

**JEFF ATWATER**  
President



**LARRY CRETUL**  
Speaker



**The Florida Legislature**  
**Joint Legislative Auditing Committee**

**Representative Greg Evers, Chair**  
**Senator Alex Diaz de la Portilla, Vice Chair**

**Meeting Packet**  
Monday, February 1, 2010  
4:00 P.M. to 6:00 P.M.  
309 Capitol

**AGENDA**  
**JOINT LEGISLATIVE AUDITING COMMITTEE**

**DATE:** Monday, February 1, 2010

**TIME:** 4:00 p.m. to 6:00 p.m.

**PLACE:** Room 309, The Capitol

**MEMBERS:** Representative Greg Evers, Chair  
Senator Alex Diaz de la Portilla, Vice Chair

Senator Andy Gardiner  
Senator Charlie Justice  
Senator Jeremy Ring  
Senator Stephen R. Wise

Representative Betty Reed  
Representative Dwayne L. Taylor  
Representative John Tobia  
Representative Charles E. Van Zant

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**Department of the Lottery:**

Presentation of the department's financial statements

Presentation of the Auditor General's audit of the department's financial statements

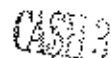
Presentation of the Office of Program Policy Analysis and Government Accountability's review of the department

Presentation of Auditor General Report No. 2010-062, Summary Report of Information Technology Audit Findings - Information Technology Audit



## Financial Highlights

- Transfer to EETF slightly higher (\$4.4 Mill.) than FY 2007-08.
- Ticket sales lower (\$236 Mill.) than FY 2007-08.
- Prize Payout Percentage remained constant at 59.5% of net ticket sales.



Florida Lottery

## Financial Highlights

- Vendor fees decreased by 11.5% from FY 2007-08 (new Scratch-Off contract for 76% of the year).
- Administrative expenses decreased slightly (1.9%) from FY 2007-08.

Florida Lottery



## Financial Highlights

- Non-Operating Income decreased due to lower interest rates, lower market values of investments and reduced investment holdings.
- Transfer of Unclaimed Prizes decreased by \$20 Mill. from FY 2007-08.

Florida Lottery



## Financial Highlights

- January 4, 2009 Florida joined the Multi-State Lottery Association in order to sell POWERBALL® with Power Play®.



Florida Lottery™

## Question?

- Why did transfers go up when sales went down?

### 3 Reasons

1. Sales shifted from instant to On-line (higher profit margin);
2. Significant savings due to new contract; and
3. Only 1 LOTTO PLUS™ winner (transferred excess reserves).



Florida Lottery™

## Net Assets as of 6/30/2009

(In Millions)

	<u>FY 08-09</u>	<u>FY 07-08</u>
Current Assets	\$ 173.4	\$ 188.2
Non Current Assets	1,927.9	2,307.5
Current Liabilities	1,257.0	1,498.2
Non Current Liab.	722.2	837.7
Capital Assets	1.2	1.3
Restricted Net Assets	120.9	158.5

Florida Lottery



## Important Notes about Net Assets

- All restricted assets are listed as non-current, however, the payments for which they are restricted are divided between current and non-current liabilities.
- Both the assets and liabilities for deferred prize payments are presented in present values. Assets at Fair Market Value – Liabilities at Present Value. The difference is included in Restricted Net Assets.

Florida Lottery



## Revenues, Expenses and Changes in Net Assets

(In Millions)

	FY 08-09	FY 07-08
Operating Revenue	\$3,944.2	\$4,181.8
Operating Expense	2,692.0	2,865.6
Non-Operating (Net)	(1.9)	34.2
Transfers to EETF	1,287.9	1,283.4
<i>Operations</i>	1,241.1	1,216.8
<i>Unclaimed Prizes</i>	46.8	66.6
Change in Net Assets	-37.6	67.0

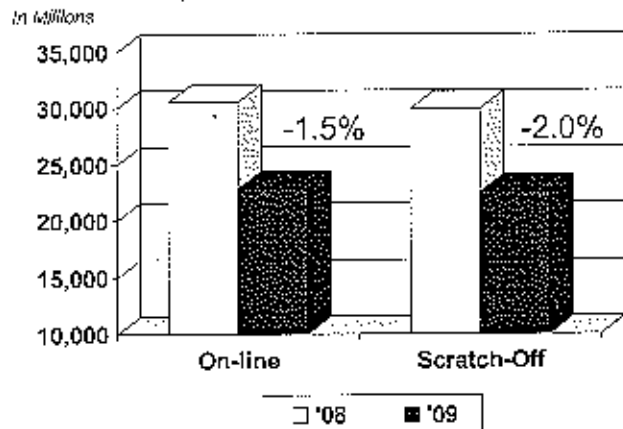
Florida Lottery

## Important Notes about Revenues, Expense & Changes in NA

- The effects of the representation of the deferred prize payments assets and liabilities are shown in the non operating revenue section.
- These required market adjustments are not considered when calculating the EETF transfer.
- The utilization of funds held for future prizes is reflected in the Changes of Net Assets.

Florida Lottery

## U.S. Lottery Industry Ticket Sales



Florida Lottery



## Florida Lottery's Investments

Note 2

- Deferred Prize Payments to winners are invested in U.S. Treasury Strips with maturity dates that match the required payment date.
- Deferred Prize Investments are purchased and managed by SBA.
- Grand (Deferred) Prize Investments Portfolio is shortening in duration due to fewer selections of deferred payments. 83% of the total investments are scheduled to mature by FY 2018-19.

Florida Lottery





## Florida Lottery's Investments

Note 2

- Cash not needed on a daily basis for operations or held for a restricted purpose is invested at the State Treasury – SPIA.
- The Lottery participates in the SBA's Security Lending Program. The assets and liabilities of that program are reflected as Restricted Investments and Liabilities. Any income derived from that program is transferred to EETF.

Florida Lottery



# Florida Lottery™

*Thank you!*

**POWERBALL®**  
**POWERPLAY®**

**Auditor General Audit  
Department of the Lottery**



## **DEPARTMENT OF THE LOTTERY** Financial Audit

**For the Fiscal Year Ended June 30, 2009**

AG Report No. 2010-082

1

### Audit Scope and Objectives

- ❖ Basic financial statements
- ❖ Effectiveness of internal controls
- ❖ Compliance with legal requirements

AG Report No. 2010-082

2

## Basic Financial Statements

In our opinion, the financial statements for the FYE June 30, 2009, present fairly, in all material respects, the financial position and changes in financial position and cash flows of the Lottery in accordance with GAAP.

## Internal Controls and Compliance

- In our opinion, the Lottery maintained, in all material respects, effective internal control over financial reporting as of June 30, 2009.
  
- No instances of noncompliance of material consequence to the financial statements.
  - Chapter 24, Florida Statutes
  - Bond covenants
  - General appropriation acts

## Other Observations and Findings

- Information Technology Controls
- Electronic Funds Transfer of Annual Prize Payments

## Other Observations and Findings

- Monthly Reports
- Noncompliance with Section 24.113, F.S.

# Questions?

## Contact Information:

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Auditor General's Office  
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Email: [kathrynwalker@aud.state.fl.us](mailto:kathrynwalker@aud.state.fl.us)

# DEPARTMENT OF THE LOTTERY

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## Financial Audit

For the Fiscal Year Ended  
June 30, 2009



STATE OF FLORIDA  
AUDITOR GENERAL  
DAVID W. MARTIN, CPA

## Secretary of the Department of the Lottery

The State of Florida, Department of the Lottery (the Lottery) was established as a State agency with the enactment of the Florida Public Education Lottery Act (the Act), Chapter 24, Florida Statutes, in 1987. The head of the Department is the Secretary, who, pursuant to Section 20.317, Florida Statutes, is appointed by the Governor subject to the confirmation of the Senate. Mr. Leo DiBenigno served as Secretary during the audit period.

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

The audit team leader was Robin Reardon, CPA, and the audit was supervised by Ben H. Cox, CPA. Please address inquiries regarding this report to Nathan D. Walker, CPA, Audit Manager, by e-mail at [nwalker@aud.state.fl.us](mailto:nwalker@aud.state.fl.us) or by telephone at (850) 487-9085. For the information technology portion of this audit, the audit team leader was Suzanne Varek, CPA, and the supervisor was Shelly Poser, CISA. Please address inquiries regarding the information technology resources portion of this report to Jonathan H. Ingram, CPA, CISA, Audit Manager, by e-mail at [jingram@aud.state.fl.us](mailto:jingram@aud.state.fl.us) or by telephone at (850) 487-9359.

This report and other reports prepared by the Auditor General can be obtained at our Web site at [www.myfloridacounty.com/audgen](http://www.myfloridacounty.com/audgen), by telephone at (850) 487-9024, or by mail at 699 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1350.



DEPARTMENT OF THE LOTTERY  
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**EXECUTIVE SUMMARY**

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**Summary of Report on Financial Statements**

The financial statements prepared by the Department of the Lottery present fairly, in all material respects, the financial position of the Lottery as of June 30, 2009, and 2008, and the changes in the financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**Summary of Report on Internal Control and Compliance**

In our opinion, Lottery management maintained, in all material respects, effective internal control over financial reporting.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards; however, we noted certain additional matters as summarized below.

**Additional Matters**

**INFORMATION TECHNOLOGY CONTROLS**

**Finding No. 1:** During our audit, we identified the need for enhancements to the Lottery's information technology control practices. Specific details of these matters are not disclosed in this report to avoid the possibility of compromising Lottery information. However, the appropriate Lottery personnel have again been notified of these issues. While the Lottery had made progress in resolving many of the findings disclosed in connection with the prior audit, some issues previously reported had not yet been fully addressed.

**ELECTRONIC FUNDS TRANSFER OF ANNUAL PRIZE PAYMENTS**

**Finding No. 2:** The Lottery pays the prizewinners of various games through a deferred payment (annuity) option rather than a single lump-sum payment. Our audit disclosed that controls over related electronic funds transfer payments could be further improved.

**MONTHLY REPORTS**

**Finding No. 3:** In accordance with Section 24.105(4), Florida Statutes, the Lottery issues monthly reports to the Governor, the State of Florida Chief Financial Officer, the President of the Senate, and the Speaker of the House of Representatives. These reports disclose details of the total lottery revenues, prize disbursements, and other expenses of the Lottery during the preceding month and present fiscal year-to-date cumulative totals. Our review disclosed errors in the reported monthly totals and a lack of procedures for a final proofing of the reports to check for mathematical accuracy prior to sending them to the designated entities.

**MINORITY RETAILER PARTICIPATION**

**Finding No. 4:** Section 24.113, Florida Statutes, requires that 15 percent of the Lottery's retailers shall be minority business enterprises, as defined in Section 288.703(2), Florida Statutes; however, no more than 35 percent of such retailers shall be owned by the same type of minority person, as defined by Section 288.703(3), Florida Statutes. Our audit disclosed that as of August 24, 2009, retailers comprising one minority type totaled 64 percent of the total number of minority retailers. A similar finding was included in prior reports.

**Audit Objectives and Scope**

Our audit objectives were to determine whether the Department of the Lottery (Lottery) had:

- Presented the Lottery's basic financial statements in accordance with generally accepted accounting principles;
- Established and implemented internal control over financial reporting and compliance with requirements that could have a direct and material effect on the financial statements;

- Complicd with the various provisions of laws, rules, regulations, and contracts that are material to the financial statements; and
- Taken corrective actions for findings included in our report No. 2009-101.

The scope of this audit included an examination of the Lottery's basic financial statements as of and for the fiscal years ended June 30, 2009, and 2008, and an examination of the effectiveness of the Lottery's internal control over financial reporting. With respect to internal control over financial reporting, our examination included obtaining an understanding of the internal control over financial reporting, testing and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We also examined various transactions to determine whether they were executed, both in manner and substance, in accordance with governing provisions of laws, rules, regulations, contracts, and grant agreements.

#### Audit Methodology

The methodology used to develop the findings in this report included the examination of pertinent Lottery records in connection with the application of procedures required by auditing standards generally accepted in the United States of America, and applicable standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

#### Related Reports

In Report No. 09-14, the Office of Program Policy Analysis and Government Accountability (OPPAGA) made recommendations to enhance the Department of the Lottery's earning capability and improve operational efficiencies. The report also tracks the Lottery's implementation of revenue enhancement initiatives and prior OPPAGA recommendations. OPPAGA plans to issue its annual Department of the Lottery report, including an examination of alternative field support service delivery models and a report examining the return on investment of the Lottery's advertising expenditures, in January 2010.



DAVID W. MARTIN, CPA  
AUDITOR GENERAL

# AUDITOR GENERAL STATE OF FLORIDA

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The President of the Senate, the Speaker of the  
House of Representatives, and the  
Legislative Auditing Committee

## INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Department of the Lottery (the Lottery), an enterprise fund of the State of Florida, as of and for the fiscal years ended June 30, 2009, and 2008. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Lottery and do not purport to, and do not, present fairly the operations of the State of Florida as of June 30, 2009, and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

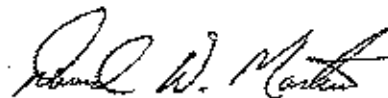
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2009, and 2008, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements in *Government Auditing Standards*, we have also issued a report on

our examination of the Lottery's internal control over financial reporting, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and on our tests of the Lottery's compliance with certain provisions of laws, rules, regulations, contracts, and other matters included under the heading **INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**. One purpose of that report is to describe the scope of our testing of internal control over financial reporting and to provide an opinion thereon. With respect to compliance, the purpose of that report is not to provide an opinion on compliance, but rather to describe the scope of our testing of compliance and the results of that testing. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The **MANAGEMENT'S DISCUSSION AND ANALYSIS** (pages 3 through 12) is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Respectfully submitted,



David W. Martin, CPA  
January 26, 2010

**MANAGEMENT'S DISCUSSION AND ANALYSIS****YEARS ENDED JUNE 30, 2009, AND JUNE 30, 2008**

As management of the Florida Lottery, we offer readers of the Florida Lottery's financial statements this overview and analysis of the Lottery's financial results and position for the fiscal years ended June 30, 2009, and 2008. We encourage readers to consider the information presented here in conjunction with the financial statements and notes to the financial statements, which begin on page 13.

**FINANCIAL HIGHLIGHTS**

The Florida Lottery has as its mission the maximization of revenues for the benefit of education in a manner consistent with the dignity of the State of Florida and the welfare of its citizens. The Florida Lottery is considered a mature lottery with a full complement of both Scratch-Off and On-line products. The Department has maintained ticket sales in excess of \$2 billion for the twentieth consecutive fiscal year and has transferred a minimum of \$800 million annually to the Educational Enhancement Trust Fund (EETF) during this same period, with the fiscal year 2009 transfer exceeding \$1 billion for the seventh consecutive year.

For the fiscal year ended June 30, 2009:

- Transfers to the EETF increased slightly at approximately \$1.29 billion compared to the prior fiscal year.
- Florida Lottery's ticket sales decreased 5.7% over the prior fiscal year from approximately \$4.17 billion to \$3.94 billion.
- Prize expense decreased \$135.7 million (5.5%) during fiscal year 2009. The Lottery has the authority to vary the prize expense in order to maximize transfers. This expense typically increases or decreases in direct proportion to ticket sales and represented approximately 59.5% of net ticket sales.
- The gaming vendors' fees and retailer commissions are based on sales and therefore fluctuate in direct correlation with sales revenue. Fiscal year 2009 expenses for these items decreased over the prior year expenses by 11.5%. The additional decrease is due to a new contract effective October 1, 2008, for Scratch-Off ticket expense, which applies variable percentages to sales of tickets with different price points. Under the new contract, Scratch-Off ticket expense during fiscal year 2009 averaged 1.29% of sales plus any required royalty fees.
- Administrative operating expenses, which includes advertising, salaries and benefits, rent, utilities and maintenance, professional fees, depreciation, and other administrative expenses, decreased slightly by 1.9%. Administrative operating expenses for fiscal years 2009 and 2008 were \$71.2 million and \$72.6 million, respectively.
- Nonoperating income decreased \$36.1 million over the prior fiscal year. Net interest earned decreased approximately \$5.5 million due to lower interest rates in fiscal year 2009 compared to fiscal year 2008.

Unrealized appreciation on investments decreased \$30.7 million due to lower market values of investments of similar securities and a reduction in holdings in fiscal year 2009 compared to fiscal year 2008.

- EETF transfers of unclaimed prize money decreased \$20 million over the prior fiscal year due primarily to the reduction of unclaimed prize money generated by Scratch-Off games. On-line games generated \$3.3 million more of unclaimed prize money over fiscal year 2008.
- On January 4, 2009, the Lottery joined the Multi-State Lottery Association (MUSL) in order to sell the multi-state On-line game POWERBALL® with Power Play®. MUSL is a nonprofit government benefit association owned and operated by its member lotteries. During the 2008-09 fiscal year, MUSL included 30 state lottery entities, the District of Columbia, and the Virgin Islands. The chief executive officer of each member lottery serves on the MUSL board of directors.

## OVERVIEW OF THE FINANCIAL STATEMENTS

The Lottery is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the Lottery's basic financial statements, along with the notes to the financial statements. The Statement of Net Assets on page 13, the Statement of Revenues, Expenses, and Changes in Net Assets on page 14, and the Statement of Cash Flows on page 15 report the Lottery's net assets and changes therein. The notes to the financial statements provide additional information that is essential to a reader's understanding of the data provided in the financial statements.

The Lottery transfers its net profits each fiscal year to the EETF. As a result, the Lottery's net assets consist of funds invested in fixed capital assets and restricted assets. The restricted assets consist of the 20 percent for unclaimed prizes designated for future prizes, the MUSL deposit amount, a reserve fund established to pay set prize amounts, and investments being held by the Lottery to fund deferred prize payouts. The investments do include the cumulative effect of periodic adjustments to recognize the fair value of the grand prize investments despite the fact that the Lottery purchased the investments with the intention of holding the investments until maturity in order to meet the future obligations and, therefore, would not realize any gains or losses related to these investments for distribution as net proceeds.

## SUMMARY OF NET ASSETS

Table 1 presents the Lottery's condensed Statement of Net Assets as of the current fiscal year ended June 30, 2009, and the prior fiscal years ended June 30, 2008, and 2007, as derived from the Statement of Net Assets.

**Table 1**  
**Condensed Statement of Net Assets**  
**As of June 30, 2009, 2008, and 2007**  
**(In Thousands)**

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Assets</b>			
Current Assets	\$ 173,395	\$ 188,200	\$ 223,108
Restricted Assets	1,926,734	2,306,205	2,553,972
Capital Assets, Net of Depreciation	1,235	1,279	1,908
<b>Total Assets</b>	<u>2,101,364</u>	<u>2,495,684</u>	<u>2,778,988</u>
<b>Liabilities</b>			
Current Liabilities	173,542	187,526	218,842
Current Liabilities Payable from Restricted Assets	1,083,453	1,310,654	1,488,254
Noncurrent Liabilities	722,190	837,694	979,115
<b>Total Liabilities</b>	<u>1,979,185</u>	<u>2,335,874</u>	<u>2,686,211</u>
<b>Net Assets</b>			
Net Investment in Capital Assets	1,235	1,279	1,908
Restricted Net Assets	120,944	158,531	90,869
<b>Total Net Assets</b>	<u>\$ 122,179</u>	<u>\$ 159,810</u>	<u>\$ 92,777</u>

**Assets**

Total assets at the end of fiscal year 2009 decreased by \$394 million from \$2.5 billion at June 30, 2008, to \$2.1 billion at June 30, 2009. At the end of fiscal year 2008, total assets were \$283 million less than the \$2.8 billion at the end of fiscal year 2007.

- Current assets decreased from \$188.2 million in 2008 to \$173.4 million in 2009, representing a decrease of \$14.8 million. This net decrease was primarily due to a decrease of \$17 million in cash and cash equivalents and an increase of \$3.1 million in accounts receivable. Accounts receivable for fiscal year 2009 included an additional day in the weekly billing cycle to retailers over fiscal year 2008.
- Restricted assets decreased \$379.5 million from \$2.3 billion in 2008 to \$1.9 billion in 2009. This decrease was mostly attributable to the continuing decrease in the size of the deferred payment investment portfolio. The net appreciation in fair value of the grand prize investments decreased \$131.4 million. However, the size of the total portfolio continues to decrease due to a consistent pattern of jackpot prizewinners selecting the cash option when they have the option of selecting either an annuity or cash. This pattern resulted in a payout of annuities for the current fiscal year of \$220.0 million and purchases of \$22.1 million in new investments. In fiscal year 2008, payouts of annuities were \$246.3 million, and purchases of new investments consisted of \$3.4



million. As a result of the diminishing size of the investment portfolio, the value of the collateral from the lending of those securities was also less than the prior years. At June 30, 2009, the Lottery held \$842.7 million in collateral versus \$1.1 billion at June 30, 2008, and \$1.2 billion at June 30, 2007.

### Liabilities

Total liabilities at June 30, 2009, were \$2.0 billion, which was \$357 million lower than the total liabilities of \$2.3 billion at June 30, 2008. The total liabilities at June 30, 2008, were \$350 million lower than the June 30, 2007, amount of \$2.7 billion.

- Current liabilities decreased from \$187.5 million on June 30, 2008, to \$173.5 million on June 30, 2009. The decrease of \$14 million was due to a combination of factors. Decreases in current liabilities were caused by a decrease of \$29.1 million in the amount due to FETV at year-end and decreases in accounts payable and security deposits payable of \$4.2 million combined. However, these decreases were offset by an increase in prizes payable of \$19.3 million. The RAFFLE game had a prizes payable on June 30, 2009, of \$7.4 million and only \$60 thousand on June 30, 2008, and the new On-line game (POWERBALL with Power Play) had a prizes payable at June 30, 2009 of \$12.4 million.
- Current liabilities from restricted assets decreased \$227.2 million from \$1.31 billion at June 30, 2008, to \$1.08 billion at June 30, 2009. This decrease can be primarily attributed to a net decrease in obligations under security lending of \$207.6 million. The June 30, 2008, balance of \$1.31 billion was \$177.6 million less than the June 30, 2007, balance of \$1.49 billion. Again, this decrease can be primarily attributed to a net decrease in obligations under security lending of \$152.6 million. Noncurrent liabilities principally consist of grand prizes payable, which represents the amount to be paid to grand prizewinners over future years. Grand prizes payable, as expected, experienced a decrease of \$115.8 million from year-end 2008 to 2009 and a decrease of \$142 million from year-end 2007 to 2008.

### Net Assets and Changes in Net Assets

Net assets decreased by \$37.6 million from June 30, 2008, to June 30, 2009. Net assets at June 30, 2009, 2008, and 2007 were \$122.2 million, \$159.8 million, and \$92.8 million, respectively. The fiscal year 2009 decrease was primarily due to decreases in restricted net assets for future prizes and promotions of \$10.7 million, in the restricted net assets for restricted prize pool relative to the LOTTO PLUS game of \$12.0 million, and in restricted net assets for undistributed appreciation on restricted investments of \$17.9 million. The Lottery expects the restricted net assets for undistributed appreciation on restricted investments to continue to decline over the foreseeable future due to the fact that grand prizewinners consistently choose the cash option when they claim their prizes. The majority of grand prizewinners that are receiving annual payments will be paid off within the next five years. Please see Note 2 – Cash and Investments in the Notes to the Financial Statements for more details.

The Lottery began selling the POWERBALL with Power Play On-line game on January 4, 2009. In accordance with MUSL's game rules for POWERBALL with Power Play, the Lottery must contribute to various prize reserves funds

maintained by MUSL for unforeseen prize payouts. As of June 30, 2009, the Lottery had deposits with MUSL of \$3.1 million, representing the Lottery's deposits of reserve funds.

### SUMMARY OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The most important element demonstrated with the Lottery's financial statements is the transfer of net income to the EETF. Accordingly, the primary focus of these financial statements is determining net income available for transfer, rather than the change in net assets of the Lottery, which primarily reflects the changes in fair value of restricted investments.

Table 2 presents a condensed Summary of Revenues, Expenses, and Changes in Net Assets for the current fiscal year ended June 30, 2009, and the prior fiscal years ended June 30, 2008, and June 30, 2007, as derived from the Lottery's Statement of Revenues, Expenses, and Changes in Net Assets.

**Table 2**  
**Condensed Statement of Revenues, Expenses, and Changes in Net Assets**  
**As of June 30, 2009, 2008, and 2007**

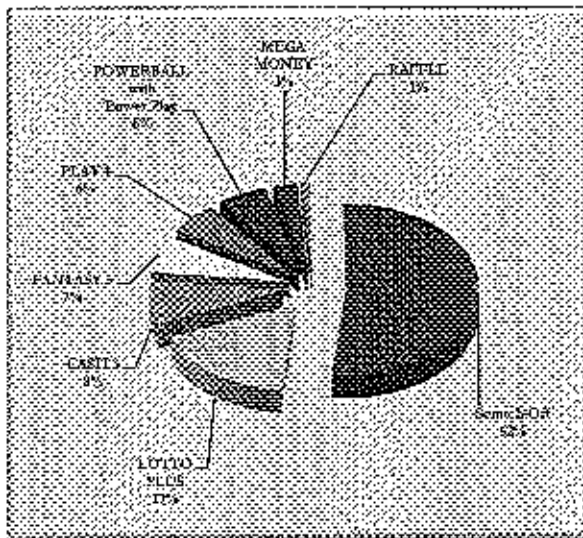
	(In Thousands)		
	2009	2008	2007
Operating Revenues			
Ticket Sales	\$ 3,938,037	\$ 4,174,776	\$ 4,122,116
Bad Debt Expense	(1,256)	(674)	(1,085)
On line & Retailer Fees and Miscellaneous	7,408	7,724	7,438
Total Operating Revenues	<u>3,944,189</u>	<u>4,181,826</u>	<u>4,128,469</u>
Operating Expenses			
Prizes	2,340,372	2,176,032	2,484,519
Retailer Commissions	220,548	235,651	234,291
Vendor Commissions	59,875	91,300	78,090
Other Expenses	71,223	72,587	72,134
Total Operating Expenses	<u>2,692,018</u>	<u>2,865,570</u>	<u>2,869,034</u>
Income from Operations	<u>1,252,171</u>	<u>1,316,256</u>	<u>1,259,435</u>
Nonoperating Revenue, Net of Expenses	<u>(1,947)</u>	<u>34,191</u>	<u>(3,102)</u>
<b>Income Before Operating Transfers</b>	<u>1,250,224</u>	<u>1,350,447</u>	<u>1,256,333</u>
Transfers to EETF from Revenue	(1,241,015)	(1,216,839)	(1,224,524)
Transfers to EETF from Undeclared Prizes	(46,840)	(66,575)	(38,748)
Total Transfers to EETF	<u>(1,287,855)</u>	<u>(1,283,414)</u>	<u>(1,263,272)</u>
<b>Change in Net Assets</b>	<u>(37,631)</u>	<u>67,033</u>	<u>(6,939)</u>
Net Assets, Beginning of Year	<u>159,810</u>	<u>92,777</u>	<u>99,716</u>
<b>Net Assets, End of Year</b>	<u>\$ 122,179</u>	<u>\$ 159,810</u>	<u>\$ 92,777</u>

**Sales**

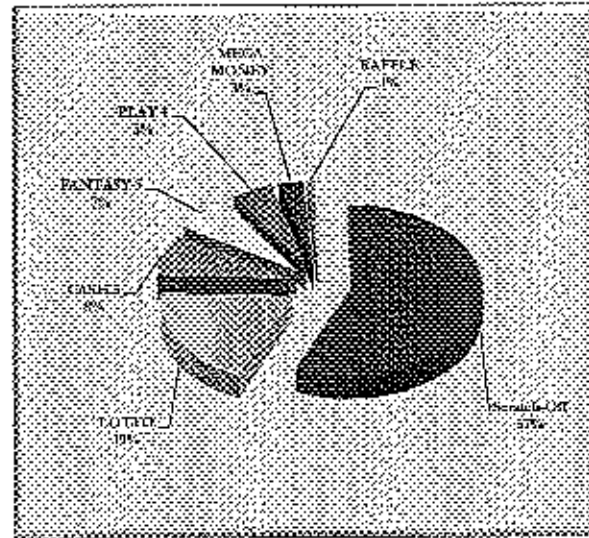
For the fiscal year ended June 30, 2009, overall ticket sales decreased \$236.7 million mirroring the downturn in the economy. Sales for On-line products increased with the new POWERBALL with Power Play game, accounting for \$233.4 million of ticket sales and compensating for the decreases in all games except for PLAY 4 and MILLIONAIRE RAFFLE, which increased \$11.0 million and \$10.5 million, respectively. Sales of Scratch-Off tickets decreased \$304.6 million from \$2.4 billion for the fiscal year ending June 30, 2008, to \$2.1 billion at June 30, 2009, and were 56.7% and 52.4% of combined sales in each of the two years, respectively. The \$5, \$10, and \$20 price point tickets accounted for approximately \$291 million of this decrease. Bad debt expense was reclassified from an operating expense to a reduction in gross revenue. The amount of bad debt expense for the fiscal years ended June 30, 2009, and June 30, 2008, was \$1,256,000 and \$674,000, respectively.

The following charts show sales by product for the various Lottery games during the June 30, 2009, and 2008, fiscal years:

**Sales by Product for 2008-09**

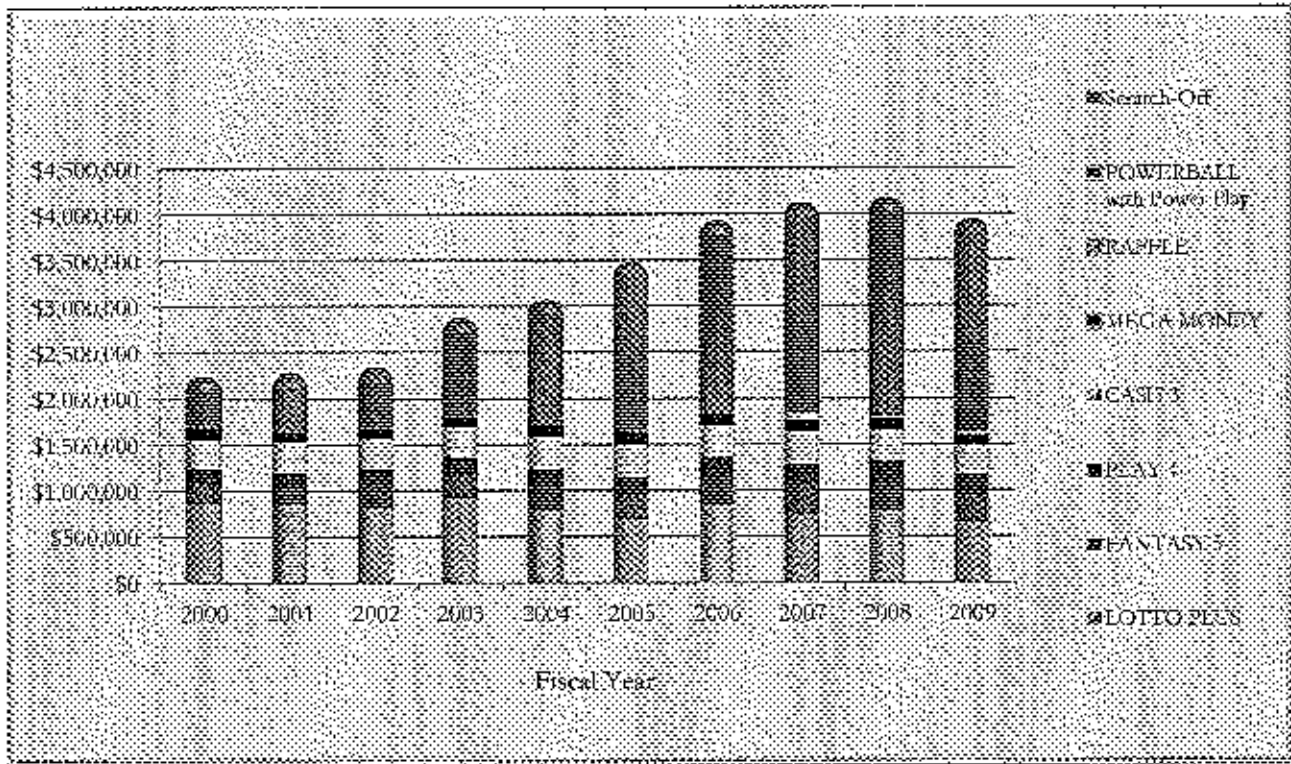


**Sales by Product for 2007-08**



The following chart and table show sales by game for the last ten fiscal years:

**Department of the Lottery  
Historical Lottery Sales by Game  
(In Thousands)**



**Department of the Lottery  
Historical Lottery Sales By Game  
Last Ten Fiscal Years  
(In Thousands)**

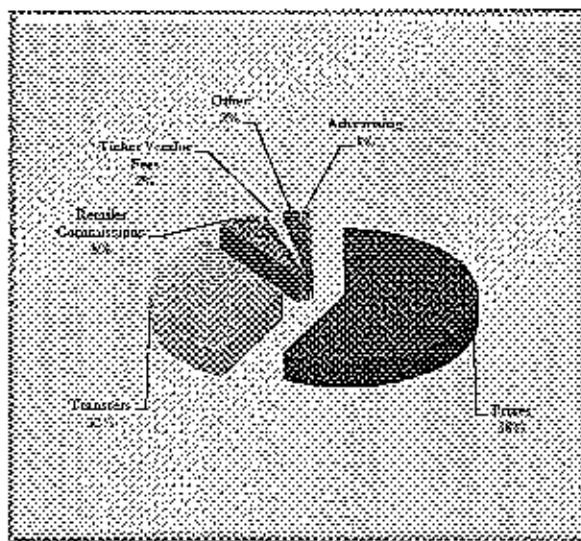
Fiscal Year Ended June 30	LOTTO PLUS™	FANTASY 5™	PLAY 4™	CASH 3™	MEGA MONEY™	MILLIONAIRE RAFFLE™	POWERBALL® with Power Play®	Scratch-Off	Combined Sales
2000	\$ 864,983	\$ 216,303	\$ 158,620	\$ 318,972	\$ 121,266			\$ 566,352	\$ 2,248,496
2001	845,433	191,614	163,157	326,471	103,842			639,209	2,274,726
2002	806,023	262,923	170,708	329,830	98,315			662,566	2,330,365
2003	925,474	259,999	182,716	330,601	95,950			1,073,861	2,867,981
2004	785,415	259,728	192,580	349,227	125,944			1,358,068	3,070,962
2005	687,820	252,467	206,982	345,598	151,248			1,844,679	3,470,734
2006	835,028	306,679	215,529	343,174	138,502			2,100,118	3,929,030
2007	735,585	326,241	225,285	348,694	130,142	\$ 72,549		2,283,620	4,122,116
2008	778,954	309,445	227,940	336,096	122,742	30,818		2,368,781	4,174,776
2009	650,603	287,285	238,957	329,157	102,190	41,314	\$ 253,396	2,064,135	3,948,037

**Expenses**

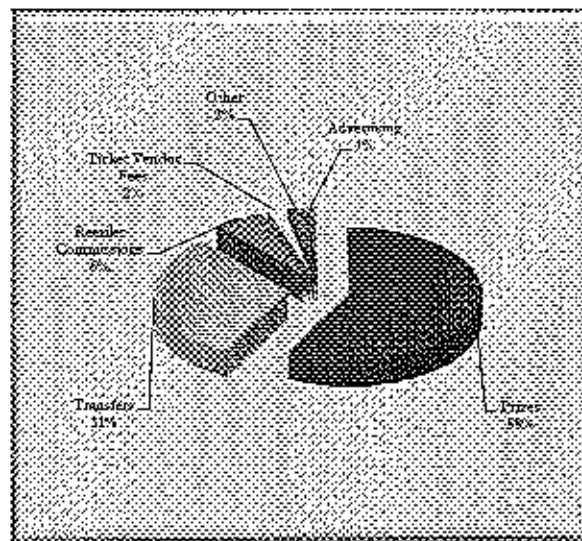
Section 24.121, Florida Statutes, stipulates that funds remaining in the Operating Trust Fund after the transfer to EETF shall be used for the payment of administrative expenses of the Lottery. These expenses include On-line game expenses, Scratch-Off ticket expenses, advertising, and other expenses required for the day-to-day operations of the Lottery.

The following charts show the major components of Lottery operating expenses and transfers as a percentage of ticket sales for the June 30, 2009, and 2008, fiscal years:

**Operating Expenses, Transfers and Reserves 2008-09**



**Operating Expenses, Transfers and Reserves 2007-08**

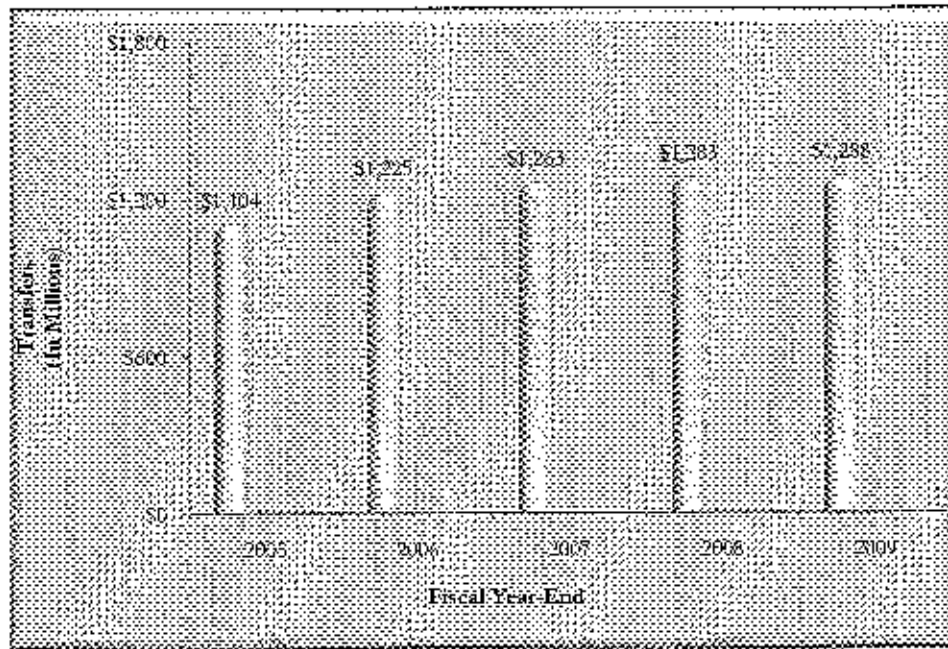


Prizes, commissions and vendor fees directly relate to sales and fluctuate accordingly. In fiscal year 2009, these expenses changed proportionally, yet as a percentage of total expenses they remained constant. The other expenses, which consist of advertising, salary and benefits, professional fees, rent, maintenance, and depreciation, have remained relatively stable. Fiscal year 2009 and 2008 administrative expenses were \$71.2 million and \$72.6 million, respectively.

**Transfers**

The Lottery's contribution to the EETF for the fiscal year ended June 30, 2009, \$1.29 billion, was the highest since the Florida Lottery began making transfers in 1988. Fiscal year 2009 was the seventh straight year in which the Lottery's contribution to EETF was over \$1 billion. Total transfers to the EETF increased by \$4.4 million from the prior fiscal year despite a \$236.7 million decrease in ticket sales. This increase was possible due to the fact that the Lottery was able to liquidate some required reserves during the fiscal year and overall prize expense was less than previous years. When adjusted for inflation, the Lottery's transfer amount for fiscal year 2009 was lower than the prior year adjusted-for-inflation transfer amount. However, overall the Lottery's transfer rates have increased slightly over the rate of inflation during the 22-year period.

The following chart shows the total transfers to the FETP for the past five fiscal years:



#### ECONOMIC FACTORS AND FUTURE IMPACTS

The main economic factors affecting lottery sales are population growth, personal income growth, tourism, and competition for discretionary consumer spending. The Lottery must continue to find ways to maintain the annual transfer to FETP of over \$1 billion. The Lottery's strategies revolve around enhancing On-line and Scratch-Off product sales and increasing retailer penetration in the state. The following are some of the functional strategies currently being explored by management:

- **Increase the focus of research and product development for the On-line and Scratch-Off product segments.** This functional strategy will be accomplished through product extensions, redesign of existing On-line games, On-line promotions, Scratch-Off games, etc.

Chapter 24.121, Florida Statutes, authorizes the Lottery to utilize variable prize payout for both On-line games and Scratch-Off games. The Lottery began utilizing higher prize payouts for On-line games in fiscal year 2005 and did not expect the same rate of return for the On-line games; however, the Department has experienced a positive return from applying the variable prize payout strategy. During fiscal year 2008-09, the Lottery utilized the higher payout authority for LOTTO PLUS and three raffle games. Individually these efforts helped to offset the negative effects of a downturn in the economy.

- **Improve market penetration through expansion of Lottery retailer network.** The Lottery has set internal goals for continuing to grow the number of retailers so that Florida's per capita level of retailers is comparable to other successful states. The Department conducted four retailer recruitment seminars across

the state as well as continuing efforts with individual communications. As of the end of fiscal year 2009, the retailer base is holding steady at just over 13,250 retailers.

#### **FINANCIAL CONTACT**

The Florida Lottery's Financial Statements and this Management's Discussion and Analysis are designed to give a general overview to all interested parties. If you have any questions regarding this report or require additional information, please contact the State of Florida, Department of the Lottery, Chief Financial Officer, 250 Marriott Drive, Capitol Complex, Tallahassee, Florida 32399.

**BASIC FINANCIAL STATEMENTS**

**DEPARTMENT OF THE LOTTERY  
STATEMENT OF NET ASSETS**

**As of June 30, 2009, and June 30, 2008  
(In Thousands)**

<b>Assets</b>	<u>June 30, 2009</u>	<u>June 30, 2008</u>
<b>Current Assets:</b>		
Cash and cash equivalents	\$126,062	\$143,031
Interest receivable	549	728
Accounts receivable, net	43,185	40,672
Prepaid expenses	27	0
Inventories	843	844
Security deposits	2,729	3,525
<b>Total Current Assets</b>	<u>173,395</u>	<u>188,200</u>
<b>Noncurrent Assets:</b>		
<b>Restricted Assets</b>		
Cash and cash equivalents	50,590	74,348
Securities lending income receivable	631	2,538
Deposit with MUSL	3,073	0
Investments, grand prize	1,029,759	1,161,202
Investments, other	842,681	1,068,317
<b>Total Restricted Assets</b>	<u>1,926,734</u>	<u>2,306,205</u>
Capital assets, net	1,235	1,279
<b>Total Noncurrent Assets</b>	<u>1,927,969</u>	<u>2,307,484</u>
<b>Total Assets</b>	<u>2,101,364</u>	<u>2,495,684</u>
<b>Liabilities</b>		
<b>Current Liabilities:</b>		
Accounts payable and accrued liabilities	8,407	11,792
Prizes payable	77,745	58,478
Due to Educational Enhancement Trust Fund	83,765	112,679
Deposits payable	2,736	3,525
Compensated absences payable	889	852
<b>Total Current Liabilities</b>	<u>173,542</u>	<u>187,526</u>
<b>Current Liabilities Payable from Restricted Assets:</b>		
Pending purchases payable	0	1,022
Securities lending fees payable	749	2,005
Obligations under securities lending	887,749	1,095,328
Grand prizes payable	194,955	212,299
<b>Total Current Liabilities Payable from Restricted Assets</b>	<u>1,083,453</u>	<u>1,310,654</u>
<b>Noncurrent Liabilities:</b>		
Grand prizes payable from restricted assets	718,790	834,545
Compensated absences payable	2,942	2,897
Postemployment healthcare benefits payable	458	252
<b>Total Noncurrent Liabilities</b>	<u>722,190</u>	<u>837,694</u>
<b>Total Liabilities</b>	<u>1,979,185</u>	<u>2,335,874</u>
<b>Net Assets</b>		
Invested in capital assets	1,235	1,279
Restricted net assets for undistributed appreciation on restricted investments	67,281	85,206
Restricted net assets for Restricted Prize Pool	32,661	44,662
Restricted net assets for MUSL	3,073	0
Restricted net assets for future prizes or special prize promotions	17,929	28,663
<b>Total Net Assets</b>	<u>\$122,179</u>	<u>\$159,810</u>

See accompanying notes to the financial statements.



**DEPARTMENT OF THE LOTTERY**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**

Years ended June 30, 2009, and June 30, 2008

(In Thousands)

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
<b>Operating Revenues:</b>		
Ticket sales	\$3,938,037	\$4,174,776
Bid debt expense	(1,256)	(674)
On-line fees and miscellaneous	7,198	7,482
Retailer fees	210	212
<b>Total Operating Revenues</b>	<u>3,944,189</u>	<u>4,181,826</u>
<b>Operating Expenses:</b>		
Prizes	2,340,372	2,476,032
Retailer commissions	220,348	235,631
Scratch-Off tickets	31,893	55,135
On-line games	27,982	26,165
Advertising	34,353	34,706
Personal services	26,857	27,240
Other contractual services	7,082	8,546
Materials and supplies	2,247	1,400
Depreciation	684	695
<b>Total Operating Expenses</b>	<u>2,692,018</u>	<u>2,865,570</u>
<b>Operating Income</b>	<u>1,252,171</u>	<u>1,316,256</u>
<b>Nonoperating Revenues (Expenses):</b>		
Interest	7,133	13,465
Securities lending income	18,183	53,189
Securities lending fees	(8,980)	(44,888)
Investment management fees	(327)	(290)
Net appreciation (depreciation) in fair value of investments	46,832	89,149
Property disposition (loss)	(31)	(52)
Amortization of grand prizes payable	(64,757)	(76,383)
<b>Total Nonoperating Revenues (Expenses), Net</b>	<u>(1,947)</u>	<u>34,191</u>
<b>Income Before Operating Transfers</b>	1,250,224	1,350,447
<b>Transfers to Educational Enhancement Trust Fund:</b>		
Transfers from revenue	(1,241,015)	(1,216,839)
Transfers from undaimed prizes	(46,840)	(66,575)
<b>Total Transfers to Educational Enhancement Trust Fund</b>	<u>(1,287,855)</u>	<u>(1,283,414)</u>
<b>Change in Net Assets</b>	(37,631)	67,033
Net Assets, Beginning of Year	159,810	92,777
<b>Net Assets, End of Year</b>	<u>\$122,179</u>	<u>\$159,810</u>

See accompanying notes to the financial statements.

**DEPARTMENT OF THE LOTTERY  
STATEMENT OF CASH FLOWS**

**Years ended June 30, 2009, and June 30, 2008  
(In Thousands)**

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
<b>Operating Activities:</b>		
Ticket sales	\$ 3,333,668	\$ 4,168,731
Prizes paid to winners	(2,326,709)	(2,503,131)
Commissions paid and payments to retailers	(230,548)	(235,651)
Paid to vendors for goods and services	(107,442)	(125,904)
Paid to employees	(26,090)	(27,130)
Other operating revenue	7,408	7,723
<b>Net Cash Provided by Operating Activities</b>	<u>1,260,287</u>	<u>1,284,638</u>
<b>Noncapital Financing Activities:</b>		
Payments to Educational Enhancement Trust Fund	(1,316,968)	(1,287,968)
<b>Net Cash Used in Noncapital Financing Activities</b>	<u>(1,316,968)</u>	<u>(1,287,968)</u>
<b>Capital and Related Financing Activities:</b>		
Purchase of capital assets	(671)	(118)
<b>Net Cash Used in Capital and Related Financing Activities</b>	<u>(671)</u>	<u>(118)</u>
<b>Investing Activities:</b>		
Cash received from maturity of grand prize investments	219,980	246,337
Cash paid to grand prizewinners upon maturity of grand prize investments	(219,980)	(246,337)
Investment income, net of fees	16,626	19,365
<b>Net Cash Provided by Investing Activities</b>	<u>16,626</u>	<u>19,365</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<u>(40,727)</u>	<u>15,919</u>
Cash and Cash Equivalents, Beginning of Year	217,379	201,450
Cash and Cash Equivalents, End of Year	<u>\$ 176,652</u>	<u>\$ 217,379</u>
<b>Reconciliation of Income from Operations to Net Cash Provided by Operating Activities:</b>		
Income from operations	\$ 1,253,171	\$ 1,316,256
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	684	695
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(5,180)	(5,034)
Inventories	1	123
Pre-paid expenses	(27)	0
Increase (decrease) in:		
Allowance for uncollectible accounts	(1,006)	(317)
Accounts payable and accrued liabilities	(3,379)	(76)
Prizes payable	16,735	(27,098)
Compensated absences payable	82	(143)
Postemployment healthcare benefits payable	206	252
<b>Net Cash Provided by Operating Activities</b>	<u>\$ 1,260,287</u>	<u>\$ 1,284,638</u>
<b>Noncash Investing, Capital and Financing Activities:</b>		
Increase/(decrease) in fair value of investments	\$ (91,099)	\$ (64,268)

See accompanying notes to financial statements.

## NOTES TO THE FINANCIAL STATEMENTS

## DEPARTMENT OF THE LOTTERY

Years ended June 30, 2009, and June 30, 2008

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****a. Reporting Entity**

The State of Florida, Department of the Lottery (the Lottery) was established as a State agency with the enactment of the Florida Public Education Lottery Act (the Act) in 1987. The purpose of the Act is "to implement Section 15, Article X of the State Constitution in a manner that enables the people of the State to benefit from significant additional moneys for education and also enables the people of the State to play the best lottery games available."

In evaluating the Lottery as a reporting entity, management has addressed all potential component units for which the Lottery may be financially accountable and, as such, be includable in the Lottery's financial statements. The Lottery is financially accountable if it appoints a voting majority of the organization's governing board and (1) it is able to impose its will on the organization or (2) there is a potential for the organization to provide specific financial benefit to or impose specific financial burden on the Lottery. Additionally, the primary government is required to consider other organizations for which the nature and significance of their relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. Management's analysis has disclosed no component units that should be included in the Lottery's financial statements.

**b. Basis of Presentation**

The Lottery is accounted for as a proprietary type enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges; or (2) where the periodic determination of net income is considered appropriate. The Lottery is reported as an enterprise fund within the State of Florida's Comprehensive Annual Financial Report.

**c. Basis of Accounting**

Basis of accounting refers to the timing of recognition of revenue and expenses in the accounts and reporting in the financial statements. The financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

The measurement focus of proprietary fund types is on a flow of economic resources method, which emphasizes the determination of net income, financial position, and cash flows. All fund assets and liabilities, current and noncurrent, are accounted for on the Statement of Net Assets. Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, proprietary funds have the option to elect to apply all pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989. The Lottery has elected not to apply FASB pronouncements issued after November 30, 1989. As also provided by GASB, the Lottery has elected not to adopt any FASB statements issued after November 30, 1989, unless so directed by GASB.

The Lottery's operating revenues and expenses generally result from the sale and marketing of Lottery tickets and the payment of related prizes. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

**d. Cash and Cash Equivalents**

The Lottery considers all highly liquid investments with an original maturity of three months or less when purchased, to be cash equivalents. This includes cash in banks, repurchase agreements with financial institutions, petty cash, balances held by the State Board of Administration (SBA), and pooled investments in the State Treasury.

**e. Investments**

Florida Statutes authorize the Lottery to invest in certain instruments. The Lottery reports investments at fair value. Investments that are not publicly quoted are priced by a third party through a discounted cash flow method. Details of investments are included in Note 2.

**f. Allowance for Doubtful Accounts**

The allowance for doubtful accounts is based on an analysis of collectibility of accounts receivable, which considers the age of the accounts.

**g. Inventories**

Supply inventory and promotional items are valued at cost, using the first-in, first-out method. Supply inventory is comprised of game merchandise and prepaid postage.

**h. Prepaid expenses**

Prepaid expenses represent warranty agreements paid for during the current year but which will not be consumed or used up until a future period.

**i. Capital Assets**

Capital assets are stated at cost less accumulated depreciation. As required by Chapter 273, Florida Statutes, a capitalization threshold of \$1,000 and useful life extending beyond one year is employed. Depreciation on capital assets is computed using the straight-line method over the following estimated useful lives:

Data processing equipment	3 to 5 years
Office furniture and fixtures	3 to 15 years
Vehicles and other equipment	3 to 20 years

When capital assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the Statement of Revenues, Expenses, and Changes in Net Assets, in the period of disposal. See Note 5 for more detailed information on Capital Assets.

**j. Net Assets**

Net Assets includes categories for net investments in capital assets, restricted net assets for undistributed appreciation on restricted investments, restricted net assets for future prizes or special prize promotions, restricted net assets for the Restricted Prize Pool, and restricted net assets for Multi-State Lottery Association (MUSL). See Note 6 for more information on MUSL.

The net investments in capital assets category represents the investment in capital assets, recorded at cost less accumulated depreciation.

The restricted net assets for undistributed appreciation on restricted investments category represents the undistributed appreciation for all restricted asset accounts.

The restricted net assets for future prizes or special prize promotions category represents the portion of unclaimed prize obligations legally reverted back to the Lottery for the payment of future prize pools or special prize promotions in accordance with Section 24.115(2), Florida Statutes.

The restricted net assets for Restricted Prize Pool category represents the prize expense reserved to support payments to winners of the Florida Lotto \$2 and \$3 jackpots in accordance with Rule 53ER08-12, Florida Administrative Code, which was replaced by Rule 53ER08-88, Florida Administrative Code.

The restricted net assets for MUSL category represents the amount placed into reserve for the Florida Lottery by the MUSL Powerball Product Group in accordance with Rule 53ER08-84, Florida Administrative Code.

#### **k. Revenue Recognition**

Lottery games are sold to the public by contracted retailers. Revenue is recognized when On-line tickets are sold to players and when books of Scratch-Off tickets are settled. Certain games include tickets that entitle the holder to exchange one ticket for another (free tickets). Such tickets are deemed to be replacements and, therefore, are not included in ticket sales.

#### **l. Commissions**

Retailers receive a commission of five percent on ticket sales. The commission on ticket sales for Scratch-Off games is based upon total tickets distributed to the players (including free tickets) which, when compared to revenue, causes the percentage to be slightly higher than five percent. Additionally, retailers are paid commissions through a one percent cashing bonus on redemption of tickets (including free tickets).

#### **m. Prizes**

In accordance with the Act, variable percentages of the gross revenue from the sale of On-line and Scratch-Off lottery tickets shall be returned to the public in the form of prizes paid by the Lottery or retailers as authorized. Prior to July 1, 2006, the Act authorized, as nearly as practicable, at least fifty percent of ticket sales must be returned to the public in the form of prizes.

Prize expense for On-line games is recorded based on prizes won by the players, as revenue is recognized. Any prize that remains unclaimed at the end of a 180-day period following a draw is considered unclaimed.

Prize expense for Scratch-Off games is recorded based on the predetermined prize structure for each game, as revenue is recognized. Any prize that remains unclaimed 60 days after a Scratch-Off game is closed is considered unclaimed.

As of July 1, 2005, 80 percent of all unclaimed prize money is deposited in the Educational Enhancement Trust Fund (EETF). The remaining 20 percent of unclaimed prize money is added to the pool from which future prizes are to be awarded or used for special prize promotions and is reported as restricted net assets for future prizes or special prize promotions. As any unclaimed prize money is remitted to EETF, it reduces overall prize expense. The Lottery also maintains reserves for

Lotto Plus and POWERBALL with Power Play. If any of these reserves are transferred to EETF, it reduces prize expense.

All prizes are recorded at the actual amount except for the annuity-funded prizes, which are paid out on a deferred basis. The actual prize expense for these types of prizes is based on the present value of an annuity using the interest yield on the investments, which were acquired to fund the annuity.

**n. *Compensated Absences***

Employees earn the right to be compensated during absences for vacation, illness, and unused special compensatory leave earned for hours worked on legal holidays. Compensated absences for annual leave are recorded as a liability when the benefits are earned. Compensated absences for sick leave are calculated based on the vesting method. Within the limits established by law or rule, unused leave benefits are paid to employees upon separation from State service. The cost of vacation and calculated sick leave benefits is accrued in the period in which earned. The compensated absences amounts are based on current year-end salary rates and include employer social security and pension contributions at current rates.

**o. *Self-Insurance***

The Lottery participates in the various self-insurance programs established by the State of Florida for property and casualty losses and employee health insurance. Coverages include property, general liability, automobile liability, workers' compensation, court-awarded attorney fees, and Federal civil rights actions. Property is self-insured for actual cash value to an aggregate of \$2 million per loss event for all perils except named windstorm and flood. Property losses in excess of \$2 million are commercially insured up to \$200 million per loss event excluding named windstorm or flooding events. Named windstorm and flood losses have a \$2 million deductible per occurrence, with a \$40 million annual aggregate deductible with commercial insurance coverage up to \$50 million per occurrence. Workers' compensation is provided to comply with the applicable law. The employee health and dental insurance program provides for payment of medical claims of employees and covered dependents.

**p. *Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, restricted net assets, revenues, and expenses, and disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

**q. *Bad Debt Expense***

Bad debt expense was reclassified from an operating expense to a reduction in gross revenue for the fiscal years ended June 30, 2009, and June 30, 2008. Bad debt expense is recognized when a Lottery retailer's uncollected revenue is past due. The amount of expense is based on an accounts receivable age analysis. The bad debt expense for the fiscal years ended June 30, 2009, and June 30, 2008, was \$1,256,000 and \$674,000, respectively.

## **2. CASH AND INVESTMENTS**

### **a. Cash and Cash Equivalents**

Cash is held in demand deposits at various financial institutions. These deposits, with a book value of approximately \$893,000 at June 30, 2009, and \$1,168,000 at June 30, 2008, were insured by either the State's collateral for public deposits in accordance with Section 280.04, Florida Statutes, or Federal depository insurance.

Chapter 280, Florida Statutes, generally requires public funds to be deposited in a Qualified Public Depository, which is a bank or savings association that is designated by the State of Florida Chief Financial Officer (State CFO) as authorized to receive deposits in the State and that meets the collateral requirements. The State CFO determines the collateral requirements and collateral pledging level for each Qualified Public Depository following guidelines outlined in Section 280.04, Florida Statutes, and Chapter 69C-2, Florida Administrative Code. Collateral pledging levels include 25, 50, 125, and 200 percent of a Qualified Public Depository's average daily deposit balance or, if needed, an amount as prescribed by the State CFO. Collateral may be held by another custodian with approval of the State CFO if conditions are met that protect the State's interest. Eligible collateral includes federal, federally-guaranteed, state and local government obligations, corporate bonds, and other securities designated allowable under conditions set by the State CFO.

Statutes provide that if a loss to public depositors is not covered by deposit insurance and the proceeds from the sale of securities pledged by the defaulting depository, the difference will be provided by an assessment levied against other Qualified Public Depositories of the same type as the depository in default.

Due to the investing policy of the Lottery, book overdrafts were approximately \$2,117,000 at June 30, 2009, and \$2,769,000 at June 30, 2008, representing outstanding prize payment checks and retailer payment checks. These outstanding checks are included as a component of prizes payable and accounts payable. The Lottery has an agreement with a financial institution to honor prize payments and retailer payments, as they are presented to the bank, up to \$75 million.

Surplus cash is maintained in the State Treasury's general pool of investments. The State CFO pools funds from all departments. Included in the pool are primarily time deposits, U.S. Government securities, federal agency securities, bankers' acceptances, commercial paper, corporate bonds and notes, repurchase agreements and reverse repurchase agreements. The Lottery's share of this investment pool was approximately \$175,759,000 and \$216,211,000 at June 30, 2009, and 2008, respectively. No allocation will be made as to the Lottery's share of the types of investments or their risk categories. The Lottery's share of the assets and liabilities arising from the securities lending agreements administered by the State Treasury will likewise not be carried on the Statement of Net Assets since the State Treasury operates on a pooled basis and to do so may give the misleading impression that the Lottery itself has entered into such agreements. For further information, refer to the State of Florida's Comprehensive Annual Financial Report or publications of the State of Florida Department of Financial Services, Office of the Chief Financial Officer.

### **b. Investments, Grand Prize**

The grand prize investments primarily consist of U.S. Government obligations held on the Lottery's behalf by the SBA. Grand prize investments and related grand prizes payable are not presented in current assets or liabilities. They are not part of current operations but instead are restricted assets and liabilities that are held by the Lottery for grand prize winnings to be paid on a deferred basis if the cash payment option is not selected.

Grand prize investments are shown at fair value, and the related grand prizes payable are adjusted to the net present value using the yield on the investments. The difference between the fair value of the investments and the net present value of the grand prizes payable is reflected as a restriction for undistributed appreciation on investments in net assets. This represents the unrealized gains on the investments. Because these investments are held restrictively for grand prizewinners, this balance is not available for transfer to the EETF.

Interest accreted on grand prize investments during the year is reflected as an increase in the carrying value of grand prizes payable on the Statement of Net Assets, and as a nonoperating expense on the Statement of Revenues, Expenses, and Changes in Net Assets. Net appreciation in fair value of investments is reflected as a nonoperating revenue on the Statement of Revenues, Expenses, and Changes in Net Assets, and takes into account all changes in fair value that occurred during the year, including purchases, maturities, and sales.

### **c. Investments, Other**

These investments consist of the fair value of investments made with cash collateral held by the SBA on the Lottery's behalf as part of a securities lending program.

The SBA, authorized by Section 215.47, Florida Statutes, participates in a securities lending program involving grand prize investments. The Lottery, through the SBA, loans various securities to borrowers for collateral with a simultaneous agreement to return collateral for the same securities in the future. Collateral received from borrowers may be cash or U.S. Government securities. The SBA is contractually limited from pledging or selling collateral except in the event of borrower default. The contract with the lending agent requires it to indemnify the SBA if the borrowers fail to return the underlying securities or fail to pay income distributions on them. No significant violations of legal or contractual provisions occurred, and no losses resulted from borrower or lending agent defaults.

Mellon Bank is the agent for lending U.S. Treasury securities to various authorized brokers for cash or U.S. Government securities. Initially, collateral received shall be in the form of cash at 100 percent, or other securities valued at 102 percent, of the fair value of the securities loaned as required by the lending agreement. Borrowers must be approved for lending by Mellon Bank's credit department. Mellon Bank monitors the fair value of collateral provided and the securities on loan on a daily basis. Additional collateral is required if the fair value of the collateral for any loan is less than 100 percent of the fair value of the securities provided for such loan. The SBA had no credit risk exposure to borrowers at year-end.

The SBA received \$887,749,000 of cash collateral for the lending program as of June 30, 2009, and \$1,095,328,000 as of June 30, 2008. At June 30, 2009, the collateral that was held for the securities lending transactions exceeded the fair value of the securities underlying the agreements (including accrued interest). The cash was invested in securities authorized by the lending agreement. Authorized securities include primarily certificates of deposit, corporate and medium term notes, asset-backed securities, and repurchase agreements. The invested cash collateral generally has a shorter maturity than the securities on loan.

A risk factor associated with this lending agreement is the potential for shortfalls in the value of the invested cash collateral. If the invested cash collateral is required to be liquidated, any shortfall between the value of the invested cash collateral and the securities lending obligation becomes the responsibility of the Lottery. As of June 30, 2009, and June 30, 2008, the potential unrealized shortfall was \$45 million and \$27 million, respectively. Other risk factors include counterparty default and failure of the custodial bank to indemnify the Lottery.



Securities lending income and expenses for the years ended June 30, 2009, and 2008, consisted of (in thousands):

	2009	2008
Securities lending income	\$ 18,183	\$ 53,189
Less broker rebates	(7,835)	(43,106)
Less bank fees	(1,145)	(1,782)
<b>Net securities lending revenue</b>	<b>\$ 9,203</b>	<b>\$ 8,301</b>

**d. Investment Credit Risk**

Lottery grand prizewinner investments have been limited to U.S. Government guaranteed securities.

The State Treasury Investment Pool's current rating by Standard and Poor's is A+f.

Listed below are the Standard and Poor's credit ratings for the lending program's invested cash collateral (in thousands):

As of June 30, 2009

Investment Type	Standard and Poor's Credit Rating							Totals
	AAA	AA	A	BBB	BB	CCC	NR	
Certificates of Deposit	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Domestic Corporate Bonds & Notes	-	9,953	195,387	12,416	-	-	4,921	222,677
Domestic Non-government Asset-backed Securities	317,625	-	-	4,196	1,494	2,114	14,357	339,786
Domestic Non-government Backed CMO's	3,915	-	-	-	-	-	-	3,915
International Corporate Bonds & Notes	19,942	-	-	-	-	-	-	19,942
International Non-government Asset-backed Securities	12,150	-	-	-	-	-	-	12,150
International Non-government Backed CMO's	72,225	-	-	-	-	-	-	72,225
Repurchase Agreements	-	-	-	-	-	-	171,988	171,988
<b>Grand Total</b>	<b>\$ 425,855</b>	<b>\$ 9,953</b>	<b>\$ 195,387</b>	<b>\$ 16,612</b>	<b>\$ 1,494</b>	<b>\$ 2,114</b>	<b>\$ 191,266</b>	<b>\$ 842,681</b>

As of June 30, 2008

Investment Type	Standard & Poor's Credit Rating					Totals
	AAA	AA	A	BB	NR	
Certificates of Deposit	\$ -	\$ -	\$ -	\$ -	\$ 7,966	\$ 7,966
Domestic Corporate Bonds & Notes	9,956	199,853	290,646	-	-	500,435
Domestic Non-government Asset-backed Securities	373,148	-	-	5,527	14,833	393,508
International Corporate Bonds & Notes	19,947	-	-	-	-	19,947
International Non-government Asset-backed Securities	30,283	-	-	-	-	30,283
International Non-government Backed CMO's	108,462	-	-	-	-	108,462
Repurchase Agreements	-	-	-	-	7,714	7,714
<b>Grand Total</b>	<b>\$ 541,798</b>	<b>\$ 199,833</b>	<b>\$ 290,646</b>	<b>\$ 5,527</b>	<b>\$ 30,513</b>	<b>\$ 1,068,317</b>

### e. Investment Interest Rate Risk

The investment policy objective is to match maturities of investments with the maturities of the lottery winner annuities. Therefore, investments are held to maturity after they are purchased thereby eliminating interest rate risk. Listed below are the Lottery's investments in U.S. Treasury Strips (in thousands):

As of June 30, 2009		As of June 30, 2008	
Time to Maturity	Fair Value	Time to Maturity	Fair Value
< 1 year	\$ 201,477	< 1 year	\$ 217,587
> 1 year to 3 years	325,664	> 1 year to 3 years	358,555
> 3 years to 5 years	221,593	> 3 years to 5 years	251,279
> 5 years to 10 years	178,920	> 5 years to 10 years	239,954
> 10 years to 15 years	47,805	> 10 years to 15 years	40,310
> 15 years to 20 years	37,026	> 15 years to 20 years	34,796
> 20 years to 25 years	15,410	> 20 years to 25 years	17,771
> 25 years	1,864	> 25 years	950
<b>Total</b>	<b>\$ 1,029,759</b>	<b>Total</b>	<b>\$ 1,161,202</b>

The Lottery contracts with the SBA to execute the securities lending program. The securities lending authorization agreement between Mellon Bank and the SBA requires that the maximum weighted average portfolio maturity not exceed 90 days. The lending program invests a significant amount of its assets in floating rate securities and limits the maximum reset period for interest rate changes to six months. Next reset dates are used in the calculation of weighted average maturity. Listed below are the weighted average maturities for the lending program's invested cash collateral (in thousands):

Investment Type	June 30, 2009	
	Fair Value (Thousands)	Weighted Average Maturity (Days)
Domestic Corporate Bonds & Notes	\$ 222,677	43
Domestic Non-government Asset-backed Securities	339,786	19
Domestic Non-government Backed CMO's	3,913	7
International Corporate Bonds & Notes	19,942	15
International Non-government Asset-backed Securities	12,150	77
International Non-government Backed CMO's	72,235	32
Repurchase Agreements	171,988	1
<b>Total Fair Value</b>	<b>\$ 842,681</b>	
<b>Portfolio weighted average maturity</b>		<b>23</b>

The effective duration of the State Treasury Investment Pool at June 30, 2009, and June 30, 2008, was approximately 1.84 years and 3.31 years, respectively.

### f. Investment Concentration of Credit Risk

Since all long-term investments (other than in the securities lending program) are in U.S. Government-guaranteed securities, the Lottery has not adopted a policy regarding concentration of credit risk. The

securities lending program has established investment concentration of credit risk policies that limit the aggregate exposure to any one issuer or guarantor that is not the U.S. Government or guaranteed by the U.S. Government to 10 percent of the book value of the lending program's invested cash collateral. No invested cash collateral exceeded the 10 percent limitation.

**g. Investment Custodial Credit Risk**

Custodial credit risk is defined as the risk that an entity may not recover securities held by another party. The Lottery does not have a formal policy regarding custodial credit risk. The custodian for the SBA-administered lending program is also the counterparty to the investment transactions. Therefore, the amount of investments subject to investment custodial credit risk at June 30, 2009, and June 30, 2008, was \$842,681,000 and \$1,068,317,000, respectively.

At June 30, 2009, and June 30, 2008, all non-lending investments held were either insured or registered and held by the Lottery or its agents in the Lottery's name and thus were not subject to custodial credit risk.

**h. Foreign Currency Risk**

The Lottery had no exposure to foreign currency risk as of June 30, 2009, and June 30, 2008.

**i. Investment Summary**

The following schedule summarizes all investments and investments loaned under securities lending agreements at June 30 (in thousands):

Investment Type	June 30, 2009 Carrying Value	June 30, 2008 Carrying Value
Certificates of Deposit	\$ -	\$ 7,966
Repurchase Agreements	171,988	7,714
U.S. Government Obligations & Federally Guaranteed Obligations	152,569	79,413
Domestic Corporate Bonds & Notes	222,677	500,435
Domestic Non-government Asset-backed Securities	339,786	393,508
International Corporate Bonds & Notes	19,942	19,947
International Non-government Asset-backed Securities	12,150	30,285
Domestic Non-government Backed CMO's	3,913	.
International Non-government Backed CMO's	72,225	108,462
Investments Held by Others Under Securities Lending Agreements - U.S. Obligations	877,190	1,081,789
Pooled Investments with State Treasury	175,759	216,211
<b>Total Investments</b>	<b>\$ 2,048,199</b>	<b>\$ 2,445,730</b>

The following schedules reconcile cash and investments to the Statement of Net Assets at June 30 (in thousands):

	June 30, 2009			
		Cash at Financial	Cash at State	
	Investments	Institutions	Treasury	Total
Cash and cash equivalents	\$ 125,169	\$ 807	\$ 86	\$ 126,062
Restricted cash and cash equivalents	50,590	-	-	50,590
Investments, grand prize	1,029,759	-	-	1,029,759
Investments, other	842,681	-	-	842,681
<b>Total</b>	<b>\$ 2,048,199</b>	<b>\$ 807</b>	<b>\$ 86</b>	<b>\$ 2,049,092</b>

	June 30, 2008			
		Cash at Financial	Cash at State	
	Investments	Institutions	Treasury	Total
Cash and cash equivalents	\$ 141,863	\$ 687	\$ 481	\$ 143,031
Restricted cash and cash equivalents	74,348	-	-	74,348
Investments, grand prize	1,161,202	-	-	1,161,202
Investments, other	1,068,317	-	-	1,068,317
<b>Total</b>	<b>\$ 2,445,730</b>	<b>\$ 687</b>	<b>\$ 481</b>	<b>\$ 2,446,898</b>

**3. ACCOUNTS RECEIVABLE**

Accounts receivable as of June 30 consisted of (in thousands):

	2009	2008
Ticket sales receivable	\$ 44,533	\$ 42,477
Other receivables	118	67
Total receivables	44,651	42,544
Less allowance for doubtful accounts	(1,466)	(2,472)
<b>Accounts receivable, net</b>	<b>\$ 43,185</b>	<b>\$ 40,072</b>

**4. SECURITY DEPOSITS AND DEPOSITS PAYABLE**

The Lottery receives certificates of deposit and cashier's checks from certain vendors and retailers in order to secure contract performance. Certificates of deposit are held in trust by the State with any interest earnings being credited to the vendor or retailer. Cashier's checks are held as cash by the Lottery. These deposits are established to reduce the potential financial risk to the Lottery in the event of a breach of contract. The certificates appear on the Statement of Net Assets, in assets as security deposits, and in liabilities, as deposits payable. The checks appear on the Statement of Net Assets, in assets as cash, and in liabilities, as deposits payable.

## 5. CAPITAL ASSETS

Capital assets at June 30 consisted of (in thousands):

	Balance 30-Jun-07	2007-08		Balance 30-Jun-08	2008-09		Balance 30-Jun-09
		Increase	Decrease		Increase	Decrease	
Data processing equipment	\$ 9,394	\$ -	\$ (158)	\$ 9,236	\$ 317	\$ (4,162)	\$ 5,391
Office equipment and fixtures	5,968	8	-	5,968	-	-	5,968
Vehicles and other equipment	3,172	110	(226)	3,056	367	(308)	3,115
	18,526	118	(384)	18,260	684	(4,470)	14,474
Less accumulated depreciation	16,618	695	(332)	16,981	684	(4,426)	13,239
<b>Total capital assets, net</b>	<b>\$ 1,908</b>	<b>\$ (577)</b>	<b>\$ (52)</b>	<b>\$ 1,279</b>	<b>\$ -</b>	<b>\$ (44)</b>	<b>\$ 1,235</b>

## 6. MULTI-STATE LOTTERY ASSOCIATION

MUSL is an unincorporated government-benefit voluntary association created for the purpose of administering joint lottery games. MUSL included 30 state lottery entities, the District of Columbia, and the Virgin Islands during fiscal year 2008-09. This association offers the POWERBALL with Power Play On-line game and several other On-line games in participating states. The chief executive officer of each member lottery serves on the MUSL board of directors.

During the fiscal year, the Lottery joined the MUSL POWERBALL with Power Play On-line game on January 4, 2009. As a member of MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize payments. MUSL periodically reallocates the prize reserve funds among the states based on relative POWERBALL with Power Play sales levels. All remaining funds remitted, and the related interest earnings (net of administrative costs), will be returned to the Lottery upon leaving MUSL, less any portion of unanticipated prize claims that may have been paid from the fund.

As of June 30, 2009, the Lottery had deposits with MUSL of \$3,073,441, representing the Lottery's deposits of reserve funds.

A copy of the MUSL financial statements may be obtained by submitting a written request to MUSL, 4400 N.W. Urbandale Drive, Urbandale, Iowa 50322.

**7. LONG-TERM LIABILITIES**

**a. Grand Prizes Payable**

Grand prizes payable at June 30 consisted of (in thousands):

	<u>2009</u>	<u>2008</u>
LOTTO grand prizes (face value)	\$ 1,159,485	\$ 1,351,603
Mega Money grand prizes (face value)	8,081	7,660
Win for Life grand prizes (face value)	13,022	13,386
Flamingo Fortune Game Show grand prizes (face value)	900	1,000
Monthly Grand game prizes (face value)	12	36
Win a Million grand prizes (face value)	450	500
Yearly Bonus grand prizes (face value)	200	250
Lucky for Life grand prizes (face value)	11,900	12,300
Set for Life grand prize (face value)	2,640	2,820
Cash Spectacular grand prize (face value)	700	750
Cash for Life	240	250
Loaded for Life	3,150	3,250
Billion Dollar Blockbuster	9,500	-
Gas for Life	204	-
Less imputed interest	<u>(296,739)</u>	<u>(316,961)</u>
Net present value of grand prizes payable	<u>\$ 913,745</u>	<u>\$ 1,046,844</u>
Current prizes payable from restricted assets	\$ 194,955	\$ 212,299
Noncurrent prizes payable from restricted assets	<u>718,790</u>	<u>834,545</u>
<b>Total grand prizes payable</b>	<u>\$ 913,745</u>	<u>\$ 1,046,844</u>

The following depicts by fiscal year the value (in thousands) of the grand prize annuities to pay prizewinners:

<u>Year Ended June 30</u>	<u>Amount</u>
2010	\$ 201,688
2011	178,428
2012	154,177
2013	132,613
2014	109,804
2015-2019	223,032
2020-2024	83,000
2025-2029	81,725
2030-2034	39,557
2035-2039	<u>6,160</u>
Grand prizes (face value)	1,210,484
Less imputed interest	<u>(296,739)</u>
Net present value of grand prizes payable	<u>\$ 913,745</u>

**b. Compensated Absences Payable**

Compensated absences payable at June 30 consisted of (in thousands):

	<u>2009</u>	<u>2008</u>
Current compensated absences	\$ 889	\$ 852
Noncurrent compensated absences	<u>2,942</u>	<u>2,897</u>
<b>Total</b>	<u>\$ 3,831</u>	<u>\$ 3,749</u>

**c. Changes in Long-Term Liabilities**

Changes in long-term liabilities are summarized as follows (in thousands):

	2008-2009				
	Balance			Amount Due	
	July 1, 2008	Additions	Reductions	June 30, 2009	Within One Year
Grand prizes payable	\$1,046,844	\$86,881	(\$219,980)	\$913,745	\$194,955
Compensated absences payable	3,749	1,775	(1,693)	3,831	889
Postemployment healthcare benefits payable	252	206	-	458	-
<b>Total long-term liabilities</b>	<b>\$1,050,845</b>	<b>\$88,862</b>	<b>(\$221,673)</b>	<b>\$918,034</b>	<b>\$195,844</b>

	2007-2008				
	Balance			Amount Due	
	July 1, 2007	Additions	Reductions	June 30, 2008	Within One Year
Grand prizes payable	\$1,213,419	\$79,762	(\$246,337)	\$1,046,844	\$212,299
Compensated absences payable	3,892	1,505	(1,948)	3,749	852
Postemployment healthcare benefits payable	-	252	-	252	-
<b>Total long-term liabilities</b>	<b>\$1,217,311</b>	<b>\$81,519</b>	<b>(\$248,285)</b>	<b>\$1,050,545</b>	<b>\$213,151</b>

See Note 9 for additional information regarding the postemployment healthcare benefits payable.

**8. DUE TO EDUCATIONAL ENHANCEMENT TRUST FUND**

In accordance with the Act, effective July 1, 2005, variable percentages of the gross revenue from the sale of On-line and Scratch-Off lottery tickets as determined by the Lottery, and other earned revenue, excluding application processing fees, shall be deposited in the Educational Enhancement Trust Fund (EETF) as provided in Section 24.121, Florida Statutes, as amended. Previously, the Act required at least 39 percent of On-line and miscellaneous revenue, net of retailer fees, be transferred to the EETF for the benefit of public education. Effective July 1, 2002, the Department was authorized, pursuant to Section 24.121(1), Florida Statutes, to increase the percentage of Scratch-Off game revenues returned as prizes and transfer a variable percentage to the EETF. The Lottery implemented this strategy in September 2002. The amount transferred for the fiscal year ended June 30, 2009, was \$1,287,855,000 (32.6 percent of revenues), and for the fiscal year ended June 30, 2008, the transferred amount was \$1,283,414,000 (30.7 percent of revenues).

Because the net appreciation in fair value of investments and amortization of grand prizes payable, included in nonoperating revenue and expenses, relate to valuations of the restricted grand prize investments and grand prizes payable, they are excluded from the determination of transfers to the EETF.

Effective July 1, 2005, provisions of the Act relating to the allocation of revenues for public education were revised. The changes in the provisions were designed to maximize the transfers of moneys to the EETF.

These revisions resulted in changes in the methodology used to calculate the transfer based on a business model of revenue minus expenses rather than a percent of revenue.

The amount due to EETF at June 30, 2009, and June 30, 2008, was as follows (in thousands):

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
On-line ticket sales	\$ 1,873,902	\$ 1,905,996
Average percent transferred	41%	37%
Transfer of On-line ticket sales	<u>767,245</u>	<u>675,547</u>
Unclaimed On-line ticket prizes	36,816	33,514
Percent transferred	80%	81%
Transfer of unclaimed On-line ticket prizes	<u>29,453</u>	<u>26,811</u>
Scratch-Off ticket sales	2,064,135	2,368,781
Average percent transferred	22%	22%
Transfer of Scratch-Off ticket sales	<u>450,584</u>	<u>512,143</u>
Unclaimed Scratch-Off ticket prizes	21,734	49,785
Percent transferred	80%	80%
Transfer of unclaimed Scratch Off ticket prizes	<u>17,387</u>	<u>39,764</u>
Nonoperating revenues (expenses), net	(1,947)	34,191
Add:		
Net (appreciation) depreciation in fair value of investments	(46,832)	(89,149)
Amortization of grand prizes payable	<u>64,757</u>	<u>76,383</u>
Total Nonoperating revenues, net	<u>15,978</u>	<u>21,425</u>
On-line fees and miscellaneous revenue	<u>7,408</u>	<u>7,724</u>
Due for the year	<u>\$ 1,287,855</u>	<u>\$ 1,283,414</u>
Balance dec, beginning of year	112,879	117,433
Paid during the year	<u>(1,316,969)</u>	<u>(1,287,968)</u>
Due to Educational Enhancement Trust Fund, June 30	<u>\$ 83,765</u>	<u>\$ 112,879</u>

## 9. PENSIONS AND OTHER POSTEMPLOYMENT BENEFITS

### a. Retirement Programs

**Florida Retirement System.** The Florida Retirement System (FRS) is primarily a State-administered cost-sharing multiple-employer defined benefit retirement plan (Plan). FRS provisions are established by Chapters 121 and 122, Florida Statutes; Chapter 112, Part IV, Florida Statutes; Chapter 238, Florida Statutes; and Florida Retirement System Rules, Chapter 60S, Florida Administrative Code; wherein eligibility, contributions, and benefits are defined and described in detail. Essentially, all regular employees of participating employers are eligible to enroll as members of the FRS.

Benefits in the Plan vest at six years of service. All members are eligible for normal retirement benefits at age 62 or at any age after 30 years of service, which may include up to 4 years of credit for military service. The Plan also includes an early retirement provision, but imposes a penalty for each year a member retires before his or her normal retirement date. The Plan provides retirement, disability, and death benefits, and annual cost-of-living adjustments.

A Deferred Retirement Option Program (DROP), subject to provisions of Section 121.091, Florida Statutes, permits employees eligible for normal retirement under the Plan to defer receipt of monthly benefit payments while continuing employment with an FRS employer. An employee may participate in



DROP for a period not to exceed 60 months after electing to participate. During the period of DROP participation, deferred monthly benefits are held in the FRS Trust Fund and accrue interest.

The State of Florida establishes contribution rates for participating employers. Contribution rates as a percentage of gross salary were as follows:

<u>Class or Plan</u>	<u>Fiscal Year</u> <u>Ended</u>	<u>Fiscal Year</u> <u>Ended</u>
	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Senior Management	13.12 percent	13.12 percent
Regular Employees	9.85 percent	9.85 percent
Special Risk	20.92 percent	20.92 percent
DROP - Applicable to members from all of the above classes	10.91 percent	10.91 percent

Employer rates include 1.11 percent for the postemployment insurance subsidy. Also, employer rates, other than for DROP participants, include 0.05 percent for administrative costs of the Public Employee Optional Retirement Program.

The Lottery's liability for participation is limited to the payment of the required contribution at the rates and frequencies established by law on future payrolls of the Lottery. The Lottery's contributions for the fiscal years ended June 30, 2009, June 30, 2008, and June 30, 2007, totaled \$1,505,000, \$1,575,000, and \$1,605,000, respectively, which were equal to 100 percent of the required contributions for each fiscal year. These contributions represented 8.4 percent, 8.7 percent, and 9.0 percent of covered payroll, for the fiscal years ended June 30, 2009, June 30, 2008, and June 30, 2007, respectively.

Section 121.4501, Florida Statutes, provides for a Public Employee Optional Retirement Program (PEORP). The PEORP is a defined contribution plan alternative available to all FRS members in lieu of the FRS defined benefit plan. Lottery employees already participating in DROP are not eligible to participate in this program. Employer contributions are defined by law, but the ultimate benefit depends in part on the performance of investment funds. The PEORP is funded by employer contributions that are based on salary and membership class (Regular Class, Special Risk Class, etc.). Contributions are directed to individual member accounts, and the individual members allocate contributions and account balances among various approved investment choices. Required employer contributions made to PEORP for the fiscal years ended June 30, 2009, 2008, and 2007, totaled \$320,295, \$281,510, and \$218,759, respectively.

Financial statements and other supplementary information of the FRS are included in the State's Comprehensive Annual Financial Report, which is available from the Florida Department of Financial Services. An annual report on the FRS, which includes its financial statements, required supplementary information, actuarial report, and other relevant information, is available from the Florida Department of Management Services, Division of Retirement.

**Senior Management Service Optional Annuity Program.** Some Lottery employees also participate in the Senior Management Service Optional Annuity Program (SMSOAP). The SMSOAP is a defined contribution plan that provides retirement and death benefits to the participant pursuant to Section 121.055, Florida Statutes. Participants have full and immediate vesting of all contributions paid on their behalf to the participating provider companies to invest as directed by the participants. Employees in eligible State positions may make an irrevocable election to participate in the SMSOAP in lieu of the Senior Management Service Class. Employers contributed 12.49 percent of covered payroll for July 2008 through June 2009. This contribution rate includes a contribution that would otherwise be paid to the Retiree Health Insurance Subsidy (HIS) Program described below so the SMSOAP retiree is not eligible

to receive monthly HIS benefits. A participant may contribute by salary reduction an amount not to exceed the percentage contributed by the employer.

**Retiree Health Insurance Subsidy (HIS).** The Retiree Health Insurance Subsidy (HIS) was created by the Florida Legislature in 1987 to assist FRS retirees in paying health insurance costs. The HIS is a cost-sharing multiple-employer defined benefit pension plan established under Section 112.363, Florida Statutes. For the fiscal years ended June 30, 2009, and 2008, eligible retirees or beneficiaries received a monthly HIS payment equal to the number of years of creditable service completed at the time of retirement multiplied by \$5. The payments to individual retirees or beneficiaries were at least \$30 but not more than \$150 per month. To be eligible to receive the HIS, an FRS retiree must apply for the benefit, provide proof of health insurance coverage, which can include Medicare or TRICARE, and be approved.

The HIS is funded by required contributions from FRS participating employers. For the years ended June 30, 2009, 2008, and 2007, the Lottery contributed 1.11 percent of payroll for all active employees covered by the FRS, pursuant to Section 112.363, Florida Statutes. For the years ending June 30, 2009, 2008, and 2007, the Lottery contributed \$184,076, \$185,528, and \$180,607, respectively, in employer contributions to the HIS Program. HIS contributions are deposited in a separate trust fund from which HIS payments are authorized. If these contributions fail to provide full subsidy benefits to all participants, the subsidy payments may be reduced or canceled.

Further disclosures and other supplementary information for the HIS are included in the Comprehensive Annual Financial Report of the State of Florida, which may be obtained from the Florida Department of Financial Services.

**Deferred Compensation Plan.** The Lottery, through the State of Florida, offers its employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Code. The plan (refer to Section 112.215, Florida Statutes), available to all regular payroll State employees, permits them to defer a portion of their salaries until future years. The deferred compensation is not available to employees until termination, retirement, death, or an unforeseen emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are held in trust for the exclusive benefit of participants and their beneficiaries as mandated by 26 U.S.C.s.457(g)(1).

The Lottery does not contribute to the plan. Participation under the plan is solely at the discretion of the employee.

The State has no liability for losses under the plan but does have the duty of due care that would be required of an ordinary and prudent investor. Pursuant to Section 112.215, Florida Statutes, the Deferred Compensation Trust Fund is created in the State Treasury.

## **b. Postemployment Healthcare Benefits**

The Lottery participates in the State Employees' Health Insurance Program, a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the State of Florida, Department of Management Services, Division of State Group Insurance, to provide group health benefits. Section 110.123, Florida Statutes, provides that retirees may participate in the State's group health insurance programs and assigns the authority to establish and amend benefit provisions to the Department of Management Services. Although premiums are paid by the retiree, the premium cost to the retiree is implicitly subsidized by the commingling of claims experience in a single risk pool with a single premium determination. An actuarial valuation has been performed for the plan and the Lottery's employees were included in the actuarial analysis. For more information on the plan regarding the funding policy and actuarial methods and assumptions, see the State's Comprehensive Annual Financial Report, which is available from the Department of Financial Services.

In accordance with GASB Statement 45, the Lottery is required to record its portion of the implicit postemployment health benefit liability beginning in the fiscal year ended June 30, 2008.

Postemployment health benefits payable at June 30, 2009, and June 30, 2008, was \$458,000 and \$252,000, respectively.

**10. OPERATING LEASES**

The Lottery has entered into operating leases for the rental of office and warehouse space for the headquarters and district offices as well as the rental of computer equipment. Certain leases are renewable at the option of the Lottery.

Future minimum rental payments as of June 30, 2009, are scheduled as follows (in thousands):

Year Ending June 30	Headquarters	Districts	Total
2010	\$ 2,587	\$ 949	\$ 3,536
2011	2,612	885	3,497
2012	2,639	889	3,528
2013	2,666	630	3,296
2014	2,693	274	2,967
Total	<u>\$ 13,197</u>	<u>\$ 3,627</u>	<u>\$ 16,824</u>

Rental expense under all operating leases totaled approximately \$2,959,000 and \$3,412,000 for the fiscal years ended June 30, 2009, and 2008, respectively.

**11. OTHER COMMITMENTS**

The Lottery has entered into contractual agreements under which On-line and Scratch-Off lottery game vendors provide gaming systems, tickets, and related services. The Lottery's On-line gaming system contractor is compensated at a rate of 1.1499 percent of sales. The contractor's compensation for On-line games for the fiscal years ended June 30, 2009, and 2008, was \$27,982,000, and \$26,165,000, respectively.

The Lottery entered into a new contract for Scratch-Off game tickets and related services on October 1, 2008. The rates under the new contract range from 0.9744 percent to 2.24 percent based on ticket price points and total annual sales. The rate in effect for July 1, 2008, through September 30, 2008, was 2.25 percent based on net sales. Compensation under these agreements amounted to \$31,893,000 for the fiscal year ended June 30, 2009, and \$55,135,000 for the fiscal year ended June 30, 2008.

**12. LITIGATION**

The Lottery is involved in litigation and other claims incidental to the ordinary course of its operations. In the opinion of Lottery management, based on the advice of legal counsel, the ultimate disposition of these lawsuits and claims will not have a material adverse effect on the financial position of the Lottery.



DAVID W. MARTIN, CPA  
AUDITOR GENERAL

# AUDITOR GENERAL STATE OF FLORIDA

G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450



PHONE: 850-488-5534  
FAX: 850-488-6975

The President of the Senate, the Speaker of the  
House of Representatives, and the  
Legislative Auditing Committee

## INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

We have audited the financial statements of the Florida Department of the Lottery (the Lottery) as of and for the fiscal year ended June 30, 2009, and have issued our report thereon included under the heading **INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS**. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

### **Internal Control Over Financial Reporting**

We have examined the Lottery's internal control over financial reporting as of June 30, 2009, based on criteria established in *Internal Control -- Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Lottery's management is responsible for maintaining effective internal control over financial reporting, and for its assertion of the effectiveness of internal control over financial reporting, included in the accompanying **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**. Our responsibility is to express an opinion on the Lottery's internal control over financial reporting based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our examination included obtaining an understanding of the internal control over

financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of the internal control based on the assessed risk. Our examination also included performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Lottery maintained, in all material respects, effective internal control over financial reporting as of June 30, 2009, based on the criteria established by *Internal Control – Integrated Framework* issued by COSO.

We did note additional matters involving the internal control over financial reporting, which are discussed in the **SCHEDULE OF FINDINGS**.

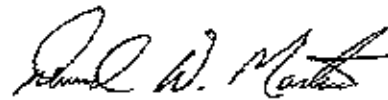
#### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, rules, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain additional matters involving legal compliance, which are discussed in the **SCHEDULE OF FINDINGS**.

The Lottery's response to the findings described in the **SCHEDULE OF FINDINGS** section of this report is included as Exhibit - A. We did not audit the Lottery's response and, accordingly, we express no opinion on it.

Pursuant to Section 11.45(4), Florida Statutes, this report is a public record and its distribution is not limited. Auditing standards generally accepted in the United States of America require us to indicate that the provisions of this report relating to compliance and other matters are intended solely for the information and use of the Legislative Auditing Committee, members of the Florida Senate and the Florida House of Representatives, and applicable management and are not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



David W. Martin, CPA  
January 26, 2010

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

CHARLIE CRIST  
Governor



LEO DIBENIGNO  
Secretary

FLORIDA LOTTERY

Management's Report on Internal Control Over Financial Reporting

The Florida Lottery's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Management is responsible for establishing and maintaining effective internal control over financial reporting. Management assessed the effectiveness of the Florida Lottery's internal control over financial reporting as of June 30, 2009, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*. Based on that assessment, management concluded that, as of June 30, 2009, the Florida Lottery's internal control over financial reporting is effective based on the criteria established in *Internal Controls - Integrated Framework*.

The Florida Lottery

Leo DiBenigno  
Secretary

January 26, 2010



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www.flalottery.com

STATE OF FLORIDA  
DEPARTMENT OF THE LOTTERY  
SCHEDULE OF FINDINGS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

ADDITIONAL MATTERS

**Finding No. 1: Information Technology Controls**

Information technology (IT) controls are intended to protect the confidentiality, integrity, and availability of data and IT resources. During our audit, we identified the need for enhancements to the Lottery's IT control practices. To avoid the possibility of compromising Lottery information, specific details of these findings are not disclosed in this report. However, the appropriate Lottery personnel have been notified of these issues. While the Lottery had made progress in resolving many of the findings disclosed in connection with the prior audit, some issues previously reported had not yet been fully addressed.

**Recommendation:** We again recommend that the Lottery make the necessary enhancements to its IT control practices to address the issues identified.

**Finding No. 2: Electronic Funds Transfer of Annual Prize Payments**

The Lottery pays the prizewinners of various games through a deferred payment plan (annuity) option rather than a single lump-sum payment. The Lottery annually pays approximately \$220 million to its 795 annuity recipients, approximately 716 of whom receive their payments through an electronic funds transfer. In Auditor General Report No. 2009-101, we concluded that controls over related electronic funds transfer payments could be improved. Our review of claims processing procedures used by the Lottery during fiscal year 2008-2009 disclosed that although the Lottery had made some improvements in controls over electronic funds transfers to annuity recipients, these controls could be further improved. Specific details of this matter are not disclosed in this report to avoid the possibility of compromising Lottery information. However, the appropriate Lottery personnel have again been notified of this issue.

**Recommendation:** We recommend that the Lottery make the necessary enhancements to its controls over electronic funds transfer payment of annuities.

**Finding No. 3: Monthly Reports**

In accordance with Section 24.105(4), Florida Statutes, the Lottery issues monthly reports to the Governor, the State of Florida Chief Financial Officer (State CFO), the President of the Senate, and the Speaker of the House of Representatives. These reports disclose details of the total Lottery revenues, prize disbursements, and other expenses of the Lottery during the preceding month and present fiscal year-to-date cumulative totals.



A review of the 12 monthly reports submitted for the 2008-09 fiscal year disclosed 13 instances where amounts shown for the reported month were incorrect on 5 of the reports. Examples of errors included the following:

- In the November 2008 report, the month's prize disbursement amounts for Mega Money and Scratch-Off tickets were reported with October's monthly totals rather than the November amounts. As a result, Mega Money prize disbursements were overstated by \$85,000 and Scratch-Off ticket prize disbursements were overstated by approximately \$3.7 million.
- In the June 2009 report, due to a formula error, the combined total for June's prize disbursements was overstated by approximately \$2.5 million.
- In the Transfers Due to Education table in the April and May 2009 reports, a formatting error resulted in each month's On-line expense total being rounded to millions and appearing as \$90,000 and \$96,000, respectively. On-line expense for April and May 2009 should have been shown as approximately \$90 million and approximately \$96.3 million, respectively. The calculation of the total available for transfer was correct.

Our audit disclosed that there were no procedures in place for a final proofing of the reports to check for mathematical accuracy prior to sending them to the oversight bodies. Lottery personnel indicated that these reports were produced through a manual process that depended largely on spreadsheets to calculate monthly activity. They also indicated that this manual process, along with staffing issues, led to the undetected report errors.

Reports such as these are relied upon by oversight entities such as the Governor, the State CFO, and the Legislature in order to monitor Lottery operations. When the amounts reported are in error, the conclusions drawn in reliance on these reports may also be prone to error.

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**Recommendation:** We recommend that the Lottery establish and follow a procedure for the performance of a final review of these reports prior to sending them to the Governor, the State CFO, and the Legislature.

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**Finding No. 4: Minority Retailer Participation**

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Section 24.113, Florida Statutes, requires that 15 percent of the Lottery's retailers shall be minority business enterprises, as defined in Section 288.703(2), Florida Statutes; however, no more than 35 percent of such retailers shall be owned by the same type of minority person, as defined by Section 288.703(3), Florida Statutes.

Our audit disclosed that as of August 24, 2009, retailers comprising one minority type totaled 64 percent of the total number of minority retailers. A similar finding has been included in previous audit reports.

The Lottery has developed an outreach program to increase retailer participation in under-represented minority groups; however, despite these efforts, the level of participation from these groups has decreased slightly over the past fiscal year.

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**Recommendation:** We recommend that the Lottery continue to take steps to resolve this finding.

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EXHIBIT - A  
MANAGEMENT'S RESPONSE

CHARLIE CRIST  
*Governor*



LEO DUBENIGNO  
*Secretary*

FLORIDA LOTTERY

January 26, 2010

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

Dear Mr. Martin:

The Lottery has received your January 13, 2010 report of preliminary and tentative findings and recommendations resulting from your audit of the Lottery's financial activities for the fiscal year ended June 30, 2009. The staff has discussed your recommendations and responds as follows:

1. Recommendation: The Lottery should make necessary enhancement to its IT control practices to address the issues identified.

Response: The Lottery has an ongoing process to improve technology controls for information technology. The enhancements presented by this audit have been considered and either have been or are in the process of implementation.

2. Recommendation: The Lottery should make the necessary enhancements to its controls over annuity electronic funds transfer payments.

Response: The Lottery will update all written procedures and related documents to ensure the new security enhancements are consistently utilized.

3. Recommendation: The Lottery should establish and follow a procedure for the performance of a final review of the monthly reports prior to sending them to the Governor, the State CFO, and the Legislature.



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EXHIBIT - A  
MANAGEMENT'S RESPONSE (Continued)

David W. Martin, CPA  
Auditor General  
Response to Preliminary and Tentative Findings  
January 26, 2010  
Page 2 of 2

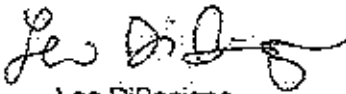
Response: The Lottery takes its financial reporting requirements very seriously to ensure all data is timely and accurate. The department will enhance its review processes as well as evaluate additional alternatives to ensure accuracy of monthly and year to date data.

4. Recommendation: The Lottery continue to take steps to resolve the Minority Retailer Participation requirement of Section 24.113, Florida Statutes.

Response: As recommended the Lottery has and will continue to address the Minority Retailer Participation criteria established in s.24.113 using a variety of approaches. In addition to attempts to amend s. 24.113(1) to eliminate the conflict created by including both a floor and a ceiling, the Lottery has implemented strategic initiatives to seek out and recruit under-represented minorities. The strategic initiatives include identifying and partnering with minority oriented business associations, conducting retailer recruitment seminars, advertising for new retailers in community newspapers and magazines and exploring non-traditional trade styles for Lottery retailer prospects. As always, the Lottery must ensure that EETF transfers are the foremost objective when making retailer contract and terminal placement decisions.

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

Sincerely,



Leo DiBenigno  
Secretary

cc: Dennis Harmon, Deputy Secretary  
Ken Hart, General Counsel  
Marcy Jackson, Chief Financial Officer  
Andy Mompeller, Inspector General

## The 2009 Florida Statutes

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Title IV  
EXECUTIVE BRANCH

Chapter 24  
STATE LOTTERIES

### 24.123 Annual audit of financial records and reports.--

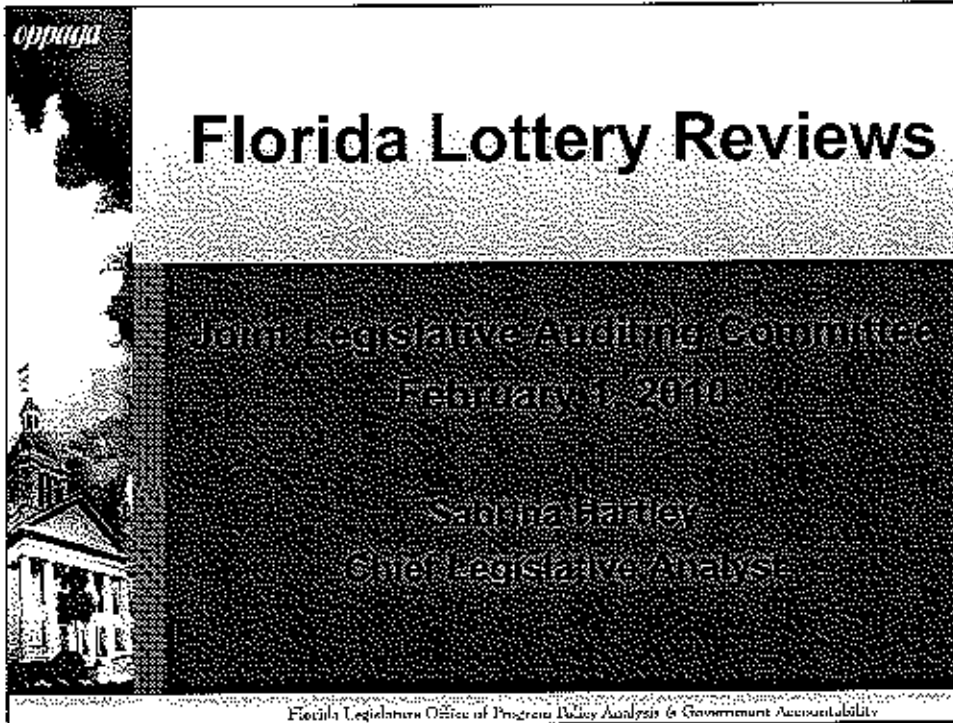
(1) The Legislative Auditing Committee shall contract with a certified public accountant licensed pursuant to chapter 473 for an annual financial audit of the department. The certified public accountant shall have no financial interest in any vendor with whom the department is under contract. The certified public accountant shall present an audit report no later than 7 months after the end of the fiscal year and shall make recommendations to enhance the earning capability of the state lottery and to improve the efficiency of department operations. The certified public accountant shall also perform a study and evaluation of internal accounting controls and shall express an opinion on those controls in effect during the audit period. The cost of the annual financial audit shall be paid by the department.

(2) The Auditor General may at any time conduct an audit of any phase of the operations of the state lottery and shall receive a copy of the yearly independent financial audit and any security report prepared pursuant to s. [24.108](#).

(3) A copy of any audit performed pursuant to this section shall be submitted to the secretary, the Governor, the President of the Senate, the Speaker of the House of Representatives, and members of the Legislative Auditing Committee.

**History.**--s. 23, ch. 87-65; s. 4, ch. 2001-89.

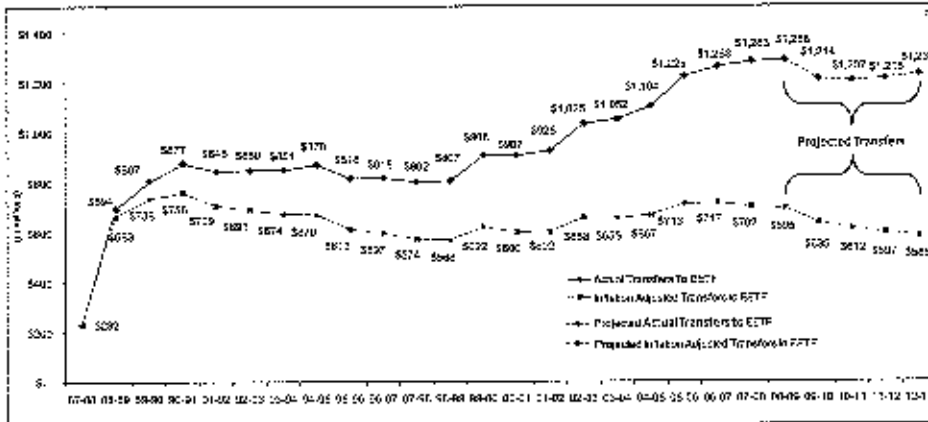
**OPPAGA Review**  
**Department of the Lottery**



## Projects

- **Annual Review – s. 24.123 Florida Statutes**
  - Identify options to
    - enhance earning capability
    - improve operational efficiency
  - Examine Field Support Services Delivery – 2009 GAA proviso directive
  
- **Lottery Advertising – return on investment**

## Transfers to Education Have Levelled Off



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## Revenue Enhancement

- Lottery has taken steps to increase sales/transfers
  - Joined Powerball
  - Installed 1,000 Instant Ticket Vending Machines
  - Redesigned LOTTO
- New products that could increase revenues and education transfers
  - Video Lottery Terminals - \$404 million to \$648 million in transfers
  - Keno - \$64 million to \$358 million in transfers
  - Mega Millions - \$26 million to \$35 million in transfers

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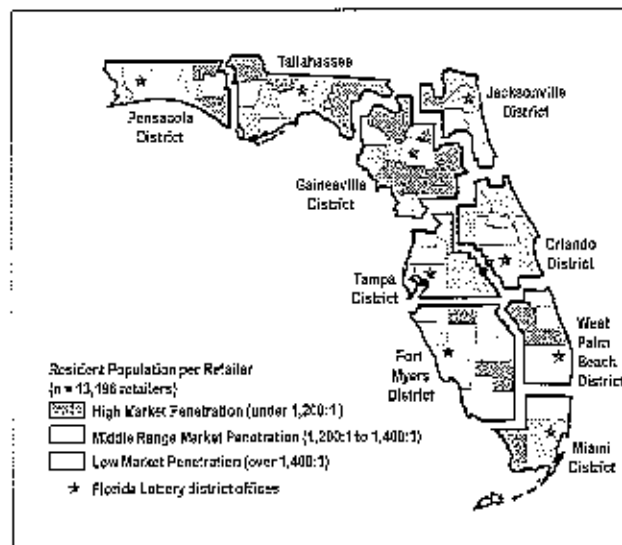
## Delivery Options Could Increase Revenues and Transfers

- Full Service Game Vending Machines – currently illegal in Florida
- Internet sales – requires legal clarification
- Increase the retailer network
  - Net loss of 86 retailer outlets in 2008-09
  - 1,500 more retailers required to meet the top-performing states' average market penetration rate – estimated additional \$32 million in transfers

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## About Half of Florida Has Low Market Penetration



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6



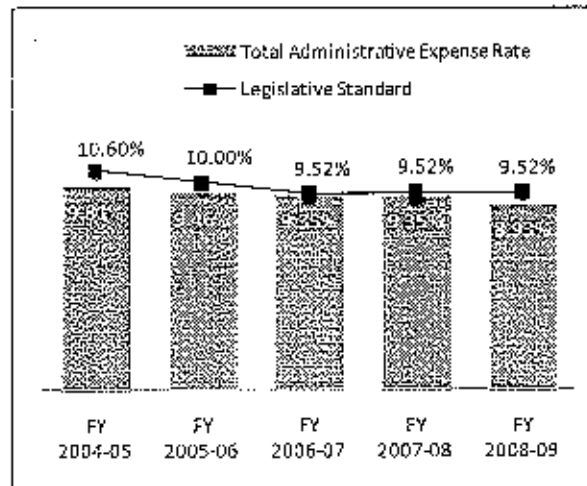
## **Retailer Recruitment Efforts Have Had Mixed Results**

- **Field Sales Blitz – 294 new retailers**
- **Recruitment Seminars – 38 new retailers**
- **Not all recruitment mechanisms have been examined for return on investment and not all costs were included in those that were reviewed**

## **New Games and Delivery Options May Have Complications**

- **Increases state gambling**
- **Negative social costs/consequences**
- **Indian tribes gaming compact negotiations**

## The Lottery's Administrative Expense Rate Has Declined



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## Commission Structure Pays Disproportionately for Some Tickets

- **Retailer Commissions**
  - 5 cents for every \$1 ticket sold
  - \$1 for each \$20 ticket sold
  - \$1.50 for each \$30 ticket sold
  
- **Lottery directed to review and report on commission structure**

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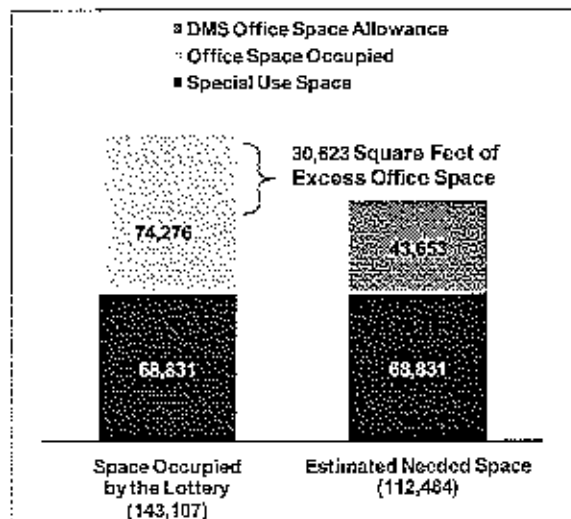
## Lottery Leases Excess Headquarters Space

- Since 2002 OPPAGA has recommended reduce excess office space
- Lottery leases about 30,623 sq. ft. of excess office space - \$496,000 annually
- Draw studio moving in-house (3,756 sq. ft.)
- Special use space should be consolidated and warehouse space better utilized
- DMS should help develop renovation/consolidation plan

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## Lottery Leases 30,623 Square Feet of Excess Office Space



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## **Field Support Services are Delivered In-house**

- **Field support services includes**
  - 115 sales representatives; 125 accounts each
  - 12 field sales managers
  - 5 sales executives
  
- **\$10.8 million current cost (salaries, benefits, fleet)**

## **Field Support Services are Outsourced in Some States**

- **Six states have outsourced field support services – 4 total; 2 partial**
  - Texas and Pennsylvania have sales forces comparable in size to Florida
  - Pennsylvania Lottery ranked 8<sup>th</sup> nationally
- **Generally successful model but emphasis on contract details for consistency, quality**
- **Prohibitively expensive to bring function back in-house**

## **Outsourcing Field Support Services has Pros and Cons**

### **■ Pros**

- increased staffing flexibility
- potential reduced cost to the state if a vendor can perform the function cheaper
- ability to provide incentives – pay, schedule, etc.

### **■ Cons**

- no direct-line authority over sales force
- limited legislative oversight and accountability
- potential loss of established retailer relationships

## **Recommendations**

### **■ Department of Lottery**

- Consider joining Mega Millions
- Increase retailers – target areas of low penetration and non-saturation; request legislative authorization to raise terminal cap as necessary
- Evaluate recruitment efforts and target corporate accounts
- Request legislative authorization for more instant ticket vending machines (if performance warrants)
- Work with DMS to reduce excess office space
- Update the business case study to examine the option of outsourcing field support services

# Recommendations

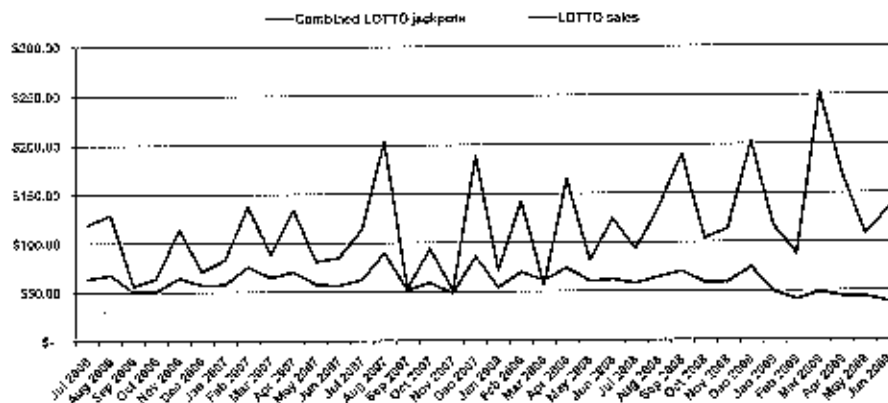
## ■ Legislative

- Authorize full service vending machines (with on-line and scratch-off games)
- Consider authorizing Internet sales following legal interpretation
- Consider authorizing new games, taking into account the social implications

# Advertising

- Lottery spends \$34.8 million annually - includes vendor fees, production costs, and a compulsive gambling helpline
- Separate vendor contracts for Spanish and English language markets

## Jackpot Size is the Primary Driver of Ticket Sales



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18

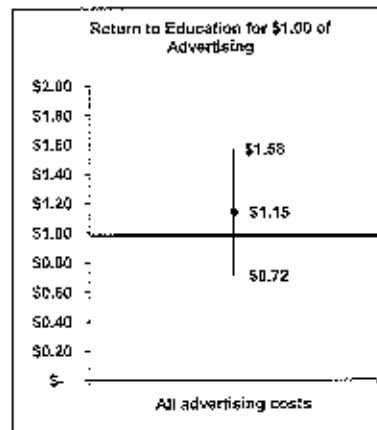
## Advertising is Necessary to Maintain Sales

- States that eliminated or severely reduced advertising experienced a 7% - 16% drop in sales.
- If Florida Lottery advertising were reduced by 10% and sales dropped 7%, education transfers would be reduced by \$83 million.

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## Increased Advertising Expenses May Mean Increased Education Transfers



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## Costs Affect Advertising Return on Investment

- Media buys represent the greatest return on investment - returning \$.98 to \$2.17 with a midpoint of \$1.57
- Production costs reduce the advertising return on investment - returning \$.72 to \$1.58 with a midpoint of \$1.15
- Reduced production costs translate into increased media buys and return on investment

Florida Legislature Office of Program Policy Analysis & Government Accountability

22



## **Gambling Helpline Calls**

- In FY 2008-09, 39% (868 of 2,253) of helpline callers identifying a specific gambling issue mentioned Lottery
- Lottery-related helpline calls did not increase commensurate with advertising spending
- Lottery-related helpline calls are linked to the state's unemployment rate

## **QUESTIONS?**

**Sabrina Hartley**  
[hartley.sabrina@oppaga.fl.gov](mailto:hartley.sabrina@oppaga.fl.gov)



Office of Program Policy Analysis & Government Accountability

OPPAGA supports the Florida Legislature by providing evaluative research and objective analyses to promote government accountability and the efficient and effective use of public resources.

# Florida Lottery™

Responses to OPPAGA  
Reports on Lottery Programs

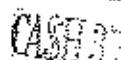
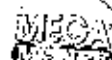
January 2010



## Florida Lottery Response

### OPPAGA Report

*Lottery Profits Flat; Increasing  
Retailer Outlets is Critical to  
Increasing Sales*



# Florida Lottery Response

**OPPAGA:** Consider offering Mega Millions, another multi-state lottery game

## Lottery

- Evaluation underway
- Net gain in sales and EETF?
- Impact on FLORIDA LOTTO sustainability?
- Timing of another game launch



Florida Lottery

# Florida Lottery Response

**OPPAGA:** Take additional steps to increase the number of participating retailers

## Lottery

- Geographically-focused sales outreach; fewer retailer seminars
- Increased Lottery website presence and recruitment advertising
- Fresh look at Business Development unit operations
- Continued refinement of Retailer Recruitment System as a research tool



Florida Lottery

# Florida Lottery Response



**OPPAGA:** Evaluate and report on retailer recruitment efforts and target increasing corporate accounts

## Lottery

- Committed to comprehensive ROI covering all recruitment strategies; using standard criteria
- Improved coordination between Business Development and Sales Team
- Strengthening of corporate recruitment efforts; but, need to be realistic

Florida Lottery

# Florida Lottery Response



**OPPAGA:** Request legislative authority to install additional Instant Ticket Vending Machines

## Lottery

- Legislative authority would be budgetary rather than statutory
- ITVMs completely installed for 90 days at this point
- Early indications good—Retailers with ITVMs up 18% vs retailers statewide down 2%

Florida Lottery

# Florida Lottery Response



**OPPAGA:** Examine the retailer commission structure

## Lottery

- Study complete as per proviso
- Touched base with more than 500 Florida Lottery retailers
- Looked at other U.S. lotteries
- Next step: Decide on changes, develop specifics

Florida Lottery

# Florida Lottery Response



**OPPAGA:** Work with the Department of Management Services to reduce excess office space

## Lottery

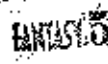
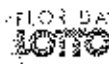
- Committed to continuing work with DMS, continuing to streamline our need for space
- Significant reduction in excess office space
- Best course—Restructured lease terms for existing site

Florida Lottery

## Florida Lottery Response

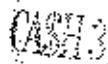


**OPPAGA:** Update the business case study regarding field support services



### Lottery

- Will update the business case study by January 2011
- Vital that we maintain and improve the quality of our service to retailers and players



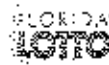
Florida Lottery

## Florida Lottery Response



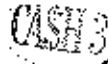
### OPPAGA Legislative:

- Authorize the Lottery to offer on-line game vending machines
- Consider authorizing the Lottery to offer Internet sales
- Consider authorizing new games, but consider social implications



### Lottery

- Will assist Legislature in any way we can in analyzing these proposals



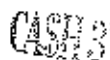
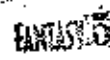
Florida Lottery

# Florida Lottery Response



## OPPAGA Report

*Lottery Jackpots, Retailer Density,  
and Advertising Drive Transfers to  
Education*



Florida Lottery

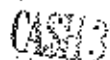
# Florida Lottery Response



## OPPAGA Finding:

Prize payouts are the primary driver of education transfers

- Larger prizes increase transfers to education
- Adding more Lottery retailers would increase education transfers



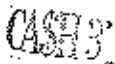
Florida Lottery

# Florida Lottery Response



## Lottery

- Legislature's grant of variable prize payout authority has worked well
- Committed to improving the effectiveness/coordination of our retailer recruitment effort
- Important to be mindful of the degree to which we can influence each of these factors



Florida Lottery

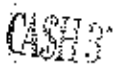
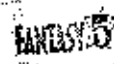
# Florida Lottery Response



## OPPAGA Finding:

While advertising is critical to maintain Lottery sales, additional expenditures may have a limited effect on net revenues

- Advertising is necessary to maintain sales
- Increased Lottery advertising may have a limited effect on increasing transfers to education
- Reducing advertising production costs would increase education transfers



Florida Lottery

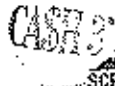


# Florida Lottery Response



## Lottery

- Pleased that the OPPAGA study found what previous studies and our experience clearly show about the critical role of advertising
- Concur with suggestion to shift funding to media—our strategy for the past year
- Sole reservation: OPPAGA's finding that additional spending "may have limited effects on revenue"
  - Not at "saturation point"
  - Revenue percentages devoted to advertising by competing companies



Florida Lottery

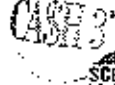
# Florida Lottery Response



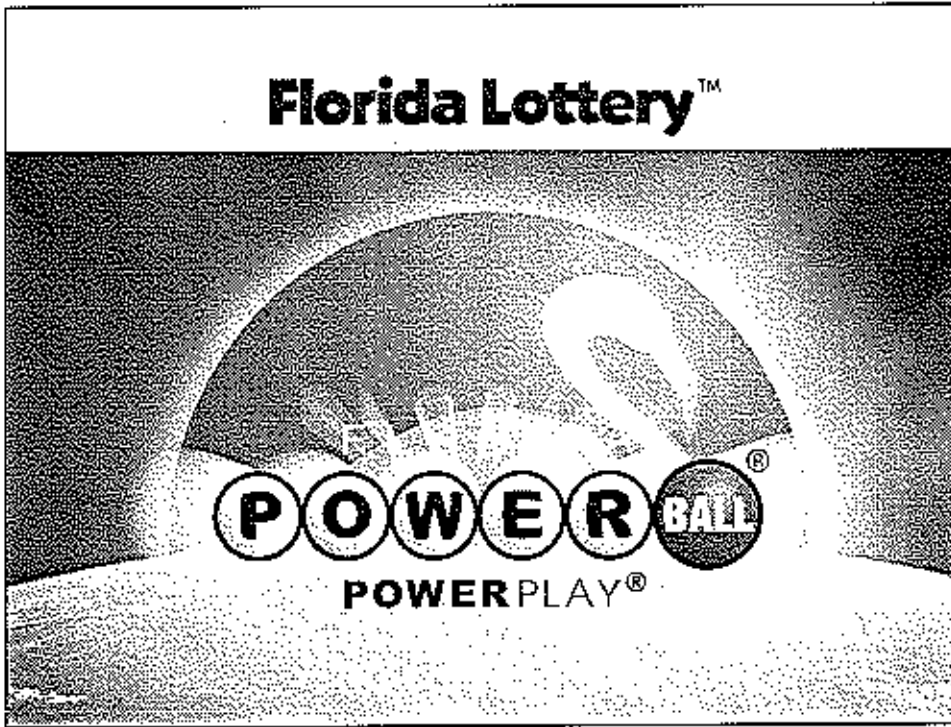
## OPPGA Finding:

Lottery gambling problems are more strongly related to unemployment than advertising

- About two out of every five callers to the state gambling helpline mentioned the Lottery
- Lottery-related helpline calls are not driven by Lottery advertising or awareness levels but are related to changes in the state unemployment rate



Florida Lottery





## Lottery Profits Flat; Increasing Retailer Outlets Is Critical to Increasing Sales

### *at a glance*

Growth in Lottery transfers to the Educational Enhancement Trust Fund has leveled off and current forecasts indicate continued slowing of revenue growth due to the economic recession.

The Lottery has taken several steps to maximize its sales and transfers to education, including joining Powerball, adding instant ticket vending machines, and redesigning Lotto. While the Legislature could consider authorizing new games such as video lottery, keno, vending machines for on-line games, and Internet-based games, these options would likely increase associated negative social costs and could conflict with the proposed Indian gaming compact. A more acceptable alternative would be for the Lottery to increase the number of participating retailers, as its market penetration rate is lower than that of other successful state lotteries.

The Lottery's operating expense rate continues to decline, making it among the most efficient U.S. lotteries. It could realize additional efficiencies by continuing to explore ways to reduce costs for leasing office space, providing field support functions, and compensating retailers.

### Scope

As directed by the Legislature, OPPAGA examined the Department of the Lottery and assessed options to enhance its earning

capability and improve its efficiency, including alternatives for providing Lottery field support services.<sup>1</sup>

### Background

Following voter approval of a constitutional amendment, the 1987 Legislature enacted the Florida Public Education Lottery Act. The act created the Department of the Lottery to generate funds for education and to enable the state's citizens to play state operated lottery games. The Lottery provides both on-line and scratch-off games. On-line games allow players to pick from a range of numbers on a play slip. On-line game tickets are printed by terminals that are connected to the Lottery's central computer system for a drawing at a later date. Scratch-off games sell tickets with a latex covering that players scratch-off to determine whether they have won.

The Lottery is headquartered in Tallahassee with nine district offices that serve the dual

<sup>1</sup> Section 24.123, *F.S.*, requires an annual financial audit of the Lottery, which is to include recommendations to enhance the Lottery's earning capability and efficiency. The Joint Legislative Auditing Committee directed OPPAGA to conduct the assessment of Lottery efficiency, while the Auditor General was directed to conduct the required financial audit of the Lottery. Chapter 2009-81, *Laws of Florida*, also directed OPPAGA to examine alternative field support service delivery models and the effectiveness of major advertising and promotional campaigns for lottery games (see OPPAGA Report No. 10-17).

role of providing field support services to retailers and acting as prize redemption and payment centers.<sup>2</sup> The Lottery's nine district offices sell and redeem tickets and act as a hub for the field support services.

The Lottery generates revenue from the sale of both on-line and scratch-off tickets. The Lottery is self-supporting and receives no general revenue. For Fiscal Year 2009-10, the Legislature appropriated \$139 million and 438 positions for Lottery operations.

Since its inception, the Lottery's core functions to produce, advertise, and sell tickets have been outsourced to retailers and private vendors. To sell Lottery products, the Lottery contracts with a wide range of retailers across the state such as supermarkets, convenience stores, gas stations, and newsstands. Retailers receive commissions for selling Lottery products at a rate of 5% of the ticket price in addition to 1% of the prize value for redeeming winning tickets. Retailers can also receive bonuses for selling select winning tickets and performance incentive payments.

The Lottery procures several major services from private vendors including those below.

- In January 2005, the Lottery entered a six-year contract with CTECH, its on-line gaming system vendor, to provide computer systems, retailer terminals, software, telecommunications, and technical support services.
- In November 2007, the Lottery entered a three-year contract with Machado Garcia-Serra Advertising, Inc., for Hispanic market advertising.
- In October 2008, the Lottery entered a six-year contract with Scientific Games to print, market, and distribute scratch-off game tickets.
- In September 2009, the Lottery entered a three-year contract with St. John & Partners

Advertising and Public Relations Inc., for English market advertising.

In Fiscal Year 2009-10, approximately 66%, or \$91.5 million, of the Lottery's \$139 million appropriation was allocated to pay vendors for advertising and on-line and scratch-off games. Retailer commissions are paid directly from sales revenues and do not appear in the department's appropriation.

## Lottery Transfer Performance

In Fiscal Year 2008-09, the Lottery transferred \$1.3 billion to the Educational Enhancement Trust Fund; \$4 million more than in the prior year. The Lottery exceeded its legislatively approved transfer performance standard of \$1.206 billion for Fiscal Year 2008-09 and has reported a primary objective of transferring at least \$1 billion annually to the Educational Enhancement Trust Fund. The department has a long-term goal to increase annual education transfers to \$1.5 billion by Fiscal Year 2012-13.

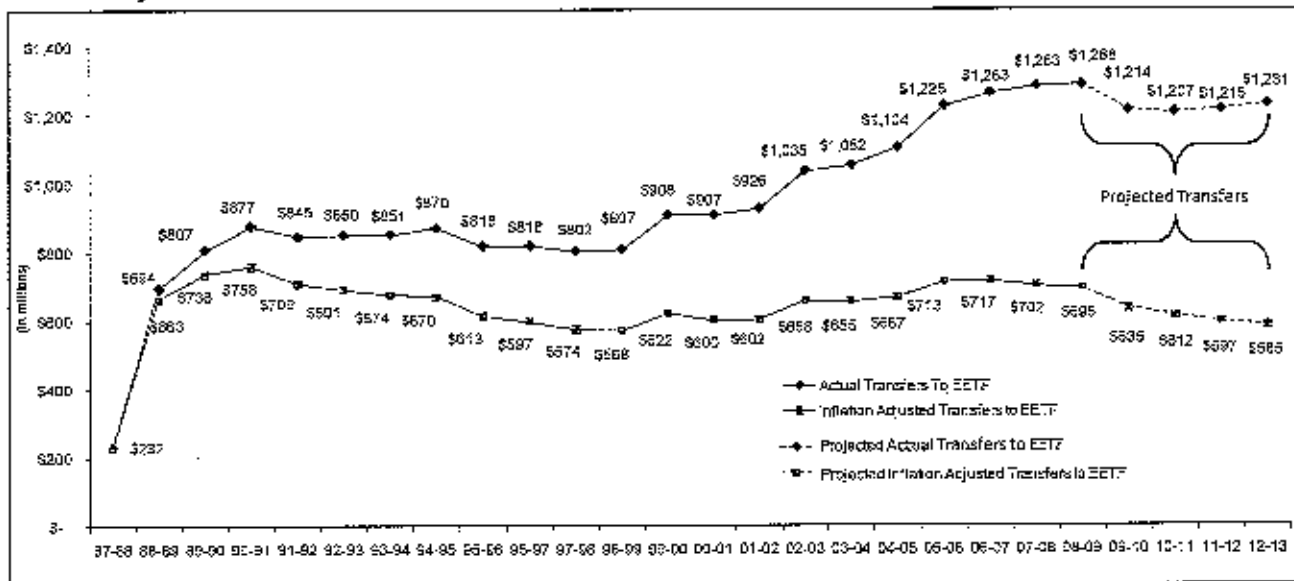
As shown in Exhibit 1, Lottery transfers to education have leveled off, due primarily to the depressed economy that limits consumers' discretionary spending on lottery products. The October 2009 Revenue Estimating Conference projected that Lottery transfers to education will decline by \$75.6 million in Fiscal Year 2009-10 and by about \$7 million in 2010-11 before increasing the following year (see Exhibit 1). These projections indicate that the Lottery must make a concerted effort to increase its transfers or offer a declining value to the state.

The effect of inflation also lowers the purchasing value of the Lottery's transfers to education. As shown in Exhibit 1, inflation adjusted transfers to education has remained relatively flat over the past 20 years and has declined annually since 2006-07. Inflation will continue to erode the value of the Lottery's education transfers unless the Lottery increases the dollar value of the transfers to at least meet the rate of inflation.

<sup>2</sup> Lottery retailers can pay prizes up to \$599. District offices can pay up to \$250,000 for Florida Lottery prizes and up to \$1 million for Powerball. Prizes exceeding these amounts must be collected at Lottery headquarters in Tallahassee.

**Exhibit 1**

**Unadjusted Transfers to Education Increased \$4 Million (0.3%) in Fiscal Year 2008-09 But Are Projected to Decline in 2009-10<sup>1</sup>**



<sup>1</sup> Projected transfers from the October 14, 2009 Revenue Estimating Conference were adjusted for inflation using a five-year average rate of 1.6%.

Source: OPPAGA analysis of Lottery financial data, Revenue Estimating Conference, October 14, 2009, and U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index.

## Revenue Enhancement Options

The Lottery has taken several steps in the past year to maintain and increase its sales and transfers to the Educational Enhancement Trust Fund, including joining Powerball, adding instant ticket vending machines, and redesigning its Lotto game. While generally successful, these steps have not reversed the overall trend of relatively flat Lottery transfers to education.

We assessed two strategies the Lottery could implement to increase sales and transfers in future years; both require legislative approval. First, the Lottery could implement additional games that have been used in other states, such as video lottery and a keno game. However, these options would likely increase the negative social costs of gambling and could conflict with the proposed Indian gaming compact (see Appendix A for a list of additional game options). Second, the Lottery could

expand product distribution by adopting new ways of selling lottery tickets and expanding its retailer network, as Florida's market penetration is relatively low compared to other states. Expanding the number of retailers would likely increase sales with relatively low negative social consequences (see Appendix B for a list of additional product distribution options).

**The Lottery has launched Powerball, installed vending machines, and redesigned Lotto to maintain sales and transfers.** In January 2009, Florida became the 30th state to join Powerball, a multi-state jackpot game. With jackpots starting at \$20 million and increasing with each rollover, Powerball offers players the chance to win large jackpots for \$1 per play.<sup>2</sup> Powerball reached sales of \$233.4 million in Florida

<sup>2</sup> Between January 4, 2009, and October 15, 2009, Florida has had one player win a \$189 million jackpot, 13 winners at the \$1 million prize level, 49 winners at the \$200,000 level, and a total of more than 8.5 million players winning more than \$275.8 million.

during the last six months of Fiscal Year 2008-09 which translates to approximately \$94.9 million in transfers to education.<sup>4</sup> The February 2009 Revenue Estimating Conference estimated that 51.9% of Powerball sales were due to a shift in sales from other Lottery products, resulting in an estimated \$45.7 million net transfer to education in Fiscal Year 2008-09. Without the addition of Powerball to the Florida Lottery product mix, Lottery transfers to education would likely have declined about 3% in Fiscal Year 2008-09.

The Lottery has continued to refresh its games to stimulate sales and to ensure an effective product mix. For example, with the addition of Powerball in January 2009, the Lottery concluded that there was no longer a need for Lotto to be designed as a super jackpot game, and it redesigned its add-on feature and launched Lotto Xtra on October 11, 2009. Xtra offers players the opportunity to multiply their non-jackpot winnings by up to five times with \$1 more per play. During the first 16 Xtra drawings, nearly 10% of Lotto players opted to pay the additional dollar, adding \$5.8 million in sales. The Xtra number, from 2 to 5, is drawn at random preceding the Lotto drawing to determine the non-jackpot cash prize multiplier for that draw.

Also, between August and October 2009, the Lottery installed 1,000 instant ticket vending machines across the state at existing retailers to increase scratch-off ticket sales.<sup>5,6</sup> Vending machines are used by 29 other U.S. lotteries, producing more than \$2 billion in national sales in 2007-08. The Lottery's first experience using vending machines, which was discontinued in 2002, found that they were cost-effective in only certain locations. The Lottery conducted an instant ticket vending

machine pilot study in 2007 and concluded that the machines were cost-effective in grocery stores, and it has installed the instant ticket vending machines primarily in these locations. During the first 15 weeks, scratch-off weekly sales averaged about \$2,500 per vending machine, and the May 2009 Revenue Estimating Conference projected the net fiscal impact of the vending machines will be \$3.4 million annually after expenses.<sup>7</sup> In addition to increasing scratch-off ticket sales, the vending machines provide players convenient access to a larger selection of games, transmit sales in real-time, allowing the Lottery to better track ticket sales, and improve retailer operational efficiency.

**Some new Lottery products could generate substantial revenues but would represent expanded gambling.** There are several options for Lottery games that could attract new players and substantially increase state revenues. For example, Florida could introduce video lottery terminals, which could generate an additional \$404 million to \$648 million in transfers to education, while introducing keno (a quick draw game) could generate between \$64 million and \$358 million in additional transfers.<sup>8,9</sup> In Fiscal Year

<sup>7</sup> Comparing 15 weeks of sales between October 12 and January, 2008 to 2009-10, retailers with instant ticket vending machine scratch-off sales increased 18% in contrast to a 2% decline in scratch-off sales for all Lottery retailers.

<sup>8</sup> Fast keno or a quick draw game is an on-line lottery game in which players choose as many as 10 numbers from a pool of 80 numbers in the hope of matching their choices to those drawn by a central computer. Keno is similar in principle to other on-line games, but it is more frequent (normally every five minutes) and normally played in a social setting such as a bar or restaurant. Video lottery terminals are player activated and can be programmed to play casino-style games such as poker, blackjack, keno, and bingo; or simulate mechanical slot machines or roulette wheels.

<sup>9</sup> OPPAGA's keno revenue estimates are based on other states' per capita sales performance, while video lottery terminal revenue estimates are based on Florida's net income per slot machine. The keno range is based on high and low state per capita sales after excluding the outlier states from the upper and lower quartiles. The video lottery terminal range is based on Florida's pari-mutuel lowest net income per slot machine to the highest net income per slot machine. For keno, the Fiscal Year 2010-11 projected on-line transfer rate to the Educational Enhancement Trust Fund of 40.29% and a 31.09% blended transfer rate for video lottery terminal estimates. Lottery administrative costs for operating video lottery terminals at pari-mutuel facilities are assumed to be covered by licensing fees.

<sup>4</sup> On-line game transfer rates averaged 40.68% for Fiscal Year 2008-09.

<sup>5</sup> Section 24.105(9)(a)4, F.S., provides that the only player-activated machine which may be utilized is a machine which dispenses instant lottery game tickets following the insertion of a coin or currency by a ticket purchaser.

<sup>6</sup> The Lottery's cost to lease the 1,000 vending machines from its on-line vendor, GTECH, is \$329 per month per vending machine or \$3,948,000 per year. On May 27, 2009, the Lottery received spending authority to lease the 1,000 vending machines.

2007-08, 6 states operated video lottery terminals and 13 offered keno.

Another option would be for Florida to sell the multi-state Mega Millions game, which operates similar to Powerball. The Lottery could offer both games, as the multi-state lottery associations are expected to permit states to cross-sell Powerball and Mega Millions starting in early 2010. Currently, Georgia participates in Mega Millions and Florida in Powerball. Rather than potentially lose sales to Georgia, particularly when Mega Millions offers large jackpots, Florida could keep sales in-state by selling both games. Since Powerball drawings are held Wednesday and Saturday, and Mega Millions drawings are held Tuesday and Friday, cross selling provides players more choice. Based on other states' sales, the Lottery could generate an additional \$26 million to \$35 million in transfers to education by offering Mega Millions.<sup>10</sup> However, potential sales shifts from Lotto could substantially weaken the game's viability.

However, adding some new lottery games would represent an expansion of legalized gambling and could produce negative social costs. Video lottery terminals and keno are considered to be more addictive than traditional lottery games and could contribute to problem and pathological gambling rates and increase law enforcement costs to combat crime typically associated with gambling. A small percentage of gamblers develop pathological addictions leading to a variety of financial, physical, and emotional problems. Studies indicate that problem and pathological

gamblers can suffer financial hardship, bankruptcy, unemployment, and may resort to crimes to support their addictive behavior as well as commit domestic violence, engage in substance abuse, and/or commit suicide. Studies have shown that the negative effects associated with problem gambling may take as long as three to four years to manifest. As a result, some long-term adverse effects are not immediately apparent when legalized gambling is approved or expanded.

The National Gambling Impact Study Commission estimated that the annual average costs of job loss, unemployment benefits, welfare benefits, poor physical and mental health, and problem or pathological gambling treatment to society are approximately \$1,195 per pathological gambler per year and approximately \$715 per problem gambler per year.

Further, implementing video lottery terminals, quick-draw games, and Internet lottery games could conflict with the proposed Indian gaming compact. The compact, as currently drafted, would grant Florida tribes exclusive rights to operate some types of gambling, and it appears that expanded Lottery games could conflict with these provisions.

**Some states are using vending machines for on-line games and are planning to implement Internet-based games.** Several of the top performing state lotteries are starting to use new vending machine technology to dispense on-line games.<sup>11</sup> However, the Florida Lottery does not have legislative authorization to use vending machines to dispense on-line game tickets since the law was written before such technology existed. Authorizing player activated vending machines for on-line games could facilitate the recruitment of large corporate accounts such as Walmart and CVS.<sup>12</sup>

<sup>10</sup> No real experience by other states cross-selling Powerball and Mega Millions yet exists. Therefore, the transfer estimate is subject to error. OPPAGA's revenue estimate for the Mega Millions game is based on other states' per capita sales performance. These figures were multiplied by Florida's projected population for Fiscal Year 2010-11 to determine an estimated sales amount. These sales amounts were then reduced by the estimated transfer rate to the Educational Enhancement Trust Fund and further reduced by a sales shift estimate. The Fiscal Year 2010-11 projected on-line transfer rate to the Educational Enhancement Trust Fund of 40.29% was used while the sales shift estimate used was 80%.

<sup>11</sup> Top-performing state lotteries, based on per capita sales that are beginning to use on-line vending machines include Georgia, Michigan, and New Jersey.

<sup>12</sup> Currently, Walmart and CVS do not sell lottery products anywhere in the U.S., but the Florida Lottery continues to pursue these retailer outlets.

Full service vending machines (i.e., selling both on-line and scratch-off games) may be attractive to large corporate chains, as they minimize on-site required labor and provide increased player choice and potential for larger sales. For example, the most recently available 2007 data provided by GTECH indicates that Lottery sales from adding full service vending machines at 167 Walmart super stores could potentially provide from \$71 million to \$140 million annually in transfers to education. As of October 2009, Walmart operated 167 Supercenters and 112 smaller stores in Florida.<sup>13</sup>

Selling Lottery products over the Internet could increase sales but legal barriers would need to be addressed. Other states that permit player-activated terminals sell subscriptions for select on-line games over the Internet, but do not offer individual on-line or scratch-off tickets. For instance, New Hampshire sells Tri-State Megabucks and Powerball subscriptions over the Internet, but requires a New Hampshire mailing address, and telephone number, and a charge card to make the purchase. Florida law currently restricts the use of player-activated terminals and does not authorize the use of credit cards for lottery purchases without purchase of \$20 in other goods. According to Lottery estimates, if Florida performed at average levels, annual sales through subscriptions could generate an additional \$10 million in transfers to education.

Selling individual lottery tickets over the Internet requires enhanced technology to ensure that Internet sales are made within a state's borders. Currently, no U.S. lottery is selling individual lottery tickets over the Internet, but New Hampshire is developing plans to launch such individual game sales in 2010. British Columbia does offer Internet-based games. The British Columbia Lottery

Corporation uses computer infrastructure to ensure player identification and location.

There are conflicting interpretations about whether federal law authorizes Internet sales of lottery products. Proponents argue that federal law may be interpreted to allow intrastate Internet gambling so long as a bet is initiated, received, and paid within the same state. However, opponents contend that it is not feasible to ensure that Internet lottery sales occur only intrastate because data transmitted by the Internet likely crosses state lines. The U.S. Department of Justice has not issued an opinion on the matter. Internet sales could provide players with increased access but, given the convenience and privacy of play, may also increase associated negative social consequences.

**Increasing the retailer network would increase revenues while largely avoiding negative social consequences.** Increasing the number of retailers that sell lottery tickets has the potential to increase revenues by making lottery products more readily available to residents and tourists. Nationwide data on state lotteries shows that there is a significant relationship between per capita sales and the number of residents per retailer, with states achieving higher sales when they have more retailers per 10,000 residents. However, the Florida Lottery ranks 15<sup>th</sup> in retailer density among 42 U.S. lotteries (excluding the Iowa Lottery that did not report the number of its on-line retailers for 2007-08).

In Fiscal Year 2007-08, the top nine U.S. lotteries ranked by per capita sales had an average of 1,200 residents per retailer. During that period, the Florida Lottery averaged almost 1,400 residents per retailer, and ranked 10<sup>th</sup> among U.S. lotteries in per capita sales. To meet the top-performing states' average market penetration, the Lottery would need to expand its retail network from 13,500 to 15,000 retailers.<sup>14</sup> Adding 1,500 new retailers has the

<sup>13</sup> This estimate is based on a projection made by the Lottery's on-line vendor assuming optimistic sales conditions. The projection estimates that average sales would be \$22 million per center. OPPAGA calculated the profit using a blended transfer rate of 31.09% and considering current economic conditions.

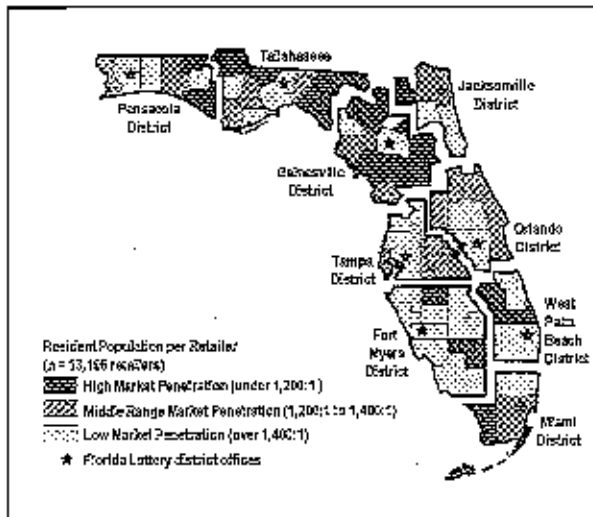
<sup>14</sup> To do so, the Lottery would need spending authority to operate additional sales terminals, as it is currently authorized up to 13,500 terminals.



potential to generate about \$32 million annually in additional transfers to the Educational Enhancement Trust Fund.

The Lottery's current market penetration rate varies across the state with pockets of the highest market penetration typically found in rural counties (see Exhibit 2). Approximately half (32) of Florida's 67 counties have low market penetration, including highly populated urban counties such as Broward, Hillsborough, Orange, and Palm Beach. These areas represent the greatest opportunity to expand the department's retailer network.

**Exhibit 2  
Retailer Market Penetration Varies  
Across the State**



Source: OPPAGA analysis of Lottery data.

The department has taken steps to recruit additional retailers, but it has also lost many retailers due to factors including the current economic conditions, which have forced some participating businesses to close. In Fiscal Year 2008-09, the Lottery recruited 2,087 new retailers but lost 2,173, for a net loss of 86 outlets.

Both headquarters and district staff work to recruit corporate and independent retailers. Corporate chain accounts represent multiple retailer outlets and the potential for significant sales and education transfers. Currently, both

the Office of Business Development, located in the Lottery's Tallahassee headquarters, and five sales executives, distributed across the state, participate in corporate chain recruitment. It is important that the Lottery balance its recruitment efforts between independent and corporate accounts and continue to specifically target and coordinate efforts to increase corporate retailers. More corporate outlets would have a positive effect on both sales and transfers to education.

To increase the number of independent retailers, the Office of Business Development employs three primary recruiting methods: calls to prospective retailers, retailer recruitment seminars, and responding to retailer inquiries from the Lottery's website, telephone, mail, and fax. To recruit independent retailers in the field the department conducted a 'sales blitz' retailer recruitment competition.

The department's inspector general recently reviewed these activities and concluded that, in general, recruitment seminars and outreach phone calls produced limited return on investment, while the department's website and the field recruitment 'sales blitz' were more effective. However, the Lottery's Office of Business Development disagreed with this assessment and asserted that its retailer recruitment seminars were successful. With the exception of the retailer recruitment seminars, neither the Office of the Inspector General nor the Office of Business Development performed a cost benefit analysis to assess the cost effectiveness of the department's other recruitment methods.

The Office of Business Development has hosted 10 retailer recruitment seminars across Florida over the past three years to educate prospective independent retailers about the benefits of becoming a Florida Lottery retailer. These events were relatively expensive – the department estimated that it spent \$370,000 hosting eight of the seminars, and this estimate

did not include all associated costs.<sup>15</sup> Collectively, the department recruited 38 new retailers through the seminars.<sup>16</sup>

The Lottery's Division of Sales conducted a district-level retailer recruitment competition, or 'sales blitz', for three months in 2008 (January thru March). This effort used the department's 115 sales representatives to solicit new retailers, with a goal of obtaining 500 new retailers. This effort recruited 294 new retailers. The department did not track how much time staff spent conducting these recruiting efforts, and thus its per-retailer recruitment cost cannot be identified.<sup>17</sup>

Also, the department has not assessed its recruitment efforts to determine which mechanisms work best in different areas of the state and which methods are most successful in recruiting retailers with the highest sales potential. While the Lottery began tracking retailer referrals in October 2008, it has examined only select recruitment mechanisms in detail and has attempted to calculate a return on investment for only one. In addition, the department does not collect information on its staff costs associated with retailer recruitment efforts, which limits its ability to evaluate the cost efficiency of those efforts. As a result, the department does not have an overall perspective on the effectiveness of its recruitment efforts.

<sup>15</sup> The Lottery held eight seminars located in Fort Myers, Gainesville, Jacksonville, Hollywood, Orlando, Pensacola, Tallahassee, and West Palm Beach. The estimated cost for these events did not include staff costs to plan the event; typically one FTE dedicated for nine weeks per seminar. The Lottery did not collect documented cost information for seminars held in Miami in 2006 and Tampa in 2007.

<sup>16</sup> We estimate that, as of June 30, 2009, these additional retailers produced Lottery sales that resulted in approximately \$619,000 in education transfers; this figure is based on OPPAGA's analysis of the recruitment mechanisms and their rate of return.

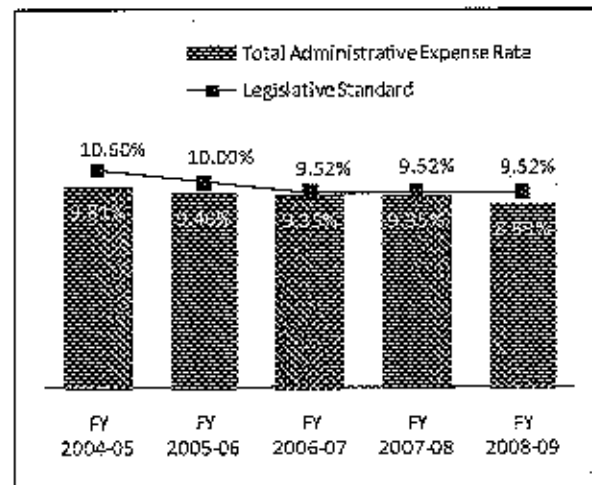
<sup>17</sup> We estimate that these additional retailers produced sales that resulted in about \$8.5 million in education transfers.

## Operational Efficiency Options

The Lottery has reduced its administrative costs as a result of lower vendor fees. There are two areas where the Lottery may be able to achieve additional administrative cost reductions—modifying its retailer commissions and reducing excess office space. In addition, the department may be able to realize operational and/or cost efficiencies by examining how it provides field support services.

**The department's administrative expense rate has declined.** The Lottery's administrative expenses in relation to its sales continue to be lower than the legislative standard as shown in Exhibit 3 and this rate has declined over time. After increasing in each of the last five years, the Lottery reduced its administrative expenses in the Fiscal Year 2008-09 by 10%, or \$38 million. This was primarily due to a reduction in vendor fees in the new scratch-off ticket contract.

**Exhibit 3**  
**The Lottery's Administrative Expense Rate Has Declined Over Time**



Source: OPPAGA analysis of Lottery performance information submitted to the Legislature.

**The department could modify its retailer commissions to reduce costs.** The Lottery's current retailer commission structure pays disproportionately high commissions for selling some lottery tickets. These commissions are based on 5% of the ticket price and 1% of prize redemptions. While retailers incur the same costs to sell all tickets, they receive higher commissions without increased labor costs when they sell \$20 and \$30 scratch-off tickets. Retailers receive five cents for every \$1 ticket sold, \$1 for each \$20 ticket sold, and \$1.50 for each \$30 ticket sold. The department expressed concern that some retailers may not stock higher priced tickets if the department changes its commission structure; potentially reducing income and overall education transfers. This could be addressed by adopting a commission structure that is tied to performance and actual transfers to education.

Consistent with prior OPPAGA recommendations, the 2009 Legislature directed the Department of Lottery, in proviso language, to study the retailer commission structure for all games and develop alternatives for rewarding retailers' performance. The department's report is due January 31, 2010.

**Leased headquarters space continues to exceed Lottery needs.** Currently, the Lottery pays \$496,000 annually to lease about 30,623 square feet of excess office space and it needs to consolidate its special use space. Since the late 1990s the Lottery has reduced its need for headquarters office and warehouse space through staff reductions and outsourcing functions like telemarketing and scratch-off ticket distribution. At the same time, however, the Lottery has not commensurately reduced the amount of space it leases.

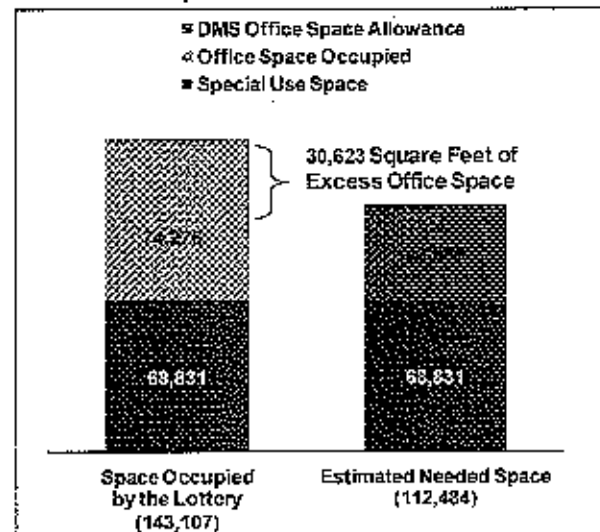
With the assistance of the Department of Management Services' tenant broker, the Lottery recently renegotiated the lease for its 159,759 square foot headquarters building and is in its second year of a 10-year lease. The Lottery's annual lease payment is \$2.6 million for Fiscal Year 2009-10. In effect, the Lottery pays a

combined office and warehouse rate of \$16.19 per square foot for its headquarters building.<sup>18</sup>

The Lottery occupies 143,107 square feet of the building after subleasing 16,652 square feet to three of its major vendors.<sup>19</sup> Of the 143,107 square feet occupied by the Lottery, 74,276 square feet is office space and 68,831 square feet is special use space (e.g., conference and training centers, secure storage areas, cafeteria/break rooms, winner conference areas and warehouse space).

While the Lottery occupies about 74,276 square feet of leased office space for its 242 headquarters employees (i.e., about 300 square feet per employee) it needs only 43,653 square feet of office space according to Department of Management Services standards.<sup>20</sup> Therefore, as shown in Exhibit 4, the Lottery leases about 30,623 square feet of excess office space (see Appendix C for a detailed inventory of department headquarters space).

**Exhibit 4**  
**The Lottery Leases About 30,623 Square Feet of Excess Office Space**



Source: OPPAGA analysis of Lottery data.

<sup>18</sup> The Lottery's lease rate includes janitorial services and lawn care but does not include utilities.

<sup>19</sup> The Lottery currently subleases office and warehouse space, reducing its lease payments by \$232,400 in Fiscal Year 2009-10 (\$169,745 for office space and \$62,655 for warehouse space).

<sup>20</sup> In addition to the 242 employees, 16 Lottery employees have offices located in special use space and 4 District I sales representatives housed in the headquarters building are not assigned office space.

In addition, the Lottery should consolidate its special use space. This space includes 45,421 square feet of conference and training centers, secure storage areas, a cafeteria, winner conference areas, and 23,410 square feet of warehouse space occupied by the Lottery. Based on our review and facility observations, much of the special use space is underutilized. For example, the conference and training centers are used infrequently and rarely simultaneously; indicating that there may not be a need for both centers. Our tour of the Lottery's warehouse space found that it was underutilized and used in part to store empty boxes, excess furniture, and surplus gaming equipment, that could likely be consolidated or properly disposed.

To address this issue, the General Appropriations Act has annually, for the last six years, required the Lottery to develop a plan to consolidate its lease of office space where economical and to sublet excess office and warehouse space to suitable tenants.<sup>21</sup> The Lottery is in the process of reducing its excess leased headquarters office space by 4,220 square feet. To do this, the department is moving its leased offsite production studio; where winning lottery numbers are drawn, to its headquarters. The new studio will occupy 3,756 square feet of space at the headquarters building. The facility is currently under construction and the department anticipates moving draw productions to the new facility beginning April 2010. To further reduce excess space, the department expanded the amount of subleased space by subleasing 464 square feet to its advertising firm.

In response to the appropriations proviso, the department reports that it has sought to find an appropriate tenant but has not been able to do so due, in part, to concerns that portions of the Lottery headquarters are high security areas. The Lottery has not yet developed a written headquarters consolidation plan, but it plans to develop a proposal to renovate its

headquarters facility using landlord provided tenant improvement funds and present this proposal to the department secretary in spring 2010. Department officials reported that this proposal is expected to consolidate excess office space to make it more readily available for sublease and improve operational efficiencies by moving like units in close proximity to one another. The Lottery should work with the Department of Management Services in developing its renovation and consolidation plan, as the department has expertise in evaluating the space needs of state agencies. Collectively, the two agencies should evaluate the Lottery's current and future space needs, develop a consolidation plan, define space available to sublet, and find a suitable tenant.

***The Lottery should continue to evaluate alternative field support services delivery models***

As the Lottery is a sales operation, functions that support ticket sales are critical to its success in generating funds for education. The Lottery maintains a workforce of 115 field sales representatives that work directly with retailers to promote sales. These staff visit retailers, deliver new game point-of-sale materials, recruit and train new retailers, and assist in stocking, ordering, and display. Each sales representative provides support for an average of 125 retailer accounts along an established route. In addition, the Lottery has 12 field sales managers that supervise the field support staff, and five sales executives that service and support corporate chain accounts. Together, these staff, sales representatives, field support managers, and sales executives, make up field support services. The department spends \$10.8 million annually for field support services, including salaries and benefits and related expenses.<sup>22</sup>

<sup>22</sup>This figure is based on the number of field sales representatives, sales managers, and sales executives employed as of November 2009.

<sup>21</sup> Chapter 2009-81, *Laws of Florida*.

In contrast, at least six other states, including one of the top performing state lotteries, have outsourced all or part of their field support staff. There are advantages and disadvantages associated with outsourcing this function, and there is relatively little data to compare the Florida Lottery's costs to those of the other states. The Lottery should prepare an updated business case study to inform a decision on whether to outsource field support services.

**Six states have outsourced all or part of their lottery sales force.** At least six states currently outsource either all or a portion of their lottery sales force; four outsource all sales representative functions, and two partially outsource these functions.<sup>23</sup> Lottery administrators from these states indicated that this outsourcing has generally been successful. One of the states, Pennsylvania, is among the top 10 performing lotteries in the nation, ranking eighth, based on per capita sales.

Two of these states (Texas and Pennsylvania) have a sales force comparable in size to Florida. Texas contracts for its entire sales force of 140,

while Pennsylvania employs 92 state sales representatives and contracts for 18 support field positions; for a total sales force of 110. The remaining four states have smaller sales forces than Florida.<sup>24</sup>

**There are advantages and disadvantages to outsourcing field support services, but little cost-effectiveness information is available.** States that have outsourced their sales forces reported that this option provided them with greater flexibility in obtaining needed positions, but cautioned that service contracts must be well-written and sufficiently detailed to ensure consistent, quality service. The primary disadvantage cited by these states was that their lotteries did not directly supervise their sales force. Several state lottery administrators reported that once outsourced, it would be prohibitively expensive to bring this function back in-house due to the infrastructure needed to provide field support services. Exhibit 5 summarizes the advantages and disadvantages associated with outsourcing field support services.

<sup>23</sup> Nebraska, Oklahoma, Texas, and West Virginia outsource the entire state lottery sales force, while Delaware and Pennsylvania outsource a portion of the lottery sales force. Pennsylvania uses contracted staff primarily for training and support of their employed sales force, while in Delaware three outsourced field staff perform the same functions as three state-employed sales staff. All of the states that have outsourced all or part of their field sales force have used this service delivery model long-term; three since inception of the state's lottery and three for a decade or longer.

<sup>24</sup> Oklahoma has an outsourced sales force of 20 positions, while Nebraska has 13 positions. West Virginia has 16 and Delaware has 6 positions, of which 3 are outsourced and 3 are state employees.

**Exhibit 5**

**There Are Several Pros and Cons Related to Outsourcing Lottery Field Support Services**

Field Support Delivery Option	Pros	Cons
Outsource field support services	<ul style="list-style-type: none"> <li>▪ Increased flexibility to hire staff and modify staffing to meet changing needs</li> <li>▪ Potential to reduce costs if vendor(s) can provide comparable services cheaper than the \$10.8 million currently paid by the department (includes salaries/benefits; fleet supervision)</li> <li>▪ Shifting employment to a contractor reduces the state's liability for long-term benefits and retirement.</li> <li>▪ A vendor may be more qualified to provide training to both sales representatives and retailers.</li> <li>▪ Ability to incentivize the sales force to increase sales and/or retailers</li> <li>▪ Ability to provide flexible schedules</li> <li>▪ Ability to contractually hold vendor accountable for specific sales figures</li> <li>▪ Ability to focus staff to target areas for special projects or attention</li> <li>▪ Potential to shift district facility costs to a vendor</li> <li>▪ No staff union restrictions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Department no longer has direct line authority over sales force representatives.</li> <li>▪ Department/sales reps lose the direct relationship with retailers.</li> <li>▪ Requires high level of communication to ensure that goals, objectives, operations are clearly communicated</li> <li>▪ Legislative oversight and accountability is limited since services are no longer performed by state employees.</li> <li>▪ Transition time of 3-6 months could result in decreased sales and/or service to retailers.</li> <li>▪ Significant up-front infrastructure costs if services are later brought back in-house</li> <li>▪ Department may incur a onetime expense of up to \$736,000 in accrued leave if existing sales force was no longer employed.</li> <li>▪ Potential additional state unemployment compensation costs if current sales reps are not hired by the contractor/vendor</li> </ul>
Outsource a portion of field support services	<ul style="list-style-type: none"> <li>▪ Allows the department to compare costs and operations on a pilot basis</li> <li>▪ Could represent a cost savings to the state if a portion of the cost of field support services could be borne by a vendor at a lower cost</li> </ul>	<ul style="list-style-type: none"> <li>▪ Could result in a divided and unequal workforce if there are varying levels of access to training and information and/or differing pay and incentive bonus structures</li> <li>▪ Information and data access may be restricted for vendor-employed sales reps.</li> <li>▪ Currently, no need to 'supplement' or 'support' the state's existing sales force</li> <li>▪ Costs to bring outsourced operations in-house when pilot ends</li> </ul>

Source: Interviews with other states and Florida Lottery administrators, district personnel, and sales representatives.

We could not determine whether outsourcing the Florida Lottery's field support services would be cost-effective. Neither of the two national vendors (GTECH and Scientific Games) that provide lottery field support services would provide cost information about the outsourced lottery sales forces they provide. The two vendors reported that this information is proprietary and both would likely submit a proposal should Florida seek to outsource the function. Likewise, most states with outsourced lottery sales forces were unable to provide cost data because they could not break out the cost for these services from their total contract costs.

The two states that could provide estimated costs for outsourced field support staff reported that their cost per field representative ranged from \$75,000 to \$138,000.<sup>25</sup> The Florida Lottery's cost for field support services averages about \$97,000 annually per field representative, including salaries, benefits, supervision, and vehicle costs; however, this figure excludes costs for new vehicle purchases

<sup>25</sup> The Pennsylvania Lottery reported that it pays its vendor approximately \$2.5 million for 18 contract field support positions; or approximately \$138,000 annually per contracted position. The Nebraska Lottery reported that its contracted sales representatives cost about \$75,000 annually when salary, benefits, incentives, and fleet costs are included.

and storage space that sales representatives use at district offices.<sup>26</sup>

**The Lottery should update its field support services business case study.** Florida statutes require state agencies considering outsourcing a function to develop a business case that evaluates the feasibility, cost-effectiveness, and efficiency of outsourcing the service.<sup>27</sup> The business case must include a detailed description of services; an analysis of advantages and disadvantages; a cost-benefit analysis; specific performance standards; and, a description of necessary legislative and budgetary actions.

The department has considered the option of outsourcing its field support services in the past and, in 2004, submitted a draft business case proposal to the Legislature. The draft report recommended conducting an open and competitive bid to take into account increased retailer numbers and to allow for multiple vendors to respond. Although the Center for Efficient Government in February 2005 approved the Lottery to proceed with the bid, the department has taken no further action. Instead, the department reports that it adopted efficiencies identified through the business case process while retaining the function in-house. Since that time, economic conditions have changed and additional operational efficiencies may exist.

The Lottery should update its field support services business case study to clearly define its operations and related costs, identify potential operational efficiencies, and assess the potential risks and benefits of outsourcing the function. If these results indicate potential benefits and acceptable risks for outsourcing field support services, the department should issue a formal request for proposals to determine whether outsourcing field support services could be cost effective. As part of this process, the Lottery's sales division should

submit its own proposal to maintain the function within the department. This process would enable the department to determine whether contracting out field support services in Florida would pose acceptable risks and produce material costs savings.

## Recommendations

There are steps that both the Legislature and the Department of Lottery can take to increase sales, reduce administrative expenses and ultimately increase transfers to education.

### *Department Recommendations*

We recommend that the Department of Lottery take several steps to enhance its revenues and increase its efficiency.

**Consider offering Mega Millions, another multi-state lottery game.** Introducing a second multi-state super jackpot game could increase transfers to education. The Lottery should carefully evaluate the benefits and disadvantages of adding another multi-state game and provide the results of its assessment to the Legislature.

**Take additional steps to increase the number of participating retailers.** We recommend that the department examine its market penetration geographically by type of retailer to identify specific areas in need of additional retailers based on the population rate, and to target retailer recruitment efforts in locations with low penetration rates and trade styles that have not been saturated, such as independent grocery stores, drug stores, and liquor stores. When the department approaches 13,500 terminals, the maximum currently authorized, it should request legislative budget authority to increase the number of retailer terminals.

**Evaluate and report on retailer recruitment efforts and target increasing corporate accounts.** We recommend that the department evaluate its retailer recruitment efforts by conducting a cost-benefit ratio analysis that includes all associated planning and production costs, to determine what methods work best where and to identify an

<sup>26</sup> This cost figure is based on the number of sales representatives employed as of November 2009.

<sup>27</sup> Section 297.0571, F.S.

acceptable cost per retailer per recruiting method. This information should be collected on a regular basis and reported to executive management. In addition, the department should establish standard criteria to be used by both the Office of the Inspector General and the Office of Business Development to evaluate specific recruitment mechanisms. To maximize the number of retailers statewide, the department should also target its recruitment efforts on increasing corporate chain accounts.

**Request legislative authorization to install additional Instant Ticket Vending Machines.** If instant ticket vending machines meet or exceed projected sales levels, we recommend that the department seek legislative authority to expand the number of instant ticket vending machines statewide with the option of installing the equipment in both existing and new retail outlets.

**Examine the retailer commission structure.** We recommend that the department continue to review its retailer commission payment structure including prize cashing bonus and incentives to reward retailers for performance that reflects the volume of tickets sold and their contribution to education.

**Work with the Department of Management Services to reduce excess office space.** To ensure the state's short- and long-term interests are maintained, the Legislature should direct the Department of Lottery to develop a space consolidation plan in conjunction with the Department of Management Services. This plan should clearly identify space to be consolidated where economical, particularly excess office and redundant special use space, including the warehouse, and to clearly identify space most suitable for sublease. In this way, rather than shopping for a sublet tenant based on undefined available space, the Department of Management Services and the Lottery can search for a tenant that is appropriate for the defined available sublet space. This plan should then be presented to the Legislature for approval before the Lottery may proceed with

any further renovation plans. The Legislature should also direct the Department of Management Services to evaluate the Lottery's current and future headquarters space needs, identify options for meeting those needs, and present the options to the Legislature.

**Update the business case study.** We recommend that the department update its field support services business case study. If the results indicate that the benefits and risks of outsourcing field support services are acceptable, it should issue a request for proposals for the function. For complete comparative information, the Lottery's sales division should submit a proposal to maintain the services in house.

### ***Legislative Recommendations***

We also recommend that the Legislature consider authorizing the Lottery to expand its current games to enhance revenues.

- **Authorize the Lottery to offer on-line game vending machines.** The Legislature could consider authorizing the department to use vending machines to distribute on-line products. Vending machines selling both scratch-off and on-line games have the potential to appeal to large corporate retailers not currently distributing Lottery products.
- **Consider authorizing the Lottery to offer Internet sales.** The Legislature could consider selling Lottery products over the Internet, but would need to address several legal barriers. The Legislature would at a minimum need to authorize player activated technology for purposes of purchasing Lottery products over the Internet. To ensure against the potential for violating federal law, the Legislature may need to request the U.S. Justice Department issue an opinion regarding the legality of an intrastate system for Internet sales of Lottery products under the intrastate provision of the Unlawful Internet Gambling Enforcement Act.



- **Consider authorizing new games, but consider social implications.** The Legislature could consider expanding Lottery games which have the greatest potential to significantly increase transfers to education (video lottery terminals and keno), but this would entail an expansion of legalized gambling in the state.

## Agency Response ———

In accordance with the provisions of s. 11.51(5), *Florida Statutes*, a draft of our report was submitted to the Secretary of the Department of the Lottery for review and response. The Secretary's written response to this report is in Appendix D.

## Appendix A

# New Lottery Game Options

New games that attract new players have the potential to substantially increase revenues to the Lottery. While the Legislature could consider authorizing the Lottery to offer new games such as video lottery and a keno game, these options would likely increase the negative social costs of gambling and could conflict with the proposed Indian gaming compact. The following table lists these and other game options that could increase Lottery sales and transfers to education, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates

**Table A-1  
New Games Could Raise Over \$500 Million for Education**

Option	Advantages	Disadvantages
<p><b>Video Lottery Terminals</b> Players use video terminals that can be programmed to play casino-style games such as poker, blackjack, keno, and bingo, or simulate mechanical slot machines or roulette wheels.</p>	<ul style="list-style-type: none"> <li>▪ Potential recurring transfers to education range from \$404 million to \$548 million per year.</li> <li>▪ To reduce issues/concerns about underage players, play could be limited to pari-mutuel facilities such as racetracks or establishments with liquor licenses.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Because of its rapid play style, it may be more addictive than other lottery games increasing social costs associated with problem and pathological gambling.</li> <li>▪ Could violate conditions of the proposed Indian gaming compact</li> <li>▪ Represents a substantial change for gambling in Florida by permitting casino-style lottery games statewide and could be criticized by anti-gambling groups</li> <li>▪ Would require legislative action to legalize player-activated terminals in Florida</li> <li>▪ If launched in racinos (i.e., horse or dog race tracks with casinos), it could erode sales of traditional Florida Lottery games within certain market segments.</li> <li>▪ Could be considered an expansion of gambling</li> </ul>
<p><b>Fast Draw Keno</b> On-line lottery game in which players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to those drawn by the central computer at Lottery headquarters. It may be played frequently (e.g., every five minutes) on monitors in social settings such as bars or restaurants.</p>	<ul style="list-style-type: none"> <li>▪ Potential recurring transfers to education range from \$64 to \$358 million per year.</li> <li>▪ It can be limited to existing areas where betting is allowed such as pari-mutuel facilities or social settings such as bars and restaurants.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Fast keno is more addictive than traditional lottery games, though not as addictive as video lotteries.</li> <li>▪ Could be regressive in that a larger percentage of disposable income from lower socio-economic players is wagered</li> <li>▪ Could be considered an expansion of gambling</li> </ul>
<p><b>Daily Keno</b> On-line lottery game in which players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to those drawn by the central computer at Lottery headquarters. Similar in principle to other on-line games. It may be played weekly or daily.</p>	<ul style="list-style-type: none"> <li>▪ Potential recurring transfers to education range from \$6.8 to \$11.2 million per year.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Could be considered an expansion of gambling</li> </ul>

Option	Advantages	Disadvantages
<p><b>Mega Millions</b> Powerball states and Mega Millions states now have the authority to cross-sell games.</p>	<ul style="list-style-type: none"> <li>▪ Potential recurring transfers to education range from \$26 million to \$36 million annually.</li> <li>▪ It offers players greater opportunities for very large jackpots.</li> </ul>	<ul style="list-style-type: none"> <li>▪ More frequent mega jackpots could reduce incentive for occasional players to respond to large jackpots.</li> <li>▪ Probable sales shift from Powerball and Florida Lotto</li> <li>▪ Could be considered an expansion of gambling</li> </ul>
<p><b>Higher Priced Scratch-off Games</b> As the economy strengthens or the value of the dollar depreciates, higher priced scratch-off games can be offered (e.g., \$50 games)</p>	<ul style="list-style-type: none"> <li>▪ Since 2002, most scratch-off growth in transfers to education in Florida has been due to higher price point games proving higher priced tickets have significant revenue generating potential.</li> <li>▪ Compared to other states offering high priced tickets, Florida is an industry leader in \$20 and \$30 scratch-off game sales proving its success in this area and potential to sell high priced tickets.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Higher priced scratch-off games are contingent on the strength of the economy. Only Texas is currently offering tickets above \$30.</li> <li>▪ Florida's experience with \$30 tickets was not encouraging and the growth in scratch-off sales has begun to level off indicating there are limits to what will sell.</li> <li>▪ Only seven states offer scratch-off tickets over \$20 dollars, including Connecticut, Florida, Indiana, New Hampshire, New York, Pennsylvania, and Texas. Texas offers the only \$50 game.</li> </ul>
<p><b>Monitor Games</b> Computer animated games simulating horse racing, golf, etc. that are played on in-store monitors similar to the way Keno is played.</p>	<ul style="list-style-type: none"> <li>▪ May have less association to casino gambling than Keno</li> <li>▪ Could appeal to emerging markets of Lottery players that have grown up playing computer games</li> <li>▪ Allows the Lottery to recruit new retailers in social venues such as bars and restaurants</li> </ul>	<ul style="list-style-type: none"> <li>▪ Because of its rapid play style, it could be more addictive than traditional lottery games.</li> <li>▪ Could be regressive in that a larger percentage of disposable income from lower socio-economic players is wagered</li> <li>▪ Could be considered an expansion of gambling</li> </ul>
<p><b>Instant On-line Games</b> These games allow players to find out the results instantly or as soon as the tickets are printed from the lottery terminal.</p>	<ul style="list-style-type: none"> <li>▪ On-line tickets would have more graphic images and can use familiar games such as Bingo and Tic Tac Toe.</li> </ul>	<ul style="list-style-type: none"> <li>▪ May have small player base</li> <li>▪ Could produce shift in sales from traditional scratch-off games</li> <li>▪ Could be considered an expansion of gambling</li> </ul>
<p><b>Pulltabs/Breakopen Tickets</b> Players win instantly by 'breaking open' the ticket instead of scratching off the covering. Pulltabs can be sold in sets that have a predetermined number of winning tickets. Retailers order individual sets guaranteeing them of a specific number of winners in each deal.</p>	<ul style="list-style-type: none"> <li>▪ Potential recurring transfers to education range from \$2 to \$10 million per year.</li> <li>▪ May be possible to increase Lottery sales by offering a new product that can be sold in controlled establishments not considered traditional lottery retailers such as bars</li> </ul>	<ul style="list-style-type: none"> <li>▪ Pulltab/Breakopen tickets would compete with the same funding source as scratch-off games, which could cause a decrease in sales for scratch-off games due to lower prize payouts.</li> <li>▪ Could cause shift in sales from other Lottery products, particularly scratch-off games</li> <li>▪ Implementation would require lease or purchase of validation equipment</li> <li>▪ Could be considered an expansion of gambling</li> </ul>
<p><b>Interactive Games</b> Players purchase a ticket at a Lottery retailer and take it home to play an interactive game on the Lottery website or through a CD-Rom</p>	<ul style="list-style-type: none"> <li>▪ Potential recurring transfers to education range from \$4 to \$6 million per year.</li> <li>▪ Play style offers more intrinsic value than a traditional paper lottery ticket and may be more marketable.</li> <li>▪ Attractive to the young adult market (20-34 years)</li> <li>▪ Can have validation codes to prevent underage gambling and underage players would not be permitted to redeem tickets even if they played the CD</li> </ul>	<ul style="list-style-type: none"> <li>▪ Higher operational costs than other scratch-off style games</li> <li>▪ Could lose some entertainment value since gratification is deferred, as players must play the game on a computer, not on the premises</li> <li>▪ May increase underage gambling by appealing to younger market segments</li> <li>▪ Could be considered an expansion of gambling</li> </ul>

Source: OPPAGA analysis of industry and Lottery information.

**Appendix B**

**Product Distribution Options**

Increasing the number of retailers has the potential to increase revenues by making lottery products more readily available to residents and tourists and has been shown to drive lottery sales more than advertising or jackpot size. Florida’s retailer penetration rate lags behind that of the top performing states. New equipment such as on-line vending machines and product distribution through the Internet could also increase the number of retailers and subsequent revenue. The following table lists these and other product distribution options that could increase Lottery sales and education transfers, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates.

**Table B-1  
Expanding Product Distribution Could Raise Over \$32 Million for Education**

Option	Advantages	Disadvantages
<p><b>Expand Retailer Network</b> Add additional Lottery retailers in both traditional locations such as convenience and grocery stores and non-traditional locations such as airports, hotels, and restaurants.</p>	<ul style="list-style-type: none"> <li>▪ Should result in incremental sales increases if terminals are placed in the right retailer locations</li> <li>▪ Florida has been below the average in terminal density compared to other successful Lottery states so expanding its network should improve per capita sales.</li> <li>▪ Could increase product distribution and awareness, making products available to new players that don't shop where products are currently being sold</li> <li>▪ Adding 1,500 new retailers has the potential to generate about \$32 million annually in additional transfers to the Educational Enhancement Trust Fund.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Requires legislative budget approval for more terminals</li> <li>▪ Retailer expansion has been difficult during recession because retailer closings have been higher than new retailers recruited.</li> <li>▪ The non-traditional lottery business model may require the approval of different products and distribution strategies.</li> <li>▪ May require additional lottery staff to service new accounts</li> </ul>
<p><b>Expand Instant Ticket Vending Machines (ITVMs)</b> Self-service vending machines for Scratch-off tickets are currently being installed in 1,000 Lottery retailers.</p>	<ul style="list-style-type: none"> <li>▪ Allows additional product facings at high volume Lottery retailers</li> <li>▪ Latest technology provides improved functionality, better security, and better accounting.</li> <li>▪ Early ITVM sales show increases in retailer sales where ITVMs are sold.</li> <li>▪ Could be cost-effective where scratch-off tickets are not being sold, such as in hotels and restaurants</li> </ul>	<ul style="list-style-type: none"> <li>▪ Requires legislative budget approval for more ITVM units</li> <li>▪ Requires monitoring of underage play</li> <li>▪ Some criticize the potential ease of access to problem gamblers.</li> </ul>
<p><b>Authorize Full-Service Vending Machines</b> The Legislature would amend the law to permit player activated vending machines that are capable of selling on-line quick pick tickets.</p>	<ul style="list-style-type: none"> <li>▪ Provides more convenience to players who do not want to stand in line to purchase tickets</li> <li>▪ Successful in other Lottery states</li> <li>▪ May attract large corporate retailers currently not selling lottery products</li> <li>▪ Provides a business model allowing retailer network expansion into non-traditional retailer locations, e.g., in airports and hotel.</li> <li>▪ Would not require a modification to the Lottery retailer contracts that require retailers to carry both scratch-off and on-line games</li> <li>▪ Could potentially increase transfers to education by a range of \$71 million to \$140 million annually</li> </ul>	<ul style="list-style-type: none"> <li>▪ Requires a Florida Statute change to allow player activated terminals for on-line games</li> <li>▪ Requires legislative budget approval</li> <li>▪ Requires monitoring of underage play</li> <li>▪ Some criticize the potential ease of access to problem gamblers</li> <li>▪ Could be considered an expansion of gambling</li> </ul>

Option	Advantages	Disadvantages
<p><b>Authorize Internet Sales</b> The Legislature would enact laws to authorize intrastate Internet sales of Lottery products.</p>	<ul style="list-style-type: none"> <li>▪ Provides more convenience to players who prefer to purchase their Lottery products from their personal computer or cellular device</li> <li>▪ Canadian lotteries are selling individual games over the Internet using technology that detects the players location (e.g., British Columbia Lottery Corporation at <a href="http://www.bclic.com">www.bclic.com</a>).</li> </ul>	<ul style="list-style-type: none"> <li>▪ The state would need to request the U.S. Justice Department to issue an opinion regarding the legality of an intrastate system for Internet sales of Lottery products under the Intrastate provision of the Unlawful Internet Gambling Enforcement Act. Absent a clear answer from the federal government, authorizing Internet sales of Lottery products could violate federal law.</li> <li>▪ Could be considered an expansion of gambling</li> </ul>
<p><b>Subscription Play</b> Players can subscribe to on-line game drawings for up to one year in advance on the Florida Lottery website.</p>	<ul style="list-style-type: none"> <li>▪ Potential to generate about \$10 million annually in additional transfers to the Educational Enhancement Trust Fund</li> <li>▪ Internet technology has made subscription services much easier and more cost-effective for lotteries to manage.</li> <li>▪ Key benefits for the consumers are no missed draws, no waiting in lines, and ease of prize claims.</li> <li>▪ Provides the ability for people to play who may not be able to otherwise such as seasonal residents and physically challenged residents</li> <li>▪ Subscription play is offered in about 15 U.S. lotteries.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Use of credit cards for lottery purchases without purchase of \$20 in other goods would require law changes.</li> <li>▪ Must comply with federal laws that restrict subscriptions from out-of-state players unless they have in-state mailing addresses</li> <li>▪ Game changes require communication with players and possibly a replacement ticket.</li> <li>▪ Because all prize payments will be paid automatically, subscription play will generate no unclaimed prize funds.</li> <li>▪ Could be considered an expansion of gambling</li> </ul>
<p><b>Selling at Grocery Store Checkout Lanes</b> Grocery stores typically have between 5 and 15 checkout lines that could be used to distribute lottery products.</p>	<ul style="list-style-type: none"> <li>▪ May increase product distribution points and make it easier to purchase and redeem lottery products</li> <li>▪ Could increase sales because it encourages impulse purchases and is a player convenience</li> </ul>	<ul style="list-style-type: none"> <li>▪ It could cause some accounting issues for grocery stores in tracking the sales at every checkout line.</li> <li>▪ Would require expenditures for dispensers for each grocery store to display/merchandise the product at the point of purchase</li> <li>▪ May be difficult to get supermarkets to participate because it would require reconfiguring their operation and systems</li> </ul>
<p><b>Paying at the Pump for Scratch-off Games</b> Paying at the pump for lottery tickets would give another distribution outlet for purchasing lottery tickets. Ideally, the consumer would be able to combine their gas and Lottery purchase.</p>	<ul style="list-style-type: none"> <li>▪ A pay at the pump option would add player convenience and may attract new players who might not otherwise seek somewhere to play.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Most likely would require the purchase of special dispensing machines like instant ticket vending machines and this technology is in development</li> <li>▪ Florida laws require credit card purchases for lottery tickets have \$20 sales of other products.</li> <li>▪ Florida laws currently do not allow player-activated terminals.</li> <li>▪ Paying at the pump for gas eliminates the need for many consumers to go inside which will have a direct impact on all product sales inside the store.</li> <li>▪ Adverse reaction from retailers who want players to come into the store</li> <li>▪ Could present site-based security issues, such as theft or underage purchase</li> </ul>

Source: OPPAGA analysis of industry and Lottery information.

**Appendix C**

**Lottery Headquarters Leased Space**

As shown in Table C-1, current floor plans show the Lottery’s headquarters building has 159,759 square feet of rentable floor space including 130,461 square feet of office space (located mostly on the top two floors of a four-story building) and 29,298 square feet of air-conditioned warehouse space (located on the bottom floor and two stories high). The Lottery leases about 30,623 square feet of excess office space.

**Table C-1  
The Lottery Leases About 30,623 Square Feet of Excess Office Space**

<b>Lottery Headquarters Space</b>	<b>Square Feet<sup>1</sup></b>	<b>Total Square Feet<sup>2</sup></b>
Rentable Floor Space (warehouse and office)		159,759
Special Use Space (warehouse)		
Subleased to Lottery Vendor (GTECH)	5,888	
Lottery Occupied	23,410	
Rentable Warehouse Space	29,298	
		130,461
Rentable Office Space		
Special Use Space (office)		
Subleased to Lottery Vendor (GTECH)	9,312	
Subleased to Lottery Vendor (Scientific Games)	988	
Subleased to Lottery Vendor (St. John & Partners)	464	
Bathrooms	3,642	
Public Reception Areas (for winners and to check security)	2,460	
Draw Studio (for public viewing of number draws)	3,756	
Elevator Machine Room	162	
Security CAS Backup	499	
Mail Room and Janitorial Services	1,695	
Armory	451	
Office (for computer repair)	165	
Information Resource Management Data Center	5,150	
Ledge (for B1 to B2 access)	373	
Security File Room	317	
Forensics Labs	559	
Evidence Room	54	
Test Lab	169	
Evidence Storage	166	
Filing Records Storage	241	
Information Technology Training/Testing and Auditing	2,878	
Inspector General Confidential Interview Room	145	
Secured Storage	190	
Merchandise Inventory	391	
Cafeteria	2,248	
Employee Records File Room	332	
District Customer Service	154	
Training Center	1,306	
Conference Center	4,792	
Draw Room (for monitoring draws)	160	
Net Usable Area (Special Use Space)	43,219	
Circulation 30% of net usable space <sup>2</sup>	12,966	
Total Usable Special Use Space	56,185	

Lottery Headquarters Space	Square Feet <sup>1</sup>	Total Square Feet <sup>1</sup>
Remaining Rentable Office Space (Rentable Office minus Special Use Space)		74,276
Personnel Space <sup>2</sup>		
Executive (enclosed office)	3,150	
Administrator (enclosed office)	1,500	
Managers Requiring Confidentiality (enclosed office)	4,900	
Professionals (workstation)	11,680	
Para Professional (workstation)	1,380	
Support Space <sup>2</sup>		
Reception	600	
LAN Rooms	600	
Open Files	1,521	
Storage	600	
Pantry	800	
Copy	800	
Conference/Meeting Rooms	3,650	
Net Usable Space (sum of Personnel and Support Space)	31,181	
Circulation 40% of net usable space <sup>2</sup>	12,472	
Total Usable Personnel and Support Space	43,653	
Excess Leased Rentable Office Space		30,623

<sup>1</sup> Measurements taken from the Lottery's most current floor plans dated May 22, 2007; Lottery reported measurements; and OPPAGA calculations of floor plan space.

<sup>2</sup> Based on the DMS space allocation worksheet (FM 4100 R05/04) allowances.

<sup>3</sup> Based on the DMS space allocation worksheet allowances cross walked to Lottery staff positions.

Source: OPPAGA analysis of Lottery headquarters floor plans, building tour, interviews with Lottery and DMS officials, and DMS space allocation worksheet.

**Appendix D**

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CHARLIE CREST  
Governor



LEO IBENSONO  
Secretary

FLORIDA LOTTERY

January 28, 2010

Gary R. VanLandingham, Ph.D.  
Director  
Office of Program Policy Analysis and  
Government Accountability  
111 West Madison Street  
Tallahassee, Florida 32399-1475

Dear Dr. VanLandingham:

Thank you for the opportunity to respond to your office's report entitled "Lottery Profits Flat: Increasing Retailer Outlets Is Critical to Increasing Sales." Our response is organized around your recommendations.

**Consider offering Mega Millions, another multi-state lottery game.**

*Introducing a second multi-state super jackpot game could increase transfers to education. The Lottery should carefully evaluate the benefits and disadvantages of adding another multi-state game and provide the results of its assessment to the Legislature.*

The Lottery concurs with this recommendation and is currently in the process of evaluating the benefits and disadvantages of adding another multi-state game. We will keep the Legislature apprised as that evaluation proceeds. One study indicates that, among U.S. lotteries, the Florida Lottery has the least to gain by launching Mega Millions at this time, given the fact that we have offered Powerball for only one year and have not yet realized its full sales impact. In addition, the negative impact a second multi-state game could have on our in-state Florida Lotto game could jeopardize the very nature and sustainability of that game. The Lottery would be better served to take the time to learn from other states' experiences before making a decision about whether to join Mega Millions or to wait for a possible National Game at a later date.

**Take additional steps to increase the number of participating retailers.**

*We recommend that the department examine its market penetration geographically by type of retailer to identify specific areas in need of additional retailers based on the population rate, and to target retailer recruitment efforts in locations with low*




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*penetration rates and trade styles that have not saturated, such as independent grocery stores, drug stores, and liquor stores. When the department approaches 15,500 terminals, the maximum currently authorized, it should request legislative budget authority to increase the number of retailer terminals.*

The Lottery concurs with this recommendation and is currently modifying the telephone outreach retailer recruitment program and pursuing other alternatives to strengthen the recruitment of new Lottery retailers. This includes, but is not limited to revising the assigned work structure within the Business Development unit to improve the telephone outreach retailer recruitment program, holding geographically-focused sales outreach missions in addition to two retailer recruitment seminars annually, reducing the overall cost of the retailer recruitment seminars, conducting specific retailer recruitment advertising on the Lottery's website, conducting on-going upgrades to the new retailer recruitment system to further improve monitoring and tracking of the success of the program, and continuing to provide lead source support to the Sales Team for future state-wide retailer recruitment contests. Finally, the Business Development unit conducts ongoing research to identify new recruitment ideas having the potential to increase the size and quality of the Florida Lottery's retailer network.

**Evaluate and report on retailer recruitment efforts and target increasing corporate accounts.**

*We recommend that the department evaluate its retailer recruitment efforts by conducting a cost-benefit ratio analysis that includes all associated planning and production costs, to determine what methods work best where to and to identify an acceptable cost per retailer per recruiting method. This information should be collected on a regular basis and reported to executive management. In addition, the department should establish standard criteria to be used by both the Office of Inspector General and the Office of Business Development to evaluate specific recruitment mechanisms. To maximize the number of retailers statewide, the department should also target its recruitment efforts on increasing corporate chain accounts.*

The Lottery concurs with this recommendation. The Business Development unit will work with the Corporate Sales Team and other units of the Lottery to conduct a comprehensive Return on Investment analysis, using mutually agreed-upon standard criteria appropriate for our various recruitment methods.

The Lottery already collects, on an on-going basis, in-depth information on all retailer prospects using its Retailer Recruitment System (RRS). The RRS was designed to monitor, manage, track and help to identify new recruitment opportunities. The RRS provides the Lottery with an extensive data base for use in evaluating the cost-effectiveness of its retailer recruitment efforts. The Business Development unit evaluates weekly and monthly reports from the RRS to assess retailer recruitment efforts and to identify ways to increase the number of Lottery retailers.

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Jointly, the Lottery's Business Development and Corporate Sales units will re-double their efforts to increase the effectiveness of corporate recruitment efforts. However, the challenge of current economic conditions and the programs already underway should be recognized.

Presently, the Business Development unit begins its solicitation effort with a corporate retailer prospect by providing a tailored presentation to that prospect. Should the prospect respond with expressions of interest, a more in-depth formal proposal is submitted, complete with detailed estimates of the sales, customer traffic and other benefits the corporation could experience in selling the Lottery product line as well as offers of assistance in expediting Lottery retailer application procedures. This proposal is followed up by calls to the appropriate, executive-level points of contact within the corporation with offers to answer further questions and resolve any issues.

An alternative sequence is sometimes followed, particularly by the Lottery's Corporate Sales unit. There, the practice is to start by approaching regional or district corporate managers with the notion of selling Lottery products in the hope of engaging those people in convincing corporate headquarters of the advantages of partnering with the Lottery. Once any interest is registered, the follow-up procedures can be much the same as in the first approach.

**Request legislative authorization to install additional Instant Ticket Vending Machines.**

*If instant ticket vending machines meet or exceed projected sales levels, we recommend that the department seek legislative authority to expand the number of instant ticket vending machines statewide with the option of installing the equipment in both existing and new retail outlets.*

The Lottery concurs with this recommendation and is closely monitoring the incremental impact of the current allocation of 1,000 Instant Ticket Vending Machines. Once the department has sufficient data to support a legislative request for additional units, the department may seek additional legislative budget authority.

**Examine the retailer commission structure.**

*We recommend that the department continue to review its retailer commission payment structure including prize cashing bonus and incentives to reward retailers for performance that reflects the volume of tickets sold and their contribution to education.*

The Lottery concurs with this recommendation. As mandated in the General Appropriations Act for this fiscal year, the Lottery is completing a thorough analysis of the structure of its retailer compensation program. This study will be submitted to the

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chairs of the Senate Committee on General Government Appropriations and the House Government Operations Appropriations Committee by January 31.

The Retailer Compensation study will analyze the issues identified in proviso language, including the idea of fixed compensation per ticket, performance incentives, Florida's compensation compared to other U.S. lotteries and the impact of inflation on Lottery retailer earnings. To accomplish this, a variety of research techniques will have been used including direct discussions with Lottery retailers through surveys, focus groups and interviews. It is the Lottery's hope that the study's findings will provide the basis for improving the program in ways that strengthen the Lottery's relationship with its retailers, improve customer service and promote increased sales and educational enhancement funding.

**Work with the Department of Management Services to reduce excess office space.**

*To ensure the state's short- and long-term interests are maintained, the Legislature should direct the Department of Lottery to develop a space consolidation plan in conjunction with the Department of Management Services. This plan should clearly identify space to be consolidated where economical, particularly excess office and redundant special use space, including the warehouse, and to clearly identify space most suitable for sublease. In this way, rather than shopping for a sublet tenant based on undefined available space, the Department of Management Services and the Lottery can search for a tenant that is appropriate for the defined available sublet space. This plan should then be presented to the Legislature for approval before the Lottery may proceed with any further renovations plans. The Legislature should also direct the Department of Management Services to evaluate the Lottery's current and future headquarters space needs, identify options for meeting those needs, and present the options to the Legislature.*

The Lottery concurs with OPPAGA to continue working with DMS to reduce excess office space. The Florida Lottery has been diligent in attempting to sublease excess office space to include consultation with the Department of Management Services as well as its DMS-authorized tenant broker (Cushman & Wakefield "C&W").

The state's interests were enhanced by engaging C&W to assist in the renegotiation of the lease at the headquarters facility. C&W assessed the market and evaluated options such as other available private lease space, state-owned space, and build-to-suit. C&W's business review recommended that the Lottery negotiate a lease renewal with restructured terms. The recommendation was based on the absence of private or state space suitable to the Lottery's needs, and the fact that prevailing market rates were in excess of what the Lottery was paying. Additionally, a build-to-suit option was determined to be cost prohibitive. Finally, relocation expenses of several million dollars were also a factor in C&W's analysis. The Lottery could only consider such expenditures if the Legislature indicated a desire to appropriate the funding.

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Given this information, the Lottery opted for a lease renewal that resulted in immediate savings to the State rather than pursuing alternatives that might have resulted in greater savings and close conformity to DMS standards, but only after many years of delay and deferral of those cost savings. The restructured lease terms resulted in annual rate reductions averaging \$50,000, as well as the landlord absorbing janitorial and lawn care services of approximately \$170,000 annually. Finally, the landlord agreed to tenant improvement funds of \$2.34 million for the renovation of the facility.

In an effort to further streamline business operations and better utilize available space, the Lottery is relocating its televised game drawings to the headquarters building in April 2010, which will use 3,756 square feet of the "excess" space identified by OPPAGA last year.

The Florida Lottery continuously seeks opportunities to streamline its facilities operations to achieve administrative efficiencies and economies. The Lottery, with the concurrence of DMS, also recognizes that achieving the present DMS-recommended standards for a facility that was built over 20 years ago, for a unique business organization and in accordance with different building codes, would require significant reconstruction involving major additional funding.

The Lottery has made significant gains in reducing "excess office space" as defined by OPPAGA as a review of previous OPPAGA reports show:

OPPAGA Annual Report	Excess HQ Office Space
2006	62,905 sq. feet
2007	58,804 sq. feet
2008	55,413 sq. feet
2009	56,653 sq. feet
2010	30,623 sq. feet

**Update the business case study.**

*We recommend that the department update its field support services business case study. If the results indicate that the benefits and risks of outsourcing field support services are acceptable, it should issue a request for proposals for the function. For complete comparative information, the Lottery's sales division should submit a proposal to maintain the services in house.*

The Lottery concurs with this recommendation and will update its business case study by January 2011. Should the findings warrant that we do so, the Lottery then will consider a competitive procurement to provide the basis for a decision on out-sourcing.

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While concurring with the recommendation, it must be said that the quality of our field service operations has improved dramatically during the six years since the previous business case proposal was submitted. Internally, our sales staff is highly regarded throughout the Lottery; externally, Lottery retailers give this unit 90% satisfaction ratings in our annual retailer survey.

Very few state lotteries outsource their field service sales team. Therefore, finding suitable examples of best practices and lowered costs will be difficult. The main reason nearly all states maintain lottery sales staff as public employees is because this structure provides a higher level of supervision and direct oversight that would naturally be reduced by allowing a private vendor to provide that service.

Finally, it is important to bear in mind that the cost of a field sales team is not eliminated by outsourcing. Rather, it is merely paid to a private vendor to conduct the same critical services. The budget savings, if any, may be minimal if the primary objective - which the Lottery believes it should be - is to maintain at least the same level of quality service to retailers and players.

In closing, the Florida Lottery always welcomes constructive suggestions for ways to improve our performance and productivity. Thank you for the time and attention your staff and you have devoted to this year's review.

Sincerely,



Leo DiBenigno  
Secretary

cc: Dennis Harmon, Deputy Secretary  
Andy Mompeller, Inspector General  
Marcy Jackson, Chief Financial Officer  
Terry Perkins, Chief Administrative Officer  
Ken Hart, General Counsel

*The Florida Legislature*  
*Office of Program Policy Analysis*  
*and Government Accountability*



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OPPAGA provides performance and accountability information about Florida government in several ways.

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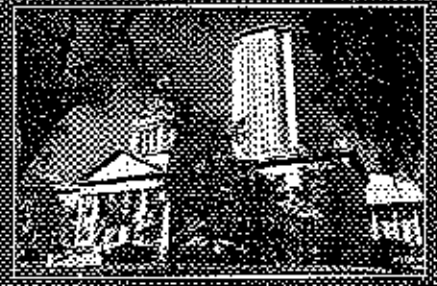
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Gary R. VanLandingham, Ph.D., OPPAGA Director

# oppaga

OFFICE OF PROGRAM POLICY ANALYSIS  
& GOVERNMENT ACCOUNTABILITY



January 2010

Report No. 10-17

## Lottery Jackpots, Retailer Density, and Advertising Drive Transfers to Education

### *at a glance*

While advertising is critical to maintaining Lottery sales, additional expenditures may have a limited effect on net revenues and transfers to the Florida Educational Enhancement Trust Fund. Lottery ticket sales also are affected by factors such as jackpot amounts and retailer density, which are more highly related to net Lottery profits than advertising expenditures. Florida's compulsive gambling helpline receives few calls specifically related to the Lottery, and there does not appear to be a link between Lottery advertising spending and Lottery-related calls to the state's gambling helpline. Instead, Lottery-related calls are more strongly associated with state unemployment rates.

### Scope

As directed by the Legislature, this report examines the effectiveness and return on investment of the Department of Lottery's advertising and promotion campaigns.

### Background

The Florida Lottery's primary purpose is to maximize its net revenue to support public education. The Lottery regularly conducts advertising campaigns to bolster its profits, attract new players, and maintain sales. The Lottery contracts with private vendors for

advertising services targeted towards a variety of media outlets in 10 Florida market areas.

The Lottery was appropriated \$34.8 million for advertising in Fiscal Year 2009-10, which includes vendor fees, production costs, media buys, and operating a compulsive gambling helpline.<sup>1</sup> The department sells two product lines—on-line and scratch-off games. On-line games, such as PowerBall, LOTTO, and Fantasy Five, allow players to pick from a range of numbers on a play slip. On-line game tickets are printed by terminals that are connected to the Lottery's central computer system for a drawing at a later date. Scratch-off games are pre-printed tickets with a latex covering that the player removes to determine whether he or she has won a prize.

The department contracts with two vendors to provide advertising services for these games. In November 2007, the Lottery entered a three-year contract with Machado Garcia-Serra Advertising, Inc.; for Hispanic market advertising, and in September 2009 it entered a three-year contract with St. John & Partners Advertising and Public Relations Inc., a Jacksonville based company, for English market advertising. These firms are responsible for creating, producing and placing Lottery advertising in television, radio, print, and other media.

<sup>1</sup> The 2009 General Appropriations Act specified that, of the total appropriation, \$3,486,945 be used for advertising agency fees and \$1,119,000 for a compulsive gambling program.

## Methodology

The purpose of Lottery advertising is to maximize ticket sales and net profits, which are deposited into the Florida Educational Enhancement Trust Fund. We analyzed the outcomes of the Lottery's advertising expenditures based on their effect on education transfers. During the three-year period from July 2006 to July 2009, the Lottery transferred 31% of its ticket sales revenue to the Florida Educational Enhancement Trust Fund. This combined transfer rate reflects total transfers from on-line games (about 40% of sales) and scratch-off games (about 20% of sales).

To assess Lottery advertising effectiveness, we analyzed the relationship between advertising expenditures and sales over three years (from March 2006 to March 2009) using department data for its 10 market areas. We present a range and midpoint for estimates of the return on investment on advertising expenditures; the midpoint is the best estimate of the return on investment and there is a 95% probability that the actual return falls within the range.<sup>2</sup>

The econometric model we used to estimate the advertising return on investment is strong, explaining 87% of the variation in Lottery ticket sales. However, since the three years we examined include the worst economic downturn in recent Florida history, our return on investment estimates may understate future returns on advertising spending.<sup>3</sup> See Appendix A for a more detailed discussion of our research methodology.

## Findings

Advertising is critical to maintaining Lottery sales, but additional expenditures may not necessarily translate into increases in net

revenues and transfers to the Florida Educational Enhancement Trust Fund. Jackpot amounts and retailer density affect Lottery ticket sales and resulting profits more than advertising expenditures. Advertising spending levels do not appear to be linked to Lottery-related calls to the state's gambling helpline.

### *Prize payouts are the primary driver of education transfers*

Our analysis and studies of other states' lotteries indicate that Lottery sales and resulting transfers to education are affected by multiple factors including jackpot amounts, lottery retailer density, and advertising. Jackpot amounts have the greatest effect on sales and transfers to education.

#### **Larger prizes increase transfers to education.**

Our econometric analysis indicated that jackpot amounts are the single largest driver of Lottery sales and educational transfers. Players are more likely to buy Lottery tickets when large jackpots are available for on-line games such as LOTTO and PowerBall. As Exhibit 1 shows, over the last three years, there was a strong relationship between LOTTO sales and jackpots. For example, in November and December 2007, LOTTO jackpots rose by \$137 million due to rollovers when no player had a winning ticket; sales increased by \$37.4 million during this period. In the following month (January 2007), LOTTO jackpots fell \$116 million, and sales declined by \$31.5 million. The correlation between LOTTO sales and jackpots was lower after May 2008 due to the economic downturn and the introduction of PowerBall, a new on-line game. While PowerBall has increased overall on-line lottery sales, it has reduced LOTTO sales.

Increasing prizes for scratch-off games also typically increases sales.<sup>4</sup> This occurs because some players are more likely to buy tickets for scratch-off games that they perceive as paying higher prizes. Also, players who win small

<sup>2</sup> We do not present a return on investment analysis for specific online and scratch off advertising or for media types (e.g., TV, radio, billboards) as our estimate ranges had considerable overlap, indicating no difference.

<sup>3</sup> Our analysis considered the economic downturn and found a higher return on advertising spending prior to the downturn. However, due to the limited number of observations, we could not draw a statistical distinction between lottery sales during the periods of economic growth and contraction.

<sup>4</sup> For more information on this relationship, see our prior reports *Lottery Scratch off Sales Increase; Options Available to Enhance Transfers to Education*, OPPAGA Report No. 07-09, and *Justification Review Sale of Lottery Products Program*, OPPAGA Report No. 02-11.



prizes such as \$1 or \$5 will frequently use some of their winnings to purchase more tickets for that game. Since 2003, when the Legislature authorized the Lottery to use variable prize payouts to maximize education transfers, annual Lottery sales have increased by \$867 million, (from \$3.07 billion in Fiscal Year 2003-04 to \$3.94 billion in Fiscal Year 2008-09). Most of this increase, (81%), was attributable to increased scratch-off ticket sales.

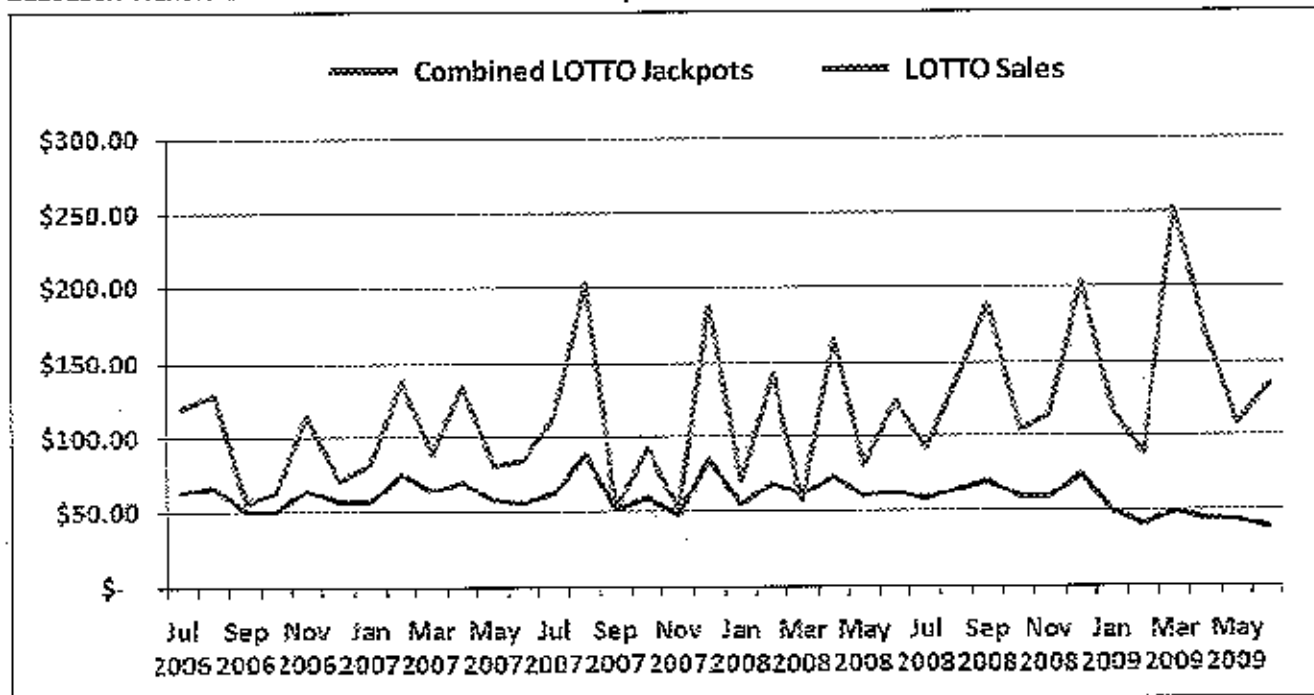
**Adding more Lottery retailers would increase education transfers.** A second factor that is highly correlated to Lottery sales and transfers to education is the availability of retailers who sell Lottery products. In general, customers are more likely to buy lottery tickets when these products are readily available. Our analysis indicated that market areas in Florida with greater concentrations of participating retailers tend to have higher per capita sales and

transfers to education. For example, the Panama City market area has the most Lottery retailers per capita as well as the highest average monthly per capita sales; \$19.22. The Fort Myers-Naples market area has the fewest retailers per capita along with the lowest average monthly per capita sales; \$13.94.

In Fiscal Year 2007-08, the top nine state lotteries ranked by per capita sales had an average of 1,200 residents per retailer. In contrast, the Florida Lottery averaged about 1,400 residents per retailer, and it ranked 10<sup>th</sup> among U.S. lotteries in per capita sales. To match the top-performing states' average market penetration, the Lottery would need to expand its retail network to 15,000 retailers.<sup>5</sup> We estimate that adding 1,500 new retailers would generate about \$32 million annually in additional transfers to the Educational Enhancement Trust Fund.

<sup>5</sup> To do so, the Lottery would need spending authority to operate additional sales terminals, as it is currently authorized up to 13,500 terminals and has 13,200 terminals in operation.

**Exhibit 1**  
**Education Transfers Tend to Increase as LOTTO Jackpots Rise<sup>1</sup>**



<sup>1</sup> Values in this exhibit are in millions of dollars.  
 Source: OPPAGA analysis of Florida Department of Lottery data.

***While advertising is critical to maintain Lottery sales, additional expenditures may have a limited effect on net revenues***

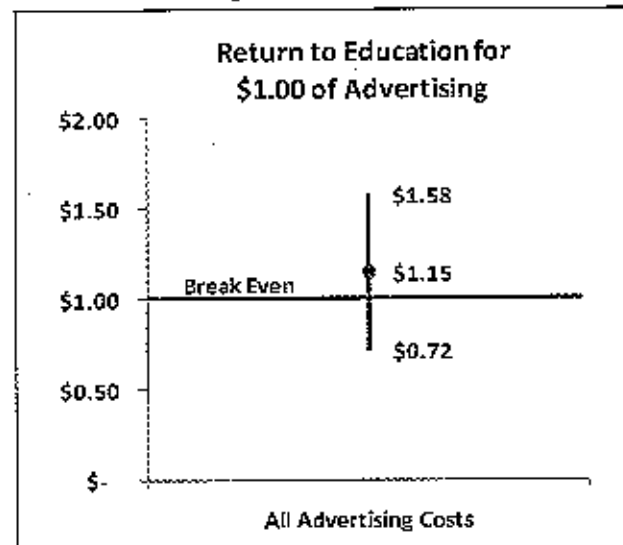
Both our analysis and studies of other state's lotteries show that advertising has a positive effect on lottery ticket sales. However, increasing the Lottery's current level of advertising expenditures may not necessarily translate into an increase in net revenues and education transfers. Reducing advertising production costs, which would allow a larger proportion of advertising funding to be spent on media buys (airtime), would help increase education transfers.

**Advertising is necessary to maintain sales.** Experiences in other states show that major reductions in Lottery advertising reduce sales. A study of three states that significantly curtailed lottery advertising (two states eliminated television advertising and the third reduced its advertising budget by 97%) estimated that each 10% reduction in advertising expenditures resulted in a sales reduction of 7% to 16%. If the Florida Lottery reduced its advertising expenditures by 10% and experienced a 7% decrease in sales, education transfers would be reduced by a net of \$83 million based on Fiscal Year 2008-09 sales data.<sup>6</sup>

**Increased Lottery advertising may have a limited effect on increasing transfers to education.** While Lottery advertising does not appear to have reached a saturation point in which a dollar spent on advertising (media buys, production costs, and vendor fees) returns less than a dollar to education, there is uncertainty as to whether additional advertising expenditures would produce a net return in educational transfers. As shown in Exhibit 2, the estimated range of return to education for an additional

dollar of Lottery advertising spending is between \$0.72 and \$1.58; the midpoint (most likely) estimate is that the return on investment is \$1.15.<sup>7</sup> However, as the bottom range of this estimate is below \$1, there is a potential that additional advertising expenditures could result in a net decrease in transfers to education if the advertising was funded with funds that would otherwise have been directly deposited into the Educational Enhancement Trust Fund. As most of the estimated return on investment is above \$1, reducing the current level of advertising would likely reduce transfers to education.

**Exhibit 2  
Increased Lottery Advertising May Have a Limited Effect on Increasing Education Trust Fund Revenues**



Source: OPPAGA analysis of Florida Department of Lottery data.

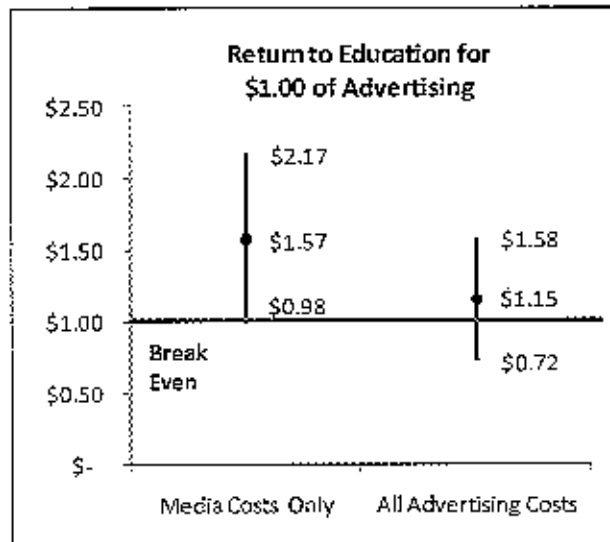
**Reducing advertising production costs would increase education transfers.** While media buys (TV and radio airtime, billboard space, print advertisement) affect Lottery sales, this return on investment is diminished by advertising production and vendor costs. We estimate that each advertising dollar spent on direct media buys returns \$1.57 to education, with an estimated range of \$0.98 to \$2.17. (See Exhibit 3.) However, this return on investment is reduced when advertising production and

<sup>6</sup> This estimate assumes that 10% of the Lottery's \$38.4 million advertising budget would be transferred to the Educational Enhancement Trust Fund. Sales would decline by an estimated \$276 million, which would result in a decline of \$66 million in educational transfers, for a net reduction of \$83 million.

<sup>7</sup> This estimate controls for factors including jackpot amounts and market areas with different retailer concentration rates.

vendor costs are included in the analysis. During Fiscal Year 2008-09, the Lottery spent \$28.8 million in media costs and \$5.4 million on production and vendor fee costs.

**Exhibit 3**  
**The Return on Lottery Advertising Is Reduced by Production Costs and Vendor Fees**



Source: OPPAGA analysis of Florida Department of Lottery data.

Accordingly, it is important for the Lottery to try to reduce its advertising production costs so that funds can be shifted to media buys. In this way, the department can attain the highest return on its overall advertising investment. For example, the Lottery should explore options such as extending the life of some advertising campaigns rather than producing new campaigns, which would reduce production costs and allow a greater proportion of advertising funds to be spent on airtime purchases. However, it is also important to recognize that advertising campaigns must be refreshed periodically to avoid loss of effectiveness.

## Lottery gambling problems are more strongly related to unemployment than advertising

One issue of concern is whether Lottery advertising tends to produce negative social consequences by increasing compulsive gambling. Our analysis of calls to Florida's compulsive gambling helpline showed that it receives relatively few calls related to the Lottery, and there is no correlation between Lottery advertising levels and the number of callers who reported Lottery related problems. However, changes in the state's unemployment rate are somewhat more strongly correlated with Lottery-related helpline calls than to calls related to other forms of gambling.

**About two out of every five callers to the state gambling helpline mentioned the Lottery.** In Fiscal Year 2008-09, the state's compulsive gambling helpline received 2,253 calls in which the caller identified a specific gambling issue. Of these, 868 calls (39%) were specifically related to Lottery gambling.<sup>8</sup>

**Lottery-related helpline calls are not driven by Lottery advertising or awareness levels but are related to changes in the state unemployment rate.** We found no correlation between Lottery advertising spending and the number of Lottery-related helpline calls, or between awareness of the Lottery advertising and helpline calls. In those months where the department spent the most on advertising, there was no increase in Lottery-related calls to the state's gambling helpline. For example, in August 2008, the Lottery spent approximately \$2.9 million on advertising and the helpline received 42 Lottery-related calls. In contrast, the Lottery spent \$306,000 on advertising in March 2009 and the hotline received 74 Lottery-related calls. There was a similar lack of correlation between public awareness of the Lottery, as measured by the Lottery's monthly public surveys and Lottery-related helpline calls.

<sup>8</sup> Of these callers, 272 reported Lottery play as their primary gambling issue and 596 reported it as a secondary issue.

In contrast, there is a relatively strong positive (0.62) correlation between Lottery-related helpline calls and the state's unemployment rate, while there is no correlation between the state unemployment rate and non-Lottery helpline calls.<sup>9</sup> For example, when Florida's unemployment rate was 5% in January 2008, there were 56 Lottery-related calls made to the gambling helpline; however, calls increased to 88 when the state unemployment rate rose to over 7% in October 2008. Overall, for the last two fiscal years, each percentage point increase in

the state's unemployment rate was associated with an increase of five Lottery-related calls to the state's gambling helpline.

We did not find a similar relationship between the unemployment rate and non-Lottery related helpline calls. For example, in January 2008, when the state's unemployment rate was below 5%, the number of non-Lottery related helpline calls was 163. When the unemployment rate rose to over 7% in October 2008, the number of non-Lottery related gambling helpline calls was lower at 102.

<sup>9</sup> A perfectly correlated relationship has a value of 1, while a value of 0 means no relationship; the closer to 1 the correlation, the stronger the relationship.

## Appendix A

# Method Used to Estimate the Return to Education from Advertising Lottery Products

To estimate transfers to the Educational Enhancement Trust Fund generated by Lottery advertising, we used ordinary least squares time series regression. This statistical method uses the correlation between the timing of lottery sales and media expenditures to estimate the return in sales for a dollar spent in media expenditures, which can be converted to estimate the impact of a dollar in advertising expenditures on transfers to the Florida Educational Enhancement Trust Fund.

**Data.** The Department of Lottery provided sales data for the 36 month period between July 2006 and June 2009, and advertising expenditure data for the period March 2006 through March 2009. We used these slightly different time periods because sales tend to slightly lag advertising expenditures; prior research on lottery advertising concluded that advertising spending affects sales in the month that the expenditure was made as well as subsequent months. Also, the department was unable to provide expenditure data through June 2009, when we made our data request because compiling advertising expenditure data was a manual process. The department also provided data on lottery retailers, advertised jackpots, and the types of lottery games offered during the period (e.g., available payouts by type of scratch-off and online game). The Legislature's Office of Economic and Demographic Research provided county-level data on population and taxable sales, and we obtained county-level unemployment information from the U.S. Bureau of Labor Statistics.

**Methods of analysis.** We used ordinary least squares time series regression to estimate monthly lottery sales per capita generated by a dollar in monthly media expenditures per capita (excluding advertising production costs and vendor fees). We aggregated these data by month and market area, producing 33 months of observations for Florida's 10 market areas ( $n=330$ ). Our model included media expenditures per capita for the current and prior month, as well as combined monthly jackpot amounts for on-line games, population per lottery retailer, an indicator of the months affected by the economic downturn; the calendar month (allowing us to adjust sales for seasonal patterns); and the market area. The market area variables adjusted for local differences that influence sales, such as population characteristics that are not otherwise included in the model. We adjusted for serial correlation in the time series data using a correction based on the Durbin-Watson statistic (Gujarati, 1988). The final model explained 87% of the variation in lottery sales.

The return on investment for media expenditures (e.g., purchased radio and television airtime or billboard space) is the estimated regression coefficient from the model described above. We made two adjustments to this coefficient to produce an estimate of the transfers to education per dollar of total advertising expenditures. First, we estimated the return in sales from total advertising expenditures, including media, production, and ad agency costs ( $SALES/TOTS = (SALES/MEDIAS)/(1/(MEDIAS/(PROD\$+AGENCY\$)) + 1)$ ). In this equation, the return in lottery sales (SALES) per every dollar of total advertising expenditures (TOTS) is computed using the ratio of sales (SALES) to media expenditures (MEDIAS) and the ratio of

media expenditures (MEDIA\$) to the sum of production expenditures (PROD\$) and vendor fees (AGENCY\$).

Second, we multiplied the estimate calculated above by 0.31 to reflect the results in terms of transfers to education. About 31% of lottery sales are transferred to the Educational Enhancement Trust Fund to be used for education.

**Statistical results.** As shown in Table A-1, the model produced confidence intervals, which are shown as the range of predicted estimates of return on investment. The midpoint is the most likely result. Overall, we estimate that a dollar of advertising expenditures generated \$1.15 (range of return from \$0.72 to \$1.58) in transfers to education.

**Table A-1**  
**One Dollar of Advertising Expenditures Generates \$1.15 in Transfers to Education**

Expenditures	Estimate	Range
Lottery sales per \$1 in media expenditures	\$5.03	\$3.14 to \$6.91
Lottery sales per \$1 in total advertising expenditures	\$3.67	\$2.29 to \$5.04
Transfers to the Educational Enhancement Trust Fund	\$1.15	\$0.72 to \$1.58

Source: OPPAGA analysis.

Table A-2 shows the model estimates and the 95% confidence intervals for the effect media expenditures, combined online jackpots, and people per retailer have on monthly per capita lottery sales.

Our model found that monthly lottery sales were affected by media expenditures in the month of the sale and the previous month. One dollar in media expenditures for a month generated a total of \$5.03 in lottery sales; \$3.33 in the month of the media expenditure and \$1.70 in the following month.

The effect of online jackpot amounts was non-linear, with lottery sales increasing with larger jackpots but at a lower rate as jackpots rise. For example, an increase in a combined online jackpot total of \$10 million to \$20 million is estimated to increase monthly sales by \$12.5 million, while an increase in monthly online jackpots from \$20 million to \$30 million is estimated to increase monthly sales by \$9.2 million.

Our model also predicted that lottery sales will decrease as the number of people per retailer increases (i.e., sales fall when there are fewer retailers per person). Thus, increases in the number of lottery retailers will tend to increase lottery sales. Our model estimate that reducing the ratio of persons in an area to retailers by 100 (for example, from 1400 individuals per retailer to 1300) increases per capita monthly sales by \$1.20, generating \$22.8 million in statewide Lottery sales.

**Table A-2**  
**Advertising Media Expenditures, Jackpots, and Retailers Per Capita Affect Lottery Sales<sup>1</sup>**

	Estimate	95 Percent Confidence Range
Lottery sales per media expenditures		
Current month	\$3.33	\$2.38 to \$4.28
Prior month	\$1.70	\$0.76 to \$2.63
Lottery sales per \$10 million in combined online jackpots		
Combined online jackpots in current month	\$0.93	\$0.76 to \$1.09
Square of combined online jackpots in current month	-\$0.09	-\$0.10 to -\$0.07
Lottery sales per retailer density (people per retailer)	-\$0.012	-\$0.014 to -\$0.010

<sup>1</sup> Estimates are adjusted for the economic downturn, seasonality, and market area characteristics. Level of statistical significance is  $p < 0.05$ .

Source: OPPAGA analysis.

**Appendix B**

CHARLIE CRIST  
Governor



LEO DIBENIGNO  
Secretary

FLORIDA LOTTERY

January 23, 2010

Gary R. VanLandingham, Ph.D.  
Director  
Office of Program Policy Analysis and  
Government Accountability  
111 West Madison Street  
Tallahassee, Florida 32399-1475

Dear Dr. VanLandingham:

Thank you for the opportunity to respond to your office's report entitled "Lottery Jackpots, Retailer Density, and Advertising Drive Transfers to Education."

OPPAGA is to be commended for the extensive data compilation and rigorous analysis reflected in this study. While the study presents no recommendations, the Lottery interprets its results as affirming the direction of previous analyses conducted by the Revenue Estimating Conference and the Lottery itself in regard to the positive effects of advertising spending, retailer density and jackpot levels on Lottery contributions to the Educational Enhancement Trust Fund (EETF). That the returns on the investments in advertising are somewhat lower than previously found we would attribute primarily to the different time frames examined in the different studies and, in particular, to the dampening effects of the current recession on the returns—a fact also noted by OPPAGA in its analysis.

The Lottery is also pleased with OPPAGA's finding that investments in media expenditures have a better return to EETF than expenditures for production costs. This is the basis for their suggestion that we attempt to reduce production costs and shift the money to media buys. This has been a strategy the Lottery has been following for the past year as is exemplified by our consolidation of several commercial "shoots" into one session and the adoption of a continuing ad campaign that can feature a variety of Lottery games.

There is but one reservation the Lottery has about the study write-up. We see no basis in the analysis for the statement: "Increased Lottery advertising may have a limited effect on increasing transfers to education." (page 4) OPPAGA itself states that: "... Lottery



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www.flalottery.com



Gary R. VanLandingham, Ph.D.  
OPPAGA Response to Preliminary and Tentative Findings  
January 28, 2010  
Page 2 of 2

advertising does not appear to have reached the saturation point . . ." (also page 4). Nor are any data provided supporting a diminishing returns relationship for advertising spending. The return on investment range of \$0.72 to \$1.58 characterizes the set of advertising experiences examined by OPPAGA. Based on this study, one could expect a return in this range (with a "most likely" estimate of \$1.15) whether or not the Lottery's advertising expenditures were above or below the current appropriation level.

To illustrate the point above, consider that typical consumer product companies (that are direct competitors to lottery tickets) invest many times the percentage of revenue on advertising than does the Lottery. As a percentage of revenue, Lottery advertising is less than 1%, while companies like Pepsi, Anheuser Busch and Wrigley's Gum spend from 5% to 28% of their revenue on advertising. Again, while the Lottery agrees with OPPAGA's conclusion that we have yet to hit an advertising "saturation point", it is important to emphasize our position that advertising expenditures as a percentage of revenue could be doubled or even tripled before any fear of achieving saturation.

Again, thank you for the analysis and for allowing us the opportunity to comment on the draft report.

Sincerely,



Leo DiBenigno  
Secretary

cc: Dennis Harmon, Deputy Secretary  
Andy Mompeller, Inspector General  
Marcy Jackson, Chief Financial Officer  
Pat Keop, Chief Marketing Officer  
Ken Hart, General Counsel

*The Florida Legislature  
Office of Program Policy Analysis  
and Government Accountability*



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OPPAGA provides performance and accountability information about Florida government in several ways.

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- PolicyCasts, short narrated slide presentations, provide bottom-line briefings of findings and recommendations for select reports.
- Government Program Summaries (GPS), an online encyclopedia, [www.oppaga.state.fl.us/government](http://www.oppaga.state.fl.us/government), provides descriptive, evaluative, and performance information on more than 200 Florida state government programs.
- The [Florida Monitor Weekly](#), an electronic newsletter, delivers brief announcements of research reports, conferences, and other resources of interest for Florida's policy research and program evaluation community.
- Visit OPPAGA's website at [www.oppaga.state.fl.us](http://www.oppaga.state.fl.us)

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Gary R. VanLandingham, Ph.D., OPPAGA Director

CHARLIE CRIST  
*Governor*



LEO DIBENIGNO  
*Secretary*

## FLORIDA LOTTERY

October 30, 2009

Representative Greg Evers  
Alternating Chairman, Joint Legislative Auditing Committee  
876 Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1400

Dear Representative Evers:

The General Appropriations Act for the last few years has included proviso language directing the Florida Lottery to continue to develop a plan to consolidate its lease of office space, where economical, and to sublet excess office and warehouse space to suitable tenants. The Lottery is further directed to report its progress, at least annually to the chair of the Senate Committee on General Government Appropriations, the chair of the House Government Operations Appropriations Committee, the Office of Program Policy Analysis and Government Accountability, and the Joint Legislative Auditing Committee. As an update, I am pleased to provide the following report.

### General Background

The Lottery currently leases approximately 157,653 square feet of office and warehouse space at 250 Marriott Drive in Tallahassee. The four-story building houses the Lottery's headquarters and Tallahassee District office. The Florida Lottery currently subleases 16,756 square feet of office and warehouse space.

In a February 2002 Justification Review, OPPAGA reported that the Lottery's headquarters building exceeds the Department of Management Services standard for leased office space. Both the Lottery and OPPAGA agree that the excessive space resulted from a 42% reduction in the size of the Lottery's workforce over fiscal year 1998-99 levels. In addition, there are certain inherent building design inefficiencies, such as 1) oversized hallways that would be cost prohibitive to correct and 2) vertical column penetrations that complicate the efficient layout of modular office systems. Finally, relocating to another building has been considered in the past, but at a minimum cost of \$5 million. This option was also deemed cost-prohibitive, and might subject the Lottery to legal liabilities for breaking the lease.



The OPPAGA Justification Review recommended the following:

- Moving the Tallahassee District office into the headquarters building;
- Consolidating district offices; and
- Subleasing a portion of headquarters space to another suitable agency.

As discussed in earlier Lottery reports as required by similar proviso language contained in previous general appropriations acts, the Lottery has undertaken and completed the first two recommendations. The Tallahassee District office was relocated to the headquarters building in July 2003. Approximately 2,000 square feet of office space and 3,423 square feet of warehouse space are used to meet the district's space needs. The Lottery has also implemented the recommendation to consolidate district offices. In July 2003, the St. Petersburg District office was closed. Staff was reassigned to the Tampa District office to meet the customer service needs of lottery players in that region. The Ft. Lauderdale District office was also closed. Staff was reassigned to the Miami District office.

In a December 2004 follow-up Justification Review, OPPAGA, using a new DMS standard of 180 square feet per full-time equivalent position, determined that the Lottery was leasing approximately 49,000 square feet of excess office space. As a result of the new standard, the Lottery fell further out of compliance with the DMS benchmark, even taking into account the significant advancement the Lottery achieved in the relocation of the Tallahassee District office. In the 2004 follow-up report, OPPAGA again recognized that it might be difficult for the Lottery to fully meet the DMS standards because compliance "would require a major reconfiguration of its existing layout of hard wall offices and hallways at substantial upfront costs."

After achieving two of the three major OPPAGA recommendations, the Lottery has been focusing its efforts on the third recommendation, namely finding a suitable tenant to sublease any excess office space that may be available. While admittedly the Lottery's attempts at finding a suitable tenant have thus far been unsuccessful, it hasn't been for a lack of will or effort. The layout and access of the Lottery's headquarters building is what it is and has been since the Lottery first occupied the building in 1987. It is important to note, that in order to ensure the security and integrity of Lottery operations, and maintain a high level of public confidence in the Lottery, it is crucial that any sublease in the headquarters building recognize the need to restrict access to the Lottery by non-Lottery employees. Subleasing a portion of the building to a non-Lottery contract tenant may require construction of a new entrance and possible reconfiguration of these portions of the building to restrict access to the Lottery by non-Lottery employees. Subleasing space to a non-Lottery tenant would also be complicated by fire escape routes that are designed for a single tenant facility.

Additionally, as stated in previous Lottery reports, requesting from the Legislature authority to hire additional security personnel necessary to accommodate a sublease tenant and funds for acquisition of new security equipment would be required. This is supported in the bi-annual security audits required in section 24.108(7), Florida Statutes, which has required multiple layers of security in the Lottery's operations, including facility security.

To sublease space to an organization that is not involved with the Florida Lottery's operations would present security issues that would require extensive modification to facility security operations.

In 2008 the Lottery contracted with Cushman & Wakefield to renegotiate the renewals for its headquarters lease agreement. This engagement included a business case analysis that indicated renewing the lease was the most cost effective and efficient action, despite the excess office space. The ensuing renewal provided the Florida Lottery with a restructured lease agreement which lowered its annual lease rates, provided Tenant Improvement Funds and assigned janitorial and landscaping costs to the landlord. Absent major reconfiguration of the headquarters building and with the understanding that relocating the Lottery to another building or construction of a new facility (build-to-suit) is both impracticable and cost-prohibitive, the Lottery continues to move forward on two major fronts in order to achieve the stated and shared goal of making the most efficient use of its currently leased headquarters office and warehouse space.

Specifically, the Lottery is actively pursuing the following two objectives:

1. Streamline operations and make more efficient and appropriate use of headquarters office space; and
2. Seek a suitable sublease tenant, state agency or otherwise to sublease office space.

A partial listing of entities that the Lottery has been involved in discussion with regarding a possible sub-lease agreement include:

- RESPECT of Florida;
- Pitney Bowes for a central mail distribution center;
- Department of Health;
- Department of Education;
- Department of Transportation;
- Florida Department of Law Enforcement;
- Department of State; and
- Department of Highway Safety and Motor Vehicles.

Two of the most promising discussions took place with the Florida Department of Law Enforcement (FDLE) and RESPECT of Florida. The FDLE discussions centered around their need for a new DNA Lab where approximately 12,000 square feet of the Lottery's excess office space was initially identified as a suitable location that could provide space, resources and access that FDLE required while providing the safeguards required by the Lottery.

Unfortunately, after further review and a more in-depth analysis, which included a site visit by FDLE personnel, the Lottery was informed by letter in October 2006 that FDLE decided to proceed with a formal RFP process to assist them in identifying suitable space for their proposed DNA lab. The FDLE letter made it clear that the available Lottery space did not meet their guidelines.

In regards to RESPECT of Florida, that organization and the Lottery discussed an arrangement where it would consolidate and expand its t-shirt manufacturing activities into the Lottery's available office space. This arrangement was viewed as positive on two fronts since the Lottery and RESPECT of Florida were engaged in contract negotiations. First, achieving the Lottery's goal of finding a tenant for the unused office space and, secondly, having another vendor located within the Lottery headquarters building might produce additional cost savings or at a minimum a more efficient distribution method for a product the Lottery uses everyday. Again, the discussions ended on November 30, 2006, when RESPECT of Florida informed the Lottery that they were already too far along in the permitting and site preparation for construction of a new facility.

The Florida Lottery has been diligent in seeking opportunities to sublease space, particularly when it comes to soliciting for new contracts in which it would be beneficial for business operations to have contractor staff co-located with the Lottery. Specific examples include:

- Solicitation for Lottery Drawing Auditing Services;
- Solicitation for Instant Scratch-Off Tickets;
- Solicitation for General Market Advertising Services; and
- Production Services

As the above examples clearly indicate, the Lottery continues to make reasonable efforts to identify potential sublease tenants for the excess office space. However, it should be noted that the first priority is to accommodate opportunities that allow the Florida Lottery to streamline its operations. Once the Lottery's business operations have been accommodated, then subleasing with an outside tenant could be considered.

Again, it should be noted that to accommodate such a sublease, the requisite facility and operational changes or modifications would come at significant costs to the Lottery and would offset any savings that might otherwise be realized from a sublease agreement with a tenant that is not associated with the Florida Lottery's operations.

An obvious driving factor that will determine whether the Lottery can find such a tenant will ultimately be the open marketplace. Therefore, any hope to find a suitable tenant is dependent on those tenants finding the available space suitable for their needs, not the Lottery's need to find suitable tenants.

In the report filed in 2008, the Florida Lottery identified the following tactics in our efforts to identify a tenant that finds the available space suitable to their needs and organize the current use of office space in a more efficient manner:

1. Continue working with DMS and a DMS-contracted tenant broker to assist in locating a suitable tenant;
2. Have discussions with the Lottery advertising vendor for a possible sublease of space;
3. Consider the relocation of the nightly Draw Studio from its current location into the Lottery headquarters building;
4. Include the availability of excess space for functions provided by the Lottery's scratch-off vendor when the procurement solicitation was released; and
5. Conduct and complete a reorganization of the Lottery's current configuration and use of various functions in a more efficient and appropriate manner.

### **Warehouse Space Background**

In response to follow-up questions from OPPAGA concerning adjustments to the Lottery's efforts to sublease warehouse space, the Lottery responded in December 2008 that no excess warehouse space was present. Specifically, there is no standard rate of space measurement, nor a Department of Management Services / Building Owners and Managers Association (BOMA) standard for warehouse space.

Notwithstanding the absence of standards, the Lottery fully utilizes all warehouse space by subleasing space as well as storing Lottery items in safely accessible space. But for the safety factor, the Lottery could actually expand vertical and depth storage capacity in the warehouse. The necessary equipment (double-reach electric forklift) is not available due to budget restrictions. Lottery warehouse items include materials associated with claims processing, marketing, special events, information resources, records storage, district operations, and facilities management.

### **Recent Accomplishments**

The Florida Lottery completed the renovation of excess office space into a new Draw Studio in Summer 2009. The new location occupies 3,756 square feet of what was previously excess office space.

Discussions with the previous incumbent general market advertising contractor, Cooper DDB on moving its Tallahassee operations in the excess office space resulted in not being advantageous at the time. However, the Florida Lottery has completed the solicitation process as identified above and the new advertising firm, St. John & Partners Advertising and Public Relations, has subleased 464 square feet of previously excess office space.

### **Moving Forward**

This year will present the Florida Lottery with opportunities as identified above to streamline its business operations while significantly diminishing its excess leased office space. These opportunities are the direct result of initiating activities to implement most of the tactics previously mentioned.

In preparing for the renovation and planning for realigning business operations, the Florida Lottery met with DMS to discuss space measurement methodologies and subsequently contracted with an architectural and engineering firm to develop as-built floor plans and to measure the headquarters space and provide a report on the Lottery's space considering the DMS standards. After applying the DMS standards, it was determined that the Florida Lottery currently leases 25,682 square feet of excess office space.

In the upcoming months, the Lottery will begin renovation of its headquarters facility using the tenant improvement funds provided by the landlord. The renovation efforts will include working with the Department of Management Services and an office space planner to assist staff in achieving compliance with the DMS standards as much as possible while increasing operational efficiency by aligning integrated work units. These efforts will target sharing business resources such as copiers, fax machines, printers and filing areas.



Representative Greg Evers  
October 30, 2009  
Page 7

Finally, should there be sufficient excess leased office space after the above initiatives have been accomplished, the Florida Lottery will reengage the Department of Management Services and the Lottery's contracted tenant broker representatives (Cushman & Wakefield) to assist in seeking a suitable tenant.

If you have any questions, or require additional details pertaining to the above information, please contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Leo DiBenigno". The signature is stylized and cursive, with a long horizontal stroke extending to the right.

Leo DiBenigno  
Secretary

**Auditor General  
Report No. 2010-062**

# Joint Legislative Auditing Committee Monday, February 1

Summary Report of IT Audit Findings  
Included In Our Financial and Operational Audit Reports  
Issued During the 2008-09 Fiscal Year

Auditor General's Office  
Report No. 2010-062  
December 2009



## Why We Prepared This Summary Report

- Information and the related technology are critical public assets.
- This is the age of e-Government: public entities at all levels of government depend on IT to achieve their missions and serve the public.
- The widespread use of IT, without proper safeguards, can lead to significant risks to entity operations and assets.
- Appropriate, cost-effective information security measures are necessary to mitigate the risks.

## Inherent IT Risks

- Loss or theft of payments and collections.
- Use of IT resources for unauthorized purposes.
- Disclosure of confidential or exempt information.
- Disruption of critical operations.
- Modification of information for identity theft, embezzlement, or other types of crime.
- Unavailable/poorly functioning IT-dependent services.
- Costly mismanagement of IT system acquisitions or development.

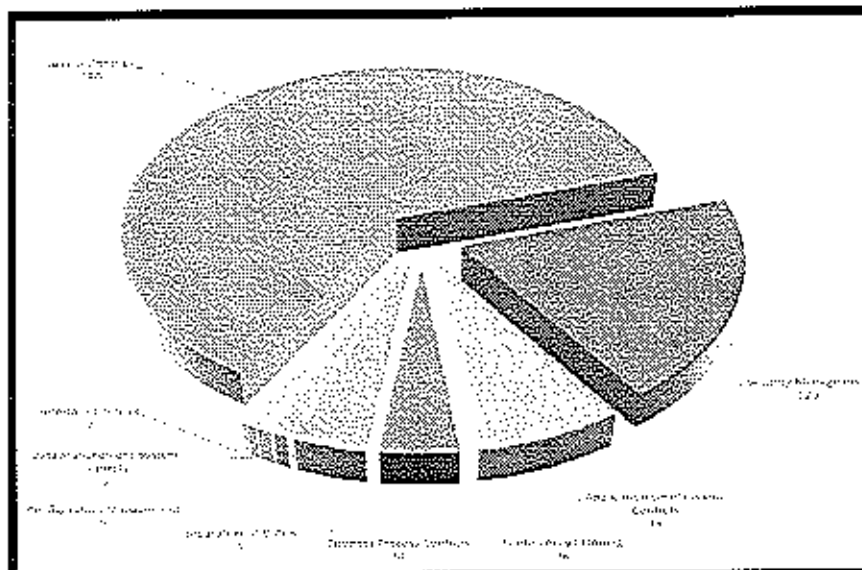
## Improvement is Needed in Florida's Information Security Management

- Opportunities for improvement have been reported in our financial and operational audits for some time.
- Similar IT audit findings have tended to recur from entity to entity.

## Overall Summary Results

- 87 of 167 financial and operational audit reports issued during 2008-09 included IT audit findings.
- 613 IT audit findings involving 80 public entities.
- 23 percent (144) were repeat findings.
- Most prevalent – issues with access to data and IT resources, IT security management.

## Findings By Control Category



## Examples of Commonly Found IT Control Deficiencies

- Risk management deficiencies.
- User identification and authentication (e.g., shared user IDs and weak passwords).
- Inappropriate or unnecessary access privileges – some involved administrator (largely unrestricted) capabilities.
- Lack of timely removal of access privileges.
- Deficient measures protecting sensitive data.
- Inadequate logging/monitoring of security activity.
- See Exhibit B for a detailed breakdown.

## Overall Recommendation

- Entity management, those charged with governance, and stakeholders at all levels of government need to place increased emphasis on IT security and control.
- Special attention is needed in Florida's education system – no single IT security champion.

Questions?



**SUMMARY REPORT OF  
INFORMATION TECHNOLOGY AUDIT FINDINGS**

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Included In Our Financial and Operational Audit Reports  
Issued During the 2008-09 Fiscal Year



STATE OF FLORIDA  
AUDITOR GENERAL  
DAVID W. MARTIN, CPA



A listing of the specific entities for which audit reports included information technology (IT) audit findings is included in this report as Exhibit A.

The project was conducted by Edda S. Morgan, CPA, CISA, and supervised by Tina Greene, CPA, CISA. Please address inquiries regarding this report to Jim Ingram, CPA, CISA, Audit Manager, by e-mail at [jim Ingram@audstatefla.com](mailto:jim Ingram@audstatefla.com) or by telephone at (850) 488-0840.

This report and other reports prepared by the Auditor General can be obtained on our Web site at [www.audflorida.com/audgen](http://www.audflorida.com/audgen), by telephone at (850) 488-9024, or by mail at 6740 Linda Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

## SUMMARY REPORT OF INFORMATION TECHNOLOGY AUDIT FINDINGS

Included In Our Financial and Operational Audit Reports  
Issued During the 2008-09 Fiscal Year

### SUMMARY

Public entities rely heavily on information technology (IT) to achieve their missions and business objectives. As such, IT controls are an integral part of entity internal control systems. The Auditor General evaluates the effectiveness of entity controls over IT as a part of financial and operational audits. IT audit findings included in our financial and operational audit reports issued during the 2008-09 fiscal year are summarized below:

- In 87 audit reports, we disclosed 613 IT audit findings involving 80 public entities. These findings related to entity IT controls that were deficient or needed improvement. Of the 613 IT audit findings, 144 findings, or approximately 23 percent, were also included in audit reports for the same entities from previous fiscal years. Nineteen of the findings had been included in more than one previous audit report for the same entity.
- The most prevalent IT audit findings disclosed that improvements were needed in controls over access to entity data and IT resources and described deficiencies in entity IT security management.
- The nature and extent of the IT audit findings disclosed in our audits and the percentage of repeated findings are indicative of the need for entity management, those charged with governance, and other stakeholders to place increased emphasis on improving the security and control over data and IT resources.

### BACKGROUND

Information and the related technology are critical public assets. Public entities, including State agencies and institutions of public education, depend on IT to achieve their missions and to record, process, maintain, and report essential financial and program information. However, the widespread use of IT, without proper safeguards, can lead to vulnerabilities that enable the perpetration of errors by employees in their daily work processes and frauds by persons with malicious intentions.

Public entity management, therefore, has an important stewardship responsibility for establishing effective IT controls that provide reasonable assurance of the achievement of management's control objectives, including, in particular, the confidentiality, integrity, and availability of data and IT resources. The absence of effective IT controls can result in significant risks to entity operations and assets, such as risk of unauthorized or erroneous disclosure, modification, or destruction of financial information and IT resources. Examples include:

- Financial resources, such as payments and collections, could be lost or stolen.
- IT resources could be used for unauthorized purposes, including diverting financial resources and launching attacks on other systems or networks.
- Information that is confidential or exempt from public disclosure by law, such as student data, taxpayer data, Social Security numbers, medical records, other personally identifiable information, and proprietary business information could be inappropriately added, disclosed, copied, modified, deleted, or destroyed.
- Critical operations, such as those supporting law enforcement and emergency services, could be disrupted.

- Information could be modified for purposes such as identity theft, embezzlement, and other types of crime.
- Public confidence in State government and the public education system could be diminished as a result of embarrassing incidents such as the disclosure of personally identifiable information, unavailable or poorly functioning IT-dependent services, IT-related fraud, or costly mismanagement of large IT system acquisition or development projects.

Recognizing the need for improved IT security management in State government, the Florida Legislature has enacted recent legislation (Chapter 2009-80, Laws of Florida) that provides for additional IT security management and reporting responsibilities for the Agency for Enterprise Information Technology (AEIT) and other State agencies as defined in Section 216.011(1)(qg), Florida Statutes. This legislation provides, in part, that:

- The Office of Information Security (Office) is established within the Agency for Enterprise Information Technology, to be overseen by a state Chief Information Security Officer.
- The Office is responsible for establishing rules and publishing guidelines for ensuring an appropriate level of security for all data and IT resources for executive branch agencies.
- The Office is required to develop, and annually update by February 1, an enterprise information security strategic plan.
- The Office is required to submit to the Governor, President of the Senate, and Speaker of the House of Representatives by December 31, 2010, a proposed implementation plan for IT security.
- State agencies are required to annually submit to the Office strategic and operational security plans pursuant to the rules and guidelines established by the Office.

Similar provisions of law do not exist for institutions of public education.

#### SUMMARY OF IT AUDIT FINDINGS

The Auditor General conducts financial and operational audits of State agencies, universities, community colleges, district school boards, and other governmental entities pursuant to Section 11.45(2), Florida Statutes. The Auditor General may, pursuant to Section 11.45(3), Florida Statutes, conduct audits or other engagements of the accounts, records, and IT programs, activities, functions, or systems of any governmental entity created or established by law.

We evaluate IT controls in financial audits and in many operational audits. Consideration of IT controls is an essential and significant part of the audit process in these audits because entity business processes that are relevant to the audit objectives are generally dependent on IT. In addition, IT systems are the specific topic of many operational audits by our IT Audits Division.

During the 2008-09 fiscal year, we issued 219 audit reports, including 167 financial or operational audit reports. Of the 167 financial or operational audit reports, 87 reports (representing 80 entities) included one or more findings relating to entity management and control of IT, for a total of 613 findings. Of the 613 IT audit findings, 144 findings, or approximately 23 percent, were also included in audit reports for the same entities from previous fiscal years. Nineteen of the findings had been included in more than one previous audit report for the same entity.

We have analyzed each of the 613 IT audit findings and, for the purposes of this report, summarized the findings into nine control categories based on the Federal Information System Controls Audit Manual (FISCAM), issued by the United States Government Accountability Office (GAO) in February 2009. The nine control categories, representing a grouping of related controls having similar types of risks, are:

### General Controls

- Security Management: Controls providing assurance that security management is effective. Examples include a security management program, periodic risk assessments and validation, and security control policies and procedures.
- Access Controls: Controls providing assurance that access to data, software, equipment, and facilities is reasonable and restricted to authorized individuals.
- Configuration Management: Controls providing assurance that changes to IT system resources are authorized and systems are configured and operated securely and as intended.
- Separation of Duties: Controls providing assurance that incompatible duties are effectively separated.
- Contingency Planning: Controls protecting information resources, minimizing the risk of unplanned interruptions, and providing for the recovery of critical operations should interruptions occur.

### Business Process Application Controls

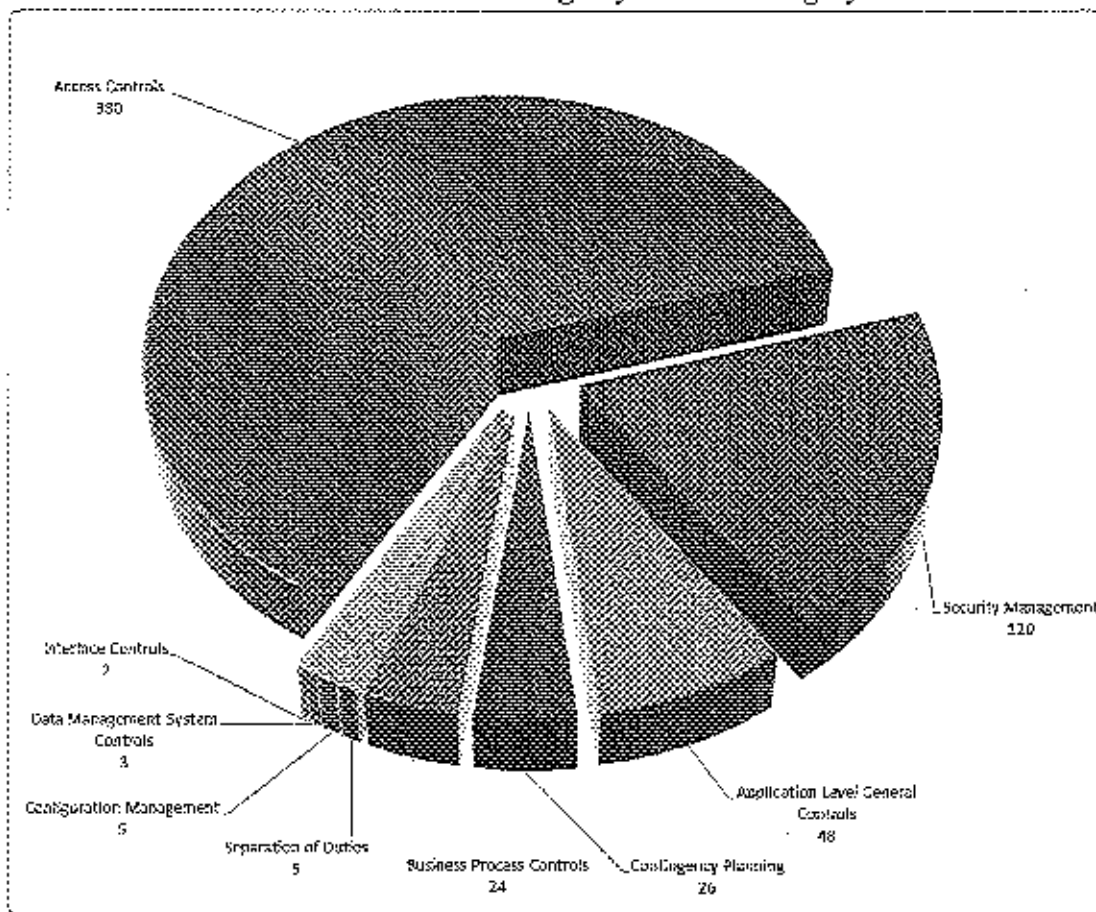
- Application Level General Controls: General controls, including the five types of controls listed above, operating at the business process application level.
- Business Process Controls: Automated and manual controls applied to business process flows, including controls over transaction data input, processing, and output and controls over master data.
- Interface Controls: Controls over the timely, accurate, and complete processing of information between applications and other feeder and receiving systems and the complete and accurate migration of clean data during conversion.
- Data Management System Controls: Controls used in data management systems, such as database management systems, middleware, data warehouse software, and data extraction and reporting software.

The IT controls included within the scope of individual audits varied based on many factors, including the overall audit objectives and scope, the nature of entity business operations and the entity's use of IT, the entity's IT environment and other risk-based planning considerations. Controls such as Access Controls and Security Management were frequently selected for audit. In contrast, other IT controls such as Interface Controls were not as frequently included in the scope of audits. Consequently, any conclusions drawn based on the distribution of IT audit findings among the nine control categories should take into consideration that certain IT controls were addressed in audits more frequently than other IT controls.

The following table and chart provide a high-level summary of IT audit findings by control category (for a more detailed breakdown and description of the findings, please see Exhibit B of this report):

Control Category	Number of Findings
Access Controls	380
Security Management	120
Application Level General Controls	48
Contingency Planning	26
Business Process Controls	24
Separation of Duties	5
Configuration Management	5
Data Management System Controls	3
Interface Controls	2
<b>Total Number of Findings</b>	<b>613</b>

Number of Findings By Control Category



As shown above, the predominant IT audit findings were in the categories of Access Controls and Security Management. Although these categories of IT controls were frequently included within the scope of the 87 audits, the number of findings in these two categories indicates that many opportunities exist within State government and the public education system for improving IT security, as discussed below.

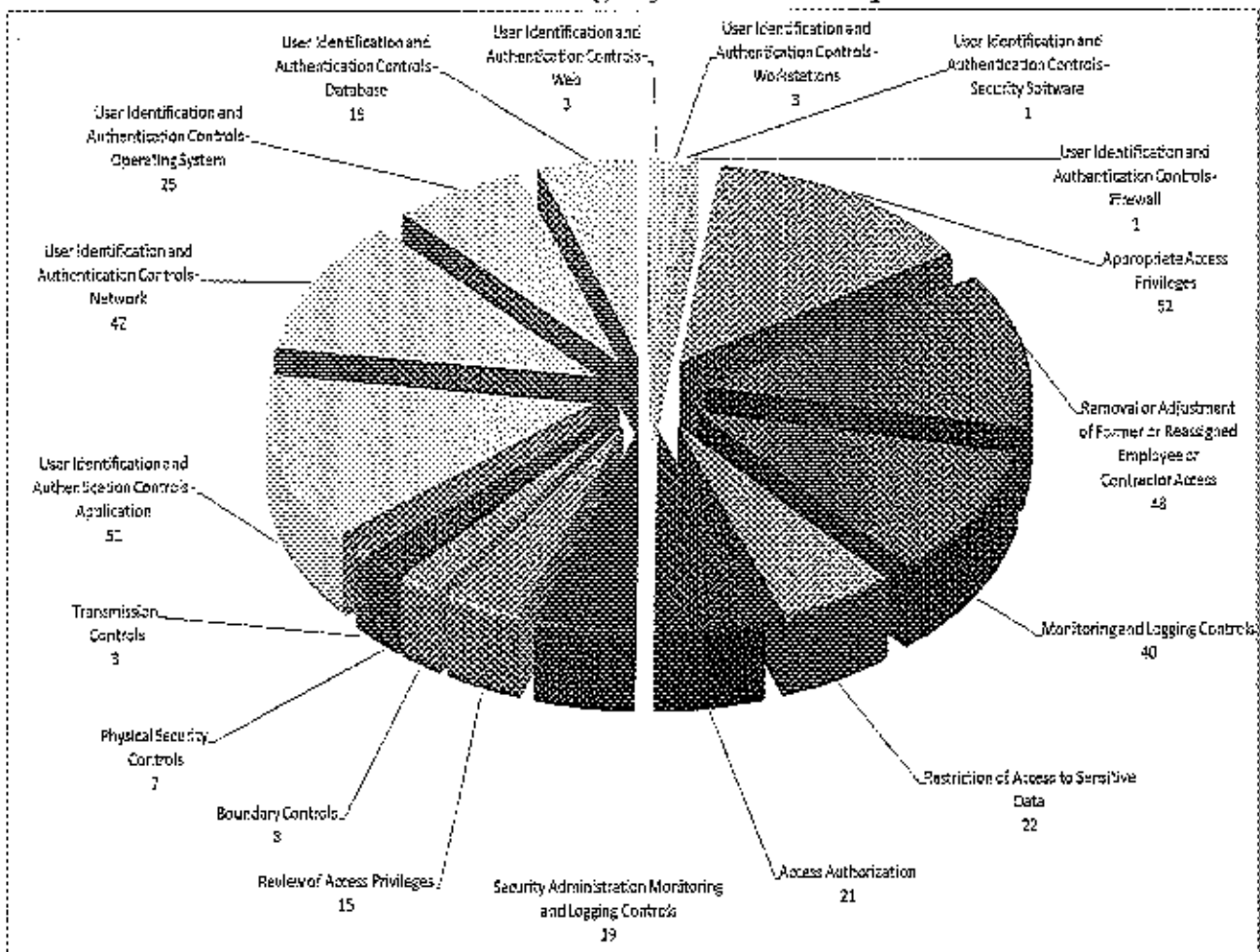
#### Access Control Findings

Access controls limit or detect inappropriate access to IT resources, thereby protecting the IT resources from unauthorized disclosure, modification, and loss. Without adequate access controls, unauthorized individuals, including outside intruders and former employees, can surreptitiously read and copy sensitive data and make undetected changes or deletions for malicious purposes or personal gain. In addition, authorized users can intentionally or unintentionally read, add, modify, delete, or exfiltrate (remove) data or execute changes that are outside their span of authority.

The following table and chart provide a breakdown of access control findings by the specific control technique needing improvement.

Access Controls-- Control Techniques	Number of Findings	Number of Entities
Appropriate Access Privileges	52	15
User Identification and Authentication Controls -- Application	51	44
Removal or Adjustment of Former or Reassigned Employee or Contractor Access	48	41
User Identification and Authentication Controls -- Network	42	41
Monitoring and Logging Controls	40	28
User Identification and Authentication Controls - Operating System	25	25
Restriction of Access to Sensitive Data	22	20
Access Authorization	21	17
User Identification and Authentication Controls -- Database	19	16
Security Administration Monitoring and Logging Controls	19	18
Review of Access Privileges	15	13
Boundary Controls	8	8
Physical Security Controls	7	6
Transmission Controls	3	3
User Identification and Authentication Controls - Web	3	3
User Identification and Authentication Controls - Workstations	3	3
User Identification and Authentication Controls - Security Software	1	1
User Identification and Authentication Controls - Firewall	1	1
<b>Total Number of Findings</b>	<b>380</b>	

**Access Controls**  
**Number of Findings By Control Technique**



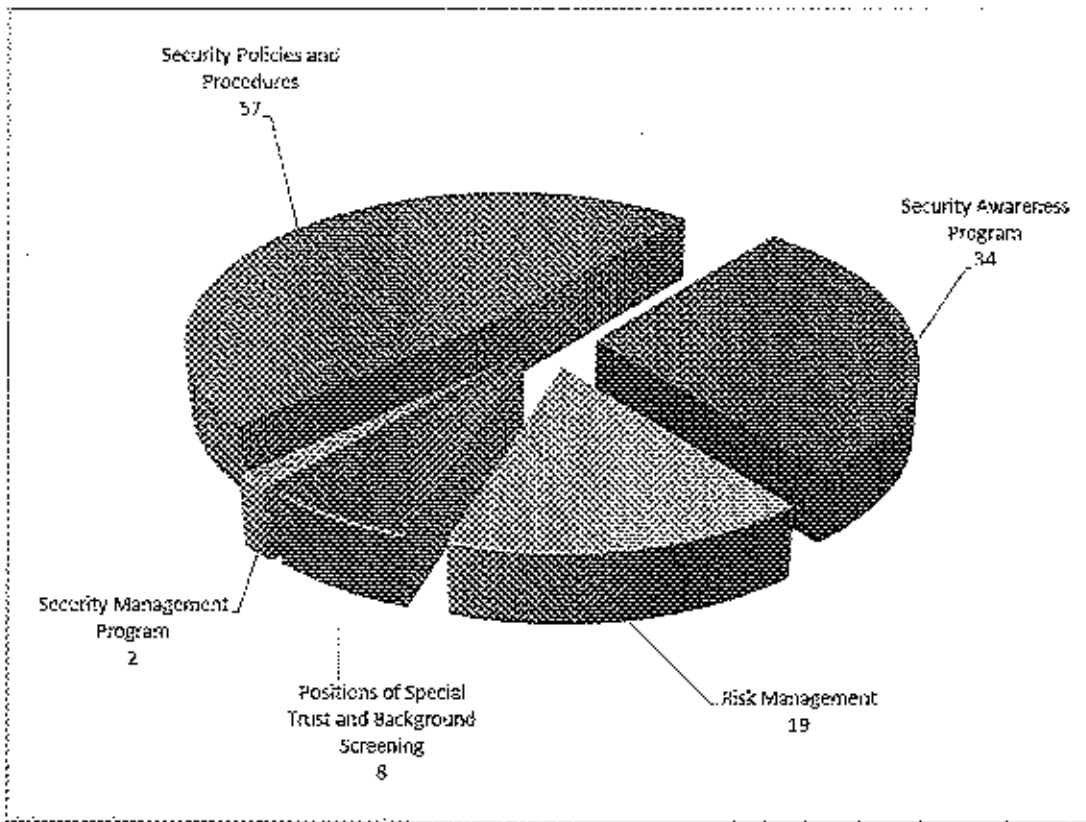
Security Management Findings

The effectiveness of an entity's access controls and other aspects of IT security are dependent in part on the effectiveness of its overall security management. An entitywide security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. The security management program should establish a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of the procedures. Improvements in the overall IT security management of public entities would enhance their ability to identify, assess, and remedy deficiencies in IT security controls in a cost-effective manner.

The following table and chart provide a breakdown of security management findings by the specific control technique needing improvement.

Security Management – Control Techniques	Number of Findings	Number of Entities
Security Policies and Procedures	57	48
Security Awareness Program	34	33
Risk Management	19	17
Positions of Special Trust and Background Screening	8	8
Security Management Program	2	1
<b>Total Number of Findings</b>	<b>120</b>	

**Security Management  
Number of Findings By Control Technique**



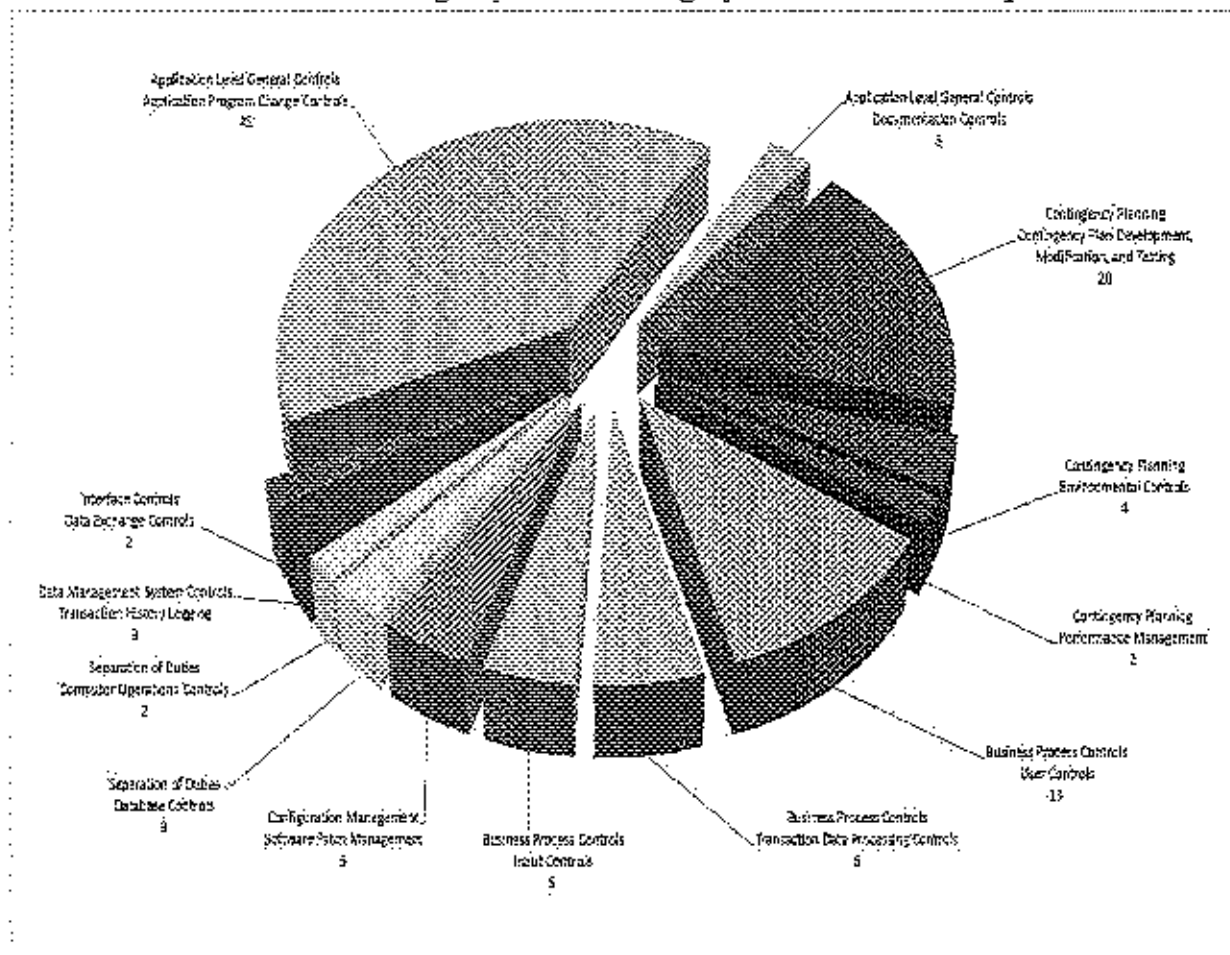


Other Control Categories

The following table and charts provide a breakdown of IT audit findings that were grouped into the seven other control categories, including the specific control techniques that were the subject of the findings.

Control Category	Control Technique	Number of Findings	Number of Entries
Application Level General Controls	Application Program Change Controls	45	28
	Documentation Controls	3	2
Contingency Planning	Contingency Plan Development, Modification, and Testing	20	20
	Environmental Controls	4	4
	Performance Management	2	2
Business Process Controls	User Controls	13	9
	Transaction Data Processing Controls	6	5
Configuration Management	Software Patch Management	3	3
	Database Controls	3	3
Separation of Duties	Computer Operations Controls	2	2
	Transaction History Logging	3	3
Interface Controls	Data Exchange Controls	2	2
<b>Total Number of Findings</b>		<b>113</b>	

**Number of Findings By Control Category and Control Technique**



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**RECOMMENDATION FOR THE LEGISLATURE**

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Maintaining effective internal controls, including IT controls, is an important management responsibility. As shown in the summarizations of IT control issues provided above, the nature and extent of IT audit findings noted in our audit reports issued during the 2008-09 fiscal year and the percentage of repeated findings indicate that information security programs have not yet been fully or effectively implemented for numerous entities and that entity management, those charged with governance, and other stakeholders should place an increased emphasis on improving the security and control of public data and IT resources. Without effective IT security and control practices, controls may continue to be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied.

As previously discussed, Chapter 2009-80, Laws of Florida, provides that the Office of Information Security within A&IT is responsible for establishing rules and publishing guidelines for ensuring an appropriate level of security for data and IT resources for executive branch agencies. In addition, Section 282.318(4), Florida Statutes, provides that each agency head is responsible for assisting the Office by, in part, conducting and updating comprehensive security risk analyses, establishing written internal policies and procedures, developing cost-effective safeguards to reduce identified security risks, and ensuring the conduct of periodic internal audits and evaluations of agency security programs for data, information, and IT resources. Consistent with these requirements, we encourage agency management, those charged with governance, and other stakeholders to work toward improving IT security and control practices.

Similar provisions do not exist in State law for promoting and encouraging effective IT security and control in Florida's K-20 education system. Some administrative rules and regulations exist that address certain IT security requirements for educational entities. However, State law does not clearly address responsibilities within the public education system for the security and control of data and IT resources.

Of the 80 entities for which audit reports were released in the 2008-09 fiscal year disclosing IT audit findings, 56 were educational entities. The significant number of educational entities with IT audit findings, the importance of IT to the accomplishment of educational entity missions, and the existence of significant confidential and exempt information within educational entity IT systems indicates a need to promote and encourage IT security and control practices in the public education system.

Identifying and addressing responsibilities within Florida's K-20 public education system for the security and control of data and IT resources is a significant task. Florida's K-20 public education system consists of a diverse group of entities, including the State University System, the State college system, and district school boards, as well as other related entities such as Florida Distance Learning and the Florida Center for Library Automation. These educational entities have different missions, governance structures, requirements, and levels of resources. These entities all use IT resources to various degrees; however, the IT environments vary from entity to entity in such areas as the type of IT infrastructure, type and number of application systems, age of the infrastructure and systems, size of the entity being supported, and the number and qualifications of staff and amount of monetary resources available to support IT. Financial application systems used by educational entities range from complex Enterprise Resource Planning systems to legacy mainframe systems. Many educational entities use IT consortia, regional data centers, or private service providers for various levels of IT services.

Because of the diverse and complex nature of the educational entities' environments, a collaborative approach is necessary to identify strategies and solutions for achieving an appropriate level of security of data and IT resources among all educational entities while at the same time allowing these entities the autonomy provided for in State Constitution and law. Within the governance structure for Florida's K-20 public education system, there are organizations that may be able to assist entities within their jurisdiction. Such organizations include the Department of Education that has certain oversight responsibilities for school districts and colleges; the Information Resource Management office within the State University System Board of Governors that has issued a regulation for Universities regarding security of data and related IT resources; and the Chief Information Officers (CIOs) of educational entities, who collaborate and share information regarding the advancement of educational technology. In addition, AEIT is well positioned to provide information and assistance to all public entities regarding IT security and control best practices.

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**Recommendation:** We recommend that the Legislature consider establishing a workgroup composed of applicable stakeholders to study and make recommendations for strategies to promote an appropriate level of security of data and IT resources for Florida's educational entities. The workgroup should include representatives from the Department of Education, the Board of Governors of the State University System, the educational entities' CIO communities, and AEIT. Matters to be addressed by the workgroup could include strategies in the following areas: promoting information security awareness, standards, and guidelines; conducting security planning and risk analyses; establishing cost-effective IT security and control practices to reduce identified security risks; and ensuring the conduct of periodic internal audits and evaluations of information security programs. The workgroup should consider establishing a long-range security plan for achieving an appropriate level of security of data and IT resources for Florida's K-20 education system.

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#### OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of this project was to analyze and summarize all IT audit findings reported by the Auditor General during the 2008-09 fiscal year.

The scope of this project included a review of 167 Auditor General financial or operational audit reports released during the 2008-09 fiscal year.

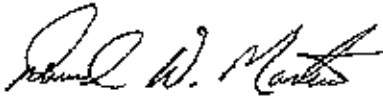
Our methodology included a review of applicable audit reports and an analysis and summarization of IT audit findings. We conducted this review in accordance with applicable generally accepted government auditing standards. We believe that the procedures performed provide a reasonable basis for the summaries of IT audit findings included in this report.

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AUTHORITY

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Pursuant to the provisions of Section 11.45(3)(b), Florida Statutes, I have directed that this report be prepared to present a summary of IT audit findings included in our financial and operational audit reports issued during the 2008-09 fiscal year.



David W. Martin, CPA  
Auditor General

**EXHIBIT - A**

**LISTING OF  
FINANCIAL AND OPERATIONAL AUDIT REPORTS ISSUED DURING THE 2008-09 FISCAL YEAR  
THAT INCLUDED INFORMATION TECHNOLOGY (IT) AUDIT FINDINGS**

<u>Report No.</u>	<u>Entity Name</u>	<u>Report No.</u>	<u>Entity Name</u>
2009-003	Agency for Workforce Innovation	2009-099	Baker County District School Board
2009-004	Department of Financial Services	2009-100	Department of Children and Family Services
2009-011	Department of Corrections	2009-101	Department of the Lottery
2009-013	Department of Citrus	2009-102	Citizens Property Insurance Corporation
2009-017	Department of Transportation	2009-109	University of West Florida
2009-018	Department of Health	2009-118	Jackson County District School Board
2009-020	Department of Legal Affairs	2009-119	Sarasota County District School Board
2009-022	Florida Hemando Community College	2009-128	Liberty County District School Board
2009-024	Department of Revenue	2009-131	Northwest Florida State College
2009-028	Mason County District School Board	2009-132	North Florida Community College
2009-029	Franklin County District School Board	2009-134	Dixie County District School Board
2009-031	Department of State	2009-138	Franklin County District School Board
2009-042	Office of Insurance Regulation	2009-139	Levy County District School Board
2009-033	Palm Beach Community College	2009-140	Hamilton County District School Board
2009-034	Hernando County District School Board	2009-141A	Citrus County District School Board
2009-036	Office of Insurance Regulation	2009-142	Hendry County District School Board
2009-038	Department of Law Enforcement	2009-143	Volusia County District School Board
2009-039	Department of Children and Family Services	2009-144	Department of Financial Services, Department of Community Affairs, Agency for Workforce Innovation, Department of Revenue, Department of Education, Department of Health, Department of Children and Family Services, and Division of Emergency Management
2009-040	Indian River County District School Board		
2009-041	St Johns College		
2009-048	Lee County District School Board		
2009-049	Department of State		
2009-052	Department of Management Services	2009-145	Lake Sumter Community College
2009-053	Department of Financial Services	2009-149	Valencia Community College
2009-055	Seminole County District School Board	2009-151	Miami Dade College
2009-056	Madison County District School Board	2009-152	Bay County District School Board
2009-057	St. Petersburg College	2009-153	Bradford County District School Board
2009-062	Gulf Coast Community College	2009-154	Walton County District School Board
2009-063	Nassau County District School Board	2009-155	Indian River State College
2009-065	Columbia County District School Board	2009-159	Polk Community College
2009-067	Lake County District School Board	2009-161	Santa Rosa County District School Board
2009-070	Agency for Workforce Innovation, Department of Revenue, and Department of Management Services	2009-163	Washington County District School Board
2009-078	Department of Management Services, Division of Administrative Hearings, Florida Commission on Human Relations, and Public Employees Relations Commission	2009-164	Wakulla County District School Board
2009-082	Gulf County District School Board	2009-166	Glades County District School Board
2009-083	Agency for Workforce Innovation, Department of Agriculture and Consumer Services, Department of Health, Fish and Wildlife Conservation Commission, and Office of State Courts Administrator	2009-169	Putnam County District School Board
2009-086	Division of Emergency Management	2009-171	Taylor County District School Board
2009-087	Florida Agricultural and Mechanical University	2009-172	Clay County District School Board
2009-091	Department of Financial Services	2009-175	Highlands County District School Board
2009-093	Department of Transportation	2009-179	Charlotte County District School Board
2009-094	Jefferson County District School Board	2009-186	Pinellas County District School Board
2009-096	Sumter County District School Board	2009-188	Gadsden County District School Board
2009-097	Gilchrist County District School Board	2009-189	Leon County District School Board
2009-098	Hardee County District School Board	2009-197	Department of Veterans' Affairs
		2009-199	Department of Revenue
		2009-200	Department of Management Services
		2009-208	Department of Education
		2009-209	Monroe County District School Board
		2009-213	Department of Education

EXHIBIT B

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding, Results, and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
1. Security Management	1. Security Management Program	Senior management should establish a security management structure for entitywide, system, and application levels that have adequate independence, authority, expertise, and resources. An information systems security manager should be appointed at an agency (entity) level and at appropriate subordinate (i.e., system and application) levels and given appropriate authority. The security program documentation should clearly identify owners of computer-related resources and those responsible for managing access to computer resources. Security responsibilities and expected behaviors should be clearly defined at the entitywide, system, and application levels for information resource owners and users, information technology management and staff, senior management, and security administrators.	<ul style="list-style-type: none"> <li>The placement of the CIO within the Department's organizational structure needed review and the scope of his authority for performing IT duties assigned in State law needed improvement to provide increased oversight of all Department IT functions.</li> <li>The Department and Divisions had not clearly established the roles and responsibilities of the Department's information security manager and the Division data security administrators.</li> </ul>	2	1	0	1
Security Management	2. Risk Management	Appropriate risk assessment policies and procedures should be documented and based on security categorizations. Information systems should be categorized based on the potential impact that the loss of confidentiality, integrity, or availability would have on operations, assets, or individuals. Risks should be reassessed for the entitywide, system, and application levels on a periodic basis or whenever systems, applications, facilities, or other conditions change. Risk assessment documentation should include security plans, risk assessments, security test and evaluation results, and appropriate management approvals. Changes to systems, facilities, or other conditions and identified security vulnerabilities should be analyzed to determine their impact on risk and the risk assessment should be performed or revised as necessary.	<ul style="list-style-type: none"> <li>There were no policies and procedures for a periodic risk analysis for critical information resources or for a comprehensive risk analysis after major changes in software, procedures, environment, organization, or hardware.</li> <li>A formal risk assessment had not been performed to identify and document information technology systems and resources, vulnerabilities and exposures, policies and control measures, and management's signed acceptance of unmitigated risks.</li> <li>The auditee did not conduct routine network and system vulnerability testing.</li> <li>There was no enterprise risk management function; consequently there was no documentation to support that an enterprise wide evaluation of the effectiveness of controls had been conducted.</li> <li>Contrary to the security policy, the auditee did not have an approved security plan for a major information system.</li> <li>Contrary to the security policy, the auditee did not perform a certification and accreditation for a major information system.</li> <li>The first phase of a strategic plan had been completed but still lacked further exposure to IT stakeholders and formal approval.</li> <li>Vulnerability assessment and penetration testing had never been performed.</li> </ul>	19	6	11	17

<sup>1</sup> For the purposes of this summary, Citizens Property Insurance Corporation was included with the State agencies.

EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Findings, Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Facilities	Total No. of Findings
			<ul style="list-style-type: none"> <li>▪ The auditee did not have a policy for the classification of data according to risk and importance to support decisions regarding the appropriate level of data protection to be employed during systems development and change activities.</li> <li>▪ The auditee had not classified its data according to sensitivity or level of significance.</li> <li>▪ Data owners had not been identified.</li> <li>▪ The Department had not prepared security plans and strategies for implementing appropriate cost-effective safeguards to reduce, eliminate, or recover from the identified risks to data, information, and IT resources.</li> </ul>				
Security Management	3. Security Policies and Procedures	<p>Security control policies and procedures at all levels should:</p> <ul style="list-style-type: none"> <li>▪ be documented</li> <li>▪ appropriately consider risk</li> <li>▪ address purpose, scope, roles, responsibilities, and compliance</li> <li>▪ ensure that users can be held accountable for their actions</li> <li>▪ appropriately consider general and application controls</li> <li>▪ be approved by management</li> <li>▪ be periodically reviewed and updated.</li> </ul> <p>Security policy is senior management's directives to create a computer security program, establish its goals, and assign responsibilities. Procedures are detailed steps to be followed to accomplish particular security-related tasks (for example, preparing new user accounts and assigning the appropriate privileges).</p>	<ul style="list-style-type: none"> <li>▪ The auditee's Electronic Security for Public Records Policy was outdated.</li> <li>▪ The auditee lacked written policies and procedures for certain IT functions (including security functions) or they were not sufficiently comprehensive or fully approved.</li> <li>▪ The auditee did not have written security administration policies and procedures for an application.</li> <li>▪ There was no written policy prohibiting the sharing of user and system administrator identifications.</li> <li>▪ There were no written policies to prohibit the granting of workstation administrator rights to end-users.</li> <li>▪ There were no written procedures for requesting, approving, assigning, and removing user access privileges.</li> <li>▪ There were no written procedures addressing the erasing, data backup, or physical security of surplus IT property.</li> <li>▪ The auditee did not follow its written property disposal procedures.</li> <li>▪ The auditee had not established security protocols for controlling access through user names and passwords.</li> <li>▪ The auditee had not established a process to ascertain the appropriateness of security controls for their vendor-owned application.</li> <li>▪ There were no policies and procedures for monitoring access privileges to the application or the security events were not monitored.</li> <li>▪ The auditee allowed the use of instant messaging software on its computers without establishing a specific policy or procedures governing its secure use.</li> <li>▪ There were no written policies and procedures for network and system administration functions such as configuration and management of routers, switches, and other security devices.</li> <li>▪ No written policies and procedures</li> </ul>	37	12	36	48

EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
			<p>existed for backup, recovery, and restoration of application data and programs.</p> <ul style="list-style-type: none"> <li>No written procedures existed for the security monitoring activities of the security administrator.</li> <li>The Department's security program, including its security policies and procedures, needed improvement.</li> <li>The Department, not the divisions, had written procedures in place addressing physical security for the server rooms.</li> </ul>				
Security Management	4. Security Awareness Program	<p>An ongoing security awareness program should be implemented that includes security briefings and training that is monitored for all employees with system access and security responsibilities. Training should be documented and monitored. Typical means for establishing and maintaining security awareness include:</p> <ul style="list-style-type: none"> <li>informing users of the importance of the information they handle and the legal and business reasons for maintaining its integrity and confidentiality</li> <li>distributing documentation describing security policies, procedures, and users' responsibilities, including their expected behavior</li> <li>requiring users to periodically sign a statement acknowledging their awareness and acceptance of responsibility for security and their responsibilities for following all organizational policies</li> <li>requiring comprehensive security orientation, training, and periodic refresher programs to communicate security guidelines to both new and existing employees and contractors.</li> </ul>	<ul style="list-style-type: none"> <li>The auditee had not developed a written security awareness training program or performed ongoing information technology security awareness training for all employees.</li> <li>The personnel file did not always include signed Acceptable Use of Information Technology Agreements and the personnel file did not always include a signed Confidentiality and Non-Disclosure Agreement.</li> <li>The auditee's security awareness training program needed improvement.</li> <li>Security awareness training was not provided on a recurring basis.</li> <li>The Department did not retain documentation of employee participation in security awareness training activities.</li> </ul>	34	6	27	33
Security Management	5. Positions of Special Trust and Background Screening	<p>For prospective employees, references should be checked and background checks performed. Nondisclosure or security access agreements should be required for employees and contractors assigned to work with sensitive information.</p>	<ul style="list-style-type: none"> <li>The auditee had not established a written policy for designating positions of special trust.</li> <li>The auditee had not performed level 2 background screenings with fingerprints for all employees or contractors in positions of special trust.</li> <li>The auditee's contract for application services did not require that appropriate background screenings be conducted of contractor staff and adequate background checks were not performed for all contracted staff.</li> <li>The auditee had not identified which positions require access to confidential data or designated those positions as positions of special trust.</li> <li>The Department did not perform Federal background checks on one</li> </ul>	8	8	0	8



EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
			<p>division's application contractors.</p> <ul style="list-style-type: none"> <li>Department policies contained inconsistent guidance regarding whether contractors could be considered as occupying positions of special trust.</li> </ul>				
3. Access Controls	1. Boundary Controls	<p>Networks should be appropriately configured to adequately protect access ports within and between systems, using appropriate technological controls (e.g., routers, firewalls, etc.).</p>	<ul style="list-style-type: none"> <li>Changes to firewall settings were not monitored.</li> <li>The auditors was unable to provide documentation of an approved baseline firewall configuration.</li> <li>The auditors had not installed a firewall to protect its network.</li> <li>An unauthorized wireless network was in use at the auditee's headquarters even though they monitored for rogue wireless devices.</li> <li>Default port settings had not been changed where necessary.</li> <li>There were no written policies and procedures for the use of firewalls.</li> <li>There was no written procedure to periodically review facilities for rogue wireless access points.</li> <li>Numerous wireless access points did not have the appropriate firmware.</li> </ul>	8	4	4	8
Access Controls	2. User Identification (ID) and Authentication Controls - Application	<p>Users or processes should be appropriately identified and authenticated through logical access controls. User authentication establishes the validity of a user's claimed identity typically during access to a system or application. Logical controls should be designed to restrict legitimate users to the specific systems, programs, and files that they need and prevent others, such as hackers, from entering the system at all. Passwords are the most widely used means of authentication. Controls for protecting the confidentiality of passwords include:</p> <ul style="list-style-type: none"> <li>Individual users are uniquely identified rather than sharing group IDs.</li> <li>Generic user IDs and passwords are not used.</li> <li>Password selection is controlled by the user and is not subject to disclosure.</li> <li>Passwords are changed periodically, about every 30 days.</li> <li>Passwords are not displayed when entered.</li> <li>Passwords contain alphanumeric and special characters.</li> <li>Passwords have a minimum character length of at least 8 characters.</li> <li>Use of old passwords is prohibited.</li> <li>Vendor-supplied passwords are replaced immediately.</li> <li>Attempts to log on with invalid passwords are limited.</li> </ul>	<p>These findings were for numerous types of applications, including financial, payroll/human resource, student, and others. In some cases, these weaknesses existed for more than one application for an auditee.</p> <p>Application passwords and user IDs:</p> <ul style="list-style-type: none"> <li>Passwords were not required to log on to the application.</li> <li>User IDs and passwords were shared.</li> <li>Passwords were assigned by the security administrator and could not be changed by the user.</li> <li>Users were not required to change the password at initial logon.</li> <li>Password and logon controls did not enforce a password change interval or the interval was too long.</li> <li>Password and logon controls did not enforce password complexity requirements.</li> <li>Password and logon controls did not enforce password minimum length requirements or the minimum length was too short.</li> <li>Password and logon controls did not enforce password reuse rules (history) or the history setting was too short.</li> <li>Password and logon controls did not limit the number of allowed invalid access attempts or the limitation was too high.</li> <li>Password and logon controls did not enforce a password-protected timeout for idle workstations or the time set was too long.</li> <li>There were no password reset</li> </ul>	51	17	27	44

**EXHIBIT B (Continued)**

**SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE**

Control Category	Control Technique	Description	Finding Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
			<p>procedures for the security software.</p> <ul style="list-style-type: none"> <li>▪ Accounts locked after three failed logon attempts were automatically unlocked at midnight.</li> <li>▪ Users were automatically logged off the system after 120 minutes of inactivity instead of 30.</li> <li>▪ The default superuser ID was not fully secured.</li> <li>▪ Password age was set at 0 days.</li> </ul>				
Access Controls	3 User ID and Authentication Controls - Database	Same description as shown above for User Identification (ID) and Authentication Controls - Application.	<p>Database passwords and user IDs:</p> <ul style="list-style-type: none"> <li>▪ Password standards were not enforced.</li> <li>▪ User IDs and passwords were shared for administering the database.</li> <li>▪ Users were not required to change the password at initial logon.</li> <li>▪ Password and logon controls did not enforce a password change interval or the interval was too long.</li> <li>▪ Password and logon controls did not enforce password complexity requirements.</li> <li>▪ Password and logon controls did not enforce password minimum length requirements or the minimum length was too short.</li> <li>▪ Password and logon controls did not enforce password reuse rules (history) or the history setting was too short.</li> <li>▪ Password and logon controls did not limit the number of allowed invalid access attempts, the limitation was set too high, or the user could bypass the control by using another session.</li> <li>▪ Password and logon controls did not enforce a password-protected timeout for databases or the time set was too long.</li> <li>▪ Vendor default accounts had not been changed.</li> </ul>	19	4	12	16
Access Controls	4 User ID and Authentication Controls - Firewall	Same description as shown above for User Identification (ID) and Authentication Controls - Application.	<p>Firewall passwords and user IDs:</p> <ul style="list-style-type: none"> <li>▪ User IDs and passwords were shared for administering the firewall.</li> <li>▪ Passwords did not expire, contrary to procedures.</li> </ul>	1	1	0	1
Access Controls	5 User ID and Authentication Controls - Network	Same description as shown above for User Identification (ID) and Authentication Controls - Application.	<p>Network passwords and user IDs:</p> <ul style="list-style-type: none"> <li>▪ The network was not password protected.</li> <li>▪ The password procedures were inconsistent.</li> <li>▪ There were no password reset procedures for the network.</li> <li>▪ Network passwords were not required to be changed upon initial logon.</li> <li>▪ Password and logon controls did not enforce a password change interval or the interval was too long.</li> <li>▪ Password and logon controls did not enforce password complexity requirements.</li> </ul>	42	7	34	41

EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
			<ul style="list-style-type: none"> <li>▪ Password and logon controls did not enforce password minimum length requirements or the minimum length was too short.</li> <li>▪ Password and logon controls did not enforce password reuse rules (history) or the history setting was too short.</li> <li>▪ Password and logon controls did not limit the number of allowed invalid access attempts or the limitation was set too high.</li> <li>▪ Password and logon controls did not enforce a password-protected timeout for the network or the time set was too long.</li> <li>▪ Local logons were used instead of managed network logons.</li> <li>▪ The session lock function had not been activated leaving users in control of setting or disabling the session lock function.</li> <li>▪ The Division still needed to improve the authentication of I/P servers.</li> <li>▪ Minimum password age was incorrectly set.</li> </ul>				
Access Controls	6. User ID and Authentication Controls - Operating System	Same description as shown above for User Identification (ID) and Authentication Controls - Application.	<p>Operating system passwords and user IDs</p> <ul style="list-style-type: none"> <li>▪ No password standards were enforced on the operating system.</li> <li>▪ Security features had not been configured for the operating system and any user could change their user identifier to a superuser.</li> <li>▪ Users were not required to change the password at initial logon.</li> <li>▪ Password and logon controls did not enforce a password change interval or the interval was too long.</li> <li>▪ Password and logon controls did not enforce password complexity requirements.</li> <li>▪ Password and logon controls did not enforce password minimum length requirements or the minimum length was too short.</li> <li>▪ Password and logon controls did not enforce password reuse rules (history) or the history setting was too short.</li> <li>▪ Password and logon controls did not limit the number of allowed invalid access attempts or the limitation was set too high.</li> <li>▪ Password and logon controls did not enforce a password-protected timeout for operating systems or the time set was too long.</li> <li>▪ Vendor default settings had not been changed for the servers.</li> <li>▪ The default password parameters for some user accounts on production servers were oversize to make them less restrictive.</li> <li>▪ The root account and some user</li> </ul>	25	1	24	25

## EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entries
			accounts on some production servers were set to never expire. <ul style="list-style-type: none"> <li>Some operating system user IDs were shared among multiple users.</li> </ul>				
Access Controls	7. User ID and Authentication Controls - Security Software	Same description as shown above for User Identification (ID) and Authentication Controls - Application.	Security software passwords and user IDs: <ul style="list-style-type: none"> <li>Password and logon controls did not enforce a password change interval or the interval was too long.</li> </ul>	1	0	1	1
Access Controls	8. User ID and Authentication Controls - Web	Same description as shown above for User Identification (ID) and Authentication Controls - Application.	Web interface passwords and user IDs: <ul style="list-style-type: none"> <li>Password and logon controls did not enforce a password change interval or the interval was too long.</li> <li>Password and logon controls did not enforce password complexity requirements.</li> <li>Password and logon controls did not enforce password reuse rules (history) or the history setting was too short.</li> <li>User IDs and passwords were shared among staff for the Web interface.</li> <li>The limitation on invalid logon attempts was set too high and automatically reset after 15 minutes.</li> <li>The automatic inactivity timeout was set at eight hours.</li> </ul>	3	3	0	3
Access Controls	9. User ID and Authentication Controls - Workstations	Same description as shown above for User Identification (ID) and Authentication Controls - Application.	Workstation passwords and user IDs: <ul style="list-style-type: none"> <li>Password and logon controls did not enforce a password change interval or the interval was too long.</li> <li>Password and logon controls did not enforce password complexity requirements.</li> <li>Password and logon controls did not enforce password minimum length requirements or the minimum length was too short.</li> <li>Password and logon controls did not enforce password reuse rules (history) or the history setting was too short.</li> <li>Password and logon controls did not limit the number of allowed invalid access attempts on the workstations, the limitation was set too high, or the control could be bypassed.</li> <li>Password and logon controls could be changed or totally disabled by the user for the password-protected screen-savers on workstations.</li> </ul>	3	1	2	3
Access Controls	10. Access Authorization	To adequately control user accounts, an entity should institute policies and procedures for authorizing logical access to information resources and document such authorizations. Resource owners should have identified authorized users and the access they are authorized to have.	These findings were for access to numerous types of applications, including financial, payroll/human resource, student, and others. They were also related to access requests for the operating systems, databases, networks, and other information technology resources. <ul style="list-style-type: none"> <li>Documentation of access</li> </ul>	21	8	9	17

**EXHIBIT B (Continued)**

**SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE**

Control Category	Control Technique	Description	Finding Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
		Approved authorizations should be maintained on file.	<p>authorization requests could not be provided because the documentation was not required or was not retained.</p> <ul style="list-style-type: none"> <li>▪ Documentation of access authorization requests did not provide adequate evidence that the level of access granted was the same as requested, including not having adequate descriptions of what was being requested.</li> <li>▪ Access privileges granted did not correspond to the access privileges authorized on the authorization forms.</li> <li>▪ Documentation was not sufficient to determine the user's identity.</li> <li>▪ Supervisory approvals were not required before access privileges were granted.</li> <li>▪ There were no written procedures regarding authorization of access privileges.</li> </ul>				
Access Controls	11. Appropriate Access Privileges	Access should be limited to individuals with a valid business purpose (user privilege)	<ul style="list-style-type: none"> <li>▪ Users had application update access that was not required for their duties or allowed them to perform incompatible duties.</li> <li>▪ Security administration capabilities were inappropriately granted to individuals other than security administrators.</li> <li>▪ An excessive number of application users were granted correction mode access.</li> <li>▪ Users had full administrator rights on their workstations.</li> <li>▪ Security was incorrectly set up and allowed users more access than needed.</li> <li>▪ Individuals (users and IT staff) had access capabilities in various IT areas that were not required for their duties.</li> <li>▪ IT staff performed incompatible IT-related duties (sometimes with the superuser account).</li> <li>▪ More people than necessary had domain administration access capabilities to administer the servers.</li> <li>▪ IT staff had end-user update access to the application.</li> <li>▪ Help desk staff could enter data into the application for users.</li> <li>▪ Individuals had unnecessary access capability to make changes to the application data files outside application controls.</li> <li>▪ Default accounts were not appropriately restricted.</li> <li>▪ There were incompatible duties between system administration and security administration.</li> <li>▪ Logging in using the root ID was not disabled on the production servers.</li> <li>▪ There were unnecessary duplicate accounts.</li> <li>▪ Users' access could not be limited to</li> </ul>	52	14	31	45

EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
			<p>only the finance or payroll datasets, thereby allowing some users, who only needed access to one of the datasets, to be assigned to both.</p> <ul style="list-style-type: none"> <li>▪ Ninety-one users, including technical staff and end users, were assigned the transaction code privileges that allowed access to programs not necessary for their job functions.</li> <li>▪ Contractor staff had been granted access to the application source code and administrative privileges to the application and database server and application management server software.</li> <li>▪ Certain application users had an application profile that allowed access to social security administration information not needed for their job classification.</li> <li>▪ A consultant had the capability of approving requisitions.</li> </ul>				
Access Controls	12. Review of Access Privileges	Security managers should review access authorizations and discuss any questionable authorizations with resource owners. Resource owners should periodically review access authorizations for continuing appropriateness.	<ul style="list-style-type: none"> <li>▪ A review of application access privileges was not being performed on a periodic basis to ensure that access privileges remained appropriate and necessary.</li> <li>▪ There was no documentation of a periodic review of user access rights.</li> <li>▪ The security officer assigned user roles based on the employee's supervisor's recommendation, rather than a review of the employee's position description as required by auditee policy.</li> <li>▪ There were no written requirements for data owners to conduct a periodic review of access to the data for which they were responsible.</li> </ul>	15	8	5	13
Access Controls	15. Security Administration Monitoring and Logging Controls	All changes to security access authorizations should be automatically logged and periodically reviewed by management independent of the security function and unusual activity should be investigated.	<ul style="list-style-type: none"> <li>▪ Security tables were not subject to logging and monitoring.</li> <li>▪ Security events were logged but they were not periodically reviewed.</li> <li>▪ The application (and sometimes the database) did not have the functionality to maintain an audit log of security accesses.</li> <li>▪ The system did not provide adequate logging of access privilege changes.</li> <li>▪ The auditee had not implemented periodic reviews of the appropriateness of the security system settings.</li> <li>▪ The history file that contained changes to file permissions, changes to file ownerships, and deletions of files had been inadvertently deleted.</li> <li>▪ Logs of network access modifications made by security administrators did not exist.</li> <li>▪ The security software did not have a logging function available which prevented management from reviewing access modifications made within the security software.</li> <li>▪ The division did not monitor security</li> </ul>	19	6	12	18

**EXHIBIT B (Continued)**

**SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE**

Control Category	Control Technique	Description	Finding Details and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
			<ul style="list-style-type: none"> <li>changes for the application or network.</li> <li>The division did not have security change logs for the application.</li> </ul>				
Access Controls	14. Removal or Adjustment of Former or Resigned Employee or Contractor Access	Inactive accounts and accounts for terminated or reassigned employees and contractors should be disabled, removed, or adjusted in a timely manner.	<ul style="list-style-type: none"> <li>Former or reassigned employees (or contractors) continued to have active e-mail, maintenance, operating system, network, or database accounts.</li> <li>A former employee's user ID was being used by programming staff to run batch programs.</li> <li>Users who had been given temporary update access privileges retained access privileges beyond the time frame necessary.</li> <li>Former employees had their user IDs used beyond their termination date and the auditee was unable to determine what activities were performed.</li> <li>The auditee did not document the date the employees' access privileges were removed from the application.</li> <li>There was no formal or timely process for notifying security administrators of employees leaving employment or changing positions.</li> <li>Auditee policy allowed for employees to access the auditee's network and e-mail for up to 30 days after terminating employment.</li> <li>Terminated employees continued to be defined as active in the network after termination.</li> <li>A contractor continued to have access to the source code library after his access termination request date.</li> <li>User accounts of former employees were not revoked timely and continued to have access beyond their termination dates.</li> </ul>	48	13	28	41
Access Controls	15. Restriction of Access to Sensitive Data	Access to sensitive/privileged accounts should be restricted to individuals or processes having a legitimate need for the purposes of accomplishing a valid business purpose. Password/authentication services and directories should be appropriately controlled and encrypted when appropriate.	<ul style="list-style-type: none"> <li>The auditee collected and used certain employee social security numbers (SSNs) in the application with no specific authorization in law (in some cases as unique identifiers).</li> <li>The auditee did not have a policy or procedure for classification of application data as confidential, sensitive, or public to address requests for employee related nonpublic information; or to address physical security of documents containing nonpublic information.</li> <li>Auditee was inappropriately disclosing SSNs, contrary to State law.</li> <li>Instances were noted where vendor files containing SSNs were not adequately secured.</li> <li>Procedures for monitoring procurement record attachments for confidential information needed improvement.</li> <li>All passwords were stored in clear text.</li> </ul>	22	16	4	20

**EXHIBIT B (Continued)**

**SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE**

Control Category	Control Technique	Description	Findings Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
			<ul style="list-style-type: none"> <li>▪ Security administrators could print a list of users and their respective passwords.</li> <li>▪ User IDs and passwords were distributed in unencrypted e-mail.</li> <li>▪ Steps had not been taken to ensure that staff were aware of policies regarding nonpublic information safeguards.</li> <li>▪ Purchasing agreements and contracts did not contain clear and comprehensive security clauses prohibiting the disclosure of nonpublic information by vendors.</li> <li>▪ There were no procedures to address erasing or destroying electronic media that was to be disposed and some were not completely erased.</li> <li>▪ Accurate documentation regarding surplus computers was not always maintained.</li> <li>▪ Effective security controls had not been established for compact discs containing protected data that were distributed to other entities.</li> <li>▪ The District did not adequately sanitize the hard drives of surplus equipment.</li> </ul>				
Access Controls	16. Transmission Controls	Cryptographic tools should be implemented to protect the integrity and confidentiality of sensitive and critical data and software programs where appropriate. Encryption procedures should be implemented in data communications where appropriate based on risk.	<ul style="list-style-type: none"> <li>▪ Confidential and sensitive information was not adequately protected during transmission to outside entities.</li> <li>▪ Secure transmission was not used when remotely accessing the network and remote access did not go through a firewall.</li> <li>▪ The auditee utilized unencrypted telnet and unencrypted file transfer protocol.</li> <li>▪ Office applications were not encrypted and traffic over the network including transfer of bank accounts and SSNs was not encrypted between the District and Headquarters offices.</li> </ul>	3	2	1	3
Access Controls	17. Monitoring and Logging Controls	An effective intrusion detection system should be implemented, including appropriate placement of intrusion-detection sensors and incident thresholds. An effective process should be established based on a risk assessment to identify auditable events that will be logged. All auditable events, including modifications of sensitive or critical system resources, should be logged. Audit records should contain appropriate information for effective review including sufficient information to establish what events occurred, when the events occurred, the source of the events, and the outcome of the events. Audit records should also be retained long enough to provide support for after-the-fact investigations of security incidents and to meet regulatory and organizational information retention requirements.	<ul style="list-style-type: none"> <li>▪ The auditee had not established appropriate security standards for logging user activity within the application.</li> <li>▪ The auditee lacked the capability to log user activity on the network.</li> <li>▪ Logging was not enabled on the database.</li> <li>▪ Although the auditee logged modifications of sensitive or critical tables, files, and transactions, there was no periodic review of the logs.</li> <li>▪ The tracking list was not always reviewed daily as required.</li> <li>▪ There were no logs documenting the computers for which the hard drives were erased or when and by whom the erasure had been performed.</li> <li>▪ The lack of auditee monitoring and logging reports prevented the auditee from determining if generic user IDs had been used.</li> <li>▪ Application, database, and network</li> </ul>	40	11	17	28



EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding, Results and Issues	No. of Findings	No. of Audit Agencies	No. of Educational Entities	Total No. of Entities
			activity and performance were not monitored. • The console log did not provide sufficient detail to clearly describe the change made or identify the person who made the change. • Audits monitoring procedures did not include monitoring a subscription established application's security policies and controls during the fiscal year. • The auditee was unable to provide documentation showing where employees acknowledged that they had reviewed the system logs for inappropriate activity. • There was no intrusion detection system installed on the production servers and the access and network traffic were not monitored. • There was no notification to IT support staff of repeated unsuccessful access attempts. • The auditee did not monitor or review application security events such as accesses to and modifications of critical tables and files. • Accounts with sensitive privileges did not have the audit flag enabled and the logs that were created were missing certain days' activity. • Oracle database auditing was not enabled and actions taken by the system account were not recorded. • There were no procedures in place regarding monitoring of security events or breaches to the applications or databases. • The Department did not have available logging activated to record the activities of individuals using inherently risky application functions. • Logs identifying invalid access attempts and intruder logons for the network were not periodically reviewed.				
Access Controls	18. Physical Security Controls	Physical security controls should be implemented to restrict physical access to computer resources including: • primary computer facilities • cooling system facilities • network devices such as routers and firewalls • terminals used to access a computer • access to network connectivity • computer file storage areas • telecommunications equipment and transmission lines. Access should be limited to those individuals who routinely need access through the use of guards, identification badges, or entry devices such as key cards. Management should conduct a regular review of individuals with	• Physical access to the computer data center was not always effectively restricted. • Access to the data center was not removed for individuals who had terminated employment. • Sensitive, nonpublic, or proprietary information was stored in an unlocked location. • Documentation did not always support adherence to the policy requirement of at least two employees being present in the vault at all times while it is open. • Access to the server or network room was not restricted to only staff who required access to perform server or network maintenance work. • The Department did not periodically	7	6	0	6

EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding, Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Facilities	Total No. of Entities
		physical access to sensitive facilities to ensure such access is appropriate.	<p>review the appropriateness of physical access privileges to the servers.</p> <ul style="list-style-type: none"> <li>Sixteen key fob or key pad combination assignments were not appropriate.</li> <li>There was a hole in the door above the door knob that was large enough to allow a person to open the door from the inside.</li> <li>Maintenance staff had keys providing unrestricted access to the server room.</li> </ul>				
3. Configuration Management	1. Software Patch Management	<p>An effective patch management process should be documented and implemented, including:</p> <ul style="list-style-type: none"> <li>identification of systems affected by recently announced software vulnerabilities</li> <li>prioritization of patches based on system configuration and risk</li> <li>appropriate installation of patches on a timely basis, including testing for effectiveness and potential side effects on the entity's systems</li> <li>verification that patches, service packs, and emergency fixes were appropriately installed on affected systems.</li> </ul>	<ul style="list-style-type: none"> <li>Systems used versions of software that were no longer supported by the vendor.</li> <li>The auditee's patch management software was not a current version.</li> <li>The anti-virus software that was used on some desktop clients and servers did not have the current patch version installed.</li> <li>The operating system did not have the current patch version installed.</li> <li>The auditee did not require programmers to complete a record of work, including workflow authorization signatures, when implementing patches and updates for system software.</li> <li>Department policy had not been updated to address security patches for the Division's new operating system environment.</li> </ul>	3	4	1	5
4. Separation of Duties	1. Database Controls	Data administration involves planning for and administering the data used throughout the entity. Documented job descriptions should accurately reflect assigned duties and responsibilities and segregation of duty principles. All employees should fully understand their duties and responsibilities and should carry out these responsibilities in accordance with their job descriptions.	<ul style="list-style-type: none"> <li>Policies and procedures had not been provided for database administration responsibilities and activities, and data storage procedures had not been defined.</li> </ul>	3	0	3	3
Separation of Duties	2. Computer Operations Controls	Detailed, written instructions should exist and be followed for the performance of work. Instruction manuals should provide guidance on system operation. Application run manuals should provide instruction on operating specific applications.	<ul style="list-style-type: none"> <li>There were no procedures in place to ensure that all jobs were authorized and scheduled.</li> <li>Auditee staff did not follow established job scheduling procedures resulting in discrepancies in balances on the general ledger master file.</li> </ul>	2	2	0	3
5. Contingency Planning	1. Environmental Controls	Fire detection and suppression devices should be installed and working (smoke detectors, fire extinguishers, and sprinkler systems). Controls should be implemented to mitigate other disasters (floods, earthquakes, terrorism). Building plumbing lines should not endanger the computer facility. A UPS or backup generator should be provided. Humidity, temperature, and voltage should be controlled.	<ul style="list-style-type: none"> <li>A fire suppression system was not installed at the data center.</li> <li>The data center had a wet pipe fire suppression system with water pipes directly over IT equipment.</li> <li>The division server room did not have raised floors or water detectors.</li> <li>The temperature and humidity in the server room were not monitored.</li> <li>There was no automatic monitoring of the air conditioning and it was not on a separate circuit.</li> </ul>	4	1	3	4

EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entries
			<ul style="list-style-type: none"> <li>The fire extinguishers had a last recorded maintenance date of May 2005 and December 2000.</li> </ul>				
Contingency Planning	2. Performance Management	Records should be maintained on the actual performance in meeting service schedules. Problems and delays encountered, the reasons, and the elapsed time for resolution should be recorded and analyzed to identify recurring patterns or trends. Senior management should periodically review and compare the service performance achieved with the goals and surveys of user departments to see if their needs are being met.	<ul style="list-style-type: none"> <li>The auditors did not log, monitor, or review performance of the application.</li> <li>The auditors did not log, monitor, or review performance of the database.</li> <li>The auditors did not log, monitor, or review performance of the network.</li> </ul>	2	0	2	2
Contingency Planning	3. Contingency Plan: Development, Modification, and Testing	<p>A contingency plan should be documented that:</p> <ul style="list-style-type: none"> <li>is based on clearly defined contingency planning policy</li> <li>reflects current conditions, including system interdependencies</li> <li>has been approved by key affected groups, including senior management, information security and data center management, and program managers</li> <li>clearly assigns responsibility for recovery</li> <li>includes detailed instructions for restoring operations</li> <li>identifies the alternate processing facility and the backup storage facility</li> <li>includes procedures to follow when the data/service center is unable to receive or transmit data</li> <li>identifies critical data files</li> <li>is detailed enough to be understood by all entity managers</li> <li>includes computer and telecommunications hardware compatible with the entity's needs</li> <li>includes necessary contact numbers</li> <li>includes appropriate system-recovery instructions</li> <li>has been distributed to all appropriate personnel</li> <li>has been coordinated with related plans and activities.</li> </ul> <p>The contingency plan should also be periodically tested under conditions that simulate a disaster.</p>	<ul style="list-style-type: none"> <li>The auditors' security over backup tapes being transported off-site was deficient, or the off-site facility was too close to the data center.</li> <li>The disaster recovery plan did not address key elements such as prioritization of critical operations and data, provisions for backup personnel, allowable outage times before activating the alternate site, procedures to follow when the regional data center is inoperable, what responsibilities were assigned to the Recovery Team, and what supplies, forms, and support equipment would be needed at the alternate site.</li> <li>The alternate site was within close proximity to the data center and a second alternate site was not addressed.</li> <li>The disaster recovery plan had not been tested, or all critical applications had not been tested.</li> <li>The IT disaster recovery plan was in draft form and had not been officially adopted, or had not been fully implemented.</li> <li>Sole responsibility for disaster recovery was the responsibility of one individual without a named alternate.</li> <li>The disaster recovery plan had not been updated to include current software, hardware, processes, and procedures.</li> <li>The disaster recovery plan was not a comprehensive, management-approved document prepared based on the identification of disaster or disruption scenarios, criteria to initiate the recovery process, and recovery strategies.</li> <li>The auditors' signed agreement with the regional data center did not include the regional data center's commitment to resume services within two weeks of disruption of service or other responsibilities.</li> <li>Backup images were copied to tape only once a week and cycled off-site, hampering the Department's ability to</li> </ul>	20	6	14	20

EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Findings, Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
			<p>completely recover lost data by using the off-site backup tapes.</p> <ul style="list-style-type: none"> <li>▪ The disaster recovery plan had not been updated to reflect current staff or current backup operating procedures.</li> <li>▪ The Department did not have a Departmentwide disaster recovery plan that included procedures for annual testing and applied to all critical Department IT resources.</li> </ul>				
6. Application Level General Controls	1. Application Program Change Controls	<p>Entities need to proactively manage changes to system environments, application functionality, and business processes to reasonably assure financial data and process integrity. Entities should restrict and monitor access to program modifications and changes to configurable objects in the production environment. Most application configuration changes are managed using a staging process. The staging process allows the entity to develop and unit test changes to an application within the development environment, transport the changes into a quality assurance environment for further system and user acceptance testing and, when the tests have been completed and the changes are approved, transport the changes into the production environment.</p>	<ul style="list-style-type: none"> <li>▪ Programming staff did not follow established policies and procedures.</li> <li>▪ No mechanism to detect and log program changes being moved to production.</li> <li>▪ Program change requests lacked documentation to substantiate that the changes made were appropriately authorized, tested, and approved for implementation.</li> <li>▪ Programs were programmed, tested, and moved by the same person.</li> <li>▪ Programmers had access to production code and the production job schedule.</li> <li>▪ Users had update access to production code.</li> <li>▪ The work order status was not closed for completed change requests.</li> <li>▪ There was no supervisory review to ensure required approvals were in place.</li> <li>▪ Change control standards and manuals were outdated.</li> <li>▪ A user acceptance test environment did not exist.</li> <li>▪ Documentation of independent testing could not be provided.</li> <li>▪ Procedures did not require that program changes moved to production be logged, reviewed, or monitored by supervisory staff.</li> <li>▪ The development software did not provide the capability to retain historical logs of program changes.</li> <li>▪ The auditee had not activated the design lock feature to preclude concurrent development of the same program.</li> <li>▪ Development software did not control developer's access to data.</li> <li>▪ Change management procedures lacked provision for approvals of emergency changes and minimal ad hoc changes.</li> <li>▪ Testing program changes was performed in the production environment.</li> <li>▪ There was no Information System Development Methodology.</li> <li>▪ The auditee did not require programmers to complete a record of work, including work flow authorization signatures, when implementing configuration changes or database upgrades.</li> </ul>	45	14	14	28

EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Finding Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
			<ul style="list-style-type: none"> <li>The software development plan did not document the roles of some project staff and had not been updated to reflect changes in project staff that had occurred.</li> </ul>				
Application Level General Controls	2. Documentation Controls	Documentation should be updated when a new or modified system is implemented.	<ul style="list-style-type: none"> <li>Flow and management of data have not been documented for certain system functions, including financial, payroll/personnel, and student applications.</li> <li>The Division had not developed application user documentation.</li> <li>There were no user manuals, diagrams, or system documentation for the application.</li> </ul>	3	1	1	2
7. Business Process Controls	1. Input Controls	Appropriate edits should be used to reasonably assure that data are valid and recorded in the proper format. Procedures should also be established to reasonably assure that all inputs into the application have been accepted for processing and accounted for and any missing or unaccounted for source documents or input files have been identified and investigated. The procedures should specifically require the exceptions be resolved within a specified time period.	<ul style="list-style-type: none"> <li>Auditee scanning and indexing guidelines did not include provisions for supervisory or independent review of information scanned and stored in the application.</li> <li>The scanner used to input documents into the application automatically assigned document numbers thus providing a total count of documents scanned, but staff did not perform record counts prior to scanning and were unable to compare the quantity of documents processed to the system count.</li> <li>The auditee did not require adequate authentication of the data submitted on a payment form for vendors which resulted in a fraud perpetrated by a third party.</li> <li>There was no standardization for addresses in the application database.</li> <li>When group services were provided, the services for the customers within the groups were not being entered into the application.</li> </ul>	5	4	0	4
Business Process Controls	2. Transaction Data Processing Controls	Application processing of input data should be automated and standardized. System entities should use transaction logs to reasonably assure that all transactions are properly processed and to identify the transactions that were not completely processed. Transactions with errors should be rejected or suspended from processing until the error is corrected.	<ul style="list-style-type: none"> <li>The auditee did not timely address processing errors resulting from the daily data upload process.</li> <li>There was not an automatic address cross-match between entities to determine if any sexual predator or offender addresses were in the application database.</li> <li>The auditee did not fully utilize all the functional capabilities available in the system and continued to rely on workarounds and alternate systems in lieu of system functionality.</li> <li>The salary refund calculation of net pay contained a programming error.</li> <li>Deficiencies continued to exist in the 2008 tax rate calculation process.</li> <li>A programming error existed within the approval process for compromise waivers.</li> </ul>	6	5	0	5

EXHIBIT B (Continued)

SUMMARY OF IT AUDIT FINDINGS  
BY CONTROL CATEGORY AND TECHNIQUE

Control Category	Control Technique	Description	Findings Results and Issues	No. of Findings	No. of State Agencies	No. of Educational Entities	Total No. of Entities
Business Process Controls	3. User Controls	Periodic reconciliations should be performed and exceptions should be appropriately handled.	<ul style="list-style-type: none"> <li>▪ There were no procedures requiring monthly reconciliations between the audited system and FLAK.</li> <li>▪ The audited system's consolidated data was not analyzed for potential overpayments.</li> <li>▪ There was no formal review by management to ensure that changes or overrides to certain application controls had been made in accordance with established State law.</li> <li>▪ The auditee lacked reconciliation procedures.</li> <li>▪ The auditee did not consistently document the release of output data tapes to other entities.</li> <li>▪ Claims were not reviewed in a timely manner.</li> <li>▪ Reports included misstatements or incorrect calculations.</li> <li>▪ Exception reports were not reviewed by the appropriate administrative staff.</li> <li>▪ There was no control in place to prevent a failed input file from being deleted before the file was reloaded by the assigned staff.</li> <li>▪ Effective procedures for the review of the corrections of errors on the failed file did not exist to ensure that the errors were followed up on.</li> </ul>	13	8	1	9
8. Interface Controls	7. Data Exchange Controls	Procedures should include a complete list of interfaces to be run, the timing of the interface processing, how it is processed and how it is reconciled. A positive acknowledgement scheme should be used to ensure that files sent from a source system are received by the target system. The files generated by an application interface should be properly secured from unauthorized access and/or modifications.	<ul style="list-style-type: none"> <li>▪ Although data exchange errors were generated, they were deleted after seven days if not addressed.</li> <li>▪ The auditee did not retain documentation evidencing that data had been requested at least quarterly.</li> <li>▪ The auditee had not negotiated an agreement with another entity for the provision of data at needed intervals.</li> </ul>	2	2	0	2
9. Data Management System Controls	2. Transaction History Logging	Logging and monitoring controls should be in place at the data management system level that effectively satisfies requirements to accurately identify historical system activity and data access.	<ul style="list-style-type: none"> <li>▪ Transaction logging was either not in place within several applications or data logs only recorded the most recent user ID, date updated, and panel updated, but did not record the actual data fields changed.</li> <li>▪ Although changes to data files were recorded, the information was not reviewed.</li> <li>▪ Updates to datasets were not logged by the system to establish responsibility for such changes and to allow for proper monitoring and review.</li> </ul>	3	2	1	3
<b>TOTAL FINDINGS</b>				613			