>	12.8%
<b>Transfers</b>									
Lottery Profits Education Fund	\$645,137	\$646,276	0.2%	\$669,327	3.6%	\$672,184	0.4%	\$702,291	4.5%
Deferred Prizes Trust Fund	\$16,635	\$43,346	160.6%	\$14,924	(65.6%)	\$20,278	35.9%	\$33,869	67.0%
<i>Subtotal Transfers</i>	<i>\$661,772</i>	<i>\$689,622</i>	4.2%	<i>\$684,251</i>	(0.8%)	<i>\$692,462</i>	1.2%	<i>\$736,160</i>	6.3%
<b>TOTAL EXPENSES</b>	<b>\$2,157,607</b>	<b>\$2,206,284</b>	<b>2.3%</b>	<b>\$2,255,695</b>	<b>2.2%</b>	<b>\$2,321,690</b>	<b>2.9%</b>	<b>\$2,433,221</b>	<b>4.8%</b>
Operating Balance	6,753	22,401	231.7%	13,665	(39.0%)	13,112	(4.0%)	(8,029)	(161.2%)
Beginning Net Assets	33,294	40,048	20.3%	62,449	55.9%	76,115	21.9%	89,228	17.2%
<b>Ending Net Assets</b>	<b>40,048</b>	<b>62,449</b>	<b>55.9%</b>	<b>76,115</b>	<b>21.9%</b>	<b>89,228</b>	<b>17.2%</b>	<b>81,198</b>	<b>(9.0%)</b>

**Source:** The Ohio Lottery Commission's audited year-end, comprehensive annual financial reports.

**Note:** Totals may vary from actual due to rounding.

<sup>1</sup>OLC has three major funds that include: the Operating Fund, Deferred Prizes Trust Fund, and Charitable Gaming Oversight Fund. Because the Deferred Prizes and Charitable Gaming Funds are considered reserved in nature, only the Operating Fund is included in the analysis (within each individual line item). However, the Deferred Prizes Trust Fund was included at the end of the table to illustrate total OLC expenditures. OLC's charitable gaming functions are fully funded by the Attorney General, and, as such, the revenues and expenditures were excluded from **Table 4-1**.

As illustrated in **Table 4-1**, major variances have occurred in line items such as interest income from SFY 2005 to SFY 2006 and from SFY 2008 to SFY 2009. OLC receives quarterly interest income allocations based on investments maintained by the State Treasurer's Office. Prior to SFY 2005, interest rates were lower, which affected the rate of return on investments. However, from SFY 2006 through SFY 2008, OLC earned additional interest income due to higher interest rates and a higher total cash balance. In contrast, interest income decreased by 55.0 percent in SFY 2009 due to lower interest rates, as low as 0.3 percent, and a cash balance decreased by \$8 million. Moreover, by SFY 2007 all gaming equipment had been fully depreciated, which had a net impact on operating losses of capital leases. In SFY 2010, OLC converted to a new gaming system vendor and replaced the existing gaming equipment, which will affect future interest expenses on capital leases.

Expenditures for personal services, maintenance, and depreciation have also changed dramatically over the past five fiscal years, as shown in **Table 4-1**. According to OLC staff, some of the increase in personal services is related to gaming equipment expenses. Furthermore, an OLC staff member noted that OLC introduced the OAKS accounting system in SFY 2008 which changed the coding structure of line items and where some of the expenses are entered into the system, particularly with personal services and maintenance (see the \$17 million decrease to personal services in SFY 2008, offset by a similar increase to maintenance). While the table shows significant year-to-year changes per line item, the overall increases of operational expenses have remained relatively consistent. In SFY 2009, OLC spent \$11 million to purchase Keno equipment, which accounts for the majority of the increase in operating expenses generally, and the maintenance line item specifically.

**Table 4-1** shows that in recent years, OLC's total expenditures have increased at a faster rate than total revenues – an average of 3.1 percent compared with 2.9 percent, respectively. In SFY 2009, revenues increased by 3.9 percent compared with an expenditure increase of 4.8 percent. Revenue increases have not outpaced expenditure increases since SFY 2006. **Table 4-1** also shows that the average increase during this time period for expenditures for prizes, bonuses and commissions, and operating expenses was 3.2 percent, which exceeded the average increase in LPEF transfers of 2.2 percent.

Despite expenditures increasing faster than revenues, **Table 4-1** also shows that OLC maintained positive operating balances each year from SFY 2005 to SFY 2008, resulting in total net assets at the end of SFY 2008 of approximately \$89 million. In fact, the ending net assets balance increased by an average rate of 31.7 percent during this timeframe. However, in SFY 2009, OLC experienced an operating loss of approximately \$8 million, which reduced the ending balance by 9.0 percent.

The operating loss in SFY 2009 was due to the net increase in LPEF transfers of \$30 million in SFY 2009. The LPEF transfer was increased because of the introduction of Keno in August 2008, but Keno sales did not meet projections during the first year of operation. In December

2008, OLC had reforecast SFY 2009 Keno sales at \$102 million, down from the original estimate of \$292 million, but the LPEF transfer commitment was not similarly reduced. Consequently, OLC used a portion of its cash balance to meet its increased LPEF transfer commitment (see **R4.4**).

As of March 2010, Keno had generated approximately \$86 million in sales for SFY 2010. Based on a month-to-month projection, Keno would need to generate an additional \$96 million, \$32 million per month, in the remainder of the fiscal year to meet the SFY 2010 projection of \$182 million (see **R5.1**). Although Keno was not meeting SFY 2010 sales expectations, other games such as Mega Millions, Classic Lotto, and Kicker were on target to surpass projections, which at the time were offsetting the losses from underperforming games.

### Financial Performance Indicators

**Table 4-2** shows OLC's key financial performance indicators for SFY 2008 and SFY 2009, and also provides a comparison with the SFY 2008 peer average. In order to equalize comparisons across state lotteries, performance is measured on a per capita basis, as total sales will be impacted by the size of a state's population. Furthermore, ticket sales, expenses, and transfers to the lottery's public purpose(s) are key financial performance areas, and are included in the table.

**Table 4-2: OLC Financial Performance Indicators Comparison**

	SFY 2008	SFY 2009	Peer Average
<b>Revenues (In Millions):</b>			
Ticket Sales	\$2,325.14	\$2,417.68	\$2,940.83
Other Revenue <sup>1</sup>	\$7.73	\$8.15	\$21.39
<b>Total Operating Revenues</b>	<b>\$2,332.87</b>	<b>\$2,425.83</b>	<b>\$2,955.80</b>
<b>Expenditures (In Millions):</b>			
Prizes <sup>2</sup>	\$1,397.02	\$1,459.05	\$1,762.18
Retailer Commissions	\$143.93	\$150.06	\$175.01
Administrative & Operational	\$110.28	\$124.29	\$126.66
<b>Total Operating Expenses</b>	<b>\$1,651.23</b>	<b>\$1,733.40</b>	<b>\$2,063.84</b>
<b>Population (In Millions)</b>	<b>11.49</b>	<b>11.54</b>	<b>12.65</b>
<b>Transfers (In Millions)</b>	<b>\$672.18</b>	<b>\$702.29</b>	<b>\$878.83<sup>3</sup></b>
Transfers (% of Sales)	28.9%	29.0%	29.5%
<b>Performance Indicators (In Dollars):</b>			
<b>Per Capita Ticket Sales</b>	<b>\$202.36</b>	<b>\$209.50</b>	<b>\$230.31</b>
<b>Per Capita Expenses</b>	<b>\$143.71</b>	<b>\$150.21</b>	<b>\$162.63</b>
<b>Per Capita Transfers</b>	<b>\$58.50</b>	<b>\$60.86</b>	<b>\$67.99<sup>3</sup></b>

**Source:** *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009) and OLC SFY 2009 comprehensive annual financial report (CAFR).

**Note:** See **Appendix 4-C** for detailed peer information.

<sup>1</sup> OLC's other revenue includes deferred revenue of approximately \$743,000 in SFY 2008 and approximately \$735,000 in SFY 2009.

<sup>2</sup> OLC's prizes include expenses from both the Operating Fund and the Deferred Prizes Trust Fund.

<sup>3</sup> The Pennsylvania Lottery is excluded from the peer average for transfers. The Pennsylvania Lottery does not report transfers in its annual financial statements, nor did it provide this financial information to AOS.

As shown in **Table 4-2**, OLC's SFY 2008 per capita sales, expenses, and transfers were all lower than the peer average. OLC experienced variances from SFY 2008 to SFY 2009, which include the following:

- **Per Capita Ticket Sales** - OLC's per capita ticket sales increased from \$202.36 in SFY 2008 to \$209.50 in SFY 2009 (an increase of \$7.14, or 3.5 percent). However, OLC's SFY 2008 per capita ticket sales of \$202.36 were lower than the peer average of \$230.31 (\$27.95, or 12.1 percent lower). See the **operations section** for further analysis of OLC's ticket sales.
- **Per Capita Expenses** - OLC's per capita expenses increased from \$143.71 in SFY 2008 to \$150.21 in SFY 2009 (an increase of \$6.50, or 4.5 percent). However, OLC's SFY 2008 per capita expenses of \$143.71 were lower than the peer average of \$162.63 (\$18.92, or 11.6 percent lower). See **Table 4-1** for a distributive analysis of OLC's expenditures.
- **Per Capita Transfers** - OLC's per capita transfers increased from \$58.50 in SFY 2008 to \$60.86 in SFY 2009 (an increase of \$2.36, or 4.0 percent). However, OLC's SFY 2008 per capita transfers of \$58.50 were lower than the peer average of \$67.99 (\$9.49, or 14.0 percent lower). See **R4.4** for further analysis of OLC's transfers to the LPEF.

### *Budgeting*

OLC, as a State agency, develops its budget request, including budgets for its various offices, during the State biennial budget process.<sup>13</sup> Although OLC is self-funded through ticket sales, rather than the State General Revenue Fund, the General Assembly and Governor must provide the authority for OLC to use these funds through the budgetary appropriation process. In order to initiate the budget process, OBM provides OLC with instructions on preparing the Agency's budget request. The Office of Finance's Budgetary Bureau requests input from the deputy

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<sup>13</sup> According to *A Guidebook for Ohio Legislators* (Legislative Service Commission (LSC), 2009), the Office of Budget and Management (OBM) initiates the budgeting process by providing agencies that are receiving appropriated funds instructions on preparing their budget requests. OBM then reviews the budget requests and works with the Governor to prepare preliminary budget recommendations. The LSC is responsible for preparing the Governor's proposed budget legislation which by tradition is introduced in the Committee on Finance and Appropriations in the House of Representatives. The Governor's proposed budget legislation is reviewed by the Committee on Finance and Appropriations, and substitute bills are typically developed through the legislative process. After leaving Committee the bills are sent to the House floor for consideration. After passing the House the appropriations bills are introduced in the Senate. Again, the substitute appropriations bills are amended in committee and are passed by the Senate. A Conference Committee may then be convened to enable the House and Senate to reconcile differences between versions of the bills and come to a conclusion on the main operating appropriations bill. If both the House and Senate agree to the Conference Committee report, the bill is sent to the Governor for final signatory approval, veto, or combination thereof; for example, the Governor may approve the bill but use the line-item veto to disapprove of specific items within the act.

directors of each of the Agency's offices. This input includes historical budget amounts, current budgetary status, and any planned office initiatives requiring budgetary support. OLC prepares a budget request from the Executive Director that includes a summary of operations, organizational and staffing information, program budget requests, a summary of cash activity by fund, and information technology budget information. The completed budget request is then submitted to the Director of OBM. OBM reviews the budget request and works with the Governor to prepare a preliminary budget recommendation. The Governor ultimately develops an executive budget, which covers all facets of State government. The budget is introduced in legislation and subject to the legislative process. The resulting final appropriation bill that is approved by the General Assembly is then re-submitted to the Governor for final signatory approval, line item veto, or combination thereof.

Finally, if additional funds are necessary to support OLC's operations after the State budget is approved, the Agency is required to submit a request for additional appropriations to the State Controlling Board.<sup>14</sup>

In reviewing OLC's budgetary practices and process, AOS found that the Agency has a practice of formally communicating budgetary status (i.e., budgeted revenues and expenditures compared with actual amounts) to its offices twice per year. Auditors discussed the need to provide more regular budgetary updates (i.e., monthly), with OLC's senior financial management staff.

### *Organization of the Office of Finance*

OLC's internal budget development process is an Agency-wide process that includes input from all offices, but compilation and presentation are ultimately the responsibilities of the Office of Finance.

The Office of Finance is responsible for budgeting, accounts payable, agent receivables, general accounting, claims, purchasing, and payroll. The Office of Finance is overseen by a Deputy Director (Director of Finance) who reports directly to OLC's Executive Director. The Office of Finance consists of several bureaus. The following is a brief explanation of the primary role of each bureau within the Office of Finance:

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<sup>14</sup> According to the *Controlling Board Manual* (OBM, 2007), "The Controlling Board is a mechanism for handling certain day-to-day adjustments needed in the State budget." Further, "The Board's actions are restricted by the confines of the budget as approved by the General Assembly. Board actions that affect the operating budget include:

- Transferring operating appropriations between line items within the same agency and fund;
- Transferring operating appropriations between fiscal years within the same line item;
- For certain funds, increasing appropriation authority based on available fund balances;
- Providing additional resources to an agency in emergency situations through the Board's Emergency Purposes appropriation;
- In certain instances provided in law, approving transfers of cash between funds; and
- Creating new funds and establishing appropriation authority in new line items."



- **Accounts Payable Bureau** – coordination of payment of OLC’s financial obligations.
- **Budgetary Bureau** – oversight of OLC’s budgets as well as preparation of the Agency’s biennial budget request.
- **Claims Bureau** – payment of prizes and oversight of OLC’s bank cashing program.<sup>15</sup>
- **Finance Management** – oversight of OLC’s overall financial operation.
- **General Accounting** – maintenance of OLC’s general ledger, compilation of financial statements, and reconciliation of bank statements. In addition, this bureau coordinates OLC’s State and federal tax reporting obligations.
- **Purchasing** – coordination of OLC’s procurement activities.
- **Retailer Accounts** – facilitation of weekly retailer invoicing, maintenance of retailer accounts, collection of past-due funds, and assistance with retailer ticket problems and financial adjustments.

There are a total of 29 staff in the Office of Finance (26.5 FTEs), including the Deputy Director (see Table 3-1 in **organizational staffing and management** for additional information on staffing levels in the Finance Department).

### *Planning*

OLC’s strategic planning efforts have historically been completed with input from all offices. However, the Office of Operations in general, including the Strategic Planning Bureau, is specifically tasked with strategic planning. OLC’s most recently-implemented formal strategic plan was for SFY 2002 through SFY 2005. This strategic plan was updated in May 2004. However, a former Executive Director shifted OLC’s planning focus from formal strategic planning to short-term goals by office, and this was the process carried forward and across the tenures of subsequent executive directors.

The last formal example of the short-term goals document was completed for SFY 2009 and is referred to as the “2009 Department Performance Goals.” The 2009 Department Performance Goals document is based around the four goals of the corporate growth strategy, developed as part of OLC’s rebranding effort, including: Excellence, Reach, Growth, and Access. However, rather than develop new goals based on the corporate growth strategy, each office provided a status report of already existing, ongoing or planned actions that could fit within each of the four goals and this became the 2009 Department Performance Goals. There was no update to the Department Performance Goals for SFY 2010, nor has there been development of an SFY 2011 document.

The Office of Marketing Services, in conjunction with the Office of Product Development and Office of Sales, develops an annual marketing plan. The SFY 2010 marketing plan provides an overview of the corporate growth strategy, the Office of Marketing Services itself, required

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<sup>15</sup> OLC’s prizes with values between \$600 and \$5,000 are available for payout through local banks.

activities for the fiscal year as well as opportunity areas for marketing. Additionally, OLC's marketing plan outlines sponsorship budget allocations, new marketing opportunities and developing marketing campaigns (e.g., the "Winners Campaigns"), the opportunity associated with social media marketing and the Office's efforts to incorporate this into its marketing strategy, the marketing efforts for Keno, emerging point of sale ideas, new merchandise offerings and a system to track merchandise, and new promotional software. See **R5.8** in **lottery operations** for further discussion and analysis of OLC's marketing plan.

OLC also prepares an information technology (IT) investment plan that corresponds with the State biennial budget (i.e., the IT investment plan is developed in odd-numbered years and covers the same timeframes as the State budget). The IT investment plan includes both planned IT projects and the budgetary resources that OLC intends to use to complete the projects.

Finally, OLC's Executive Director has a flexible performance agreement that is considered a "performance contract" with the Governor. Each cabinet-level State agency, including OLC, is responsible for achieving the goals of the Governor's policy agenda through department performance. Performance is achieved through the development of key measures and targets, and through reporting those results. The Executive Director's flexible performance agreement includes the following:

- Grow revenue to meet or exceed commitments to transfer \$705.0 million to the LPEF in SFY 2010 and \$711.0 million in SFY 2011.
- Increase operational efficiencies by reducing overall Agency energy consumption throughout OLC by 15 percent.
- Increase diversity of Agency workforce and in purchasing programs by 3 percent.

Even though the flexible performance agreement includes goals beyond transfers to the LPEF, OLC staff indicated that the focus of the public, General Assembly, and Governor has always been on LPEF transfers.

## Recommendations

### *Strategic Planning & Budgeting*

**R4.1 OLC should develop a comprehensive strategic plan that incorporates the long-term needs and objectives of the Agency. In preparing the plan, OLC should include detailed goals, objectives, benchmarks, timeframes, performance measures, and cost estimates. In addition, OLC should link the strategic plan to the Agency-wide budget and to each office’s budget. Although the formal budget extends only across the State biennium, OLC should include a long-term perspective to more efficiently target its resources to fund both current and future priorities (see R4.3). Finally, OLC should review the Agency-wide strategic plan on a regular basis and update it as needed.<sup>16</sup>**

As noted in the *background*, OLC has had a number of different planning-related documents, including its old strategic plan, department performance goals, a marketing plan, an IT investment plan, and the directors’ flexible performance agreements (both the current and former executive directors). However, OLC does not have a current, formal strategic plan to guide Agency operations. In addition, OLC’s budgets are not formally linked to planned strategic initiatives. Finally, OLC does not formally focus on or report performance measures. There are efforts to track the type of data that would be used in reporting performance measures, but this is dependent on the efforts of each office rather than as an initiative of the Agency as a whole. For example, the Office of Marketing Services tracks performance measure data to determine the success of marketing efforts, while the Office of Operations tracks ongoing performance data for Keno including the number of retailers, sales, and sales by retailer. However, analysis within **lottery operations** found that OLC does not have a formal, performance-based decision-making process for evaluating its game offerings (see **R5.1**); indicators to measure retailer performance (see **R5.2**); or a retailer strategy plan (see **R5.3**).

*Recommended Budget Practice on the Establishment of Strategic Plans* (GFOA, 2005) notes that “strategic planning is a comprehensive and systematic management tool designed to help organizations assess the current environment, anticipate and respond appropriately to changes in the environment, envision the future, increase effectiveness, develop commitment to the organization’s mission and achieve consensus on strategies and objectives for achieving that mission.” The focus of the strategic plan should be on aligning resources to “bridge the gap between present conditions and the envisioned future.” GFOA recommends that “all governmental entities use some form of strategic

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<sup>16</sup> During the course of the audit, OLC entered into a consulting contract for the purpose of developing a long-term strategic plan. See additional discussion under *subsequent events* in the **executive summary**.

planning to provide a long-term perspective for service delivery and budgeting.” A planned approach should include:

- The support of key officials and input from stakeholders;
- A clear mission statement on the purpose of the organization;
- An assessment of environmental factors (i.e., strengths, weaknesses, opportunities, and threats);
- An assessment of critical issues;
- A small number of broad goals;
- A strategy to achieve goals;
- An action plan to implement strategies; and
- A series of measurable objectives, which should be expressed as verifiable quantities or statements, and performance measures.

Once developed, the strategic plan should be formally approved and implemented. Progress toward achieving plan goals should be measured through specific objectives at regular intervals, and performance measure results should be also be reviewed. Finally, organizations should conduct interim reviews every one to three years, and more comprehensive strategic planning processes every five to ten years, depending on how quickly conditions change.

The Florida Lottery has implemented a *Long-Range Program Plan* that is a formal document available on its web site and is in effect from SFY 2011 through SFY 2015. The Long-Range Program Plan outlines the Florida Lottery’s mission, goals, and objectives, as well as areas in which the Lottery supports the governor’s administration priorities. The Long-Range Program Plan also evaluates trends and conditions; current operations; and strengths, weaknesses, opportunities, and threats over the course of the strategic plan. Finally, the Long-Range Program Plan includes an assessment of performance measure achievement for the current fiscal year, as well as a recap of performance measures for the following two fiscal years.

The Texas Lottery also has a strategic plan that is a formal document available on its web site and is in effect from SFY 2009 through SFY 2013. The strategic plan outlines the Texas Lottery’s mission, vision, and values and then provides an overview of the Lottery—its organizational aspects and agency activities. The strategic plan then identifies external and internal factors affecting service, evaluates current operations, and identifies areas of opportunity for improvement. Finally, the strategic plan reviews performance measure achievement for the previous fiscal year and outlines objectives and performance measures for achievement over the strategic plan time period.

According to OLC, planning efforts had largely been put on hold due to the Agency’s continually shifting focus, including implementation of Keno, switching to a new gaming

system, video lottery terminals (VLTs), lawsuits (GTECH and VLTs), and launch of Powerball. During the course of the audit the Deputy Director, Office of Operations (Director of Operations) noted that OLC has begun to refocus its planning efforts. Specifically, OLC will be evaluating the attainment of the 2009 Department Performance Goals, any progress made during SFY 2010 or any additional planning efforts that have begun, and the applicability of the 2009 Department Performance Goals and any new planning efforts for SFY 2011 operations. The Director of Operations feels that OLC, using the SFY 2011 operations information as a starting point, may also engage in a formal strategic planning exercise in the near future. However, OLC asserts that the ability to do so will be dependent on the Agency engaging the services of an outside planning facilitator and possibly the availability of a third-party operations review, in addition to the performance audit.

According to members of OLC's senior staff, the Agency's strategic planning initiatives are at times politically sensitive and can be impacted by the following:

- **The Executive Director** - there has been a recent history of frequent turnover in OLC's executive director position.
- **The Governor** - some governors have been OLC supporters while other have not.
- **The General Assembly** - again, some legislators are supporters of OLC while other are not.
- **The Budget Process** - funding for OLC's operations is also impacted by the State biennial budget cycle, and according to the Director of Finance, it can be very difficult to plan for long-term operations, much of which would fall outside of the known budget.

Without the requisite planning and budgetary support, OLC may not be able to effectively market the game, allocate personnel, or provide for appropriate supplies and equipment. For example, when the Governor directed OLC to begin the Keno implementation process in January 2008, the Agency had prepared a preliminary estimate of revenue but had not engaged in any implementation planning; Keno was implemented in August 2008. Since Keno implementation, OLC has experienced (1) difficulty in achieving the projected number of Keno retailers, thus decreasing projected sales and projected revenue; (2) difficulty associated with the gaming system conversion and the compatibility of Keno equipment across game systems; and (3) political difficulty stemming from lower than projected revenue as well as purchased Keno equipment that was incompatible with the Intralot gaming system (see further discussions of Keno in **lottery operations and agency governance**).

Agencies at all levels of government, as well as within private industry, face budgetary pressures that can impact planning. Political pressures can also impact planning. However, rather than negating the need or ability to plan for the future and develop goals,

objectives, and measures, these types of pressures necessitate engaging in strategic planning, in order to ensure business continuity and operational efficiency over the long term. Without a comprehensive strategic plan to tie all program needs together, including budgetary support, OLC may have difficulty evaluating the relationship between spending decisions and program outcomes. This, in turn, increases the risk of inefficiency and ineffectiveness in addressing the Agency's long-term needs.

**R4.2 OLC should assess the potential impact that the emergence of casinos or other forms of gaming could have on game sales, revenues, and ultimately on the Agency's ability to sustain transfers to the LPEF. The assessment of this potential risk to OLC's stability should be taken into account in all Agency planning efforts including the development of a strategic plan (see R4.1), future marketing plans (R5.8), and future revenue and expenditure projections (see R4.3).**

On November 3, 2009 Ohio voters approved a constitutional amendment authorizing one casino in each of the cities of Cincinnati, Cleveland, Columbus, and Toledo. The amendment permits the new casinos to offer any types of slot machine or table games authorized in any of the states of Michigan, West Virginia, Indiana, and Pennsylvania as of January 1, 2009 or games subsequently authorized by those states.

The Executive Director is aware of the changing environment for gaming in Ohio and believes that the Agency must evolve in the marketplace and develop a product mix that will maximize profits. As an extension of this awareness, OLC is working to identify the impact that casinos will have on its operations. However, OLC has not completed any formal or informal studies or assessments on the impact of casinos on its game products.

The Executive Director indicated that, based on initial research, OLC has determined that the introduction of casinos will have only a short-term impact. Specifically, based on the research provided by Intralot, OLC's expectation is that there will be short-term loss in lottery sales and profits, and then a gradual stabilization back to historical sales and profits. The short-term decline in sales is expected to be concentrated in the areas most closely surrounding the casino developments. Finally, OLC feels that video lottery terminals (VLTs) located at racetracks are the best option to combat potential risks to profitability posed by casinos (see discussion on VLTs in **agency governance**).

OLC is exploring other strategies to lessen the impact of casinos on its sales and profits. For example, OLC is working on legislation to ensure that casinos are required to allow marketing and sales of the Agency's products (e.g., instant ticket vending machines). In addition, OLC is working to ensure that Keno offered at the casinos will be OLC Keno.<sup>17</sup>

<sup>17</sup> During the course of the audit, legislation establishing the framework for implementation of casinos was enacted. The OLC-requested provisions related to Keno and other OLC products and marketing were not included in the enacted legislation.

Intralot provided OLC with a study it developed titled, *Impact of Casinos on U.S. Lotteries*. The study acknowledges that competition occurs between forms of gaming but also that the short- and long-term impacts of other forms of gaming on lotteries are decidedly different. The Intralot study includes observations on experiences of the Illinois Lottery, Indiana Lottery, Oklahoma Lottery, Pennsylvania Lottery, New York Lottery, Michigan Lottery, and Maine Lottery. The study concludes that:

- “Casino gaming does impact lottery sales. However, most studies indicate that the overall impact is minimal, though, retailers close to the new gaming venues are most often affected.
- The impact of casino gaming on lotteries appears to be one witnessed over an initial two to three year period from the onset of this new form or gaming. After two or three years, lotteries regain their sales positions and in fact can position their product to grow sales.
- New games are critical to lottery growth when faced with competition from casino-style gaming.”

Representatives from the Florida Lottery,<sup>18</sup> Illinois Lottery,<sup>19</sup> and New York Lottery<sup>20</sup> all indicated that the impact of other forms of gaming on their traditional lottery product sales has not been significant. The Pennsylvania Legislative Budget and Finance Committee is required to issue an annual report to the Legislature analyzing the impact, if any, of the implementation of legalized slots gaming on the Pennsylvania Lottery.<sup>21</sup> The 2010 report concludes that “the operation of slots facilities does not appear to have negatively impacted, at least in any significant manner, Pennsylvania Lottery sales or net revenues.”

OLC has not assessed the potential impact that the emergence of casinos could have on its game sales and profits. This is partly an extension of OLC’s overall lack of comprehensive planning (see **R4.1**) but is also partly an extension of the Agency’s reliance on the expertise of its vendors to provide this type of information. However, the information that was provided to OLC by Intralot does not specifically address the situation in Ohio. Without a thorough analysis of the potential impact that other forms of gaming could have on OLC’s game sales, the Agency cannot accurately anticipate and plan for future operation, nor advance strategies to mitigate the impact of casinos on its retailers. As a result, OLC could have difficulty meeting its LPEF transfer goals in the case that casinos have a significant short- or long-term impact on game sales and profits.

<sup>18</sup> The State of Florida has tribal casinos / bingo halls and pari-mutuel facilities (e.g., horse racing and dog racing).

<sup>19</sup> The State of Illinois has riverboats with gambling and pari-mutuel facilities.

<sup>20</sup> The State of New York has tribal casinos/bingo halls and pari-mutuel facilities.

<sup>21</sup> The State of Pennsylvania has land-based casinos and pari-mutuel facilities.

*Forecasting*

**R4.3 OLC should expand its current two-year fiscal planning cycle (which coincides with the State budget cycle) to include five fiscal years when projecting revenues, expenditures, and the transfers to the LPEF. The projections should be formally documented and updated quarterly. Additionally, the projections should include formal detailed assumptions supported by statistical analysis, relevant trend data, known factors, and current situations. In order to best depict its changing environment, OLC should consider using rolling forecasts. By expanding OLC's awareness of potential financial threats, opportunities, and options, forecasting can facilitate long-term planning and decision-making in order to help OLC fulfill its mission.**

In preparation for the biennial budget, OLC develops revenue and expenditure projections as prescribed by OBM's budget guidelines and the Governor's executive orders. In preparing expenditures, OLC's deputy directors provide historical context, current budgetary status, and future direction for each of their offices based on short-term goals (see **R4.1** for additional detail on setting long-term goals). Once budgets have been reviewed by the Deputy Director of the Office of Finance, the proposed budgets are presented to OBM. OBM then reviews the budget request and works with the Governor to prepare a preliminary budget recommendation. The proposed budget is then subject to the legislative process, as with any other State agency (see the **background** for additional information).

The revenue projections are critical to OLC since operating expenses and LPEF transfers are based on revenues from game sales. OLC develops the official revenue projections during the biennial budget process based on sales per game and sales per month. These sales projections help drive budget decisions, but most importantly help to formulate LPEF transfers. During April of the first year of the biennium, OLC re-projects the current fiscal year sales,<sup>22</sup> which includes 10 months of actual sales data.<sup>23</sup> However, the projections for the second year of the biennium are not necessarily updated based on historical performance, unless OLC feels that the overall revenue would not meet the original sales projection. Additionally, OLC will project revenues from the introduction of new games such as Keno and Powerball. However, the sales from new games may not be included in the original budget, depending on the introduction date of the new game. For example, during the biennial budget process for SFY 2010 and SFY 2011, the decision had not been made by state lotteries to allow cross-selling of Mega Millions and Powerball during the budget development process; therefore, the sales from Ohio's addition of Powerball were not included in the projections.<sup>24</sup>

<sup>22</sup> This is an internal measure that OLC uses to review the accuracy of the original budget projections.

<sup>23</sup> The State fiscal year runs from July 1 through June 30.

<sup>24</sup> Ohio implemented Powerball in April 2010 (see **agency governance** for additional detail).



OLC's informal assumptions and methodologies supporting sales projections provide little detail on how game sales estimates are developed. OLC monitors actual-to-budget sales activity on a monthly basis and discusses the results with senior staff regularly. Some of this information is carried forward into operational decisions. In addition to the sales projections, providing detailed assumptions supported by statistical data and known trends would enable stakeholders to make better decisions based on relevant factors. Furthermore, while OLC re-projects revenues for the first year of the biennium, projections should be updated for the subsequent year as well, based on new information and trends, regardless of whether the initial projections were on target. As of March 2010, OLC's total game sales for SFY 2010 were approximately \$1.8 billion, with average monthly sales of approximately \$213 million. Based on revenue trends to that point, OLC expected to achieve the re-projected total revenue of \$2.4 billion. However, on a per-game basis, Pick 3, Pick 4, Rolling Cash 5, Ten-OH!, Raffle, and Keno were not on target to meet revenue expectations. Collectively, these games were on pace to underperform by approximately \$67 million, while the remaining games such as Mega Millions, Kicker, and EZ Play were on target to surpass expectations by approximately \$84 million for a net projected gain of approximately \$17 million over the re-projected total sales amount.

*Planning and Forecasting: Use Continuous Planning and Rolling Forecasts to Support Adaptive Management* (IBM, 2009), suggests that rolling forecasts are not only designed to help with financial planning, but forecasts have evolved into an integral part of the strategic and investment planning process. Forecasts should be developed to help management measure target performance and the actions that need to be taken if goals are not being met. To help minimize resources needed to update the forecast, criteria and established assumptions should be developed and communicated to all key stakeholders within the organization. Furthermore, to help expedite the forecasting process, emphasis should be on material assumptions that could potentially impact the overall projection (e.g., the introduction of Keno and Powerball). **Table 4-3** illustrates an example of a segmented five-quarter rolling forecast which could be integrated into a multi-year forecast.

**Table 4-3: Rolling Forecast and Schedule**

	Year 1				Year 2			
	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1	Quarter 2	Quarter 3	Quarter 4
1 <sup>st</sup> Review								
2 <sup>nd</sup> Review								
3 <sup>rd</sup> Review								
4 <sup>th</sup> Review								

**Source:** IBM

**Note:** The vertical lines in the table represent projections while the checkered pattern displays actuals.

**Table 4-3** displays one option for how OLC could implement a rolling forecast with emphasis on the timing and development of projections.

The Florida Lottery has established a rolling forecast which is updated three to four times per year. In conjunction with information provided by the Florida Legislature's Office of Economic and Demographic Research, the projections for revenue and Educational Enhancement Trust Fund (EETF) transfers, which is similar to Ohio's LPEF, are updated based on economic data, statistical trends, internal sales reports, and various forecast models. The Florida Lottery also uses historical information from La Fleur's which provides insight from other states' gaming systems. This was particularly helpful when Florida introduced Powerball in 2009.

Florida's forecast includes an Executive Summary which outlines major assumptions used in the projections. These assumptions include explanations for major variances or projection changes for both the games and the EETF. The document also includes a summary of current projections for each game, accompanied by two years' worth of projected data. Florida also develops a Lottery Sales Projections Summary which provides historical sales data from the past 20 years along with projections corresponding to those found in the Executive Summary. To accompany projections, the Florida Lottery also produces an EETF balance sheet that provides a breakdown of how the funds will be distributed to the various school systems in Florida. Lastly, the Florida Lottery produces a Financial Outlook Statement that provides details of recurring and non-recurring revenues and how those funds will be distributed to the EETF. This statement provides information on current year projections along with four years of future projections.

Long-term revenue and expenditure projections will enhance OLC's ability to make strategic changes in operations in order to meet or adjust long-term goals. Continuous and detailed reports will also help promote a heightened level of accountability and transparency to all stakeholders.

- R4.4 To increase transparency and accountability, OLC should establish an internal budget reserve policy which clearly identifies dedicated and available funds contributing to the ending fund balance within regular operations. Any reserve should be based on identified benchmarks, leading practices, and known risks in order to support OLC's ability to meet its financial obligations to the LPEF. Once budget reserves are established, OLC should work with the General Assembly and OBM to formally adopt a budget reserve fund and expectations for the size of the fund and the manner in which reserve funds will be used. Lastly, the budget reserve should be reviewed on an annual basis to ensure that an appropriate threshold has been established. A formal budget reserve and associated policies will help ensure that OLC is able to demonstrate to the public that it is transferring the maximum**

**amount of funding possible to education, while maintaining an ability to ensure that transfer obligations can be met in years when sales fail to meet projections.**

OLC does not currently have an established reserve fund, nor does it have a formal practice with regard to budget reserves. As a result, OLC had accumulated ending net assets in its operating fund of approximately \$81 million by the end of SFY 2009, as identified in **Table 4-4**. While OLC had been able to meet or surpass transfers made to the LPEF, it has traditionally carried over cash balances that could potentially be used for additional education transfers.

The Director of Finance noted that the reserve has been designed, informally, to take into account obligations, historical performance, and potential risks. For example, he indicated that balances must be maintained in the event a numbers drawing, such as Pick 3 or Pick 4, results in a popular number (e.g., “1-1-1”) that produces an unusually large number of winners. Although rare, such events do occur, and they create large unplanned liabilities for a lottery. According to the Director of Finance, most of the \$81 million in net assets are either not cash (e.g., inventory or accounts receivable) or are internally committed to specific purposes. These items are enumerated in a document prepared by the Director of Finance for internal use, but the information is not formally incorporated into Agency policies or shared with OLC’s stakeholders.<sup>25</sup> The following is a brief justification of the current ending fund balance provided by OLC:

**Potential Short-Term Obligations:**

- *StarOhio* – OLC invests \$8 million in StarOhio for short-term obligations in the event a common number is drawn in one of its numbers games, as described above. However, OLC will only sell a certain number of tickets on one number to limit the maximum liability for one drawing to \$6 million.
- *Gross Revenue Bank Account* – OLC noted that there are approximately 150 bank branches that participate in the bank cashing program.<sup>26</sup> OLC prefers to have approximately \$2 million on hand to serve as working capital for this program’s weekly operation to cover short-term liabilities.

**Accounts Receivable/Assets:**

- *Accounts Receivable* – This line accounts for open packs of instant ticket books at the retailer locations. Specifically, it represents net due to the Lottery from tickets that have been sold by the retailers but the revenue has not yet been collected by

<sup>25</sup> Such as in notes to OLC’s Comprehensive Annual Financial Report.

<sup>26</sup> OLC’s prizes with values between \$600 and \$5,000 are available for payout through local banks.

OLC in a sweep of retailer bank accounts. At the end of SFY 2009, OLC noted approximately \$30 million in receivables.

- *Prepaid Assets (Inventory)* – At the end of SFY 2009, OLC had approximately \$7 million in prepaid assets, which accounts for inventory of unopened books of tickets located in the warehouse.
- *Net Capital Assets* – OLC had \$6 million in capital assets, which accounts for such items as vehicles, computers, and equipment necessary to perform day-to-day functions.

#### **Unrestricted Cash:**

- *Cash Reserved from Unclaimed Prize Fund* – House Bill 95 (SFY 2004 and 2005 State budget) directed OBM to eliminate the Unclaimed Prize Fund and to transfer a portion of the balance to OLC's Operating Fund. At the end of SFY 2009, OLC had a remaining balance of \$7 million from that transfer. OLC stated that these funds are not restricted in use and can be used for regular operations.
- *Retained Earnings* – This item represents an accumulated balance of \$5 million, which are profits not used for operational expenses and/or not transferred to the LPEF. OLC stated that some of this balance is used for operating cash purposes.
- *Sweep Account* – OLC conducts weekly sweeps of sales from retailer bank accounts to collect revenue from instant ticket and online games. Weekly sweeps are collected into a general gross revenue account, which serves as a holding fund until the revenue is transferred to OLC's Operating Fund (or other relevant account). LPEF transfers are made from the Operating Fund. Therefore, due to the timing of year-end and the prior sweep, ticket sales may have been realized but not yet in the Operating Fund and available for the LPEF transfer. There was approximately \$17 million in the sweep account at SFY 2009 year-end.

**Table 4-4** shows the net effect of these items on the ending net assets for SFY 2009.

**Table 4-4: Adjusted Retained Earnings<sup>1</sup>**

	SFY 2005	SFY 2006	SFY 2007	SFY 2008	SFY 2009
<b>Total Revenue</b>	\$2,164,360,854	\$2,228,685,325	\$2,269,361,021	\$2,334,803,766	\$2,425,192,204
<b>Total Expenditures</b>	\$2,157,607,062	\$2,206,284,188	\$2,255,695,341	\$2,321,690,902	\$2,433,221,692
Operating Balance	\$6,753,792	\$22,401,137	\$13,665,681	\$13,112,864	(\$8,029,489)
Beginning Net Assets	\$33,294,657	\$40,048,449	\$62,449,586	\$76,115,267	\$89,228,131
<b>Ending Net Assets</b>	\$40,048,449	\$62,449,586	\$76,115,267	\$89,228,131	\$81,198,642
<b>Potential Short-Term Obligations</b>					
StarOhio	N/A	N/A	N/A	N/A	\$8,000,000
Gross Revenue Bank Account	N/A	N/A	N/A	N/A	\$2,033,222
<b>Accounts Receivable / Assets</b>					
Accounts Receivables	N/A	N/A	N/A	N/A	\$29,694,783
Prepaid Assets	N/A	N/A	N/A	N/A	\$7,238,717
Net Capital Assets	N/A	N/A	N/A	N/A	\$5,639,725
<b>Ending Cash</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>\$28,592,195</b>
<b>Unrestricted Cash (Not Available for Immediate Use)</b>					
Sweep Account	N/A	N/A	N/A	N/A	\$16,763,000
<b>Ending Available Cash</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>\$11,829,195<sup>2</sup></b>

Source: Ohio Lottery Commission

<sup>1</sup> OLC did not provide a breakdown of the adjusted retained earnings for SFY 2005 through SFY 2008 because the data is not typically available to stakeholders on an annual basis. These items are represented by "N/A" in the table.

<sup>2</sup> The adjusted retained earnings provided by OLC do not reconcile to SFY 2009 financial statements. The net effect of the adjustments compared with the year-end balance is off by approximately \$685,000.

Excluding the sweep account, OLC has approximately \$12 million in unrestricted cash as shown in **Table 4-4**. A comprehensive analysis of these funds should help OLC to develop an appropriate budget reserve level while maximizing transfers to the LPEF, and in return increase the transparency to all stakeholders.

The Georgia Lottery has implemented a shortfall reserve account. The account is equal to 10 percent of the total amount of lottery proceeds deposited in the Lottery for Education Account. If the yearly revenues cannot meet the required transfers, the shortfall reserve account may be drawn upon to meet the deficiency. The shortfall account is then brought back to the appropriate level with the first available funds.<sup>27</sup>

*Appropriate Level of Unrestricted Fund Balance* (GFOA, 2009) recommends that entities develop policies that guide the creation, maintenance, and use of resources for financial stabilization purposes. The GFOA recommends that governments maintain unreserved fund balances of no less than 5 to 15 percent of regular operating revenue, or up to two

<sup>27</sup> The OLC states Ohio has a reserve account that is fundamentally similar to the Georgia Lottery shortfall reserve account. However, OLC does not have a reserve account. Instead, a reserve fund is maintained by the Office of Budget and Management separate from lottery operations, and the funds are not available to OLC but are instead reserved for the Department of Education to make up funding shortfalls in the event they occur.

months of operating expenses. However, the adequacy of an established unreserved fund balance should be assessed based upon a government's specific financial situation. The policy should also consider the following factors:

- Applicable legal and regulatory restraints;
- The predictability of revenue and volatility of expenditures;
- The availability of resources in other funds as well as the potential of other funds to drain regular operating funds;
- Liquidity of resources; and
- Pending designations of any portion of the unreserved fund balance for a specific purpose.

Maintaining a minimum fund balance based on an established threshold, as in the Georgia Lottery, will help ensure that the LPEF can be maintained for a given period of time in the event of underperforming revenues or the unlikely event of a risk factor being experienced. Setting formal guidelines for accrual and use of a budget reserve and ensuring that the remaining funds are transferred in accordance with the public purpose of the Ohio Lottery, would establish a greater degree of financial transparency and accountability.

### *Financial Management*

**R4.5 OLC should formally review all areas of expenditure to determine if there are non-essential, non-revenue generating expenditures that could be reduced. In doing so, OLC should focus on its administrative and operational expenses. Comparison to the peer average indicates that OLC commits a relatively high percentage of total expenditures toward this category.**

OLC, as a non-General Revenue Fund agency, has largely been exempt from the Governor's Executive Orders for general State agency expenditure reductions.<sup>28</sup> However, some specific mandated cost-saving actions have applied to OLC. For example, OLC staff were required to take 10 mandatory days (or 80 hours) of unpaid leave in SFY 2010, and will be required to do so again in SFY 2011. In addition, OLC has reduced non-essential travel based on guidelines put forth by the Governor's Office. Finally, consistent with the Governor's executive order to seek reductions in contract costs, OLC has been able to achieve cost savings through the rebidding or renegotiation of its cooperative services and instant ticket printing contracts respectively, and OLC's gaming system conversion is estimated to generate an average savings of approximately \$15 to \$20 million per year over the duration of the contract.

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<sup>28</sup> In particular, those directed to General Revenue Fund agencies.

**Table 4-5** shows OLC's SFY 2008 and SFY 2009 operating expenditure distribution in dollars and as percentages of total sales and total revenue, and also provides a comparison with the SFY 2008 peer average. The percentage of expenses allocated toward a lottery's administrative and operational expenses is an important indicator of operational efficiency.

**Table 4-5: Operating Expenditure Distribution Comparison<sup>29</sup>**

Expenditures (In Millions)	SFY 2008	SFY 2009	Peer Average
Prizes	\$1,397.02	\$1,459.05	\$1,762.18
As a % of Total Sales	59.9%	60.1%	59.6%
As % of Total Expenditures	84.6%	84.2%	84.9%
Retailer Commissions	\$143.93	\$150.06	\$175.01
As a % of Total Sales	6.2%	6.2%	6.1%
As % of Total Expenditures	8.7%	8.7%	8.6%
Administrative & Operational Expenses	\$110.28	\$124.29	\$126.66
As a % of Total Sales	4.7%	5.1%	4.6%
As % of Total Expenditures	6.7%	7.2%	6.5%
Total Sales	\$2,332.87	\$2,425.83	\$2,955.80
Total Expenditures	\$1,651.23	\$1,733.40	\$2,063.84

**Source:** *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009) and OLC SFY 2008 and SFY 2009 comprehensive annual financial reports.

**Note 1:** See **appendix 4-C** for detailed peer information.

**Note 2:** Total sales does include other revenue.

As shown in **Table 4-5**, OLC's expenditure allocations for both SFY 2008 and SFY 2009 were similar to the peer average expenditure allocation in the general proportion of expenditures dedicated to major expenditure areas. For example, both OLC and the peers allocated expenditures first, toward prizes; second, toward retailer commissions; and third, toward administrative and operational expenses. **Table 4-5** also shows that from SFY 2008 to SFY 2009, OLC's proportion of spending on administrative and operational expenses, which was already a slightly higher percentage than the peer average, increased significantly, while the percentage for retailer commissions remained constant and prizes decreased.

**Table 4-6** shows OLC's SFY 2008 and SFY 2009 expenditures, the distribution of administrative and operational expenses by line item, and the difference and percent difference by category and line item.

<sup>29</sup> **Table 4-5** includes OLC's Deferred Prizes Trust Funds and Charitable Gaming Oversight Funds. When auditors adjusted the assessment to exclude these respective funds, the adjustment did not change the outcome of the assessment.

**Table 4-6: OLC SFY 2008 & SFY 2009 Expenditure Distribution**

Expenditures	SFY 2008	SFY 2009	\$ Diff.	% Diff.
<b>Prizes</b>	<b>\$1,397,019,212</b>	<b>\$1,459,048,491</b>	<b>\$62,029,279</b>	<b>4.4%</b>
<b>Retailer Bonuses and Commissions</b>	<b>\$143,926,377</b>	<b>\$150,061,039</b>	<b>\$6,134,662</b>	<b>4.3%</b>
<b>Administrative &amp; Operational Expenses</b>	<b>\$110,283,005</b>	<b>\$124,289,275</b>	<b>\$14,006,270</b>	<b>12.7%</b>
• Personal Services	\$75,022,135	\$76,176,366	\$1,154,231	1.5%
• Maintenance	\$34,216,397	\$46,278,839	\$12,062,442	35.3%
• Depreciation	\$1,028,640	\$1,821,865	\$793,225	77.1%
• Other Expenses	\$15,833	\$12,205	(\$3,628)	(22.9%)
<b>Total Expenditures</b>	<b>\$1,651,228,594</b>	<b>\$1,733,398,805</b>	<b>\$82,170,211</b>	<b>5.0%</b>

Source: OLC SFY 2008 and SFY 2009 comprehensive annual financial reports.

As shown in **Table 4-6**, OLC's maintenance expenditures accounted for the majority of the significant increase in the administrative and operational expenses line item in SFY 2009. This expenditure increase is primarily associated with the purchase of Keno equipment—approximately \$11 million in SFY 2009.

The viewpoint of OLC and lottery industry representatives consulted for this audit is that in general, the lottery industry is not concerned with expenditure problems; rather, OLC and other lotteries experience revenue-generating challenges. This focus on revenue-generation is evident in OLC's operations. For example, OLC has an ongoing process for tracking detailed revenue information, but only formally communicates expenditure status to its offices twice per year. In addition, OLC prepares a detailed revenue forecast while it forecasts expenditures at only at the very highest level (see **R4.3**). Finally, OLC has relied on cost savings associated with its gaming system transition from GTECH to Intralot, as well as changes to other contracts, to reduce overall expenditures. Analysis within the **organization, staffing and management** and **lottery operations** sections identified overstaffing in multiple offices and functions throughout the Agency. While OLC will recognize substantial cost savings associated with the transition to the new gaming system, and more minor savings through its other efforts, there may be additional areas of expenditure that it could review for efficiency. Any additional expenditure reductions could ultimately help OLC increase its transfers to the LPEF, which is the purpose of the Agency.

In its response to a draft of this performance audit, OLC provided a list of cost savings it has been able to achieve, primarily through management of its vendor contracts. In addition, OLC cited its increased ability to perform information technology services in-house rather than relying on the Ohio Department of Administrative Services and Office of Information Technology, as well as its utilization of vehicles, as efforts to achieve additional cost savings.



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*Contract Management*

**R4.6 OLC should enhance the six-month vendor performance evaluation process by ensuring that all evaluations address standard vendor performance areas in addition to specific vendor performance areas unique to each contract. The level of detail should be consistent and the areas of evaluation should be clearly defined. Additionally, OLC should ensure that sufficient information is included with checklist-style evaluation instruments to provide a clear understanding of the contract managers' conclusions. Finally, OLC should ensure that a narrative summary is included for each vendor performance evaluation.**

OLC contracts for a variety of core services including its online gaming system and instant ticket printing. OLC's reliance on these core service contracts is consistent with industry standards.

As a State agency, OLC is governed by Ohio Department of Administrative Services (DAS) contracting guidelines, which are included in the *Ohio Procurement Handbook* (DAS, 2008). These guidelines govern the formal competitive bidding process, including: invitation to bid, advertisement of opportunity, opening of bids, evaluation of bids, and award of contracts; as well as the request for proposal (RFP) process, including the creation of the RFP, advertisement of opportunity, opening of proposals, evaluation of proposals, and award of contracts. ORC § 127.16 (B)(1) requires State agencies to engage in the competitive selection process for all purchases/contracts with a value of greater than \$50,000 in a given fiscal year. However, the State Controlling Board has the authority to grant waivers of the competitive selection process. In addition, State agencies with contracts that extend beyond the biennium require Controlling Board approval to renew the contract in subsequent biennia.

The nature of OLC's core contracts (i.e., for services like the gaming system and marketing services, rather than for goods) dictates that the Agency uses the RFP process. In doing so, OLC works with DAS to develop the RFP. The Office of Finance and Office of Legal Counsel are primarily responsible for development of OLC's contracts, while the office to which the contract pertains is responsible for day-to-day oversight and management of the contract. Within its respective offices, OLC has a contract manager assigned to each of the Agency's contracts, and the contract managers have day-to-day oversight responsibility for the assigned contracts. The contract managers are assigned based on their areas of expertise within OLC.

OLC uses a formal vendor evaluation process in which the vendors associated with the Agency's major contracts are reviewed biannually for the preceding six-month period (i.e., January 1st through June 30th and July 1st through December 31st). As a part of the formal vendor evaluation, contract managers are encouraged, although not required, to

meet with vendor representatives to discuss the evaluation and provide performance feedback. The completed vendor evaluations are reviewed, filed, and retained by the Office of Legal Counsel, and the results of the evaluations are used when determining whether to extend a contract or in developing a new contract, as well as to monitor performance. For example, in 2006, the Office of Marketing Services used the vendor performance evaluation to identify and terminate a contract based on vendor underperformance.

AOS reviewed a selection of vendor performance evaluations completed during 2009.<sup>30</sup> The review found that the vendor performance evaluations lacked standardization or consistent detail. For example, the review found inconsistent levels of detail, and one evaluation with no specific information as to what was actually evaluated. The vendor evaluations from January 1, 2009 through June 30, 2009 included the following:

- **Cost Control Associates, Inc. (Audit Recovery)** – This vendor performance evaluation, completed by staff from the Office of Information Technology, includes a paragraph summary of the vendor’s accomplishments over the contract period and a single sentence statement summarizing vendor performance.
- **GTECH (Previous Gaming System)** – This vendor performance evaluation, completed by staff from the Office of Information Technology, includes yes/no/N/A (with explanation) reviews of the following areas: related subcontracts; Lottery approval of staffing; letter of credit/bonds and insurance; bookkeeping and audit requirements; base systems/hardware; software and support services; liquidated damages; and billing procedures. There is no narrative performance evaluation summary.
- **Mills James Productions, Inc. (Game Show Production)** – This vendor performance evaluation, completed by staff from the Office of Operations, includes narrative evaluations of the following areas: talent, creative, procedure compliance, client services, and budget compliance. There is an additional summary narrative titled “overall evaluation.”
- **Sunshine Electric Displays (Billboards/Point-of-Sale Signs)** – This vendor performance evaluation, completed by staff from the Office of Marketing Services, includes narrative evaluations of maintenance and service of current equipment and delivery and/or removal and installation of equipment. There is an additional summary narrative titled “overall evaluation.”

<sup>30</sup> AOS selected and reviewed the following vendor evaluations from January 1, 2009 through June 30, 2009: Cost Control Associates, Inc.; GTECH; Mills James Productions, Inc.; and Sunshine Electric Displays. AOS selected and reviewed the following vendor evaluations from July 1, 2009 through December 31, 2009: Intralot; Marcus Thomas, LLC; OLOGIE; and Scientific Games.

The vendor evaluations from July 1, 2009 through December 31, 2009 included the following:

- **Intralot (Current Gaming System)** – This vendor performance evaluation, completed by staff from the Office of Information Technology, includes yes/no/N/A (with explanation) reviews of the following areas: bookkeeping and audit requirements, letter of credit/bonds and insurance, billing procedures, liquidated damages, gaming system deliverables, software and support services, communications networks, software controls and data management, games and marketing, Lottery approval of staffing, and related subcontracts. There is no narrative performance evaluation summary.
- **Marcus Thomas, LLC (Marketing Media)** – This vendor performance evaluation, completed by staff from the Office of Marketing Services, includes yes/no (with explanation) reviews of the following areas: terms; ownership of materials, copyrights, and trademarks; scope of services; compensation and non-reimbursable items of expense; estimates and approvals; billing and payment, line of credit, bonding, and insurance; and certification. There is also a written summary performance evaluation.
- **OLOGIE (Marketing, Secondary Vendor)** – This vendor performance evaluation, completed by staff from the Office of Marketing Services, includes yes/no (with explanation) reviews of the following areas: terms; ownership of materials, copyrights, and trademarks; scope of services; compensation and non-reimbursable items of expense; estimates and approvals; billing and payment, line of credit, bonding, and insurance; and certification. There is also a written summary performance evaluation.
- **Scientific Games (Instant Ticket, Primary vendor)** – This vendor performance evaluation, completed by staff from the Office of Product Development, includes narrative evaluations and summary grades of the following areas: quality of product, creativity, planning, dependability, and follow-up. There is not a written summary performance evaluation, but there is an overall grade.

According to *Contracting for Services* (National State Auditors Association, 2003):

“Contract monitoring is an essential part of the contracting process. Monitoring should ensure that contactors comply with contract terms, performance expectations are achieved, and any problems are identified and resolved. Without a sound monitoring process, the contracting agency does not have adequate assurance it receives what it contracts for. To properly monitor a contract, the agency should:

- Assign a contract manager with the authority, resources, and time to monitor the project.
- Ensure that the contract manager possesses adequate skills and has the necessary training to properly manage the contract.
- Track budgets and compare invoices and charges to contract terms and conditions.
- Ensure that deliverables are received on time and document the acceptance or rejection of deliverables.
- Withhold payments to vendors until deliverables are received.
- Retain documentation supporting charges against the contract.
- After contract completion the agency evaluates the contractor's performance on this contract against a set of pre-established, standard criteria and retains this record of contract performance for future use.”

OLC does not have a standard vendor evaluation form, and due to the nature of the highly specialized contracts, there are specific attributes unique to each contract that must be evaluated. The Office of Legal Counsel has been working to increase the standardization of the evaluation process (e.g.: working to ensure that the evaluations include not just a checklist but also the type of detailed explanation that provides appropriate context for evaluating the contracts). While the degree of specialization in its contracts requires some variation in process, inconsistent documentation and a high degree of variation in process application reduces the effectiveness of the performance evaluation process and may compromise the quality of the process in helping OLC manage its large contracts.

Overall, OLC’s six-month contract reviews represent a leading practice (see *noteworthy accomplishments* in the **executive summary**). However, without a consistent minimum set of vendor evaluation areas, contract managers may not provide sufficient detail to ensure that the evaluation contains a minimum level of effective content. In addition, lack of consistent detail explaining checklist-style evaluations and lack of consistent narrative summaries could lead to ambiguity in the results of the overall evaluation. This could hamper OLC’s ability to effectively use the performance evaluations to monitor vendor performance or take action on vendors who are not meeting expectations.

## Appendix 4-A: OLC Average Sales per Game

**Table 4-A** illustrates OLC's average game sales and the percent of total revenue from SFY 2005 to SFY 2009.

**Table 4-A: Average Sales Per Game**

Games	Average Sales Per Game	Percent of Total Game Sales
Pick 3	\$381,058,350	16.7%
Pick 4	\$186,739,902	8.2%
Buckeye 5 / Rolling Cash 5	\$71,608,448	3.1%
Super Lotto Plus / Lot O' Play	\$70,414,620	3.1%
Classic Lotto	\$35,630,014	1.6%
Raffle	\$12,362,148	0.5%
Kicker	\$21,128,600	0.9%
Mega Millions	\$197,989,151	8.7%
EZ Play	\$23,298,210	1.0%
Ten-OH!	\$14,484,712	0.6%
Keno	\$99,791,059	4.4%
Instant Ticket Sales	\$1,311,408,746	57.6%
<b>Total Sales</b>	<b>\$2,276,048,647</b>	<b>N/A<sup>1</sup></b>

**Source:** OLC year-end Commission reports.

**Note:** Revenues reported in the Commission report will vary from the CAFR statements because of GASB adjustments.

<sup>1</sup> The percent of total games sales will not equal 100 percent because the percentages represent annual averages over multiple years.

## Appendix 4-B: OLC Game Sales History

Table 4-B shows the percentage changes per OLC game from SFY 2006 to SFY 2009.

**Table 4-B: Percentage Change in Games Sales**

	SFY 2006	SFY 2007	SFY 2008	SFY 2009	Average
Pick 3	(2.7%)	(1.7%)	4.4%	(1.3%)	(0.3%)
Pick 4	3.3%	4.1%	8.7%	3.7%	4.9%
Buckeye 5 / Rolling Cash 5	(2.9%)	0.4%	(3.3%)	(4.7%)	(2.6%)
Super Lotto Plus / Lot O' Play	(32.6%)	(71.4%)	N/A	N/A	(52.0%)
Classic Lotto	N/A	N/A	89.4%	6.6%	48.0%
Raffle	N/A	N/A	(43.9%)	(7.5%)	(25.7%)
Kicker	8.4%	(1.1%)	0.2%	0.2%	1.9%
Mega Millions	26.6%	(12.2%)	2.5%	(4.0%)	3.2%
EZ Play	N/A	N/A	N/A	178.5%	178.5%
Ten-OH!	N/A	N/A	N/A	(38.7%)	(38.7%)
Keno	N/A	N/A	N/A	N/A	N/A
Instant Ticket Sales	4.6%	6.4%	0.9%	(1.4%)	2.6%
<b>Total</b>	<b>2.8%</b>	<b>1.8%</b>	<b>3.0%</b>	<b>3.8%</b>	<b>2.9%</b>

Source: OLC year-end Commission reports.

## Appendix 4-C: OLC and Peer Financial Data

Appendix 4-C-1 presents detailed peer information used in calculating the peer averages for use in comparative analysis throughout the planning, budgeting, and financial management section.

Table 4-C-1 shows OLC, peer average, and detailed peer information used to calculate the peer average in this section of the report.

Table 4-C-1: Financial Performance Indicators, SFY 2008

	OLC	Peer Avg.	Florida	Georgia	Illinois	Indiana	Kentucky	Michigan	New Jersey	New York	Penn.	Texas
<b>Revenues (In Millions):</b>												
Ticket Sales	\$2,325.14	\$2,940.83	\$4,174.78	\$3,272.06	\$2,057.27	\$822.83	\$778.21	\$2,330.19	\$2,539.07	\$6,673.20	\$3,089.18	\$3,671.49
Other Operating Income	\$7.73	\$21.39	\$7.72	\$4.30	\$31.82	N/A	N/A	\$20.88	\$40.25	N/A	(\$0.30)	\$45.03
<b>Total Operating Revenues</b>	<b>\$2,332.87</b>	<b>\$2,955.80</b>	<b>\$4,182.50</b>	<b>\$3,276.36</b>	<b>\$2,089.09</b>	<b>\$822.83</b>	<b>\$778.21</b>	<b>\$2,351.07</b>	<b>\$2,579.32</b>	<b>\$6,673.20</b>	<b>\$3,088.88</b>	<b>\$3,716.52</b>
<b>Expenditures (In Millions):</b>												
Prizes	\$1,397.02	\$1,762.18	\$2,476.03	\$2,049.54	\$1,226.07	\$503.30	\$493.06	\$1,323.34	\$1,471.12	\$3,952.76	\$1,845.40	\$2,281.13
Retailer Commissions	\$143.93	\$175.01	\$235.65	\$230.73	\$103.93	\$59.50	\$50.14	\$172.16	\$141.39	\$400.79	\$170.05	\$185.72
Administrative & Operational	\$110.28	\$126.66	\$154.56	\$137.33	\$108.99	\$50.07	\$46.50	\$110.40	\$78.05	\$253.20	\$159.96	\$167.50
<b>Total Operating Expenses</b>	<b>\$1,651.23</b>	<b>\$2,063.84</b>	<b>\$2,866.24</b>	<b>\$2,417.60</b>	<b>\$1,438.99</b>	<b>\$612.87</b>	<b>\$589.70</b>	<b>\$1,605.90</b>	<b>\$1,690.56</b>	<b>\$4,606.75</b>	<b>\$2,175.41</b>	<b>\$2,634.35</b>
<b>Population (In Millions)</b>	11.49	12.65	18.33	9.69	12.90	6.38	4.27	10.00	8.68	19.49	12.45	24.33
<b>Transfers (In Millions)</b>	\$672.18	\$878.83	\$1,283.41	\$867.69	\$648.46	\$217.07	\$192.08	\$740.74	\$882.06	\$2,043.10	N/A <sup>1</sup>	\$1,034.88
Transfers (% of Sales)	28.9%	29.5%	30.7%	26.5%	31.5%	26.4%	24.7%	31.8%	34.7%	30.6%	N/A <sup>3</sup>	28.2%
<b>Performance Indicators (In Dollars):</b>												
Per Capita Ticket Sales	\$202.36	\$230.31	\$227.76	\$337.67	\$159.48	\$128.97	\$182.25	\$233.02	\$292.52	\$342.39	\$248.13	\$150.90
Per Capita Expenses	\$143.71	\$162.63	\$156.37	\$249.49	\$111.55	\$96.06	\$138.10	\$160.59	\$194.76	\$236.36	\$174.73	\$108.28
Per Capita Transfers	\$58.50	\$67.99	\$70.02	\$89.54	\$50.27	\$34.02	\$44.98	\$74.07	\$101.62	\$104.83	N/A	\$42.54

Source: *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009) and OLC SFY 2009 comprehensive annual financial report.

<sup>1</sup> The Pennsylvania Lottery does not report transfers in its annual financial statements.

Table 4-C-2 shows OLC, peer average, and detailed peer information used to calculate the peer average shown in Table 4-5.

**Table 4-C-2: Expenditures Distribution SFY 2008**

Expenditures (In Millions)	OLC	Peer Avg.	Florida	Georgia	Illinois	Indiana	Kentucky	Michigan	New Jersey	New York	Penn.	Texas
Prizes	\$1,397.02	\$1,762.18	\$2,476.03	\$2,049.54	\$1,226.07	\$503.30	\$493.06	\$1,323.34	\$1,471.12	\$3,952.76	\$1,845.40	\$2,281.13
<b>As % of Total</b>	<b>84.6%</b>	<b>84.9%</b>	<b>86.4%</b>	<b>84.8%</b>	<b>85.2%</b>	<b>82.1%</b>	<b>83.6%</b>	<b>82.4%</b>	<b>87.0%</b>	<b>85.8%</b>	<b>84.8%</b>	<b>86.6%</b>
Retailer Commissions	\$143.93	\$175.01	\$235.65	\$230.73	\$103.93	\$59.50	\$50.14	\$172.16	\$141.39	\$400.79	\$170.05	\$185.72
<b>As % of Total</b>	<b>8.7%</b>	<b>8.6%</b>	<b>8.2%</b>	<b>9.5%</b>	<b>7.2%</b>	<b>9.7%</b>	<b>8.5%</b>	<b>10.7%</b>	<b>8.4%</b>	<b>8.7%</b>	<b>7.8%</b>	<b>7.0%</b>
Administrative & Operational Expenses	\$110.28	\$126.66	\$154.56	\$137.33	\$108.99	\$50.07	\$46.50	\$110.40	\$78.05	\$253.20	\$159.96	\$167.50
<b>As % of Total</b>	<b>6.7%</b>	<b>6.5%</b>	<b>5.4%</b>	<b>5.7%</b>	<b>7.6%</b>	<b>8.2%</b>	<b>7.9%</b>	<b>6.9%</b>	<b>4.6%</b>	<b>5.5%</b>	<b>7.4%</b>	<b>6.4%</b>
Total Expenses	\$1,651.23	\$2,063.84	\$2,866.24	\$2,417.60	\$1,438.99	\$612.87	\$589.70	\$1,605.90	\$1,690.56	\$4,606.75	\$2,175.41	\$2,634.35

Source: *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009)



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# Lottery Operations

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## Background

This section of the performance audit focuses on the Ohio Lottery Commission's (OLC or the Agency) operations, including assessments of game offerings, recruitment and service of retailers, marketing, contract oversight related to games, and overall management of OLC's performance. OLC's operations were compared with leading practices, Ohio Revised Code (ORC) and Ohio Administrative Code (OAC) requirements, and selected peer state lotteries.<sup>1</sup> Leading practices and standards were drawn from the North American Association of State and Provincial Lotteries (NASPL), *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009)<sup>2</sup>, and the American Marketing Association.

OLC operates a number of games that generally fall into one of two categories: instant ticket games and online games. NASPL describes instant ticket games as games that involve lottery tickets that require the player to remove a latex coating to determine if the ticket is a winner. Instant tickets are sometimes referred to as "scratch-offs." At the time of the audit, OLC offered 57 instant ticket games, ranging in price from \$1 to \$20. Online game tickets are purchased through a network of computer terminals located at retail outlets. The terminals are linked to a central computer that records the wagers. At the time of the audit, OLC offered the following nine online games: Pick 3, Pick 4, Rolling Cash 5, Classic Lotto, Kicker, Mega Millions, Ten-OH!, Keno, and Powerball. In addition, OLC offers a series of EZ Play games, which are a combination of the two categories in that they play like instant ticket games, but are generated through terminals. OLC also produces a game show, Cash Explosion, which is tied to one of its instant ticket games. And finally, it offers infrequent raffle ticket games in which players purchase tickets over specific periods of time and winners are selected through drawings.

## Games and Retailer Management

### *Game planning*

#### **Instant Ticket Game Plan**

OLC has an instant ticket product plan that it develops each fiscal year. The instant ticket product plan includes the name, price point, number of tickets, Commission approval date (two

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<sup>1</sup> See the **executive summary** for a list of the ten peer state lotteries and the methodology for choosing them.

<sup>2</sup> Much of the peer state data used in this report is taken from the *La Fleur's 2009 World Lottery Almanac*, which provides SFY 2008 data. As such, this report includes some SFY 2009 information for the Ohio Lottery for context, but comparisons are based on SFY 2008 data.

months prior to the release date), and release date for each instant ticket game. In developing the instant ticket product plan, the Office of Product Development evaluates both ticket mix and prize payout structure. The instant ticket product plan is revised as needed, though typically not often, throughout the fiscal year.

OLC has a core of instant tickets at the “\$5 or less” price points that are ongoing products; these games are reordered based on inventory. OLC’s other instant ticket offerings have varying life cycles depending on the price points and prize structures. For example, instant tickets with price points of \$5 or less are designed to run for 25 weeks and sell approximately 80 percent of total available tickets before close. In contrast, instant tickets with price points of \$10 or \$20 are designed to last one to two years and as long as top prizes are still available, the games will remain open. OLC’s Office of Product Development continually monitors instant ticket sales performance by price point.

### **Online Game Plan**

OLC also has an online product plan that it develops on an ongoing basis; each version of the plan typically covers about six months. The online product plan includes any planned promotions of games (including refreshing an existing game), software batch date, and game launch/refresh date (it generally takes four to six months to launch based on system updates and rules approval). The online product plan also highlights general needs, where applicable, associated with the planned launch of each game. Finally, it identifies the general type of marketing support that each game should receive (e.g., radio, posters, or television).

In developing the online product plan, the Deputy Director of the Office of Product Development (Director of Product Development) and staff draw on available research and analysis, both internal (e.g., comparable sales data and discernable trends) and external (e.g., vendor-provided studies and industry trends), with the goal of improving overall profitability. The online product plan is reviewed and approved by the Executive Director; the Deputy Director of the Office of Operations (Director of Operations); and the Deputy Director of the Office of Finance (Director of Finance). However, the approved online product plan is treated as a fluid document and all offices are kept apprised of ongoing changes.

### *Sales Performance*

**Table 5-1** shows OLC’s State Fiscal Year (SFY) 2008 and SFY 2009 population, sales distribution, and per capita sales performance compared with the SFY 2008 peer averages.

**Table 5-1: Sales Performance Comparison SFY 2008**

	SFY 2008	SFY 2009	Peer Average
<b>Population (In Millions)</b>	11.49	11.54	12.65
<b>Sales Distribution (In Millions):</b>			
Instant Ticket Sales	\$1,364.82	\$1,349.40	\$1,671.97
Online Ticket Sales	\$960.32	\$1,068.30	\$1,268.85
Total Ticket Sales	\$2,325.14	\$2,417.70	\$2,940.83
<b>Per Capita Sales (In Dollars):</b>			
<b>Per Capita Instant Ticket Sales</b>	<b>\$118.78</b>	<b>\$116.93</b>	<b>\$128.67</b>
<b>Per Capita Online Ticket Sales</b>	<b>\$83.58</b>	<b>\$92.57</b>	<b>\$101.64</b>
<b>Per Capita Total Ticket Sales</b>	<b>\$202.36</b>	<b>\$209.51</b>	<b>\$230.31</b>

**Source:** OLC and peer SFY 2008 sales data from *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009), OLC's SFY 2009 comprehensive annual financial report (CAFR), and the United States Census Bureau's 2009 Ohio population estimate.

**Note:** Though the New York Lottery offers both traditional lottery and video lottery terminals (VLTs), the peer average includes traditional lottery only.

As shown in **Table 5-1**, OLC's SFY 2008 per capita instant ticket, per capita online ticket, and per capita total ticket sales were all lower than the peer averages. Per capita sales are indicators of performance and can be influenced by a number of factors including, but not limited to, game mix, prize payout percentages, marketing efforts (see **R5.7** and **R5.8**), and overall game management (see **R5.1**).

### *Prize Payout Percentage*

**Table 5-2** shows OLC's SFY 2008 and SFY 2009 total sales, prizes, and payout percentage as compared with the peer averages for SFY 2008.

**Table 5-2: Prize Payout Percentage Comparison SFY 2008**

	Total Sales (Millions)	Prizes (Millions)	Payout Percentage
<b>OLC SFY 2009</b>	<b>\$2,417.68</b>	<b>\$1,459.05</b>	<b>60.3%</b>
<b>OLC SFY 2008</b>	<b>\$2,325.14</b>	<b>\$1,397.02</b>	<b>60.1%</b>
<b>Peer Average</b>	<b>\$2,940.83</b>	<b>\$1,762.18</b>	<b>59.9%</b>
Florida	\$4,174.78	\$2,476.03	59.3%
Georgia	\$3,272.06	\$2,049.54	62.6%
Illinois	\$2,057.27	\$1,226.07	59.6%
Indiana	\$822.83	\$503.30	61.2%
Kentucky	\$778.21	\$493.06	63.4%
Michigan	\$2,330.19	\$1,323.34	56.8%
New Jersey	\$2,539.07	\$1,471.12	57.9%
New York	\$6,673.20	\$3,952.76	59.2%
Pennsylvania	\$3,089.18	\$1,845.40	59.7%
Texas	\$3,671.49	\$2,281.13	62.1%

**Source:** OLC and peer SFY 2008 data from *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009), and OLC's SFY 2009 CAFR.

As shown in **Table 5-2**, OLC's SFY 2008 prize payout percentage of 60.1 percent was comparable to the peer average of 59.9 percent. In addition, OLC's prize payout percentage increased slightly to 60.3 percent in SFY 2009. In the lottery industry, it is asserted that higher prize payouts attract more players and contribute to higher sales.

### *Instant Ticket Games Mix*

**Table 5-3** shows OLC's current instant ticket game offerings by price point as compared with the peer averages.

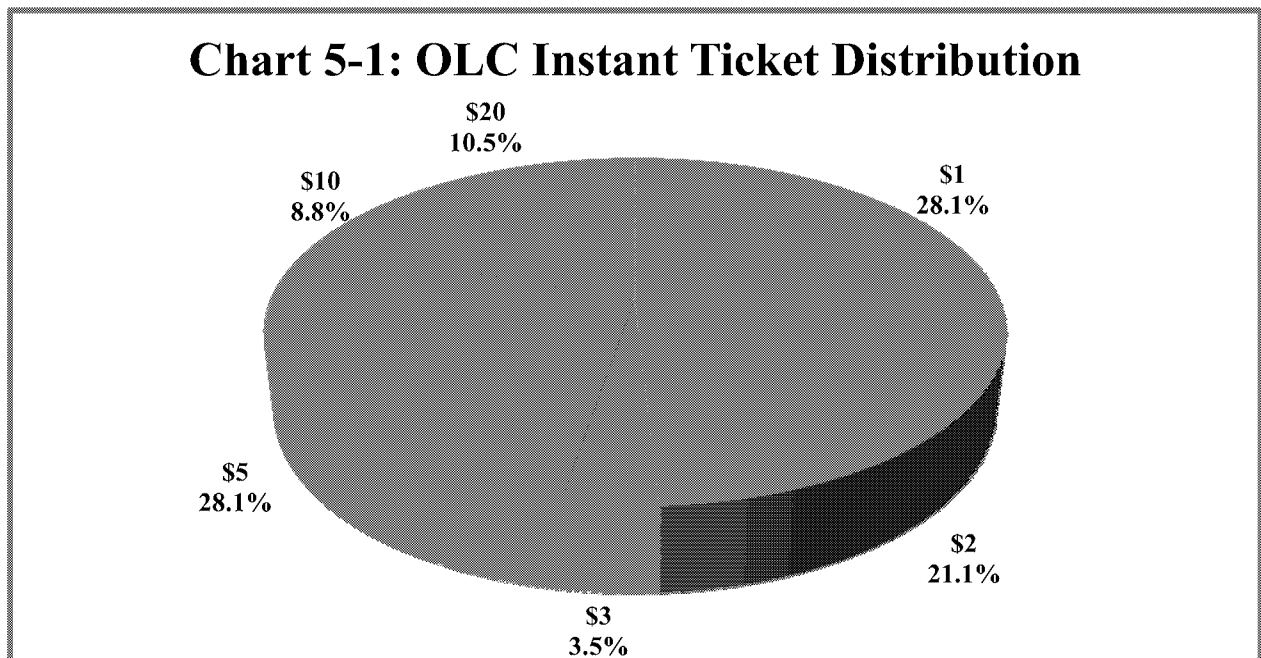
**Table 5-3: Instant Ticket Comparison May 2010**

May 2010	\$1	\$2	\$3	\$5	\$7	\$10	\$20	\$25	\$30	\$50	Total Offerings
<b>OLC</b>	<b>16</b>	<b>12</b>	<b>2</b>	<b>16</b>	<b>0</b>	<b>5</b>	<b>6</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>57</b>
<b>Peer Average</b>	<b>12.1</b>	<b>18.8</b>	<b>4.5</b>	<b>15.1</b>	<b>0.3</b>	<b>7.0</b>	<b>4.0</b>	<b>0.2</b>	<b>0.3</b>	<b>0.2</b>	<b>62.5</b>
Florida	17	19	6	16	0	6	5	0	1	0	70
Georgia	17	22	10	9	0	7	4	0	0	0	69
Illinois	10	14	5	12	0	7	3	0	1	0	52
Indiana	13	13	1	14	0	7	5	0	0	0	53
Kentucky	6	12	0	15	0	8	4	0	0	0	45
Michigan	22	50	0	25	0	12	6	0	0	0	115
New Jersey	6	16	10	12	0	5	3	0	0	0	52
New York	9	20	0	18	0	6	2	0	1	0	46
Pennsylvania	9	12	4	14	0	6	6	2	0	0	53
Texas	12	10	9	16	3	6	2	0	0	2	60

**Source:** OLC and peer lottery web sites (current instant ticket offerings).

As shown in **Table 5-3**, OLC offers approximately the same number of instant tickets as the peer average. OLC’s highest price point ticket is a \$20 offering, which all peers offer but in varying numbers. However, the Pennsylvania Lottery offers two tickets at the \$25 price point (its highest price point); the Florida Lottery, Illinois Lottery, and New York Lottery all offer one ticket at the \$30 price point (the highest price point for each of the three lotteries); and the Texas Lottery offers two tickets at the \$50 price point (its highest price point). Higher priced instant tickets typically pay out more overall in prizes and have higher top-tier prizes.

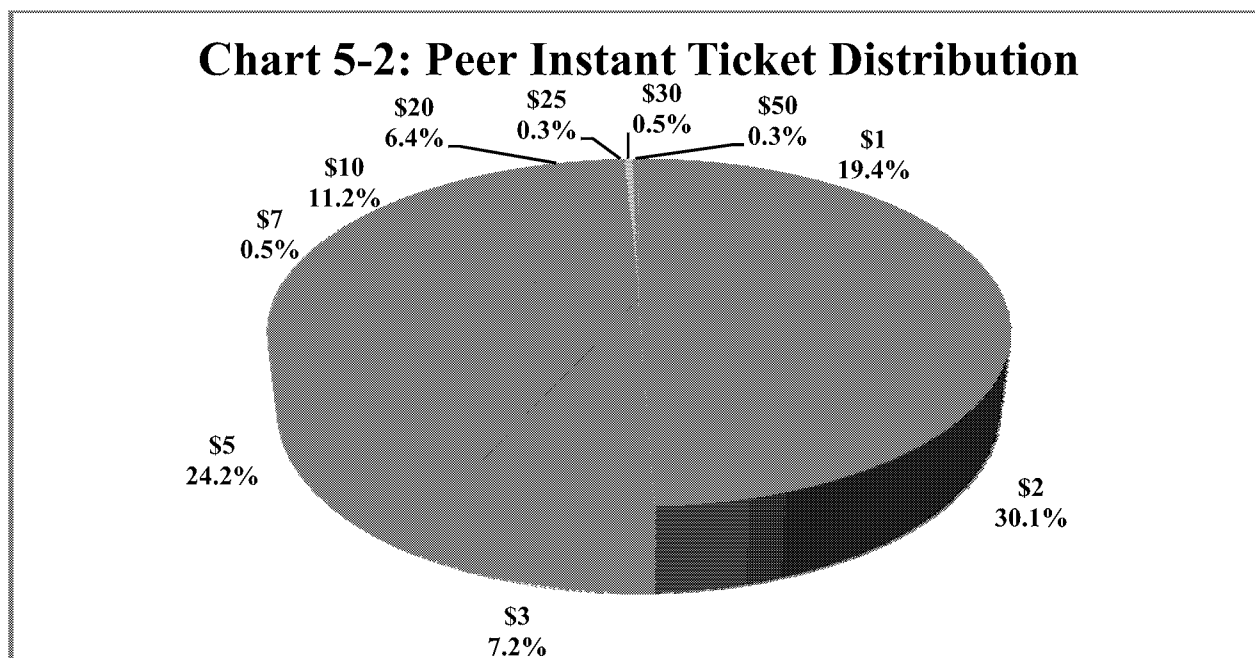
**Chart 5-1** shows the percentage distribution of OLC’s instant tickets by price point.



**Source:** OLC instant ticket offerings (May 2010).

**Note:** Percentages may vary from actual due to rounding.

**Chart 5-2** shows the percentage distribution of the peer average instant tickets by price point.



**Source:** Peer lottery web sites (instant ticket offerings) (May 2010).

**Note:** Percentages may vary from actual due to rounding.

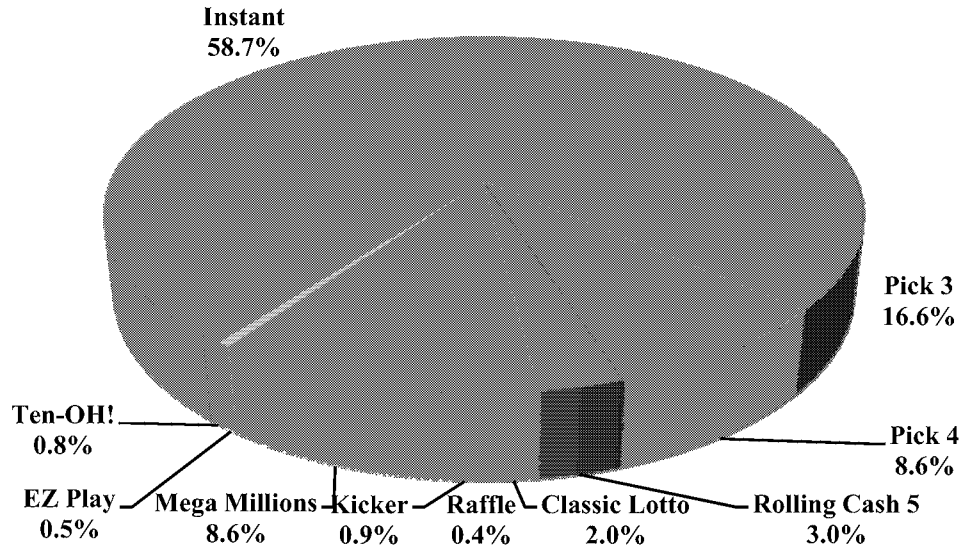
As shown by **Chart 5-1**, OLC's instant ticket mix is most heavily oriented toward \$1, \$5, and \$2 tickets: 28.1 percent, 28.1 percent, and 21.1 percent, respectively. As shown in **Chart 5-2**, the peer average instant ticket mix is most heavily oriented toward \$2, \$5, and \$1 tickets: 30.1 percent, 24.2 percent, and 19.4 percent, respectively. Auditors discussed with OLC additional areas that might warrant investigation by the Agency—evaluating the sales potential of offering instant tickets above the \$20 price point, the percentage distribution of \$1, \$2, and \$5 ticket offerings relative to the peer average distribution, and the impact that changes in percentage distribution could have on instant ticket sales.

### *Overall Games Mix*

**Chart 5-3** shows OLC's SFY 2008 game mix and percent of total sales by game.



**Chart 5-3: OLC Game Mix SFY 2008**

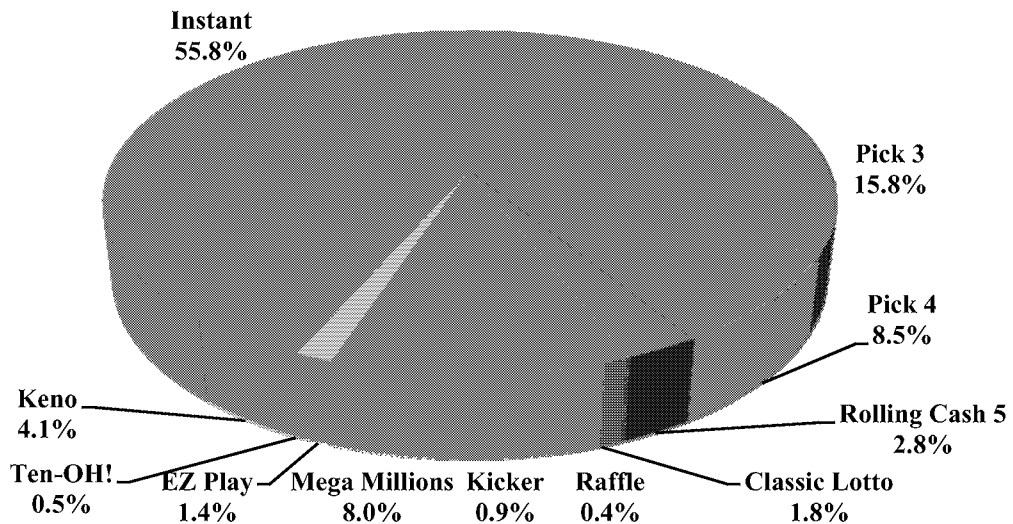


Source: OLC SFY 2008 CAFR, (sales by game information).

Note: Percentages may vary from actual due to rounding.

Chart 5-4 shows OLC’s SFY 2009 game mix and percent of total sales by game.

**Chart 5-4: OLC Game Mix SFY 2009**

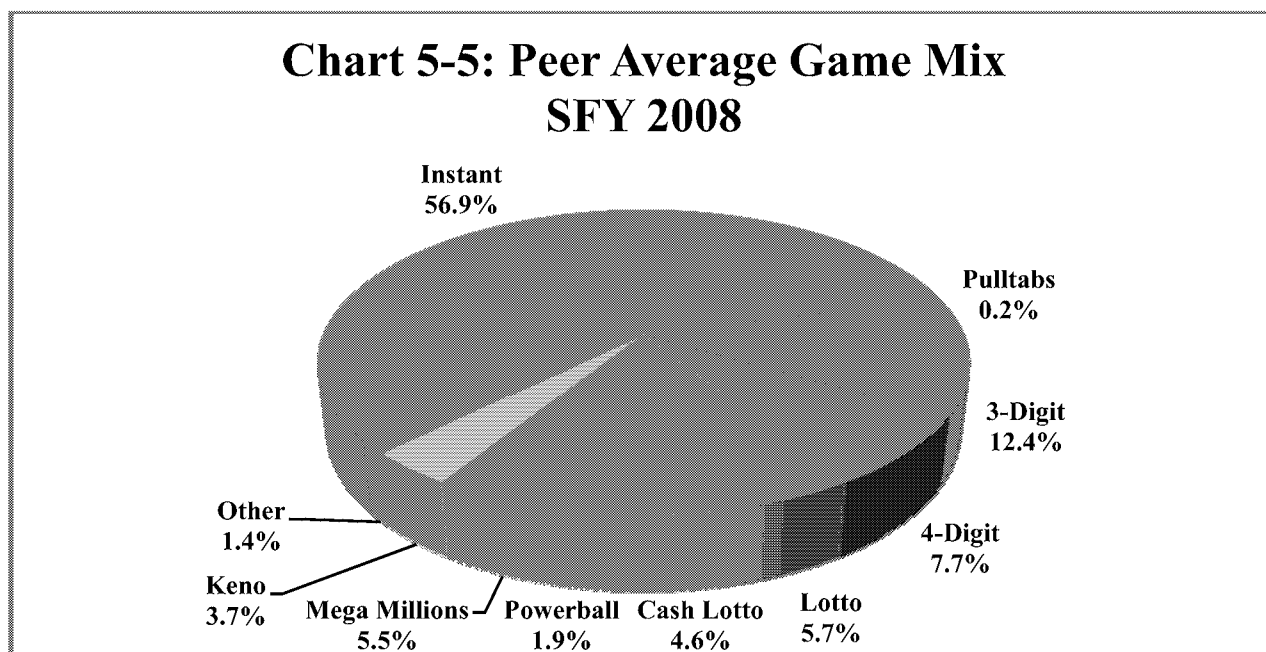


Source: OLC SFY 2008 CAFR, (sales by game information).

Note: Percentages may vary from actual due to rounding.

As shown in **Chart 5-4**, OLC's SFY 2009 game mix includes Keno at 4.1 percent of total sales. Keno is not included in **Chart 5-3** showing the SFY 2008 game mix, as the game was not introduced until August 2008.<sup>3</sup>

**Chart 5-5** shows the SFY 2008 peer average game mix and percent of total sales by game type.



**Source:** *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009).

**Note 1:** Percentages may vary from actual due to rounding.

**Note 2:** The New York Lottery offers both traditional lottery and video lottery terminals (VLTs); **Chart 5-4** includes traditional lottery only.

As shown in **Chart 5-5**, the peers offer a similar mix of games as OLC (see **Chart 5-3**). Although pulltabs are part of the peer average game mix, they represent only 0.2 percent of total sales (only three of the ten peer states offered pulltabs in SFY 2008).<sup>4</sup> As a result, OLC is not likely to significantly increase overall diversity of its game mix through implementation of pulltabs.<sup>5</sup> Auditors discussed with OLC opportunities for the Agency to evaluate the inclusion of other types of lottery games, available under its legal authority, and what results these would have on overall sales and ultimately on Lottery Profits Education Fund (LPEF) transfers.

<sup>3</sup> OLC also began offering Powerball, in addition to Mega Millions, in April 2010. Consequently, Powerball sales are not reflected in **Charts 5-3** or **5-4**.

<sup>4</sup> Pulltabs are offered by the Indiana Lottery, Kentucky Lottery, and Michigan Lottery; for SFY 2008 pulltabs represented approximately 1.6 percent, 2.0 percent, and 1.6 percent of total sales, respectively.

<sup>5</sup> Pulltabs are offered by some charitable gaming organizations in Ohio.

### Lottery Retailers

OLC sells its products through licensed lottery retail agents (retailers). According to ORC § 3770.05(B) “The director of the state lottery commission may license any person as a lottery sales agent. No license shall be issued to any person or group of persons to engage in the sale of lottery tickets as the person’s or group’s sole occupation or business.” As such, lottery retailers must operate businesses that sell other products or services to obtain a license from OLC to sell lottery products (instant and online tickets). Keno retailers must also have State of Ohio “Class D” liquor permits.

To obtain a lottery license, a retailer must complete an application; pass a criminal background check; obtain a surety bond; sign an indemnification agreement that makes the retailer responsible for lost or damaged equipment; complete a federal W-9 form; and agree to electronic fund transfers to OLC. The background check includes fingerprinting and a photograph, which are minimal in cost. A lottery retailer is required to meet the minimum surety bonding requirement which is \$15,000<sup>6</sup> or 1/26th of annual sales, whichever is greater. There is a one-time license fee of \$25, and even though licenses are reviewed and renewed annually, OLC does not charge retailers to renew their licenses. OLC regional offices assist potential retailers in completing the application process. Additionally, OLC has contracted with a preferred vendor to assist retailers in obtaining bonding.<sup>7</sup> If a retailer is denied a license, he or she has a right to a formal hearing.

Once the license is approved, OLC’s gaming system vendor installs lottery equipment and the retailer receives training from OLC sales staff on how to use the equipment. Once the lottery equipment is activated, the retailer pays a \$12 /week communication charge (per line).

OLC retailers receive 5.5 percent sales commissions for selling lottery tickets. Retailers also receive commissions of 1.0 percent for cashing winning tickets. They can earn additional 0.5 percent “cashing bonuses” if their cash-to-sales ratio for the week is 49.5 percent or greater. There are additional bonuses for retailers who validate winning tickets and assist customers with completing forms to claim prizes over \$599, as well as other various bonuses for selling winning jackpot tickets. **Table 5-4** compares Ohio’s retailer commissions paid as a percent of ticket sales with the ten peer states.

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<sup>6</sup> OLC reduced the minimum bond amount during the course of the audit from \$20,000 to \$15,000, effective July 8, 2010.

<sup>7</sup> During the course of the audit, OLC was in the process of contracting with a new preferred vendor.

**Table 5-4: State Comparison of Retailer Commissions (in millions)**

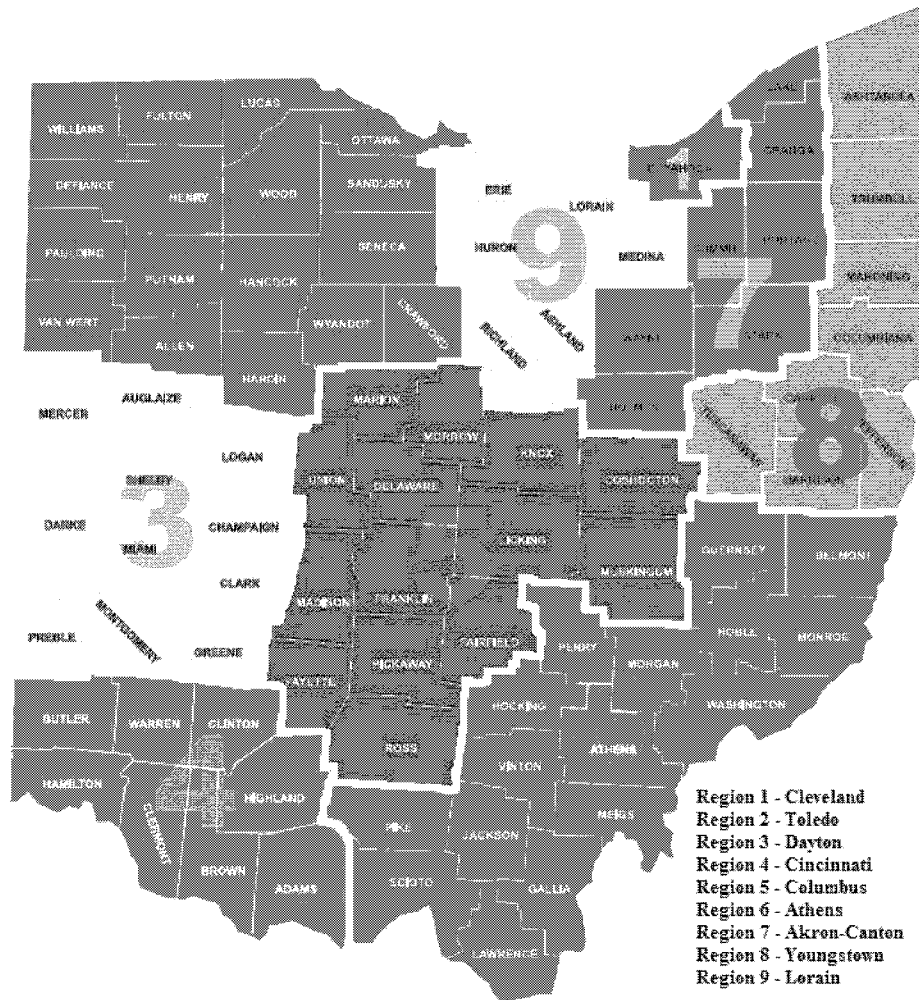
	<b>Retailer Commissions</b>	<b>Ticket Sales</b>	<b>Percent of Ticket Sales</b>
<b>Ohio</b>	<b>\$143.93</b>	<b>\$2,325.14</b>	<b>6.2%</b>
<b>Peer Average</b>	<b>\$175.01</b>	<b>\$2,940.83</b>	<b>6.1%</b>
Florida	\$235.65	\$4,174.78	5.6%
Georgia	\$230.73	\$3,272.06	7.1%
Illinois	\$103.93	\$2,057.27	5.1%
Indiana	\$59.50	\$822.83	7.2%
Kentucky	\$50.14	\$778.21	6.4%
Michigan	\$172.16	\$2,330.19	7.4%
New Jersey	\$141.39	\$2,539.07	5.6%
New York	\$400.79	\$6,673.20	6.0%
Pennsylvania	\$170.05	\$3,089.18	5.5%
Texas	\$185.72	\$3,671.49	5.1%

**Source:** *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009).

As illustrated in **Table 5-4**, Ohio's overall commission rate of 6.2 percent is in line with the peer average (6.1 percent). Retailer commissions as a percent of ticket sales ranged from 5.1 percent to 7.4 percent among the peer states. Two of the ten states (Texas and Illinois) had commission rates of 5.1 percent, while three other states (Georgia, Indiana, and Michigan) had rates over 7.0 percent. Incidentally, even though Michigan and Indiana had higher commission rates, Ohio had more revenue per retailer (see **Table 5-7** in **R5.6**).

Retailers across the State are organized into nine sales regions and 93 districts, with each region having between 6 and 14 districts. **Chart 5-6** illustrates the OLC regional sales offices

**Chart 5-6: OLC Regional Sales Offices**



Source: OLC

The sales regions report to the Deputy Director of Sales Management (Director of Sales) who is located at OLC headquarters in Cleveland. Each regional sales office is staffed with a Regional Manager, an Assistant Regional Manager, an Executive Secretary, and several Lottery Sales Representatives (LSRs). LSRs are members of the Ohio Civil Service Employee Association bargaining unit, and each is classified as either an LSR1 or LSR2. Each of the 93 districts has an LSR1 position assigned to it, and most sales regions have two LSR2 positions.<sup>8</sup> The LSR2 position is primarily responsible for the training and recruiting of retailers, and also trains new LSR1s and fills in for LSR1 absences. The LSR1 position provides direct customer support to

<sup>8</sup> The Cleveland sales region has four LSR2 positions; however, two positions are vacant and the OLC does not intend to fill these vacancies.

retailers through regular onsite visits. An LSR1 is expected to visit each retailer at least once every two weeks and to visit the top 10 to 15 largest retailers (by sales volume) weekly.

In general, with the exception of Keno, LSR1s are doing the same activities they have done for years, namely, assisting retailers with product mix, collecting unsold tickets, checking equipment and supplies, delivering signage and point-of-sale merchandise, counting and reconciling instant ticket inventory, recruiting new retailers, completing retailer applications, and assisting with other paper work. In the past, LSR1s supplied the instant ticket inventory to retailers, but now the delivery services are outsourced and tickets are shipped directly to the retailer location (see the discussion below on the Intralot Cooperative Services Program (Intralot CSP)).<sup>9</sup>

## Marketing

### *Marketing Organization*

OLC's Office of Marketing Services (Marketing Office) consists of 11 employees, including a Deputy Director (Director of Marketing) who reports to the OLC Executive Director. In FY 2008, OLC spent approximately \$20.8 million on marketing, with a goal of creating and retaining customers. Specifically, the main focus of the Marketing Office is to spread the Agency's message about new and ongoing games, and to maintain or increase sales in areas of historical difficulty. The marketing function is closely associated with the product development function, although the functions are housed in separate offices, with separate deputy directors who report to the Executive Director (see **R3.2** in **staffing**).

### *Marketing Plan/Initiatives*

The Marketing Office, in coordination with its ad agency partners, the gaming system vendor's marketing team, and the Agency's Product Development and Sales Management staff develops an annual marketing plan that guides its operations. The marketing plan attempts to align marketing operations with OLC's corporate growth strategy, define the Office's marketing objectives, identify the specific areas of planned media spending (e.g., television, billboards, and internet), and discuss key elements of planned marketing initiatives. Although the SFY 2010 marketing plan references OLC's budget for advertising, there is no clear linkage between the budget and the planned initiatives, no prioritization of initiatives based on potential budget changes, and no information about projected returns on investment (ROI) or returns on objective (ROO) (see **R5.8** for additional detail).

In addition to the annual marketing plan, the Marketing Office develops primary themes for its marketing initiatives, which generally span two to three years and are designed to achieve

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<sup>9</sup> These services are currently outsourced to Intralot (see discussion on *Intralot CSP* below).

specific objectives. Since SFY 2005, the Lottery has implemented the following primary marketing themes:

- SFYs 2005-2007: “Odds Are, You’ll Have Fun.”
- SFYs 2008-2009: “Take a Chance for Education. Odds Are, You’ll Have Fun.” The move to an education-based theme was an initiative of the prior Lottery Director, who felt the message of the Lottery supporting public education had been lost. The theme was based on research conducted for OLC. OLC felt that the best way to increase sales was to bring on new players, rather than increase the frequency of existing players. Its research showed a general lack of understanding about the public purpose of Lottery profits, and also indicated that some of the targeted non-players would be more willing to play if they felt like the money was used for a worthwhile cause.
- SFYs 2010-2011: “Winners Are Everywhere.” Having increased the awareness of its contributions to public education, the Agency has returned to a theme of fun, entertainment, and winning experiences. The tracking research showed that player attitudes toward “winning” had shifted, with many players feeling that “winning” meant hitting the jackpot, as opposed to winning any type of prize through the lottery. The “Winners” campaign focuses more on the different ways to win lottery games by emphasizing the fact that there are more than 10 million winners each month. Moreover, the “Winners” campaign offers opportunities to use newer media – online, mobile, social – to reach potential players by offering a more interactive setting where lottery winners can share their own stories.

### *Marketing Contract Management*

OLC implements its marketing strategies through partnerships with four contracted vendors. The media and sponsorship contracts are each initial one-year contracts with two (2) two-year renewal options. The creative services contracts have initial terms of two years with three (3) one-year renewal options. One contractor manages all media buying, online marketing, and sponsorships on behalf of OLC. According to the Director of Marketing, OLC used to have two separate media contracts, but having all of the services under one contract gives the Agency more flexibility in developing its marketing strategies and integrating them across different media formats.

In addition, OLC has entered into contracts with three firms to provide creative services, which encompass the design and execution of specific advertising campaigns. Of the three contractors, one serves as the primary agency while the other two are considered secondary agencies. The creative agencies are given the opportunity to bid against each other on specific products and creative campaigns. The primary contractor receives a monthly retainer and is therefore required to bid on each project/campaign, and OLC is required to provide each secondary contractor with

a minimum of four opportunities per year to bid. Secondary contractors are compensated for their time and materials when they bid on a project or campaign, as they are not paid a retainer. The Marketing Office tries to make sure that the multiple agencies each manage a product mix that allows for a focus on a single major item like Keno or Mega Millions, with additional smaller contracts. No single contractor holds all of the major contracts, and the Director of Marketing feels this dispersion of accounts helps each contractor to place appropriate focus on their particular brands.

The contracting process was administered by the Ohio Department of Administrative Services (DAS), which resulted in both positive and negative outcomes for OLC. Because DAS was involved in the process, OLC was somewhat insulated and was able to maintain its working relationships with the contractors. However, OLC's Marketing staff feels that the process also restricted the Agency's flexibility and ability to get maximum performance from its contracts. Beyond establishing minimum standards that a number of agencies can meet, OLC had little control to select the best agency to meet its needs. In the areas of marketing and advertising, it is often difficult in a request for proposal (RFP) to describe exactly what makes an agency able to meet OLC's needs. It is also difficult, as media and games change quickly, to anticipate everything that will be needed during the contract period. Although the Agency tried to write the contracts broadly enough to provide flexibility, there have been times when the language of the contracts limit what can be done.

In addition, because all of the creative marketing campaigns are limited to OLC's three contracted agencies, it is unable to use other agencies that can help with more specific and innovative campaigns. In the private sector, a company would have a primary ad agency that does the majority of its work, but might target other firms that have specific areas of expertise for specific campaigns. OLC is not able to do that.

### *Performance Measurement of Marketing Efforts*

OLC does attempt to use performance measures to track the impact of individual marketing initiatives. For each promotion, the Marketing Office works closely with the Office of Product Development to identify the games that are being promoted, the timing of the game launch and/or promotion, and the objectives. In the case of instant ticket games, the Marketing Office largely drives the process of articulating the promotions, the objectives, and the measures to be used to evaluate performance. The Marketing staff prepares summaries which contain this information for each promotion. After the promotion is completed, detailed data related to sales and other relevant metrics is collected and analyzed to determine the success of the overall promotion, as well as specific components of the promotion.

The data collected and reported in the promotion summaries allows OLC to measure the impact of marketing by comparing the performance of instant ticket games that are promoted with similar games (i.e., instant tickets at the same price point) that are not promoted. The Agency is



also able to look at the performance of a game during periods before and after the promotion to see if the promotion had an impact on sales.

The data in these reports has led OLC to explore a change in how it promotes its instant ticket games. In reviewing the data, the Marketing staff noticed that virtually all new games experience high sales at the beginning of their life cycles, regardless of whether or not they are promoted, and then sales decline after about eight weeks. Using this information, the Agency tested a strategy of not promoting a couple games until about eight weeks after they were launched, about the time that they would begin to experience their natural declines. At the time of the audit, the results of this testing were not complete, but the initial analysis showed that the delayed promotions were able to generate a second spike in sales which ultimately increased overall sales for those games. If the trend is borne out by additional results, OLC would apply this strategy more broadly across its instant ticket games.

The process of measuring game performance varies between online and instant ticket games. The Marketing Office takes the lead in establishing the metrics and measuring the performance of instant ticket games, as well as promotions of new online games. For the promotion of other online games, Product Development is the primary driver. According to Marketing staff, the Marketing Office has little input into the planning or measuring of online game promotions. In addition, Product Development tends to analyze promotions based more on historical trends than on operational data. At various points in OLC's history, the Marketing and Product Development functions have been housed under the same office, which helped ensure consistency among the various types of game promotions, as there is no operational reason for them to be measured differently (see **R3.2 in organization, staffing and management**).

In addition, within its advertising and gaming contracts, OLC requires certain levels of research. As a result, OLC receives a significant amount of market research designed to help it make decisions about future marketing initiatives. In 2005, the Agency and its media vendor commissioned a comprehensive "market segmentation study" which focused on player attitudes, motivations, and connections to various lottery games and promotional messages. This market segmentation study has been the subject of follow-up studies to track changes based on subsequent marketing efforts.

According to the Marketing Director, the Marketing Office generally coordinates OLC's process for absorbing and responding to the results of these studies. The first step is a meeting with the key stakeholders – relevant OLC deputy directors and subordinate staff, and sometimes the marketing agencies and game vendors if appropriate (it is sometimes the game vendors who conduct the research, in which case they present the findings) – to hear the information firsthand. Results are usually summarized in a PowerPoint presentation, but the entire study is made available for those desiring a more thorough analysis. The Marketing Office will generally develop recommendations for further action based on the study results. Follow-up meetings, as well as separate subgroups to focus on more specific issues, then ensue.

A number of the operational decisions made by the Marketing Office since 2005 can be traced to results of the 2005 market segmentation study, the follow-up studies, or other research provided for OLC. For example, the 2005 segmentation study found that only 58 percent of lottery players were aware that lottery profits were directed to public education. As a result, OLC devoted marketing resources to emphasizing the connection between lottery profits and education. The 2007 follow-up study found that awareness of public schools as the primary beneficiary of lottery profits had increased to 62 percent. By 2009, during the “Take a Chance for Education. Odds are You’ll Have Fun” campaign of SFYs 2008 and 2009, the awareness level reached 67 percent in a targeted tracking study. For SFYs 2010 and 2011, the Lottery decided to return to a theme focusing on prize winners, based on data from the research showing a perception among players that “winning” meant hitting a jackpot, rather than winning one of the other prizes available through its games.

## Gaming Contract Management

### *Gaming System Contract (Intralot)*

OLC’s gaming system contract with GTECH, in place since 1985, expired on June 30, 2009. The development of Ohio’s RFP for a lottery gaming system began in the fall of 2006, and OLC issued the RFP on October 12, 2007. Because of the complex and technical nature of a gaming system, OLC exercised the Release and Permit procedure offered by DAS that allows agencies to depart from the standard practice of DAS involvement in seeking proposals and selecting vendors. Although not common Statewide, this arrangement with DAS has been a standard practice for this contract.

OLC involved several offices, according to office expertise, in drafting the RFP. The Information Technology (IT) Office had the largest role since the bulk of the RFP contained specific hardware and software requirements and IT needed to understand the needs of the other offices in order to ensure the RFP met all departmental criteria. In developing the RFP and compiling its sections, OLC IT personnel considered the previous gaming system RFP and used the Battelle Memorial Institute’s RFP template for assistance.<sup>10</sup> Vendors wishing to bid on the RFP were required to provide in-depth software and marketing services as well as build-out plans for a Primary Data Center (PDC) and Secondary Data Center (SDC) necessary to house front-end processors, back office systems, and other support equipment necessary to operate the system. The three main gaming system vendors operating in the United States – GTECH, Intralot, and Scientific Games International – all responded to OLC’s RFP. An addendum was released on March 17, 2008 inviting vendors to bid on an additional component (Keno).

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<sup>10</sup> Battelle Memorial Institute is a non-profit organization located in Columbus, Ohio that provides, among other services, general services administration for electronic information technology expertise.

As specified in the RFP, OLC chose several employees to serve on the evaluation committee to review and rate the technical portions of the proposals received. The committee's methodology included a review and analysis by individual committee members of each vendor's responses to each sub-section of the RFP. Following the individual analysis, the group met for discussion that culminated in the recording of observations. For specific expertise, a Battelle Memorial Institute representative attended the evaluation meeting via teleconference to assist the committee with technical interpretation. A Certified Public Accounting firm was also retained to review the financial data and additional statements provided by vendors in support of their proposals. Throughout the process, the committee developed questions seeking clarifications from the vendors. The evaluation committee visited each vendor's corporate headquarters to view presentations and to test equipment proposed. Additionally, the committee visited the Idaho, Connecticut, and Rhode Island lotteries and their respective retailers to evaluate the proposed equipment under actual field conditions. A detailed description of the scoring is included in **appendix 5-A**. Auditors determined that the scoring process used leading edge techniques and was rigorous.

After an apparent winner (Intralot) was determined by the evaluation committee, but before an award was announced, an OLC team collected questions from Agency departments and submitted them to Intralot. Over the course of several face-to-face meetings with the vendor, each item was addressed. This due diligence was essential to ensure that both parties understood OLC's preferences, vendor pricing, subsequent conversion strategies, and other items needing clarification. At the May 2008 Commission meeting, the OLC Executive Director announced Intralot as the successful vendor for OLC's gaming system contract, valued at between \$17 and \$20 million per year.<sup>11</sup>

On May 30, 2008 GTECH formally protested OLC's gaming system contract award to Intralot. OLC convened a team of Agency staff and independent consultants to determine the validity of the protest and make a recommendation to the Executive Director, who ultimately rejected GTECH's protest. On June 17, 2008, GTECH filed a civil suit against OLC and Intralot in the Franklin County Court of Common Pleas. GTECH made several arguments, including that Intralot was not an eligible vendor under the RFP due to its limited experience in the United States. GTECH also challenged Battelle's role in the scoring process, the evaluation committee's application of the award scale (see **appendix 5-A**), the Executive Director's decision not to disclose the weighting of the various scoring elements, and OLC's decision to negotiate with Intralot before an award was announced. The Court ruled that in each area contested by GTECH, the Executive Director had not abused his authority, and the case was ultimately decided in favor of OLC/Intralot. GTECH chose not to appeal the decision.

The following components describe the RFP requirements as set forth by OLC:

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<sup>11</sup> Because Intralot receives a percentage of sales under the contract, and because the percentage amounts shift through the life of the contract, an exact per-year contract amount is unknown.

- Central Configuration;
- Retailer Terminals;
- Communications Networks;
- Software Controls and Data Management;
- Games and Marketing;
- Vendor Facilities and Disaster Recovery Plan;
- Staffing, Services, and Operations Security Plan;
- Gaming System Implementation; and
- Vendor Corporate Capability.

Each component as presented in the RFP is examined in detail in **appendix 5-A**. In addition, any issues identified with components of the contract during audit work are noted, and the steps OLC has taken to address these issues are included where appropriate. According to the Deputy Director of Information Technology, a memorandum of understanding (MOU) is in the process of being developed and could result in OLC applying liquidated damages against Intralot for any violations of the terms of the contract.<sup>12</sup> Based on the detailed analysis included in **appendix 5-A**, OLC has evaluated Intralot's identified shortcomings, is working with Intralot to improve in certain areas, and may assess damages.

OLC stated that the new contract with Intralot is one of the lowest-cost gaming system contracts in the industry. In addition, services are now included in the Intralot contract that were formerly obtained under separate contracts (e.g., instant ticket vending machines and phone/data communication systems), and annual savings under the new gaming system contract are estimated at approximately \$15 to \$20 million per year over the duration of the contract (up to ten years). Finally, according to the Director of Finance, OLC should recognize increasing cost savings over the duration of the contract due to increasingly favorable gaming system contract percentages.

The conversion from GTECH to Intralot was characterized by OLC as the largest gaming system conversion in U.S. lottery history. The conversion occurred on July 1, 2009, meaning at that point, all of OLC's online games were processed through a new computer system and retailers throughout the State would sell tickets for these games through new equipment. The conversion required months of planning; information sharing among OLC, Intralot, and GTECH; and testing to ensure a seamless switch on July 1, when OLC expected the new system to process approximately 3 million transactions. OLC felt that the actual switch was relatively seamless with only minor interruptions to the system, and that the move to new gaming equipment/system vendor has largely been a success (see *noteworthy accomplishments* in the **executive summary**). Moreover, as described in **appendix 5-A**, the Intralot Gaming System contract was determined to have adequate provisions for oversight and ensuring vendor compliance.

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<sup>12</sup> During the course of the audit, OLC finalized the MOU.

*Instant Lottery Ticket Products and Services (Scientific Games International)*

The Ohio Department of Administrative Services, Office of State Printing, issued an RFP on behalf of OLC for instant lottery ticket products and services – which in SFY 2009 accounted for approximately \$1.3 billion in sales – on March 9, 2007. The Agency sought proposals for the purpose of obtaining contractor services to provide instant ticket manufacturing, marketing services, and related licensing and delivery services.<sup>13</sup> The goal of the RFP was to award two contracts: a primary contract and a secondary contract. The contracts, ultimately awarded to Scientific Games International (SGI) and Pollard Banknote Limited, were valued at a combined \$13.5 million for SFY 2010.

The primary contractor would be the prime source of instant ticket printing, licensing agreements, sub-contract licensing agreements, marketing services, research services, and any other instant ticket related services as determined by OLC. The secondary contractor had to be capable of meeting all of the requirements of the RFP (including those of the primary contract), be capable of printing at least 50 million tickets for OLC per fiscal year, and be able to serve as backup to the primary contractor for any reason. During SFY 2009, OLC expected to print 550 million tickets. The Agency also estimated that approximately 55 to 70 instant ticket games, including re-orders, would be ordered during the first fiscal year of the contract with a range of one to forty million tickets per game. Finally, unlike the other OLC contracts examined, the RFP included the weighting method that would be applied to each component; both the vendor and scoring personnel were aware of these weights from the beginning.<sup>14</sup> According to OLC officials, this is a common practice in DAS State Printing Contracts.

Four vendors presented proposals in response to the RFP: Scientific Games International (SGI), Pollard Banknote Limited, GTECH Printing Corporation, and Oberthur Gaming Technologies.<sup>15</sup> The vendor selection process involved several OLC offices including Sales, Marketing, IT, and Product Development, along with two representatives from the DAS Office of State Printing. Each individual rated the components for the proposals on a scale of zero to nine. These ratings were combined to form the Official Consensus Score, which was reached through discussions only. No documented rationale for the scores was created. Weights were then applied and the scores tallied.

The price proposal rating was exclusive of this process and was based on a formula that identified a maximum rating—the lowest price received the highest score. The cost component was evaluated by the Office of State Printing.

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<sup>13</sup> Scientific Games International (SGI) is responsible for delivering tickets to Intralot, which then manages and distributes the tickets to retailers under the cooperative services program (CSP) contract.

<sup>14</sup> This process is reportedly common in contracts developed under the DAS requirements.

<sup>15</sup> During the course of the RFP evaluation process, SGI bought Oberthur, reducing the number of vendors that competed for this contract to three.

SGI, which has been OLC's primary vendor for instant tickets since 2001, was selected to be the primary contractor and Pollard Banknote Limited the secondary contractor on June 6, 2007. The term of the contract was July 1, 2007 through June 30, 2009 and is renewable for three, two-year terms.

OLC opted to renew the contract in 2009, and SGI and the Agency agreed to the same terms as the original contract (including pricing in the case of SGI).<sup>16</sup> Both instant ticket contracts were renewed for an additional 24 months, through June 30, 2011.

The following notes the twelve main components of the RFP. These components and OLC responses on monitoring provisions and contract fulfillment are included in **appendix 5-B**.

- Marketing Plan;
- Game Designs;
- Development of Printing and Production Schedule;
- Market Research;
- Sales Analysis;
- Contractor Representative;
- Transition Team;
- Monthly Evaluation Meeting;
- Semi-Annual Planning Meeting;
- Retailer and Player Promotions;
- Sales Forecast; and
- Proposal on Introducing At Least Four New Instant Games.

The Instant Ticket Product Manager located in the Office of Product Development is responsible for monitoring the SGI instant ticket contract. Additionally, OLC's Office of Internal Audit has conducted compliance audits of SGI for two of last three years. The results of these audits support the ratings and comments compiled in the semi-annual vendor evaluations. Based on the above and the detailed analysis in **appendix 5-B**, auditors determined that SGI appears to be complying with the requirements of the contract, and OLC is properly managing the contract. However, auditors noted some concerns with the scoring form and process which is discussed in more detail in **R5.10** and **appendix 5-B**.

### *Cooperative Services Program (Intralot)*

Intralot's Cooperative Services Program (Intralot CSP) is a separate contract from Intralot's Gaming systems contract. The contract resulted from an RFP issued by DAS State Purchasing on behalf of OLC on December 18, 2008 to secure a contractor to develop, refine, and implement

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<sup>16</sup> Pollard Banknote agreed to a 4 percent reduction in pricing for the renewal beginning July 1, 2009.

instant ticket and gaming supply inventory management, telemarketing, warehousing, and distribution services. In SFY 2010, the estimated value of the CSP contract was \$5.6 million.

According to the Director of Operations, LSRs previously planned, placed orders and delivered instant tickets and gaming supplies to the retailers in their districts. Retailers were on a two-week delivery schedule. This system was not ideal as one retailer might have an ample supply of instant tickets while another retailer would sell out quickly and would have to wait up to two weeks for the next delivery. In the early 1990s, LSRs were provided vehicles to deliver the lottery's 10–15 instant ticket games to retailers. By the mid-1990s, the vehicles were replaced with two-ton cargo vans to distribute the 60-70 instant games across the regions. An evaluation of the ticket distribution methodology became a component of the Agency's strategic plan for SFY 2004. The evaluation recommended switching to a courier delivery methodology. SGI initially served Ohio for CSP services, beginning on July 1, 2005. No post-launch study was conducted to determine if the objectives of contracting with SGI were met; however, instant ticket sales increased from \$1.16 billion in SFY 2005 to \$1.35 billion in FY 2009.

The vendor selection process initiated in 2008 involved OLC employees from various offices and bureaus including Sales, Communications, IT, and Strategic Planning, as well as one DAS representative. Once proposals were submitted, each employee rated the weighted components from the proposals on a scale of one to five<sup>17</sup> and the combined ratings formed the Official Consensus Score. The price proposal rating was exclusive of this process and was based on a formula that identified a maximum rating—the lowest price received the highest score.

Although another contractor received the highest rating for the services required in the RFP, Intralot's price was much lower, receiving the highest rating for price. Intralot was awarded the contract on March 16, 2009, since its combined rating of services and price was higher than the other two proposals.

Intralot's CSP experience was largely limited to software architecture, and therefore, much of its proposal is stated in terms of its plan to meet the RFP requirements (see **R5.10** for additional discussion). The nine main components of the request for proposal (RFP), and resulting contractual arrangement are as follows:

- Data Processing;
- Management of Instant Ticket and Gaming Supply Inventory;
- Management and Staffing of a Telephone-Based Order System;
- Packaging of Instant Tickets and Gaming Supplies;
- Delivery of Instant Tickets and Gaming Supplies;
- Return Receipt of Instant Tickets and Gaming Supplies;

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<sup>17</sup> OLC received three proposals in response to this RFP—Scientific Games International, Intralot, and Pollard Banknote Limited.

- Security Measures;
- Implementation Plan; and
- Personnel Plan.

Each component as presented in the RFP, Intralot's response, Intralot's actual practice, and the proposal score is examined in detail in **appendix 5-C**. In general, the original RFP was not amended before being implemented as the final contract and OLC has not filed a memoranda to clarify areas where service has been declined by the Agency. Likewise, certain areas included in the RFP, which became the substance of the working contract are not being met, but no steps have been taken by OLC to resolve the deficiencies because they are not deemed sufficiently material and important. These factors are addressed in more detail in **R5.10** and **appendix 5-B**.

According to the RFP, OLC is responsible for monitoring the contractor's performance and compliance with the terms, conditions, and specifications of the contract. The Intralot CSP operation is monitored by several OLC employees, but the primary responsibility falls to the Deputy Director of Product Development. Intralot CSP's personnel, which include the General Manager, Warehouse Manager, Sales Manager, and the Warehouse Lead, interact with OLC's contract managers. Additionally, OLC's internal audit function has planned to review Intralot's CSP operations and is in progress at this time. The results are forwarded to the contract managers to help support vendor performance evaluations.

For any infractions to the proposal that cannot be immediately remedied by either party, OLC's legal counsel may take steps to interpret the conditions of the contract, and if there is still no resolution, legal counsel can notify DAS through a Complaint to Vendor (CTV) to help resolve the infraction. According to OLC's Chief Legal Counsel, since Intralot assumed the CSP responsibilities in 2009 and through the time of this performance audit, no CTVs have been filed.



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# Recommendations

## Games and Retailer Management

### *Game Performance*

**R5.1 OLC should ensure that game decisions (adding, eliminating, or refreshing a game) are based on sound performance data and formally documented. Although OLC’s management staff has the collective knowledge and experience to make these types of decisions, reliance on management experience leaves the quality of these types of decisions at risk when turnover occurs. A performance-based decision-making process provides for clarity and transparency that is lacking in an informal decision-making process.**

**OLC should also update, and establish a process of continued, formal updates, for its Cash Explosion profitability analysis. In doing so, OLC should ensure that it captures the total cost (both direct and indirect) associated with Cash Explosion. A clear, up-to-date analysis of the profitability of Cash Explosion will help OLC demonstrate that continuing to offer the game is consistent with the overall purpose of the Agency (i.e., to maximize transfers to the LPEF).**

OLC’s Office of Finance develops annual projections of instant ticket sales (sales as a whole) and online game sales (sales by game). Over the course of the fiscal year, OLC records monthly sales data and benchmarks actual sales relative to projected sales. See **R4.3** for further analysis of OLC’s forecasting practices.

OLC’s instant ticket and online game vendors also provide annual presentations about the performance of games, including comparisons with other states. In addition, the vendors provide recommendations for lottery game changes and/or new lottery games. OLC’s gaming system vendor, Intralot, also offers a game optimization program that provides an analysis of game performance but the Agency has not yet used this resource. OLC also has access to vendor research and data from professional trade publications (e.g., *La Fleur’s*) and industry groups (e.g., the North American Association of State and Provincial Lotteries) which can be used to further inform game decisions.

OLC’s instant ticket games have pre-defined life cycles and percentage payouts/profit structures. The mix of instant ticket price points, though flexible, is generally consistent from year to year (see **background** for additional detail). However, OLC’s online lottery games do not have pre-determined life cycles, which necessitates further active management from the Agency. In managing its online lottery games, OLC does not have

a formal policy, regular process, or guiding principles for determining when to add a new lottery game or to eliminate or refresh an existing lottery game. Decisions to add, eliminate, or refresh games are based on the collective experience of OLC's senior staff. This collective experience takes into account historical performance, as well as game trends that other state lotteries are experiencing. However, in practicality, OLC has a practice of continuing to offer games as long as they are profitable, even if only marginally so.

### **Cash Explosion Performance**

Cash Explosion is a unique instant ticket game in that one of the prizes is entry into a drawing for a chance to be selected to appear on the Cash Explosion game show. The game show component of Cash Explosion represents an administrative cost that does not apply to other instant ticket games. OLC contracts for Cash Explosion game show production, as well as other related services which represent lesser costs relative to production, but are still additional to the typical administrative cost of an instant ticket game.<sup>18</sup>

Due to the unique structure and associated costs of the Cash Explosion game show, OLC has acknowledged the importance of the relationship between ticket sales, total cost of the game (both instant and game show), and overall profitability of Cash Explosion. For example, OLC has occasionally – most recently for 2008 – prepared a Cash Explosion Profit/Loss Analysis. Though the 2008 Cash Explosion Profit/Loss Analysis indicates that Cash Explosion is generally profitable, OLC did not update the analysis for SFY 2009, nor has the Agency prepared an analysis for SFY 2010.

OLC has expressed difficulty in quantifying the true costs associated with Cash Explosion because the perception of expenditures attributed to the game can vary depending on the leadership within the Office of Finance. Furthermore, the Director of Operations feels that there is a non-monetary value to Cash Explosion that is not taken into account with the profit/loss analysis. Cash Explosion is, in her description, also a weekly half-hour commercial for OLC and is the only instance in which the public actually gets to see players win a lottery game.

*The Basics of Performance Measurement, 2nd Edition* (Harbour, 2009) notes that the process of “management by opinion” is increasingly transitioning to “management by

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<sup>18</sup> All instant ticket games incur costs for prizes, retailer bonuses and commissions, advertising and marketing (although this varies by game), instant ticket printing costs, and overall gaming system costs (including instant ticket vending machines). Cash Explosion incurs the additional costs for game show production, dedicated game staff, travel expenses, merchandising, and fees paid to the Auditor of State's Office for monitoring of the game. There are likely other ancillary costs associated with a typical instant ticket game or specific to Cash Explosion which were omitted; however, these costs are likely insignificant for illustrative purposes.

hard fact and concrete evidence.” The key to successful management by fact is the development of a supporting performance measurement system. A performance measurement system involves management “defining, developing, collecting, synthesizing, delivering, and displaying performance-related information in an intuitive and understandable fashion.” The goal of the performance measurement system is to translate data into knowledge and meaning, and in short, performance-based facts should drive decision-making. Regardless of the specific performance measures used, a robust system will provide descriptive value, diagnostic value, and predictive value measures; specifically:

- Descriptive Value – What is happening or what did happen?
- Diagnostic Value – Why is this happening or why did it happen?
- Predictive Value – What is likely to happen, but has not yet?

Although it may be sufficient for OLC to monitor the performance of the majority of games through tracking sales data and comparing that data to past sales and forecasted sales, it appears insufficient to do so when, overall, OLC’s online and instant ticket games are performing at levels lower than the peers (see **Table 5-1**). In addition, OLC has games that account for only a small percentage of overall sales (e.g., Ten-OH! and Classic Lotto). OLC incurs costs to market these lower-selling games, and formal goals and performance measures would help OLC determine whether these resources could potentially provide a greater return on investment by allocating them toward support of more successful game offerings.

Ten-OH! Is an example of a game that has experienced decreased performance but continues to be offered by OLC. It is similar to Keno in that the player selects 10 numbers out of a possible 80. However, Ten-OH! drawings are held twice a day, while Keno drawings are held 307 times per day (every four minutes from 6:04 am to 2:28 am). Ten-OH! was first offered in SFY 2008, and total sales were approximately \$18.0 million in SFY 2008 but decreased to approximately \$11.0 million in SFY 2009, a decline of approximately \$7.0 million or 38.9 percent. Though performance metrics would indicate that Ten-OH! might be appropriate for a refresh or replacement, or even be in competition with Keno, OLC continues to offer Ten-OH! because there is a core group of players and the game remains profitable, generating approximately \$200,000 in sales per week.

Finally, Cash Explosion, due to its unique game structure, has to be regularly evaluated for profitability. The Cash Explosion profitability analysis should take into account the full cost of the game, which should be formally agreed upon by the Office of Finance and Office of Operations, as well as the intangible value of the game, though the intangible value of the game does not supersede the need for Cash Explosion to remain profitable. Based on the data available, prior profitability analyses, and observations of OLC staff, it

does appear that at the time of this audit, Cash Explosion was generating a positive return for OLC. However, without a full, ongoing analysis of the profitability of Cash Explosion, OLC is exposed to a future risk of supporting an unprofitable game show to the detriment of OLC's overall purpose, which is to maximize transfers to the LPEF.

As described above, OLC may be using its resources to maintain games that are not performing at levels that maximize the Agency's profitability and transfers to LPEF. However, without appropriate performance-based analysis, it is unclear what the overall impact these games have on OLC sales and profitability. The Agency's underperformance relative to the peers (see **Table 5-1**), its continuation of marginal (and potentially profit stifling) games, including a lack of up-to-date profitability information for sensitive games like Cash Explosion, illustrate the need for the Agency to adopt a more strenuous and ongoing performance measurement system for use in management of its lottery game offerings.

### *Retailer Strategies and Performance*

**R5.2 OLC should develop indicators to measure the performance of its retailer network and set specific performance targets for its licensed retailers. Once a retailer performance system is in place, OLC should consistently monitor the indicators and use the data to improve retailer performance. OLC should also build a retailer support strategy to help its retailers improve their performance and meet the stated goals or targets of OLC's strategic plan and retailer management strategy (see R4.1 and R5.3). OLC should also consider establishing policies and procedures for addressing low-performing retailers and incentives to improve retailer performance.**

OLC has a variety of strategies its LSRs employ to improve retailer performance. To increase sales, LSRs encourage retailers to put up more signs and displays, but OLC competes for limited space at most retailers. LSRs also encourage retailers to offer a larger variety of instant tickets by showing them which instant games are selling well and making suggestions for which instant tickets to order so that retailers have a good mix of game products. Finally, LSRs encourage retailers to promote the winning tickets they have sold and to be more aggressive and creative with in-store promotions. While LSRs work with retailers to improve sales, according to members of the Ohio Association of Convenience Stores, lottery tickets are not high profit margin items for retailers, so the incentives to increase lottery ticket sales are limited.

In general, OLC sees every retailer as an opportunity to sell more tickets and does not formally measure retailer performance. Under the new gaming system contract, Intralot is paid a percent of sales, so equipping additional retailers does not cost the Lottery additional money. Although OLC collects a substantial amount of data that could be used

to measure the performance of retailers, it is not using it to its full extent. Regional managers and staff have access to sales figures for every retailer and this data is available by day, week, month, or even year. However, the data is not consistently and systematically used to measure performance or to establish targets or improvement goals.

In both the Florida and Kentucky lotteries, sales goals/targets are set for each retailer and each region. The Kentucky Lottery uses available data on retailers and sales revenue to create a sales incentive plan and retailer incentive program. Through the retailer incentive program, retailers can earn an extra 0.25 to 1.50 percent of scratch-off sales in bonuses. The Kentucky Lottery also requires retailers to maintain minimum levels of sales activity. Through the sales incentive plan, Kentucky LSRs can earn up to 30 percent of the midpoint of their salary ranges.

The Florida Lottery uses a process it calls “business reviews,” which it conducts semiannually. The business reviews are in-depth examinations of measurements such as price points, cashing bonuses, commissions, sales, etc., by retailer. The Florida Lottery also compiles weekly reports where the results of each product are compared by brand with previous weeks, months, years, etc., by territory and retailer and uses the reports to monitor performance. If a trend appears in the weekly reports, the associated regional LSR is encouraged to try to address it right away, rather than wait for the semiannual business review of each retailer.

Because there is no additional cost to OLC to equip a retailer, there is a diminished interest in aggressively managing its retailer network to achieve optimal performance. Not having a consistent and systematic way of measuring retailer performance makes it difficult for OLC to create goals and incentives for increasing retailer sales, or to motivate LSRs to reach higher levels of performance (see **R5.5**). If OLC increases the performance management of its retailer network, it may be able to increase overall sales and generate a greater level of LPEF monies. In paying limited attention to its retailer network performance, outside of more frequent visits to high-performing retailers, OLC misses an opportunity to increase the performance of its retailer chain in total and generate higher levels of sales.

In its response to a draft of this report, OLC noted that it sends retailers benchmark reports, does business reviews with chain accounts, and assists low performing retailers with merchandizing enhancements. Though OLC provided documentation of some of these activities, its emphasis is on data provided to the LSR or region, not to the retailer directly. Furthermore, as late as July 20, 2010, the sales staff was beginning to roll out semi-annual benchmark reports to LSRs. The Deputy Director of Sales Management, in a meeting held on that date, recommended the benchmark reports be distributed to all LSRs. Supporting documentation also highlighted inconsistent LSR management of retailers but included more recent efforts (August 2009) to rectify performance issues

with selected retailers. This data supports **R5.2** and suggests that implementation of the recommendation could benefit OLC.

**R5.3 OLC should develop a formal strategy for recruiting, retaining, and improving traditional retailers that includes specific strategies and goals, similar to recent efforts to recruit Keno retailers. The goals and approaches in its retailer strategy should be consistent with and designed to support the performance goals of retailers and regional sales offices (see R5.2). If the retailer strategy includes a focus on expanding its retailer base, OLC should consider targeting businesses other than gas stations and convenience stores.**

Retailers are the vehicles through which the Ohio Lottery sells its products, and as such, the retailer network is critical to OLC's success. LSRs in the regional sales offices typically recruit traditional retailers when a new store is opened or when there is a change in ownership at an existing retailer. OLC has a mature retailer base in convenience stores and gas stations, so most owners of these types of businesses are aware of the pros and cons of being a lottery retailer and will usually contact OLC when they wish to obtain a license. Regional sales offices use traditional presentation-based recruiting methods which highlight the advantages of becoming part of the lottery retailer network. However, OLC does not have a formal strategy for recruiting traditional retailers or to guide its approach to recruiting, licensing, and maximizing the performance of its traditional lottery retailers.

**Table 5-5** shows the average number of retailers, total revenue, and average revenue per retailer for SFY 1999 through SFY 2009.

**Table 5-5: Historical Retailers and Revenue Comparison**

State Fiscal Year	Average Number of Retailers	Total Revenue (in millions)	Average Revenue per Retailer
1999	9,343	\$2,145	\$229,560
2000	9,340	\$2,150	\$230,244
2001	9,219	\$1,920	\$208,257
2002	9,074	\$1,983	\$218,560
2003	8,956	\$2,078	\$232,056
2004	8,798	\$2,155	\$244,908
2005	8,782	\$2,159	\$245,853
2006	8,626	\$2,221	\$257,463
2007	8,356	\$2,259	\$270,384
2008	8,180	\$2,325	\$284,248
2009	7,985	\$2,318	\$290,288
2009 (Including Keno)	9,005	\$2,418	\$268,492

Source: Ohio Lottery Commission

As illustrated in **Table 5-5**, OLC has steadily lost traditional retailers since SFY 2000, but sales revenue has increased every year from SFY 2002 through SFY 2008. Because there are a number of factors that contribute to lottery sales, it is difficult to determine the impact of the declining retailer base simply from these numbers. The sustained revenue growth can be partially attributed to the introduction of new games like Mega Millions and higher price point instant ticket games. The data in **Table 5-5** seems to indicate that, under the right conditions, it is possible to increase sales despite a decline in the number of retailers.

Using this assumption, OLC could pursue a policy of more selective retailer recruitment, by focusing the efforts of its sales staff only on those retailers with the highest potential for ticket sales. One OLC regional sales manager suggested this approach by stating that the emphasis of the sales staff should be retailer relations and encouraging each retailer to promote the lottery and actively participate in OLC's initiatives. Under this approach, OLC should consider revising its licensing requirements (including license renewal requirements) to help ensure that they are aligned with the strategy of recruiting and retaining high-performing retailers. Finally, if OLC chooses this route, the performance measures recommended in **R5.2** should be consistent with this goal and should be used as tools to help identify high-performing retailers and underperforming retailers who need additional support from OLC, as well as those retailers who have not met OLC's minimum requirements.

That said, some state lotteries have established formal goals to recruit more retailers in an effort to maximize lottery sales. A January 2010 study of the Florida Lottery conducted

by Florida's Office of Program Policy Analysis and Government Accountability (OPPAGA) noted that in general, customers are more likely to purchase lottery tickets when the tickets are readily available. OPPAGA found that in areas of Florida with higher concentrations of retailers, there tended to be higher per capita sales. In fact, the Florida Lottery has formal Business Development Internal Operating Procedures which include a stated goal of increasing the lottery's retailer base.

Since OLC does not have a formal retailer strategy, it is unclear whether the Agency's goal is to increase its traditional retailer base or to reduce the number of retailers in an attempt to maximize sales from each retailer. Furthermore, discussions with OLC senior staff and sales staff produce varying answers to this question, with some expressing no concern over the declining trend in retailer numbers and others stating that more retailers will always generate more sales. Absent a consistent, formal strategy, OLC's 93 sales districts will continue to pursue varying approaches, maybe even conflicting strategies, to recruiting and supporting Ohio's lottery retailers.

**Table 5-5** also illustrates that the introduction of Keno has increased the total number of lottery retailers and total revenue in SFY 2009. While this does not address the downward trend in the number of traditional retailers, Keno retailers do sell traditional lottery products. Unlike its approach to traditional retailers, OLC has developed a specific goal of increasing its number of Keno retailer to 2,000 in an effort to bring Keno sales closer to original projections (see **planning, budgeting, and financial management** for a discussion on Keno underperformance). OLC has aligned its recruitment strategy of Keno retailers with this goal and, based on an examination of its recruitment kits and strategies, it put substantial time and resources into its Keno retailer campaign.

If OLC determines that its priority is to increase its number of traditional lottery retailers to extend the number of outlets where its product may be purchased, it may find it advantageous to conduct outreach to non-traditional retailer outlets. Other states have expanded their retailer bases by recruiting new and different types of retailers. For example, Kentucky allows non-profits and charitable organizations to sell its lottery tickets. The Florida Lottery's Business Development Unit is specifically tasked with identifying retailer prospects and recruiting retailers. Florida's recruiting procedures identify specific sources for new retailers, particularly "non-traditional" retailers such as video stores, laundromats, barbershops, coffee shops, and theaters, among others; and enumerates goals and strategies for identifying retailer prospects.

The data and the experiences of other states seem to indicate that different strategies to retailer development and recruitment are successful under the right circumstances. OLC could choose to develop a more limited retailer base through selective recruiting, more stringent licensing requirements, and performance requirements for retailers with the goal of maximizing the sales from each individual retailer. Alternatively, OLC could actively



recruit as many retailers as possible under the premise that each new retailer brings new sales. This has been OLC's recent approach to recruiting Keno retailers, and the specific initiatives related to Keno have been aligned with this strategy.

Regardless of the approach it determines is most appropriate for its environment, a formal, defined approach will ensure that OLC communicates a consistent method and rationale for recruiting and retaining retailers. As it selects its preferred approach, OLC should define the specific actions of its sales staff and the associated performance measures to align with its preferred approach (see **R5.2** and **R5.5**).

**R5.4 If OLC remains subject to the State's rule-making requirements (see R2.3), it should adopt Agency rules under Chapter 119 of the Revised Code, and corresponding internal policies and procedures, defining the bonding requirements and licensing and renewal fees for retailers. OLC should take advantage of the Executive Director's latitude in defining these requirements. It should also consider the input of retailers and other interested parties when determining fees and bond requirements. OLC should use its statutory authority and the examples provided in other states to consider more flexible bonding requirements for retailers while ensuring OLC exposure to losses is minimized.**

OLC requires retailers to be bonded for a minimum of \$15,000 or 1/26th of their annual sales, whichever is greater. The retailer bond is required to ensure OLC is protected against failure to make prompt and accurate payments for lottery ticket sales, missing or stolen lottery tickets, damage to equipment or materials issued to the lottery sales agent, or to pay for expenses the Commission incurs in connection with the lottery sales agent's license.

During interviews with regional managers, the ability and cost to become bonded was consistently mentioned as a barrier to becoming a lottery retailer. In addition, some retailers noted that they stopped selling lottery tickets because the cost of bonding was too expensive or they were unable to obtain a bond.<sup>19</sup> **Table 5-6** presents the data OLC has collected regarding reasons for traditional retailers leaving the lottery.

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<sup>19</sup> Per the OLC's interactive agent database (IAD), The Finance Director noted that the bonding topic has been an issue for years, and the Lottery has looked at it many times. The Finance Director noted that one reason why retailers may have difficulty bonding is because retailers start the application process, but do not follow through on the bonding process. Additionally, many retailers may have bad credit, which results in high bond rates. Furthermore, some businesses pay most expenses through cash, and do not establish sufficient credit history to get a good bond rate.

**Table 5-6: Reasons for Retailer Leaving the Lottery Retailer Network**

Reason for Leaving	Calendar Year				
	2006	2007	2008	2009	2010 <sup>1</sup>
Accounting Difficulties	0.00%	0.40%	0.00%	0.41%	0.00%
Bond Too Expensive	0.75%	1.41%	0.17%	1.83%	2.08%
Death of Owner	0.37%	0.60%	0.17%	0.61%	0.00%
Does Not Want Lottery	34.27%	28.23%	39.51%	31.71%	9.38%
Legal Owner Cannot Be Located	0.19%	0.20%	0.35%	0.61%	0.00%
Lottery Not Agent Friendly	0.00%	0.00%	0.35%	0.20%	0.00%
Lottery Too Restrictive	0.00%	0.20%	0.17%	0.00%	0.00%
Low Sales	2.81%	2.62%	2.62%	3.86%	2.08%
Not Profitable	3.56%	4.03%	3.15%	4.27%	2.08%
Other	11.24%	7.06%	7.69%	8.74%	11.46%
Sold Business - New Owner Did Not Apply	5.43%	3.43%	5.42%	5.28%	14.58%
Store Closing	40.07%	49.40%	39.51%	39.02%	53.13%
Theft Security Issues	0.19%	0.20%	0.35%	0.41%	0.00%
Unable to Obtain Bond	1.12%	2.22%	0.52%	3.05%	5.21%
<b>Number of Retailers Exiting Network</b>	<b>534</b>	<b>496</b>	<b>572</b>	<b>492</b>	<b>96</b>

Source: OLC, Interactive Agent Database

<sup>1</sup>As of January 1, 2010 through March 16, 2010.

As shown in **Table 5-6**, the most frequent reason given for cancelling a lottery license is the store closing. The data in **Table 5-6** also indicates that in 2009, of the retailers who left the Lottery, about 5 percent were from businesses that were sold and the new owner elected not to sell lottery tickets.

The statute gives the Executive Director significant discretion in setting the bond required of retailers and the means of financing it. ORC § 3770.05 (G)(1)(b) requires that:

“Prior to approval of the application, [each applicant shall] obtain a surety bond in an amount the director determines by rule adopted under Chapter 119 of the Revised Code or, alternatively, with the director’s approval, deposit the same amount into a dedicated account for the benefit of the state lottery. The director also may approve the obtaining of a surety bond to cover part of the amount required, together with a dedicated account deposit to cover the remainder of the amount required.”

The same ORC section also requires the Executive Director to establish fees by rule for initial retailer licenses and for license renewals, and to have those fee amounts approved

by the State Controlling Board.<sup>20</sup> Although OLC has established amounts for bonding and initial license fees, it has chosen not to charge a fee for license renewals. However, none of these amounts have been adopted in rule, nor have the licensing and renewal fees been approved by the Controlling Board.

Several of the peer states, including Indiana, Kentucky, Michigan, Florida, and Illinois do not require retailers to be bonded. The Indiana Lottery charges retailers a licensing fee and a small portion of the fee is placed in escrow to offset bad debt that may be incurred. Additionally, the Michigan Lottery uses a cash bond, which is required to be posted by new retailers with negative credit evaluations, or by existing retailers when they have been delinquent. Furthermore, the New York Lottery is self-insured through a weekly retailer charge. Lastly, the Florida Lottery uses strict financial criteria to determine when a retailer needs to have a bond or a certificate of deposit, and the amount of the bonding requirement varies based on the retailer's sales.

**R2.3** of this performance audit recommends that OLC be provided with some level of exemption from the State's rule-making requirements. However, until those exemptions are granted, by not adopting administrative rules or going through the State Controlling Board process, OLC may not be in compliance with ORC § 3770.05 (G).<sup>21</sup> Further, OLC has not used the information it has collected to determine to what extent its current bonding requirements are a barrier to retailers becoming lottery retail agents. By exercising its rule-making authority and using the authority to design rules, policies, and procedures surrounding bonding and license fees for retailers, and studying retailer feedback on the hurdles posed by bonding requirements, OLC will be able to better design its bond and fee requirements to support its retailer recruiting (see also **R5.3**).

**R5.5** OLC should develop a set of performance indicators to formally measure the efficiency and effectiveness of its LSR positions and regional sales offices. The performance indicators should be linked to OLC's mission, goals, and objectives. Once performance indicators are identified, OLC should establish specific targets for its LSR positions and regional sales offices, then regularly monitor their performance. Additionally, the performance indicators should be incorporated into the annual evaluations of LSRs.

**Furthermore, OLC should develop formal swipe card and Order Pad System procedures to ensure all LSRs use the technology correctly and consistently so that**

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<sup>20</sup> A legislative body that oversees State agency spending, contracting, and other fiscal activity.

<sup>21</sup> The OLC's Chief Legal Counsel stated that the OLC's interpretation of ORC § 3770.05 is that it does not require the amount of the bond and license fees to be stated in administrative rule, only that the rules acknowledge the Director's authority to establish the fee amounts. Using this legal interpretation, the OLC would be in compliance with the rule-making requirement, although there is still no evidence that it has sought Controlling Board approval for its licensing and renewal fees.

**the Agency can better track relevant data for performance measurement. Lastly, OLC should review alternative compensation systems to determine if LSR's step schedule is the most appropriate compensation structure to challenge, motivate and reward LSR performance.**

LSR performance is generally linked to sales and the number of retailers recruited, though some regional managers periodically review other measures such as the number of retailer visits per LSR or the number of retailers per LSR. In some instances, sales regions adopted regional goals consistent with the general goals and objectives of OLC; for example, striving to recruit 250 more Keno retailers or at least 10 more retailers per LSR. Other regions use goals, set periodically, to spur friendly competitions, such as the LSR who gets their retailers to "cash" all their instant ticket books.

However, the use of goals and performance measures are inconsistent among the nine regions, as one region noted that its LSRs do not have specific goals, other than to visit retailers and work with them to improve sales. Also, goals change from year to year, which is prudent and appropriate, but the changes in focus do not appear to be consistently communicated to the regional offices and LSRs. For example, at the time of the audit, improving Keno retailer recruitment was the primary goal. Previously, the focus was on training retailers on the new Intralot equipment.

Furthermore, OLC managers at the central and regional levels do not provide specific targets for LSRs or sales regions that are linked to the overall goals of the Agency. In general, regions may identify region-specific means to motivate LSRs, but OLC has nothing formal to measure performance and challenge LSRs to reach specific performance targets.

LSRs receive formal annual evaluations that include six categories: sales, quality and efficiency, teamwork and cooperation, customer service, communication,; and flexibility. A score is provided for each category. However, no specific targets or goals are used in the evaluation process and, because LSRs are part of the collective bargaining unit, the evaluation is not used to reward performance. All LSRs are paid according to the State salary schedule for their classification and receive pay increases based on satisfactory evaluation ratings.<sup>22</sup>

While there are informal expectations for LSRs and regional sales offices, OLC has not established a formal performance measurement system. From a regional sales office perspective, priorities are usually made clear but the implementation and daily priorities

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<sup>22</sup> Per the OCSEA contract, there is currently a freeze on step movements until June 21, 2011. After June 21, 2011, subsequent step increases shall occur after one year and successful completion of probation, provided the employee receives an overall rating of "satisfactory."

are not consistent from region to region. OLC has data that could be used to measure the performance of LSRs and regional sales offices in a formal, consistent manner.

- The gaming system provides reports through its Back Office System (BOS) that show daily, weekly, monthly, and yearly sales by retailer. This data could be used to develop and track performance indicators for the regional sales offices and LSRs.
- LSRs have identification cards that they swipe when at the retailer but auditors observed inconsistent application of this process. One regional manager thought the cards were swiped when the LSR arrived at the retailer and again when the LSR departed. However, in this region, the LSR observed swiped the card only once during each visit. If the cards were used consistently, this system could provide performance information such as the average amount of time LSRs spend with the retailer. Though OLC's swipe card policy was formalized and updated July 1, 2009, the process used by LSRs remains inconsistent.
- Finally, LSRs use Order Pad to track retailer visits and take notes about the visits. Data from Order Pad could be used to identify workload by LSR and examine travel patterns and routing. Also, by setting clear expectations and requirements regarding how to use the Order Pad System and what to enter, managers could use the system to better understand what issues retailers are having and what activities LSRs perform to support retailers.

*Recommended Budget Practices – A Framework for Improved State and Local Government Budgeting* (Government Finance Officers Association (GFOA), 1999), indicates that performance measures are used for assessing how efficiently and effectively functions, programs, and activities are provided and for determining whether program goals are being met. Performance measures should be linked to specific program goals and objectives. The measures should be valid, reliable, and verifiable. Whenever feasible, they should be expressed in quantifiable terms. Performance measures should be reported in periodic reviews of functions and programs and should be integral to resource allocation decisions. Additionally, according to *Best Practices in Performance Measurement – Developing Performance Measures* (National State Auditors Association (NSAA), 2004), before beginning the process of developing performance measures, public program managers must first know what they are measuring. That involves developing a mission statement, establishing goals, setting objectives, and developing an action plan. According to NSAA, a good process for developing performance measures would include:

- Defining the desired performance measures based on the agency's mission, goals, and objectives;

- Assessing each performance measure to ensure it is meaningful, focused on stakeholder needs and demands, based upon available data, and simple enough to be understood;
- Selecting key performance measures to be reported to members of the oversight body, the public, and other stakeholders;
- Clearly defining each performance measure so that all users can easily understand it; and
- Establishing performance targets.

As a component of its efforts to provide guidance and structure to the LSRs' daily work, OLC should implement leading practices for creating a performance management system for its LSRs. Littler Mendelson (a national employment law firm) recommends using a five-step approach to successful employee performance management systems:

- Set expectations;
- Provide and ask for feedback;
- Tie expectations to the "big picture;"
- Be clear about consequences; and
- Tie performance measurement to the performance evaluation system.

As SHRM notes, managers sometimes fall into the trap of assuming employees know what to do. Clearly communicating expectations to employees about what and how to perform their work provides a reliable target upon which to base goal achievement. In setting expectations for its LSRs, the Agency should employ SMART goals—Specific, Measurable, Action-oriented and aligned, Realistic and Relevant, and Time-bound. Regional sales office managers should be encouraged to adopt the SHRM-recommended approach in helping the LSRs understand their personal connections to OLC's success. Finally, OLC should ensure that failure to meet expectations is clearly communicated. It should work with the bargaining unit and the Department of Administrative Services (DAS) to appropriately revise performance evaluation materials to align with the above-mentioned performance management system. As SHRM notes, the number one high-risk management practice for any organization is poor performance documentation. Conversely, organizations that use employee management to heighten engagement often see up to 50-percent increases in customer retention and 44 percent higher probability of achieving above-average profitability.

Without formal efficiency and effectiveness measurers and clear targets or goals for its LSRs and regional sales offices, it is difficult to objectively measure and reward performance. By creating and monitoring performance measures that are linked to the Agency's overall goals and objectives, resources and employee behaviors can be better guided toward achieving those goals and objectives. Furthermore, consistent processes

for measuring and collecting performance data will lead to more informed decision-making.

- R5.6 OLC should reduce its number of LSR positions and regional sales offices to bring the efficiency indicators shown in Table 5-7 more in line with the averages of the peer state lotteries. Specifically, OLC should eliminate 10 LSR1 positions and consider closing two regional offices, which would bring the number of retailers per LSR and retailers per sales office more in line with similar state lotteries. In implementing these reductions, OLC should consider the characteristics, needs, and performance targets (see R5.5) of each regional office.**

Because OLC has not set performance targets for its LSRs and regional sales offices, it cannot determine the efficiency or effectiveness of sales operations. In order to ascertain if OLC's performance was comparable to other states, auditors developed a series of performance indicators that are basic benchmarks. **Table 5-7** illustrates efficiency indicators that include square mile per LSR, retailers per LSR, and retailers per regional sales office. These indicators were used to measure the *efficiency* of OLC regional offices and staff. Similarly, **Table 5-7** illustrates the *effectiveness* of LSRs and the sales force by measuring sales per LSR, sales per retailer, and sales per regional office. These indicators gauge the relative performance of sales staff and were used to compare Ohio with peer states.

**Table 5-7: Sales Performance Indicator Comparison for SFY 2008**

States	Efficiency Indicators			Effectiveness Indicators		
	Square Miles per LSR	Retailers per LSR	Retailers per Sales Office	Sales per LSR	Sales per Retailer	Sales per Office
<b>Ohio (SFY 2008)</b>	<b>414</b>	<b>83</b>	<b>916</b>	<b>\$23.49</b>	<b>\$282,006.06</b>	<b>\$258.35</b>
<b>Ohio (SFY 2011) Projected (w/Keno) <sup>2</sup></b>	440	103	1,065	\$26.41	\$256,282.21	\$272.94
<b>Peer Average <sup>1</sup> (SFY 2008)</b>	<b>658</b>	<b>116</b>	<b>1,449</b>	<b>\$37.95</b>	<b>\$323,094.06</b>	<b>\$475.67</b>
<b>Florida</b>	481	113	1,410	\$37.27	\$328,878.21	\$463.86
<b>Georgia</b>	783	105	860	\$43.81	\$418,761.30	\$360.23
<b>Illinois</b>	842	115	1,516	\$31.17	\$271,336.06	\$411.45
<b>Indiana</b>	618	68	1,323	\$14.19	\$207,319.22	\$274.28
<b>Kentucky</b>	1,242	90	718	\$24.32	\$271,153.31	\$194.55
<b>Michigan</b>	888	170	1,815	\$36.41	\$213,936.83	\$388.37
<b>New Jersey</b>	185	153	1,526	\$63.48	\$415,830.33	\$634.77
<b>New York</b>	411	138	2,649	\$58.03	\$419,828.88	\$1,112.20
<b>Pennsylvania</b>	477	91	1,223	\$32.86	\$360,802.38	\$441.31

Source: *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009)

Note: For Ohio, the number of LSRs includes only LSR1 positions and assumes one LSR for each of the 93 sales districts. At any time, some of the LSR1 positions could be vacant and covered by an LSR2.

<sup>1</sup> Texas was not included in the peer average, due to its contracting out LSR services.

<sup>2</sup> Indicators are based on 9,585 retailers which includes 2,000 additional Keno retailers and 400 fewer traditional retailers because from SFY 2006 to SFY 2009, Ohio lost an average of 200 traditional retailers per year.

As shown in the **Table 5-7**, OLC's performance was significantly lower than the peers in all efficiency and effectiveness indicators. Ohio performs below the peers in terms of square miles per LSR, retailers per LSR, and retailers per regional sales office. Similarly, in terms of the effectiveness indicators, Ohio's sales per LSR, sales per retailer, and sales per regional office were all below the averages of the peer states. In SFY 2008, Ohio had 1,393 residents per retailer, which was in line with the peer average of 1,390. Therefore, it may be difficult for OLC to improve performance on some of the indicators in **Table 5-7** by increasing the number of retailers.

Because the peer comparisons are based on SFY 2008 data and OLC has since introduced Keno to its product mix, auditors updated the comparisons based on OLC's projected revenue, 2,000 additional Keno retailers, and 400 fewer traditional retailers<sup>23</sup> to see how Ohio might compare in SFY 2011. As **Table 5-7** shows, OLC is projected to improve in all the indicators except sales per retailer, but even with this improvement, its performance is still projected to be significantly below the peer averages. For example,

<sup>23</sup> From SFY 2006 to SFY 2009, Ohio lost an average of 200 traditional retailers per year, so the trend was projected forward for this comparison.



while the number of retailers per LSR in Ohio improves from 83 in SFY 2008 to 103 in SFY 2011, it is still 11.2 percent below the peer average of 116 retailers per LSR.<sup>24</sup> Based on a projected 9,585 retailers in SFY 2011, OLC would need to employ only 83 LSRs to achieve a ratio of 116 retailers per LSR. With one LSR in each of the 93 districts, OLC would need 10 fewer districts and consequently, 10 fewer LSR1 positions. Likewise, if Ohio had seven regional offices instead of nine, and 9,585 retailers, it would average 1,369 retailers per office, which is more in line with the peer average of 1,449 retailers per sales office. By closing two regional offices, OLC could potentially eliminate another 8 positions.

In its response to a draft of this audit report, OLC asserted that LSR positions differ from state to state and its staffing was appropriate. Auditors took into account the differences in each state and used a broad spectrum of states to ensure a more homogenous peer average. Though OLC LSRs are expected to visit certain retailers more frequently than some states, other states still require LSRs to deliver tickets and/or make more frequent retailer visits, creating a higher-than average workload. In each comparison conducted by the auditors, OLC's field staff was determined to be less efficient and effective than the peers. In evaluating implementation of this recommendation, OLC should balance its desire for enhanced customer service, including maintaining multiple regional offices for ticket validation and retailer support, with the need to improve the efficiency and effectiveness of its field staff.

Reducing a total of 18 positions from the regional offices would help bring OLC's Office of Sales Management staffing more in line with the peer average (see **R3.8 in organization, staffing and management**). Furthermore, if OLC chooses to focus its recruiting and retention efforts on high-volume retailers, the number of LSRs needed may decrease further (see also **R5.4**). Alternatively, if OLC focuses on recruiting non-traditional retailers, it may need to retain LSRs to initiate the campaign and then determine the appropriate configuration of offices and number of LSRs needed following the recruitment campaign. Regardless of the approach OLC ultimately determines in relation to retailer recruiting, it should streamline its LSR staffing and regional sales offices to ensure efficiency and effective deployment of its sales force.

*Financial Implication:* Eliminating 10 LSR1 positions would save \$500,000 in salaries and benefits annually. By closing two regional offices, OLC could eliminate 8 additional positions: two regional manager positions, two assistant manager positions, two executive secretaries, and two LSR2 positions; which would save an additional \$633,000 annually in salaries and benefits. Additional savings, which were not quantified, would result from operating fewer regional offices through reduced rent and utility costs.

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<sup>24</sup> Auditors determined that the number of retailers per LSR was the most applicable and conservative performance measure to use when recommending LSR reductions.

## Marketing

**R5.7. OLC should review its marketing allocation as part of its biennial budget planning, and should base the amount of funding it requests for marketing on a formal determination of its needs. If OLC establishes a corporate-style organizational model (see R2.1), it should develop an internal process for determining the appropriate level of funding for marketing.**

The 2000 report of the Lottery Profit Review Commission (LPRC) cited reduced advertising spending as a factor in OLC's sales declining for three consecutive years, from SFYs 1997-1999. According to the LPRC, the Lottery pursued a policy in the FY 1998-1999 biennium of reducing advertising spending. The LPRC called the decision to reduce advertising spending "counterproductive," citing the competitive environment in which OLC operates and the ability of advertising to influence consumer spending decisions.

In the following biennium (SFYs 2000 and 2001), the amount budgeted for OLC's advertising was \$42.9 million, an amount equal to 1.05 percent of the total ticket sales (\$4.1 billion) over the biennium. Although this was a significant increase over the previous biennium, the LPRC noted that as a percentage of sales, the amount budgeted by Ohio for advertising was below the national average of 1.3 percent of sales. Finally, the LPRC report cited testimony from national experts in the lottery industry which suggested that Ohio should invest further in advertising in order to be more competitive.

**Table 5-8** compares Ohio's spending on advertising in the 2000-2001 biennium with the 2008-2009 biennium.

**Table 5-8: Historical Advertising Spending Comparison**

	SFY 2000 & 2001	SFY 2008 & 2009	Percent Change
<b>Ticket Sales<sup>1</sup></b>	\$4,070.3	\$4,742.8	16.52%
<b>Advertising Spending<sup>1</sup></b>	\$42.9	\$41.9	(2.40%)
<b>Percent of Sales</b>	1.05%	0.88%	(0.17%)

**Sources:** Lottery Profit Review Commission report, Ohio Lottery Commission annual reports, and *La Fleur's 2009 World Lottery Almanac* (TLF Publications, 2009)

<sup>1</sup> In millions

As shown in **Table 5-8**, OLC's advertising spending in the most recently completed biennium was slightly less than the amount spent eight years earlier. As a percentage of sales, advertising spending fell from 1.05 percent to 0.88 percent. Moreover, in 2000, OLC's marketing budget supported only five online games, in addition to its instant ticket

games. By 2009, the Lottery's game mix consisted of its instant ticket games as well as 10 online games.

**Table 5-9** compares Ohio's advertising spending with the ten peer states. The states are ordered based on sales per resident to give a sense of each lottery's performance.

**Table 5-9: Peer Advertising Comparison (SFY 2008)**

State	Total Sales <sup>1</sup>	Sales per Resident	Total Ad Budget <sup>1</sup>	Advertising % of Sales	Advertising Per Resident
New York <sup>2</sup>	\$6,673.18	\$342.39	\$88.10	1.32%	\$4.52
Georgia	\$3,272.05	\$337.67	\$20.30	0.62%	\$2.09
New Jersey	\$2,539.06	\$292.52	\$9.73	0.38%	\$1.12
Pennsylvania	\$3,089.19	\$248.13	\$32.01	1.04%	\$2.57
Michigan	\$2,330.20	\$233.02	\$18.63	0.80%	\$1.86
Florida	\$4,174.78	\$227.76	\$29.81	0.71%	\$1.63
<b>Ohio</b>	<b>\$2,325.14</b>	<b>\$202.36</b>	<b>\$20.80</b>	<b>0.89%</b>	<b>\$1.81</b>
Kentucky	\$778.21	\$182.25	\$11.62	1.49%	\$2.72
Illinois	\$2,057.27	\$159.48	\$16.32	0.79%	\$1.27
Texas	\$3,671.48	\$150.90	\$30.87	0.84%	\$1.27
Indiana	\$822.85	\$128.97	\$10.00	1.22%	\$1.57
<b>Peer Averages</b>	<b>\$2,940.83</b>	<b>\$230.31</b>	<b>\$26.74</b>	<b>0.92%</b>	<b>\$2.06</b>

Source: La Fleur's 2009 World Lottery Almanac

<sup>1</sup> In millions

<sup>2</sup> New York's sales figures represent traditional lottery sales only and do not include revenue from video lottery terminals.

**Table 5-9** shows that Ohio's 2008 advertising spending as a percentage of sales was only slightly lower than the ten-peer average. Moreover, the comparison on a percentage of sales basis does not demonstrate a clear correlation with performance, as measured by sales per resident.

However, one of OLC's stated goals is to reach 70 percent of Ohioans through its marketing efforts. As such, **Table 5-9** also compares Ohio with the peer ad spending on a per-resident basis to get a sense of how much each state spends in an effort to promote their products to each citizen. When compared in this manner, Ohio's spending per resident is significantly lower than the peer average (by \$0.25), and even farther below the average of the six peers with higher per capita sales (by \$0.39). In contrast, Ohio spends just \$0.10 more per resident on advertising than the four peer states with lower per capita sales.

*The Lottery Wars* (Sweeney, 2009), an analysis of America's lottery industry from both a historical and contemporary perspective, states that American lotteries, none of which were fully privatized at the time of writing, are charged with maximizing sales, but not by

the same standards as private industry. Instead, state-run lotteries (even those with corporate-style governance models) are subject to more restrictive ethical and political limitations which impact their ability to maximize sales. Sweeney asserts that a privately-run lottery, in order to generate revenue for investors, would be more aggressive in a number of areas, including marketing.

**Table 5-10** provides an example to test Sweeney’s theory as it relates to advertising spending, by comparing OLC with a sample of 13 private sector organizations in three categories: privatized lotteries (from other countries),<sup>25</sup> entertainment industry companies,<sup>26</sup> and other private retailers.<sup>27</sup>

**Table 5-10: Private Sector Ad Spending<sup>1</sup>**

Industry Sector	Average Sales <sup>2</sup>	Average Ad Spending <sup>2</sup>	Ad Spending as % of Sales
<b>Privatized Lotteries (4)</b>	\$1,584.00 <sup>3</sup>	\$80.21 <sup>3</sup>	4.76%
<b>Other Entertainment Industry (6)</b>	\$3,511.02	\$84.35	2.83%
<b>Other Private Retailers (3)</b>	\$8,023.77	\$244.43	3.00%
<b>Ohio Lottery</b>	\$2,325.14	\$20.80	0.89%

**Source:** Annual financial reports for OLC and comparison organizations

<sup>1</sup> All data is from 2008, except that for two of the comparison organizations, 2008 information was not available. In these cases, the organizations’ most recently available information was used.

<sup>2</sup> In millions

<sup>3</sup> The four privatized lotteries compared are from different countries and use different currencies. Average sales and ad spending were converted to U.S. dollars based on the average exchange rate for the year reported.

**Table 5-10** shows that when compared with private sector companies, OLC—and state lotteries in general—spend significantly smaller portions of their sales revenue on advertising. The implications of this comparison are not easily determined. For example, Ohio’s smaller marketing budget compared with other state lotteries and private industry could indicate a level of efficiency and effectiveness. In fact, despite the warning and recommendation of the Lottery Profit Review Commission, spending on marketing has not increased since the 2000-2001 biennium, yet lottery sales have increased by more than 16 percent during that time.

On the other hand, a number of factors contribute to a lottery’s ticket sales. Since 2000, Ohio has doubled its number of online games, including the addition of Mega Millions and Keno (which in SFY 2009, combined to total 27.4 percent of the Lottery’s online ticket revenue). During that time, the Lottery has also introduced its highest instant ticket

<sup>25</sup> LotteryWest (Australia), the Ontario Lottery & Gaming Corporation (Canada), OPAP S.A. (Greek Lottery), and Milli Piyango (Turkish Lottery).

<sup>26</sup> Ameristar Casinos, Inc.; Cedar Fair Entertainment Company; Harrah's Entertainment, Inc.; MGM Mirage; MTR Gaming Group, Inc.; and Vail Resorts, Inc.

<sup>27</sup> Big Lots, Inc.; Starbucks Corporation; and The Limited, Inc.

price point (\$20). So the impact of any changes (or lack of changes) in ad spending cannot be measured based simply on overall sales.

The Director of Marketing did express her belief that the Agency is constrained by the limited resources devoted to marketing. The Marketing Office is unable to fully support all games, even when it could have an impact on sales. For example, a 2007 study conducted by OLC's media vendor was designed to help understand customer attitudes in order to identify opportunities to increase revenue. The study suggested that the Rolling Cash 5 game features two of the qualities most important to players, good odds and large jackpots. However, the game had small market penetration and OLC had not devoted significant resources to marketing the game. This analysis would suggest that there was room for growth in this game, and the study recommended that OLC consider marketing Rolling Cash 5 more heavily. But because so much of the limited marketing resources are devoted to new games that require support to generate initial awareness, the Agency has been unable to make any concerted effort to market Rolling Cash 5.

OLC has access to a tremendous amount of information, including research conducted by game and marketing vendors, tracking metrics compiled by its Marketing Office staff, and the experiences of other state lotteries, that it can use to determine whether opportunities exist to increase ticket sales by increasing its spending on marketing. However, according to Marketing staff, the marketing budget has traditionally been set within the Agency without a great deal of discussion, due largely to a supposition that the legislative and executive branches of State government would not support increasing the marketing budget, particularly given the cuts that have been imposed across all State agencies.

The development of OLC's biennial budget request and annual marketing plan (see **R5.8**) represent two opportunities to assess its marketing budget. If OLC adopts a more independent oversight structure (see **R2.1** in **agency governance**), it will have more flexibility to allocate its resources. However, even within the current structure, OLC should use the data it has to request—and make a compelling case to support the request—the appropriate level of spending authority to maximize the revenue it helps generate for the State.

- R5.8 OLC should evaluate its marketing plan and consistently incorporate the elements of a marketing plan recommended by the American Marketing Association (AMA). Specifically, the marketing plan should include an assessment of the Lottery's operating environment and any opportunities or threats that exist, specific marketing objectives and strategies for achieving them, and an analysis of the resources allocated for the marketing function and the returns on those investments. Incorporating these elements will help transform the marketing plan into a more dynamic tool for decision-making and for short- and long-term planning.**

The AMA defines a “marketing plan” as a document which contains the following elements:

- Analysis of the current marketing situation;
- Opportunities and threats analysis;
- Marketing objectives;
- Marketing strategy
- Action programs; and
- Projected income (and other financial) statements.

In other words, the marketing plan is intended to help an organization identify the specific goals of its marketing program, how it expects to attain those goals, the environment in which the organization is operating, how that environment affects its ability to market its product, and the financial investments and returns that are part of marketing the organization.

OLC’s SFY 2010 marketing plan is a presentation document, and includes elements of what the AMA recommends. One page of the presentation lists the four key areas of the Agency’s corporate growth strategy (Excellence, Reach, Growth, and Access) and aligns the marketing goals with that strategy. The next page states the goals of marketing generally, and of OLC’s marketing plan specifically, and describes how the Marketing Office can accomplish those goals. However, this examination of goals and strategies occurs at an extremely high level, and lacks specificity in terms of measurable objectives and detailed strategies to achieve those objectives. The remainder of the marketing plan provides more detailed descriptions of different games, sponsorships, and other initiatives (including three pages on the “Winners” campaign); but there are no specific objectives provided for these initiatives and no description of how they contribute to the overall goals of the marketing plan.

The marketing plan includes a relatively detailed (four pages of the 29-page presentation) exploration of the emerging social media opportunities. This discussion includes a number of facts and statistics about the increased popularity of social media in recent years, why social media should be a part of OLC’s media portfolio, and which social media outlets would be the first targets of the Agency. Yet there is no discussion about when OLC could actually deploy resources to social media (OLC began efforts to deliver content via mobile and electronic media in SFY 2009, but was forced to delay while the State government developed general guidelines on social media for all State agencies). There are no estimates related to budgets or returns on any investments into social media marketing.

A brief discussion of OLC’s marketing budget is also provided in the marketing plan. Specifically, the plan lists the total amount of its advertising contracts, notes that the

figure has remained unchanged for the past ten years (and that the “real value” of the marketing budget has declined due to inflation), and calculates the advertising budget as a percentage of lottery sales. The purpose of this analysis is evidently to highlight the limited resources devoted to marketing. However, there is no additional analysis of the level of resources allocated for marketing or the specific manner in which those resources will be deployed, including answers to the following questions:

- How does the marketing budget compare with spending in other state lotteries or comparable industries?
- Is the budget sufficient for OLC’s marketing needs?
- What games does the Marketing Office plan to support within the allocated resources, at what levels, and with what expected returns?
- What additional initiatives could the Marketing Office implement with additional resources, and what returns would it project?
- What has been the historical performance of OLC’s marketing efforts, relative to the resources allocated?

A study published by the *Journal of Marketing* (Verhoef & Leeflang, March 2009) concluded that a strong marketing department is beneficial to the performance of an organization. The marketing plan should be used as a tool to help the marketing department demonstrate greater accountability. As such, the marketing plan should include analysis of the financial implications of marketing actions. OLC’s marketing plan does not include such an analysis.

Previous versions of OLC’s annual marketing plans (auditors specifically reviewed those for SFY 2007 and SFY 2008) contained the elements suggested by the American Marketing Association. According to the Marketing Director, the decision to transition to a more summarized planning document was based on time pressures and the level of detail that the Marketing staff felt was most useful for OLC’s executive staff. However, expanding the role of the marketing plan to include the elements recommended by the AMA will help transform OLC’s marketing plan back into a true planning document that assists the Marketing Department and, by extension, Agency leadership in developing specific objectives and a course of action for achieving them. The marketing plan could also be used to identify State and national trends that could influence future marketing decisions. It could serve as the basis for performance measures that demonstrate the impact of specific marketing initiatives. Finally, it could be used as the foundation for a decision by OLC to allocate (or request authority from the General Assembly to allocate) additional resources to marketing (see **R5.7**).

**R5.9 OLC should modernize and update its web site, focusing specifically on the usability and utility of the site. A functional web site designed with customers and potential customers in mind will serve as a more effective tool for marketing the lottery.**

**Improving the utility and appeal of the web site would provide an opportunity for the Agency to expand its reach by offering access to information, promotional messages, and other lottery-related content.**

OLC maintains a web site which provides winning numbers, resources for retailers and prospective retailers, and general information about OLC and its games. Although the web site contains a significant amount of information, the structure of the site does not make the information easily accessible to users who may not already know where to look. For example, the web site includes access to OLC's annual financial report, Commission meeting minutes, and a breakdown of lottery profit distributions by county and by school district. However, all of this information requires the user to follow several links in order to access the data.

In addition, OLC staff have acknowledged that the design and appearance of the web site do not allow the Agency to convey an image of a customer-focused enterprise. OLC staff stated that OLC has considered providing more innovative and interactive content on its web site, but they are not sure if the site, which is maintained by the Department of Administrative Services, has the technical infrastructure to handle it. Moreover, State agencies are expected to use one of the State government templates for their web sites, but these templates are not designed for organizations that are trying to appeal to potential customers. Instead, they are designed with constituents seeking information about services in mind.

According to *10 Principles of Effective Web Design* (Smashing Magazine, 2008), to be able to build an effective web site for an organization, user behavior must first be understood. How users perceive a web site and how the web site is laid out will affect the way in which one navigates the site as well as the amount of time spent there.

When designing a web site, it should be considered that:

- Users appreciate quality and credibility;
- Users do not read, they scan;
- Web users are impatient and insist on instant gratification; and
- Users choose the first reasonable option to find information.

Therefore, the following principles should be incorporated into the development of a web site:

- **Make the home page (and subordinate pages) obvious and self-explanatory:** In order to promote usability, the navigation and site architecture should be intuitive with a clear structure, moderate visual clues, and easily recognizable links to help users find their desired information.



- **Focus users' attention:** Provide both static and dynamic content and include a user interface that attracts attention. Video-based advertisements, from a marketing perspective, are effective at capturing users' attention.
- **Strive for feature exposure:** Let users see clearly what functions are available within the web site, making sure that the content is well-understood and visitors feel comfortable with the way they interact with the site.
- **Make use of effective writing:** As the web site is different from print, it becomes necessary to adjust the writing style to users' preferences and browsing habits. Long text blocks without images and keywords marked in bold or italics will be skipped.
- **Strive for simplicity:** Users rarely visit a web site in order to enjoy the design. In most cases, they are looking for the information despite the design. Strive for simplicity instead of complexity.

Some of the newer elements of OLC's web site, including the pages related to its Winners campaign, the Powerball game, and the Cash Explosion game show, adopt many of the principles described as essential for effective web sites. Applying these principles to OLC's main web page (home page) would transform it into a positive marketing resource that the Agency could use in a number of ways to promote its games.

In its response to a draft version of this audit report, OLC noted that since the completion of fieldwork on the audit, it has engaged the services of one of its marketing consultants to modernize and update its web site.

## Contract Management

**R5.10 During the next round of contracting for the cooperative services program (CSP) and instant ticket printing contract (SGI), OLC should implement improved contracting, scoring, and service-revision processes. OLC should clearly document the rationale behind the scoring criteria in the evaluation form and the scores given for each component of the proposals. Similarly, OLC should meet with the vendors, shortly after awarding the contract, to discuss and formally agree on the cooperative services and products to be provided and how the services are to be implemented. Particularly for contracts of this magnitude, OLC should develop a formal process to document agreed-upon services to reduce the number of differences between what was proposed by the vendor and what is actually provided. The documentation of agreed-upon services or changes to the contract should be monitored and OLC's**

**internal auditor should annually examine contract compliance, particularly in the area of the cooperative services contract.**

OLC's process for awarding the three major contracts reviewed in this section of the performance audit (Intralot gaming system contract, Scientific Games International's (SGI) instant ticket printing contract, and Intralot's CSP contract) consisted of three phases. First, the RFP was issued by the Agency or the Department of Administrative Services on behalf of the Agency, depending on the contract. Second, responses/proposals were received from the prospective vendors and scored by a committee that primarily consisted of OLC staff, but a DAS representative was also included. Finally, after the winning vendor was selected, a formal contract would be signed by the parties.

As discussed in the *background*, the process used to evaluate the gaming system contract used leading practices and was well-documented. Auditors noted that the evaluation materials were clear and comprehensive. Since the awarding of the contract, OLC and Intralot have worked closely to ensure the success of the gaming system conversion and operations.

When reviewing the proposal scoring process for the contract on instant ticket products and services, however, auditors noted a lack of documented rationale for the scores given. Additionally, there was a variance in the manner in which OLC evaluated a few components of the RFP (e.g., Game Design, Contractor Representative, Transition Team, and Monthly Evaluation Meetings). The evaluation of these items was not readily identifiable on the scoring evaluation form (see **appendix 5-B**) and the instant ticket products and services RFP differed from what was scored by the review team.

It is customary for revisions to occur between a proposal and the resulting contract. The two contracts with Intralot consist of some formal legal provisions and signature pages, but substantive provisions are contained within the RFPs and the vendor proposals. In contrast, while the SGI contract includes the RFP and proposal by reference, it also contains a number of substantive provisions within the body of the contract.

Under the auspices of DAS, OLC had the opportunity to meet with Intralot shortly after awarding the CSP contract in 2009 to discuss and formally agree on the cooperative services to be provided and how the services were to be implemented. However, OLC did not use this opportunity to make modifications to the proposal submitted in response to the RFP.

Unlike the other two major contracts reviewed, the Intralot CSP agreement has undergone numerous modifications from the vendor's original proposal and these have not been formally memorialized. Through informal processes, OLC managers have

modified the expectations related to the provision of certain services during implementation, discontinuing some services and not requiring other deliverables from the contract.

Because the changes to the proposal/contract have not been formally memorialized, OLC does not have a contract that is representative of the services it receives. In addition, since certain items have not been formally discussed and memorialized, OLC could be paying additional amounts for services it elects not to receive.

Finally, OLC assigns contract monitors to work with its vendors after the contract award and through the life of the contract. The contract managers who oversee the gaming system and instant ticket contracts appeared to routinely use contract provisions to monitor and hold the vendors responsible for fulfilling their responsibilities under the agreement. In contrast, OLC has not used its authority as contract manager to conduct a review of Intralot's CSP policies and procedures, which can occur twice each year. As of May 2010, no such review had occurred.<sup>28</sup> In order to ensure that it receives full value for the activities covered under the cooperative services contract, OLC should use all monitoring tools available to it and included in its agreement with Intralot. Omitting monitoring procedures leaves OLC vulnerable to its contractor not fulfilling the requirements of the contract.

The variations in the evaluation of proposals, contract development and subsequent monitoring result from the newness of certain contracts compared with the more established provisions included in the gaming system and instant ticket contracts. Standards of documentation were also influenced by the lead agency involved in the contract process (OLC versus DAS). Finally, the complexity and magnitude of the contract appears to affect how aggressively OLC engages in its contract management authority.

By applying the same methodology for RFP development, proposal evaluation and documentation of scoring, and subsequent contract monitoring as that used with its gaming system contract, OLC could ensure that its intent in selecting certain vendors and efforts to obtain full value from the contract are clear to all stakeholders. Without the application of clearer scoring criteria and evaluation processes, as well as monitoring procedures, OLC may not obtain the services it expects or contract with a vendor capable of providing the service the Lottery needs.

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<sup>28</sup> In its response to the draft audit report, OLC noted that during the course of the audit, its Office of Internal Audit had commenced an audit of CSP.

## Appendix 5-A: Intralot Gaming System

This appendix describes the scoring process and criteria, major RFP/contract provisions, and any identified issues with the RFP/contact provisions for the OLC and Intralot Gaming Systems contract.

### *Scoring*

In evaluating the RFPs, OLC allocated 1,000 points for technical merit and 1,000 points for pricing. The evaluation committee used the Plus, Minus, Interesting, and Questionable (PMIQ) technique. According to the Deputy Director of Operations, this technique is fairly standard among U.S. lotteries. As a committee, each section and/or sub-section was rated according to whether it was a preferred practice (plus), a drawback (minus), interesting (could be considered a positive), or questionable (all questionable items were no longer considered “questionable” once the vendor provided the answers). After the individual scorers used the PMIQ technique to rank the various areas of the responses, the evaluation committee assigned points to each respondent for each area of the RFP. Points were earned based on the evaluation committee’s consensus judgment using the following scale:

**Table 5-A-1: Award Scale for Evaluation**

Percent	Description
90-100	The proposal was outstanding for this criterion and the committee could not determine any significant limitation.
80-89	The proposal was good for this criterion, with no more than one significant limitation and otherwise only minor limitations.
70-79	The proposal was fair for this criterion, with the committee identifying a few significant limitations or concerns, and otherwise only minor limitations.
60-69	The proposal was poor for this criterion, and there were several serious flaws and concerns with the approach or capability.
Less than 60	The proposal was found to be so severely flawed for this criterion as to render an essential element of the solution unworkable and, therefore the entire proposal is rejected.

Source: OLC

The number and significance of plus and minus items, along with the credibility established by the proposal regarding compliance with the criteria, served as the rationale for the ratings assigned by the evaluation committee. Consensus scores were developed from the evaluation and award scale.

The Executive Director assigned an additional committee to research and present three separate methods of scoring the proposals—technical, pricing, and technical/pricing combination. This

committee consisted of personnel from Legal, Operations, Finance, and IT, and a representative from Battelle Memorial Institute.

Once selected, the scoring methodologies were signed by the Executive Director and placed into a locked safe. The scoring methodologies were kept secret from the evaluation committee until the completion of the evaluation of each proposal, to avoid tainting the results.

After completing the evaluation process, the envelope containing the technical criteria and weighting was opened in the presence of representatives from the following OLC offices and bureaus: Internal Audit, Legal Counsel, Purchasing, and Finance, as well as the Executive Director, and an Auditor of State representative (in the role of drawing monitor). This group examined and confirmed that the envelope had not been opened or tampered with, the Executive Director's signature was authentic, and that the information placed inside was authentic.

Similarly, the envelope containing the pricing data and the technical/pricing combination formula was opened in the presence of OLC representatives and a representative from the Auditor of State's office. **Table 5-A-2** illustrates how each section was weighted.

**Table 5-A-2: Gaming System Contract Weighting Criteria**

RFP Selection Criteria	Weight
Central Configuration	70
Terminals	220
Communications Networks	70
Software Controls and Data Management	160
Games and Marketing	180
Facilities and Disaster Recovery Plan	50
Staffing, Services and Operations Security Plan	110
Implementation	80
Corporate Capability	60
<b>Total Points</b>	<b>1,000</b>

Source: OLC

Finally, an OLC representative of the Office of Finance and an RFP evaluation committee member applied the formulas to the evaluation committee's consensus scores to ascertain the ranking of the proposals. Representatives from OLC and Battelle Memorial Institute independently confirmed the scoring team's calculations.

This process was rigorous and auditors were able to identify documented methodologies and rationales for the decisions reached. As OLC develops future contracts, the process used for its most recent gaming system contract was superior to the process used in its other recent major contract awards.

### Contract Provisions

The provisions associated with the RFP for the gaming system and any issues identified during the audit in relation to Intralot's fulfillment of the gaming system contract are discussed below. Overall, identified issues were minor and were either addressed by the time of the audit, or had been identified by OLC or Intralot and were in the process of reaching resolution. Considering the magnitude and complexity of this contract and the system provided, identified issues were deemed minor or insignificant.

- **Central Configuration:** This component requires a configuration capable of handling the immediate and long term needs of OLC. This includes providing a gaming host system at the Primary Data Center that will support transaction processing, failover, operation procedures, communication routing, time synchronizing, and disaster recovery. The vendor must also provide a secondary data center to assume the work of the primary work load, if necessary.

Some concern was raised, after implementation, that Intralot did not have sufficient bandwidth or expertise to meet some of the requirements of the RFP and that OLC staff were fulfilling Intralot's duties. For example, Intralot is not currently writing daily central system reports as the previous vendor supplied; however, according to the Deputy Director of Information Technology (Director of IT), OLC is working with Intralot to develop this capability, which will, ultimately, go beyond what was expected in the RFP.

- Official Consensus Score: 66.5 (95 percent)

- **Retailer Terminals:** The gaming system must support a network of approximately 9,000 online retailer terminals and 1,500 ticket vending machines, operate nearly 24 hours a day and seven days a week, and supply retailer terminals.

After the conversion, it was noted that Intralot's equipment for reading bet slips was not as flexible as the previous vendor's equipment.<sup>29</sup> The previous vendor's equipment was able to read the slips regardless of whether they were fed vertically or horizontally. Intralot's equipment should have been able to read horizontal bet slips, but it was not wide enough to read them as previously constituted. According to the Director of IT, OLC is aware of the situation and is working to resolve the issue by developing a slightly smaller bet card.

- Official Consensus Score: 206.8 (94 percent)

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<sup>29</sup> A bet slip is used by players who want to consistently play the same numbers. Rather than have the clerk manually enter the numbers in the system, the slip can be scanned and the numbers automatically entered. Historically, OLC has used only one size of bet slip.

- **Communications Networks:** This component requires the vendor to design a telecommunications network to serve OLC. The vendor will oversee the design implementation and ensure the operation is in compliance with the RFP specifications including the responsibility for network management. The network is considered from terminal to the central system and all must be secured.

There have been some issues with satellite outages, which have caused frustration for some retailers. According to the Director of IT, there is a tradeoff between satellite service and service via the phone lines. While there are more frequent outages with satellites, restoration is quicker and more targeted compared with phone lines which, when down, can affect entire city blocks and restoration can take much longer. Overall, the total downtime is less with the satellites than with the phone lines, but OLC recognizes that this is an issue for some retailers.

- Official Consensus Score: 66.5 (95 percent)

- **Software controls and data management:** This component requires lottery automation and information software solutions. The vendor will support all of the Lottery's requirements for on-line and instant ticket functionality at retail locations. In addition, vendor terminals will support keyless validation.

OLC is the beta testing site for some of Intralot's most advanced products and systems, so OLC noted that bugs occur and need to be worked out. The Lottery has been working closely with Intralot to bring a more "mature" software development approach – issues such as version control, have been somewhat of a concern as well. However, according to the Director of IT, Intralot has been very responsive to resolving issues within its software. Considering the size and complexity of the new system, OLC is overall pleased with the outcome of the conversion.

- Official Consensus Score: 155.2 (97 percent)

- **Games and Marketing:** This provision requires the vendor to apply its best efforts to support the Ohio Lottery in retailer placement and network planning, game design, and marketing.

According to the Online Product Manager, this is an important component of the contract since OLC does not employ game designers. Lotteries, including OLC, rely on the expertise of vendors to assist them with new gaming ideas and with improving the games already offered.

Intralot's marketing department works directly with OLC's Office of Product Development and Office of Marketing Services. Given the complexities and follow-up

surrounding the conversion, OLC staff indicated that they were discussing strategy with Intralot during the first year of operation much more frequently than the quarterly requirement in the RFP. As a result, formal quarterly strategy meetings have not been strictly enforced. In addition, an annual marketing plan is due to OLC every April. The Online Product Manager indicated that the plan has been submitted.

- Official Consensus Score: 171.0 (95 percent)

- **Vendor Facilities and Disaster Recovery Plan:** This component requires the vendor to provide a primary data center (PDC) and a secondary data center (SDC). All site specifications must be consistent with standards of any multi-jurisdictional associations OLC may join (e.g. Mega Millions and Powerball). This component includes security systems, environmental controls, power, and fire safety. The vendor is required to provide offices at the PDC for OLC employees. In addition, the vendor must provide a quarterly update to the disaster recovery and contingency plan for the data centers.

Intralot has satisfied the requirements of providing a PDC and an SDC. The PDC is located in Strongsville, Ohio and the SDC is located in Cleveland, Ohio. Every quarter, lottery operations are run for one day out of the secondary site as a means of testing the disaster recovery plan. Once a year, operations are run for a full week at the SDC. The most recent test was in April 2010 and, according to the contract manager, was seamless.

- Official Consensus Score: 47.5 (95 percent)

- **Staffing, Services, and Operations Security Plan:** This component requires the vendor to provide a variety of staff and support services. The vendor must indicate staffing levels proposed to perform each function and where that staff will be located and whether the staff will be full-time or part-time. An organizational chart was required to be provided indicating which individuals were company employees and which were subcontractors or consultants. In addition, the vendor was required to provide operations and support services for the gaming system, which includes the operation of two data centers, one primary and one backup (see the discussion on *gaming contract management* in the **background**).

Intralot has provided staffing and support services for the areas required. However, auditors did hear some concerns expressed that repair turnaround times have taken longer than under the previous vendor. The Director of IT explained that OLC invested substantial resources in time and effort to bring the previous vendor's repair times to an acceptable level. He expects that same effort will be applied to Intralot. Intralot already employs more repair personnel than the previous vendor, and it is expected that it will improve its repair times.



- Official Consensus Score: 106.7 (97 percent)
- **Gaming System Implementation:** The implementation process requires all of the new software, hardware, and service elements of the new gaming system to be delivered, installed, tested, and put into the production operation by the vendor.

This provision of the RFP represents the actual conversion to a new gaming system. While there are ongoing elements of this piece of the contract, the ultimate test of compliance was that on July 1, 2009, retailers continued to sell tickets without significant issues, and have continued to do so ever since. The contract managers, along with other directly-involved OLC personnel, stressed that the conversion implementation was an enormous feat, the largest in U.S. lottery history to date (see *noteworthy accomplishments* in the **executive summary**).

- Official Consensus Score: 76.0 (95 percent)
- **Vendor Corporate Capability:** The vendor is required to demonstrate corporate experience, technical capability, integrity, and financial means to support the contract. In other words, the vendor must demonstrate a capacity to deliver on the promises it has made in its response to the RFP.

Intralot's capability to support the contract was verified through the RFP scoring process, and was a condition that was required to be fulfilled before OLC would award it the contract.

- Official Consensus Score: 57.0 (95 percent)

## Appendix 5-B: Scientific Games International

This appendix describes the scoring process and criteria, major RFP/contract provisions, and any identified issues with the RFP/contact provisions for the OLC and Scientific Games International contract.

### Scoring

The vendor selection process involved several OLC offices including Sales, Marketing, IT, and Product Development, along with two representatives from the DAS Office of State Printing. Each individual involved rated the components for the proposals on a scale of zero to nine. The ratings were combined to form the *Official Consensus Score*, which was determined through discussions only. The maximum total score each vendor could have received was 900 points.

The evaluation form contained the weighting for each component. **Table 5-B-1** illustrates how each component was weighted.

**Table 5-B-1: Scientific Games International Contract Weighting Criteria**

Technical Requirements	Weight
History of experience	5
Financial Information Requested	2
Corporate Review	2
Profile	2
<b>Scope of Work/RFP Criteria</b>	
Marketing Plan	15
Ticket Development Timeline	4
Market Research	15
Sales Analysis	12
Semi-Annual Planning Meeting	10
Retailer and Player Promotions	5
Sales Forecast	10
Hypothetical Games	7
<b>Additional Services</b>	
Disaster Recovery/Business Resumption Plan	3
Focus Groups	4
Advances Sales Training Seminar	4
<b>Total Weight (100) times total maximum rating (9)</b>	<b>900</b>

Source: OLC

### Contract Provisions

The instant ticket products and services RFP (and corresponding contract) is comprised of twelve main components. Below, each component is described according to the RFP, followed by Scientific Games International's (SGI) practice, and proposal score to OLC's RFP:

- **Marketing Plan:** This provision of the RFP requires the primary contractor to develop and write a comprehensive fiscal year marketing plan for all instant games, including any games to be developed by the secondary contractor. OLC's Instant Ticket Bureau and the primary contractor are to evaluate this marketing plan quarterly, and the primary contractor is to update the plan if necessary. According to the Instant Ticket Product Manager, SGI has provided these plans every year and quarterly reviews take place as required in the RFP.
  - Official Consensus Score: 120 (Rating- 8)
- **Game Designs:** This provision of the RFP requires the primary and secondary contractors to provide OLC's Instant Ticket Bureau with ticket artwork, prize structures and play styles for each instant game according to the marketing plan and/or for any additional designs requested by the Instant Ticket Bureau. According to the Instant Ticket Product Manager, OLC has a good relationship with SGI. From 2001 to 2007, SGI has provided the Ohio lottery with 355 different instant games.
  - Official Consensus Score: N/A. Auditors were unable to determine where this component was scored on the evaluation form.<sup>30</sup>
- **Development of Printing and Production Schedule<sup>31</sup>:** The primary and secondary contractors are required to provide weekly updates of all printing and production schedules as they relate to working paper development, working paper execution dates, print dates, and delivery dates to OLC's warehouse and distribution facility, currently located in Strongsville, Ohio. According to the Instant Ticket Product Manager, a conference call takes place every Monday and the contractor's representative provides a status update on the printing and production schedule and ensures that game design and other details contain the appropriate signatures for approval. The contractor representative also ensures and reports on delivery date status. According to the Instant Ticket Product Manager, SGI complies with this component.
  - Official Consensus Score: 20 (Rating-5)

<sup>30</sup> Auditors were unable to locate the score for the *Game Design* component of the contract. However, the scoring evaluation includes a component termed "Ticket Development Timeline" which states "Vendors will provide sales parameter by price point for game closing recommendations" This component received a score of 20 (Rating-5).

<sup>31</sup> This component is termed "Ticket Development Timeline" on the scoring evaluation form.

- **Market Research:** The primary contractor is required to conduct market research which is to be used to develop new instant game concepts, designs, play styles and player based demographics. Any instant ticket research being conducted for other lottery accounts is to be made available to OLC at no cost. SGI provides annual *State of the Industry* reports for instant and online games. These comprehensive reports provide useful information regarding consumer spending habits, licensed game growth, U.S. lottery market trends, average selling prices, number of instant games launched per year in the top selling states, and playership. These reports also highlight retailer data, product analyses, price points, prize payout percentage comparisons, and per capita sales of the top 16 lotteries.
  - Official Consensus Score: 105 (Rating-7)
- **Sales Analysis:** This provision requires the primary contractor to provide weekly sales analysis of all instant games. This analysis should include the net impact that each instant ticket game has on total lottery sales and weekly indexing of each game. According to the Instant Ticket Product Manager, an indexing report is one in which each game is indexed according to sales. SGI complies with this requirement.
  - Official Consensus Score: 84 (Rating-7)
- **Contractor Representative:** This component requires the primary contractor to designate a multi-skilled account representative, subject to approval of OLC, who will be the primary contact between the vendor and OLC. According to the Instant Ticket Product Manager, the contractor representative for Scientific Games International provides customer services to the OLC by working directly with the artist, the press operations, and is responsible for communicating daily price structures, working papers, and ensuring that artwork is accurate. According to the Instant Ticket Product Manager, OLC has been satisfied with SGI's level of service.
  - Official Consensus Score: N/A. Auditors were unable to determine if this component was scored on the evaluation form.<sup>32</sup>
- **Transition Team:** Upon the award of the contract, the primary and secondary contractor are required to ensure an orderly transition of services, responsibilities and continuity by providing a transition team. This team is to including data processing and marketing representatives to assist the lottery in planning and testing the vendor's products and services.
  - Official Consensus Score: N/A. Auditors were unable to determine if this component was scored on the evaluation form.<sup>33</sup>

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<sup>32</sup> Auditors were unable to locate the score for the *Contractor Representative* component of the contract.

- **Monthly Evaluation Meeting:** The primary contractor's account representative is required to meet at least one day each month with OLC's Instant Ticket Bureau at OLC headquarters or other location designated by the Bureau. According to the Instant Ticket Product Manager, he and SGI's regional manager may speak four or five times, or more, each week. He also remarked that the communication between them is very good.
  - Official Consensus Score: N/A. Auditors were unable to determine if this component was scored on the evaluation form.<sup>34</sup>
- **Semi-Annual Planning Meeting:** This provision requires the primary contractor to conduct semi-annual meetings at OLC headquarters. The meetings are to detail an updated fiscal year report, detailed game sales analysis, and report on other state lotteries. SGI meets this provision and provides OLC with a semi-annual consumer tracking report. This report includes key observations on Ohio lottery playership by game, retail trends and key recommendations. Research regarding player trends, reasons for never playing, how often certain games are played, at what type of stores lottery tickets are mostly sold, interest in coupons, recession data, at what jackpot amount players are likely to play mega millions, as well as other specific data regarding each of the games is shared. Key recommendations highlight the importance of advertising, different advertisements that may be more effective, successful promotions, and re-training retailers. In many instances, references to successful practices in other state lotteries are explored.
  - Official Consensus Score: 50 (Rating-5)
- **Retailer and Player Promotions:** As part of the marketing plan, the primary contractor is required to provide specific recommendations for two specific retailer and two specific player promotions each fiscal year. Promotion outlines must include cost analyses, sales projections, and pre and post analyses.
  - Official Consensus Score: 25 (Rating-5)
- **Sales Forecast:** The primary contractor is required to provide the Agency's Instant Ticket Bureau a twelve month sales forecast on a quarterly basis. According to the Instant Ticket Product Manager, SGI's forecasts are reviewed frequently.
  - Official Consensus Score: 80 (Rating-8)
- **Proposal on introducing at least four new instant games<sup>35</sup>:** The primary contractor and secondary contractor are required to demonstrate their instant ticket product expertise

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<sup>33</sup> Auditors were unable to locate the score for the *Transition Team* component of the contract.

<sup>34</sup> Auditors were unable to locate the score for the *Monthly Evaluation* component of the contract.

and understanding of the lottery's distribution of tickets, ticket design innovation, overall marketing acumen and ticket printing costs. In addition to this marketing assignment, the contractors are required to provide illustrations and samples of their marketing innovations, enhancements and services that would reinforce the lottery's marketing and sales efforts. According to the Instant Ticket Product Manager, SGI provided all required proposals.

- Official Consensus Score: 56 (Rating-8)

As noted above, the evaluation form contained additional scoring components (e.g., technical, financial, additional services). With the exception of the *Technical* and *Financial* components, the *Additional Services* component was in addition to the components included in the RFP. The additional scoring components include:

- **History of Vendor's Experience-** Official Consensus Score: 35 (Rating-7)
- **Financial Information-** Official Consensus Score: 10 (Rating-5, maximum rating of 5)
- **Corporate Review-** Official Consensus Score: 10 (Rating-5, maximum rating of 5)
- **Profile-** Official Consensus Score: 10 (Rating-5)
- **Disaster Recovery/Business Resumption Plan-** Official Consensus Score: 15 (Rating-5)
- **Focus Groups-** Official Consensus Score: 28 (Rating-7)
- **Advance Sales Training Seminar:** Official Consensus Score 32 (Rating-8)

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<sup>35</sup> This component is termed "Hypothetical Games" on the scoring evaluation form.

## Appendix 5-C: Intralot CSP Contract

The cooperative services program (CSP) RFP is comprised of nine main components. **Table 5-C-1** shows the scoring method used in this RFP.

**Table 5-C-1: Scoring Criteria**

Points	Description
0	DOES NOT MEET: Proposal does not comply substantially with requirements.
1	WEAK: Proposal meets most requirements, and any weaknesses or deviations from requirements are minor, acceptable and may be readily corrected or minimized in terms of material impact.
2	WEAK TO MODERATE: Proposal doesn't quite meet the objectives and a little stronger than weak.
3	MEETS: Proposal generally meets the objectives (or expectations). Weaknesses are minor, acceptable, and may be offset by strengths in other areas.
4	MODERATE TO STRONG: Proposal exceeds objectives (or expectations) in ways that are beneficial to the State and meets objectives (or expectations) and contains at least one enhancing feature that provides some benefit to the State. Weaknesses are minor and are more than offset by the enhancing feature(s).
5	STRONG: Proposal significantly exceeds objectives (or expectations) in ways that provide tangible benefits or meets objectives (or expectations) and contains at least one enhancing feature that provides significant benefits.

Source: CSP RFP

Below, each component is described according to the RFP, followed by Intralot's response, Intralot's actual practice, and proposal score to OLC's RFP.

- **Data Processing:** This section generally provides the responding vendors with information regarding the type of software and functionality of the software that will be provided. Intralot wrote in its response to the RFP, "No response required for this section," but no reference was made in the proposal, or in the scoring documentation, that leads the reader to where this component was addressed.
  - Official Consensus Score: Four.
- **Management of Instant Ticket and Gaming Supply Inventory:** This component requires a description of the processes followed for the arrival and return of instant tickets and gaming supplies and the methods for tracking incoming inventory. It also requires maintaining optimum inventory levels, successfully allocating and distributing tickets for newly-launched instant games, and implementing a method of producing initial allocation orders.

Each requirement was addressed in the proposal, although in some cases, not implemented as described. For example, Intralot states that material handlers will verify seal numbers on the tractor/trailers and if correct, a security guard will break the unopened seal. The security guard is also tasked with logging all incoming and outgoing shipments. In practice, Intralot's Warehouse Lead verifies the seal numbers, breaks the unopened seals, and logs all shipments. There are other references to security guards in the proposal but, according to the Warehouse Manager and the Administrative Assistant/Security, no security guard personnel are employed with Intralot for its CSP functions. The failure to segregate these duties among multiple employees, as provided for in the contract, creates some internal control risk for OLC.

Intralot's plan for ensuring that all retailers receive new game tickets on the same day is to assemble the ticket packages and store them in a packaging area until all the orders are filled. All packages will then be released to the courier at the same time. For further assurance, Intralot determined that it can assemble 9,000 packages of new game tickets in three days or less while maintaining the work flow to handle shipments of older tickets. The performance of Intralot relative to its proposal is not measured, though the Director of Product Development and Chief Legal Counsel maintain that as long as Intralot can ensure new games are delivered to all of the retailers on the scheduled day while keeping up with the regular orders, there is no infraction.

However, in December 2009, approximately 352 regular orders went unfilled due, in part, to higher holiday orders. The orders were to be received on a Friday but were not shipped until the following Monday. OLC discussed the matter with Intralot and determined that no liquidated damages were necessary for a variety of business reasons. No other missed shipments have occurred.

Intralot's Warehouse Lead conducts a physical inventory every month as stated in its proposal. This report is reconciled with the electronic inventory report generated by Intralot's instant games management system. According to OLC, this reconciliation of physical and electronic inventory reports just started occurring in April 2010.

- Official Consensus Score: Three
- **Management and Staffing of a Telephone-Based Order System:** The CSP contract called for the vendor to provide telemarketing services, which serve as a means to promote products to and receive orders from retailers. The telemarketers both call out to retailers and receive calls in from retailers. Intralot subcontracts telemarketing services under the direction of Power Direct. Included in this component are order processing, volume of retailer accounts per telemarketer, a plan to cover the retailer's request, number of phone lines available, and quality control processing.



Each requirement of the RFP was addressed but, in some cases, not implemented as described in the proposal. For example, Intralot describes a variety of resources for “special case” ordering (i.e., emergency order from retailers who need additional tickets right away) that includes giving the retailer means to make “special case” orders through a specially maintained email address, a retailer web site, an Intralot telephone hotline operator, the Lottery Sales Representatives (LSRs), or OLC. Several references throughout the proposal mention Intralot hotline operators. In practice, the Intralot hotline operator is a reference to Intralot’s gaming system proposal and is not affiliated with Intralot’s CSP services. Also, OLC prefers that retailers place all orders through Telemarketing Sales Representatives (TSRs). TSRs employed at Power Direct and LSRs are now the retailer’s only means of placing an order. The special email address and retailer web site were never developed, reportedly at OLC’s request.

OLC monitors the telemarketing process in real time using Customer Interaction Management software. According to the proposal and in practice, each telemarketer handles 150-200 calls per day and contacts 90 percent of the retailers once per week. The Director of Product Development receives daily reports from Power Direct and is linked electronically to review real-time reports of telemarketing activity. OLC can monitor the number of calls made by each telemarketer, total packs ordered, gross sales, and total orders placed. In the case of an absence, a TSR’s call list is redistributed to the other TSRs. All incoming and outgoing telephone calls are recorded; these calls are archived with a date and time stamp and according to the proposal, random monitoring is conducted on at least two calls from each telemarketer on a weekly basis. At OLC’s request, the Director of Product Development is present on four or five of those calls once a week.

According to the Director of Product Development, an Intralot employee oversees the activities of Power Direct by acting as the Manager and by maintaining a presence on site Monday through Thursday.

- Official Consensus Score: Four
- **Packaging of Instant Tickets and Gaming Supplies:** This component of the RFP requires a description of procedures and materials to be used for the packaging, the ability to prioritize orders, and the size and weight limits on packages. In addition, the proposal is to include a method for preventing damaged or other inappropriate materials from being shipped to the retailers.

There were no differences between the proposal and implementation identified in this component. According to the proposal and in practice, packaging materials are specified and are custom designed for lottery products. Once envelope containers are sealed at the warehouse, any attempts to open them are obvious to the retailers because of the material

used. Opening the envelope would require cutting or stretching the envelope to the point of tearing it. Shipping labels that conform to commercial carrier standards are automatically generated after the invoice is scanned by shipping personnel. To address quality control, Intralot trains its packaging personnel, supervises orders packaged, and randomly inspects orders for quality of the orders packaged and placed for the retailers.

Delivery information is accessible directly to Intralot and OLC employees via internet connection with the commercial carrier's online shipping tracking system. The commercial carrier also provides a weekly electronic summary of package deliveries. The commercial carrier notifies Intralot of mis-sorted packages or other possible delays or discrepancies. All damaged product is returned to Intralot in a separate area of the warehouse.

- Official Consensus Score: Three
- **Delivery of Instant Tickets and Gaming Supplies:** This component requires that any order placed before 5:00 p.m. be delivered the next business day to any geographic part of the state. It also requires a description of the method of delivery, justification for that method, and an alternative method. And lastly, it requires a detailed distribution plan, a plan for emergency orders, and quality control procedures.

All areas of the RFP were addressed but, in some cases, not implemented as proposed. According to the proposal, Intralot's delivery plan is that all orders placed before 5:00 p.m. will be packaged and shipped the same day for delivery on the next business day. If deliveries are required on a Saturday or Sunday, Intralot will use field service representatives (who would be stationed throughout Ohio) to make the deliveries. If necessary, Intralot will employ a private courier to make the delivery to prevent any retailer from running out of tickets. Although OLC specifically did not want Intralot employees delivering instant tickets under any circumstances due to security risks, it is unclear whether this preference was clearly communicated to Intralot. As a result, Intralot warehouse personnel stated that it has happened on a few rare occasions in order to satisfy the customer's need. However, according to OLC staff, the message has been more clearly communicated, and in the future, Intralot employees should not be delivering tickets.

Intralot coordinates with one main commercial courier for retailers to receive shipments the next business day and to ensure that all retailers receive new games on the same day. Orders are packed throughout the day, as the system processes the orders. The packaged orders are labeled and placed in a separate, secure area for pickup by the major courier. Shipping labels conform to each major courier. All packages contain a barcode that each retailer can scan directly on the retailer terminal's "receive shipment" function. This function places all of the ticket books within the shipment into the retailers' inventory.

Intralot attaches a priority status to the order in the system to identify emergency orders. Packing lines are directed to process emergency orders and other orders with high priority before proceeding with regularly scheduled orders. A review will occur regarding the reasons for emergency deliveries and could lead to proactive changes in the levels of inventory or the management of inventory.

According to the proposal, returned or refused orders are logged into a “returned shipment” order log which will be part of the Intralot help desk application used by the hotline operators. Returned and refused orders are researched by Intralot hotline operators with appropriate resolution determined and logged on the help desk tracking application. When a valid reason for the refused order cannot be determined, the hotline operators contact the retailer to get confirmation that the order should have been refused or determine if there was a mistake and the order should not have been refused or returned. Again, in the proposal, all references made to Intralot’s hotline operators are actually part of the gaming system proposal and serve no purpose relative to the CSP contract. Since the inception of the contract, Intralot has hired hotline operators specifically for the CSP contract. Returned and refused orders are actually logged daily into a spreadsheet report by Intralot’s Warehouse Lead and then researched and resolved by OLC and Intralot staff.

- Official Consensus Score: Four
- **Return Receipt of Instant Tickets and Gaming Supplies:** This component requires the vendor to document processes for the return receipt on instant tickets and gaming supplies.

Intralot’s CSP proposal states that it will document all CSP project processes according to OLC’s requirements and OLC’s full satisfaction, including any and all operating procedures and processes for the return receipt of instant tickets and gaming supplies. In addition, Intralot CSP will maintain the documentation for the life of the contract with reviews and updates twice each year. At the time of the audit, no reviews had occurred. However, according to OLC’s Internal Auditor, an audit was planned and in progress.

- Official Consensus Score: Three.
- **Security Measures:** This component requires the description of the proposed location of the warehousing facility, hours of operation, hours for accepting deliveries from lottery suppliers, the method for the destruction of returned instant tickets, and recycling efforts.

According to the proposal, the warehousing facility was to be located in the same building as Intralot’s Gaming System in Strongsville, OH. Because of that proposed arrangement, Intralot reported that the CSP facility would be operated 24 hours a day,

seven days a week, since computer operators and hotline personnel would be in residence. The proposal builds on the around-the-clock residence by stating that if shipments arrive after the proposed 4:00 p.m. cutoff, personnel in residence can accept the shipments anytime and contact CSP personnel at night and on weekends, if necessary, via cell phone.

In May 2009, Intralot requested the gaming system and CSP facility be separated because of space and security requirements. As a result, Intralot's CSP operations moved within close proximity to the original facility and a revised security plan was developed by Intralot and verbally approved by OLC's Security Director.

The proposal also indicated that Intralot would purchase and install a commercial shredding and baling system in order to provide secure destruction of instant tickets. This system was to be under camera surveillance at all times. However, in practice, Intralot subcontracts with a shredding service that is located off site. The process is under camera surveillance and an Intralot staff member accompanies the truck to the offsite facility. Once instant tickets are destroyed, OLC personnel are notified.

- Official Consensus Score: Three

- **Implementation Plan:** This component requires a plan for transferring ticket distribution responsibility. The plan needed to address the return of instant tickets; gaming supplies inventory and transferring to the new distribution warehouse; employee, retailer, and telemarketing training; and a timeline for the development of procedures.

After a review of this component, it was noted that while some of the milestone dates may have been missed, the conversion from the prior CSP vendor occurred on time.

- Official Consensus Score: Three

- **Personnel Plan:** This component requires a staffing plan that identifies all key personnel required along with their qualifications and responsibilities.

Intralot addressed the personnel requirement. See *Capabilities and Location* for more information.

- Official Consensus Score: Four.

- **Capabilities and Location:** Two other areas of the proposals were rated on vendor capabilities and location. Each candidate was rated on its ability to demonstrate three years of continuous experience performing the services that are outlined in the Scope of Work. Intralot's response did not comply with reporting three years of continuous

experience and it did not address the scope of work. The experience described was not continuous and equated to only 22 months.

Intralot CSP reported its software architecture experience—designing software that has assisted in conversions, managing media files, and integrating communication software to allow terminals to cash tickets, receive orders, and perform pack movements in real time. While there are software components to the CSP contract, no information in the “experience” portion of the response confirmed that Intralot personnel had performed the actual warehousing, sorting, and ticket distribution services outlined in the Scope of Work.

- Official Consensus Score: Four

Each candidate was to also demonstrate a minimum of three years experience managing a third-party computerized method for recording orders and retrieving proof of delivery information. Again, Intralot did not comply and cited less than two years of experience.

- Official Consensus Score: Two.

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## **Client Response**

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The letter that follows is the Ohio Lottery Commission's (OLC) official response to the performance audit. Throughout the audit process, staff met with OLC officials to ensure substantial agreement on the factual information presented in the report. When the OLC disagreed with information contained in the report and provided supporting documentation, revisions were made to the audit report.





August 27, 2010

Mary Taylor, CPA  
Auditor of State  
Performance Audit Section  
Lausche Building  
615 West Superior Avenue, 20<sup>th</sup> Floor  
Cleveland, Ohio 44113-1801

Dear Auditor Taylor:

On behalf of the Ohio Lottery Commission (the "OLC"), I am responding to the performance audit report prepared by your Office. We commend your performance audit team for their diligence and thoroughness. We have shared with them our comments and corrections on the draft report.

The OLC is proud of its record of performance. The Ohio Lottery is a leader in the lottery industry, ranking as the 9<sup>th</sup> largest lottery in the United States. The OLC recently closed out fiscal year 2010 with record sales of \$2.48 billion. Fiscal year 2010 was the OLC's ninth consecutive year of sales growth. During the year, the OLC transferred profits of \$728.6 million to the Lottery Profits Education Fund ("LPEF"), \$26.3 million more than in fiscal year 2009 and the second highest profit transfer in the OLC's 36-year history. The OLC is also pleased to have achieved a number of significant cost savings, including those related to the contracts for our gaming system, instant ticket printing, ticket distribution, and facility leases. The OLC's outstanding performance has been made possible by the support of our players, retailers, employees, and vendors. The OLC's success is also due to the support we have received from the Governor and the Legislature, our Commission, and our positive working relationships with other State agencies.

The OLC takes seriously its mission to maximize profit transfers to the LPEF while conducting our games and our overall business operations with utmost integrity. We regularly review our operations and make changes with those objectives in mind. As the report notes, during the period the audit was pending, the OLC undertook a number of initiatives that are recommended in the report. One of those initiatives is a strategic planning process that we have begun with the assistance of a lottery industry consultant. The performance audit report will be integrated into the strategic planning process. We will carefully review your Office's findings and recommendations with a view towards taking appropriate responsive measures.

Sincerely,

A handwritten signature in black ink that reads "Kathleen B. Burke".

Kathleen B. Burke  
Executive Director



**Auditor of State  
Mary Taylor, CPA**

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