

AUDIT REPORT

Oregon State Lottery: Administrative Expense Audit



Bill Bradbury, Secretary of State
Cathy Pollino, Director, Audits Division

Summary

PURPOSE

This audit was conducted to identify opportunities for the Oregon State Lottery (Lottery) to reduce the use of public funds for Lottery's administrative expenses. Any reductions in administrative expenses could increase the amount of funds available for other public purposes, such as creating jobs, furthering economic development, and financing public education.

BACKGROUND

The Oregon State Lottery Commission was created in 1984 to establish and operate the Lottery. Lottery's mission is to "operate a Lottery with the highest standards of security and integrity to earn maximum profits for the people of Oregon commensurate with the public good." All proceeds from the Lottery, excluding the costs of administration and payment of prizes, is to be used for creating jobs, furthering economic development, financing public education or restoring and protecting Oregon's parks, beaches, watersheds and critical fish and wildlife habitats.

RESULTS IN BRIEF

Although Lottery's administrative expenses include costs related to revenue generation, such as retailer commissions, we limited our audit to those expenses for which Lottery management sets policy and over which it has direct control. Our audit focused on approximately \$1.6 million of Lottery's 2001 administrative expenses and other additional expenses that came to our attention during the course of the audit.

Lottery is not subject to many of the purchasing, budgeting, and personnel rules that other state agencies are required to

follow. In addition, Oregon law does not set a meaningful limit on the amount of Lottery generated revenues that Lottery can spend on administrative expenses.

We found that Lottery could reduce its use of public funds on administrative expenses in various areas including Lottery's meetings, training, travel, cellular phones, Employee Recognition Program, Community Relations Program, and leave reporting for partial-day absences, thus making these funds available for other public purposes. We identified approximately \$219,000 in expenses that could have been avoided and an additional \$573,000 in expenses where Lottery might have realized further cost reductions. Furthermore, we questioned whether certain types of expenses were necessary and reasonable for Lottery to achieve its mission of earning maximum profits for the people of Oregon.

RECOMMENDATIONS

It is imperative that Lottery management establish the appropriate tone in its organization for how it uses public resources and ensure that expenses made are economical and are reasonable and necessary to fulfill Lottery's mission of earning maximum profits for the people of Oregon. To accomplish this, we recommend Lottery management implement the recommendations in this report.

AGENCY'S RESPONSE

Although Oregon State Lottery management agrees with some of the recommendations, they disagree with other recommendations. The full text of Lottery's response is included in the back of this report.

Introduction

The Oregon State Lottery Commission (Commission) was created through the initiative process by an amendment to the Oregon Constitution in 1984. The Commission was created to establish and operate the Oregon State Lottery (Lottery) and is comprised of five members appointed by the governor and confirmed by the Senate. The governor also appoints a director, subject to confirmation of the Senate, who is responsible for

operating the Lottery pursuant to the rules and under the guidance of the Commission. The Commission meets with the director not less than monthly to make recommendations and set policy, to approve or reject reports of the director, to adopt rules and to transact other business.

The Lottery's mission is to "operate a Lottery with the highest standards of security and integrity to earn maximum profits for the people of Oregon commensurate with the public good." All proceeds from the

State Lottery, excluding costs of administration and payment of prizes, is to be used for creating jobs, furthering economic development, financing public education or restoring and protecting Oregon's parks, beaches, watersheds and critical fish and wildlife habitats. In order to carry out its mission, Lottery employs more than 400 employees.

Lottery is exempt from some state purchasing, budgeting, and personnel rules that other agencies

are required to follow. In these cases, Lottery is allowed to set operating policy. For example, Lottery is exempt from following state travel regulations and has established its own travel policy.

State law specifies that Lottery should not spend more than 16 percent of total annual revenues on expenses. Total annual revenues include the cash that players put into traditional games and video poker, and the winnings played. For example, a player inserts \$10 into a video poker machine and during the course of play wins \$30 in computer credits but continues to play until all the credits are used up. Lottery reports the \$10 cash and the \$30 in credits (winnings played) for a total of \$40 in revenue even though the actual cash received from the player was only \$10.

For fiscal year 2001, total annual revenues (including winnings played) were approximately \$7.63 billion. Actual cash received totaled approximately \$1.50 billion. Using total annual revenues, the 16 percent administrative expense limitation would be approximately \$1.22 billion, which exceeds the actual cash received after paying out prizes. Because winnings played are included in total annual revenues, the statutory 16 percent limitation does not set an effective administrative expense limit.

Lottery management indicated that the Commission has set an administrative expense target for Lottery of 4 percent of total annual revenues. For fiscal year 2001, the 4 percent target was approximately \$305 million. Lottery spent approximately \$252 million, or 3.3%, of the total annual revenues on administrative expenses during the year. Lottery administrative expenses include all costs incurred in the operation and administration of the Lottery.

Audit Results

According to state policy, employees authorizing expenses of public funds are responsible for the “good judgment” and “lawfulness” of the expenses. Expenses are to be for authorized purposes (purchases that will further the business of the State) and are to be a responsible and appropriate use of public funds.

Oregon law states that the Lottery shall be operated to produce the maximum amount of net revenues to benefit the public purpose for which Lottery was created, commensurate with the public good. To accomplish this purpose, Lottery management needs to further ensure that expenses are an economical and efficient use of public resources, and are reasonable and necessary. In addition, Lottery management should reiterate to all its employees the importance of fiscal accountability so that maximum profits may be provided for those public purposes for which the Lottery was created.

We identified approximately \$219,000 in administrative expenses that could have been avoided and instead made available for other public purposes, such as creating jobs, furthering economic development and financing public education. We also identified an additional \$573,000 where Lottery might have realized further cost reductions. Lottery should reevaluate whether certain types of expenses identified in this audit are reasonable and necessary to serve Lottery’s mission of earning maximum profits for the people of Oregon.

Expenses reviewed fall into the following categories: meetings, training, travel, cellular phones, Employee Recognition Program, and Community Relations Program. According to Lottery’s records, it had expenses of at least \$1.6 million in these areas for calendar year 2001. In addition, we reviewed any

additional expenses that came to our attention during the course of our audit and Lottery’s practices for leave reporting for partial-day absences. Each of the areas reviewed is discussed in detail in the remainder of our report.

Lottery Meeting Expenses Could Be Reduced

Lottery conducts meetings in the course of its everyday business both at Lottery headquarters and various off-site locations. We found that Lottery could better use public resources by reducing meeting expenses in the areas of meals and refreshments, annual staff meetings and retreats, and off-site meeting room rentals.

Meals and Refreshments

Lottery has not established formal policy addressing non-travel meals and refreshments. Lottery’s practice is to provide for or reimburse employees for these expenses. Lottery management stated that snacks may be provided at any meeting (on- or off-site) when the Lottery requests employees to work through the break period. In addition, snacks, lunch, or dinner also may be provided when meeting off site if there are no alternatives for meals within a reasonable distance.

During calendar year 2001, Lottery recorded more than 400 meeting expense transactions, totaling approximately \$92,500. Expense transactions varied in amount and type and could represent one or more meetings, or a reimbursement to staff for various meeting expenses. We reviewed the 10 largest meeting expense transactions, selected a random sample of 33 of the remaining transactions, and reviewed other meal and refreshment expenses that came to our attention.

Of the 43 selected transactions reviewed, 28 transactions

(65 percent) included expenses for meals or refreshments. The 43 transactions totaled \$29,439, which included \$15,788 for food expenses. In addition to these selected transactions, we noted other instances of meal and refreshment expenses throughout the course of the audit. For example, we found 14 calendar year 2001 petty cash expenses related to food for meetings.

Lottery could reduce its administrative expenses by limiting the amount it spends in this area. Examples of meal and refreshment expenses noted during our review include:

- \$8,022 for catering charges when using off-site meeting rooms (also see off-site meeting room rentals on page 4).
- \$2,640 estimated for weekly staff meetings. One department held weekly meetings in Portland with an average of eight employees in attendance. The meeting location was convenient to department employees and the location itself was not an expense to Lottery. Refreshments, however, were purchased for every meeting, and the department manager stated that meetings were rarely cancelled. We reviewed expenses related to 18 of these department meetings and found the average cost for food to be \$66 per meeting. We conservatively estimate an annual expense of \$2,640 (\$66 x 40 weeks).
- \$206 for refreshments for one quarterly management team meeting. This included 60 individual fruit trays, with a total cost of \$165.
- \$241 for a lunch at DaVinci's restaurant in Salem. The purpose of the lunch was for Lottery's annual meeting committee to hold a debriefing session and to buy lunch for the 14 team members as a thank you for their hard work.

- \$171 for nine lunches and desserts at Tony Roma's for an Information Technology department "network backbone celebration".¹

We recommend that Lottery management reduce expenses for non-travel meals and refreshments, and develop and implement a policy that limits the instances in which public funds can be used for this purpose.

Agency's Response:

Lottery management disagrees with the audit recommendation. See page 14 for Lottery's response.

Annual Meetings and Retreats

Another area where Lottery could better use public resources is Lottery's annual staff meetings and retreats.

In 2001, Lottery spent at least \$38,000 on its annual staff meeting, which included the following expenses that, collectively, appear excessive:

- A keynote speaker fee of \$20,000, plus \$3,494 for travel and accommodations. The topic of the presentation was "Beep Beep: Competing in the Age of the Roadrunner." The presenter spoke for a total of three hours over two days. Speaker fees equate to a cost of \$6,667 an hour.
- An additional speaker fee of \$6,000, plus \$600 for travel expenses, to speak for a total of three hours.
- Approximately \$1,000 for candy, prizes, and decorations. Decorations were themed to the 1950s and included garlands, cardboard posters, buttons, plastic hamburger yo-yos, fuzzy dice, dashboard hula girls,

princess crowns, and an Elvis Presley figure.

Lottery also spent public funds on staff retreats. Examples of retreat expenses include:

- \$2,319 for a two-day staff retreat for 17 employees in Lincoln City, Oregon. Expenses included lodging, meeting rooms, meals/snacks, gratuity, phone calls, and private vehicle mileage. The retreat included two overnight stays for three employees (who live in Bend, Medford and Grants Pass) and one overnight stay for each of the remaining 14 employees. We estimate that Lottery could have saved at least \$1,720 if the training had been held at Lottery headquarters in Salem.
- \$2,503 for one day of food provided at another department retreat. This included 125 breakfasts and buffet lunches, sodas, and cookies. The vendor that rents the site required the use of a certain catering company when food is provided. Because the site was conveniently located near food services, however, it is reasonable that participants could have consumed a meal and returned within one hour. Consequently, we question the lunch expense, as well as the need for breakfast to be provided. Questionable expenses total \$1,862.

We recommend that Lottery management significantly decrease expenses for Lottery's annual meetings and retreats.

Agency's Response:

Lottery management generally disagrees with the audit recommendation. See page 15 for Lottery's response.

¹ A backbone is a computer term referring to a larger transmission line that carries data gathered from smaller lines that interconnect it.

Off-Site Meeting Room Rentals

Lottery could further reduce its administrative expenses by not renting off-site meeting rooms. Lottery management has stipulated that off-site meeting rooms can be used when focused time is needed or to limit distractions commonly present at the main office. The Lottery building has 13 meeting rooms of various sizes; the largest area can accommodate up to 100 people. In addition, other state agency meeting rooms, which can accommodate from 10 up to 175 people, are available for use at no charge.

We reviewed 31 invoices that included expenses for off-site room rentals and found that, during 2001, Lottery spent at least \$6,340 for off-site meeting room rentals and supplies that may have been avoided. At least seven of the meetings in question were for six or fewer attendees. For example, Lottery paid \$100 for an off-site meeting room for four employees to discuss certification requirements for video lottery terminals. Paying for the use of off-site meeting rooms is not a prudent use of public funds, given the availability of rooms at Lottery headquarters and at other state agencies at no cost.

We recommend that Lottery management reduce the number of off-site meetings by further utilizing Lottery headquarters or other state agencies that provide meeting sites at no cost.

Agency's Response:

Lottery management generally agrees with the audit recommendation. See page 15 for Lottery's response.

Training Expenses Could Be Reduced

According to Lottery management, Lottery provides employee training to improve job skills, morale and

productivity, as well as maintain professional certifications and licenses for some of its employees. We found that Lottery could better use public funds if it only paid for training that directly relates to Lottery's mission and if it were to obtain speakers and other training at more economical rates.

As part of its training program, Lottery has developed an Education Assistance Program. The program financially assists employees pursuing qualified certificate and certification programs, individual accredited college courses, and accredited degree programs. Lottery reimburses employees for books and tuition expenses equal to the Oregon in-state tuition rate. Although not specifically mentioned in Lottery's training policy, management indicated that it does not allow for reimbursement of religious classes, but does allow for reimbursement of other elective courses.

In comparison with other state agencies, Lottery spends significantly more money per employee on training. According to a Department of Administrative Services state training manager, a training survey was performed of 29 state agencies, representing about 26,000 employees, to determine expected training expenses for the 2001 to 2003 biennium. Nine of the agencies, representing about 8,100 employees, provided expected training costs based on a dollar amount per employee per year. The survey indicated that these agencies expect to spend an average of \$602 per employee per year for training in the 2001 to 2003 biennium. During 2001, Lottery recorded more than \$658,000 for training expenses and had approximately 425 employees for an average training expense of approximately \$1,550 per employee. If Lottery used the projected training amount of \$602 per employee, it could have reduced its training expenses by about \$402,000.

We recommend that Lottery management reduce the average amount spent per employee on training.

Agency's Response:

Lottery management disagrees with the audit recommendation. See page 16 for Lottery's response.

Auditor Comment:

Lottery staff provided to us the support for the figures cited in Lottery's response. In its response, Lottery compares itself to five of the 86 agencies it surveyed and stated that the actual training costs for these five agencies were comparable to Lottery's. These figures were flawed, however, in that they included travel costs, dues and memberships, which were not included in Lottery's \$1,550 average training cost per employee. Lottery also failed to note in its response that its survey found the average amount spent on training for all 86 agencies to be \$515, again including travel costs, dues and memberships not included in Lottery's average.

Training Unrelated to Lottery's Mission

Lottery's mission is to maximize net revenues, which are used to benefit public programs for the people of Oregon. Lottery could further reduce its training expenses by paying for only courses directly relating to its mission. Examples of training unrelated to Lottery's mission include the following:

- Lottery reimbursed one employee for a Fundamentals of Acting class and another employee for an Introduction to Rock Music class. Classes such as these do not appear to directly relate to Lottery's mission.
- Lottery spent \$3,600 to send one employee to interior design school. Although the employee's position description requires him to respond to requests for visual improvements in the Lottery building, we question whether

this training was necessary for him to perform his job duties and whether the training was necessary to Lottery's mission.

- Lottery purchased tickets totaling \$200 for an assistant director to attend an International Speaker Series that included four speeches by international figures. The topics of the speeches were foreign policy; for example, one speech was titled "Peace of the Brave: Prospects for the Middle East." It is not clear how speeches on foreign policy relate to Lottery's mission of maximizing profits for Oregon public programs.

We recommend that Lottery management reevaluate its policy of reimbursing employees for training courses that do not directly support Lottery's mission.

Agency's Response:

Lottery management generally agrees with the audit recommendation. See page 17 for Lottery's response.

More Economical Rates Available

A review of calendar year 2001 training expenses showed that some of Lottery's seminars and speakers could have been obtained at more economical rates. Examples include the following:

- Lottery contracted with one company that charged \$99,794 for eight days of training on Difficult Conversations and Negotiation Skills. Information provided by other agencies indicated that similar training could be obtained at significantly lower rates. Based on this information, we estimate that Lottery could have obtained similar training for approximately \$10,000, resulting in a savings of almost \$90,000.
- Lottery paid \$18,409 for registration fees and travel expenses for one employee to

attend a series of five out-of-state technical training classes from March to October 2001. According to the sponsoring organization's IT training advisor, all five classes were offered as interactive web-based instruction seminars during this period. Lottery could have saved \$2,400 in registration fees and \$7,234 in travel expenses if the employee had taken the interactive course on-line.

We recommend that Lottery management obtain speakers and training at more economical rates.

Agency's Response:

Lottery management disagrees with the audit recommendation. See page 17 for Lottery's response.

Auditor Comment:

Lottery's response states that only one of the five classes noted above was available on-line; however, we verified with the sponsoring company that all five classes were available as on-line courses beginning January 2001.

Travel Expenses Could Be Reduced

Lottery employees travel both in state and out of state for training, conferences, and site visits, or to conduct official Lottery business. Lottery pays for or reimburses employees for these travel expenses. Managers of traveling employees are responsible for reviewing and approving travel requests, and determining the reasonableness of all travel-related expenses.

Lottery is exempt from following state travel rules that other agencies must abide by. Instead, Lottery management has established a travel policy that differs from the state rules. For example, Lottery employees are reimbursed for reasonable and actual expenses when traveling out of state, rather than limiting expenses to a travel per diem amount.

We reviewed the employees with the 10 highest total travel expenses for calendar year 2001, and other expenses that came to our attention. We found that Lottery could better use public resources by reducing travel expenses in the areas of first-class airfare, rental vehicles, group travel, lodging and meal expenses, and personal mileage reimbursements.

First Class Airfare

Lottery could reduce its travel expenses by not paying for first class airfare. Lottery paid first class airfare on numerous occasions for two employees traveling on official state business. From October 2000 through October 2001, the two employees flew first class on 12 occasions, collectively, with airfare expenses totaling \$27,904. Coach air travel for these trips would have cost approximately \$9,036, a difference of \$18,868.

Based on information received from the travel coordinators of four state agencies representing about 15,000 FTEs, none booked first class airfare for any employees.² In instances when a state employee has special travel needs due to a physical disability, coach reservations have been made and a bulkhead aisle seat requested. Bulkhead aisle seats, located directly behind first-class seating, provide more room for easy access and maneuverability and may be requested up to 24 hours in advance of the flight leaving.

The American with Disabilities Act (ADA) and the Air Carrier Access Act of 1986 require reasonable accommodations to be provided to persons with a disability. According to the Air Carrier Act, air carriers are required to make certain provisions; for example, all air carriers must have aisle seats that have moveable armrests to allow access for people with disabilities.

² Full-time equivalent (FTE) is used to describe a unit equal to a fulltime position for one year.

Neither act explicitly states that air carriers are required to provide first class accommodations to people with disabilities.

In addition, the Oregon Accounting Manual, which other state agencies are required to follow, specifies that all air travel for state employees will be coach class and that there are no exceptions. If an employee travels by first class, he or she is required to pay for the difference from personal funds.

We recommend that Lottery management require all Lottery employees to fly coach class unless the difference is paid for from the employees' personal funds.

Agency's Response:

Lottery management disagrees with the audit recommendation. See page 18 for Lottery's response.

Use of Rental Vehicles

Lottery's travel policy states that employees are responsible for identifying and using efficient and cost-effective methods of travel. Although Lottery management approved payment for all rental vehicle expenses reviewed, we found that employees on business travel rented vehicles when other more cost-effective options were available, such as taxis or shuttles. In addition, Lottery could have avoided hotel-parking charges.

We estimate that Lottery could have saved approximately \$1,570 had employees utilized more cost-effective rental options. Some examples include the following:

- An employee rented a vehicle for two days to drive 27 miles while on an out-of-state Lottery business trip. The airport was approximately 15 miles from the hotel where the employee stayed. Taxi service was available for about \$42 round trip from the airport to the hotel. The total cost for the rental was \$120. The employee also paid \$17 for hotel parking.

- An employee rented a vehicle while attending an out-of-state conference. The vehicle was rented for four days and driven a total of 44 miles. Total expenses were \$269, which included \$48 for hotel valet parking. Taxi service was available for about \$40 roundtrip from the airport to the hotel. In addition, the conference site had eating facilities and other restaurants were within two to three blocks of the hotel.
- An employee attended out-of-state training and rented a vehicle for six days. Total expenses were \$411, which included \$6 for hotel parking. Total miles driven were 85. Taxi service was available from the airport to the hotel for about \$30 roundtrip. The training location was approximately two blocks from the hotel where the employee stayed and several restaurants were within walking distance.
- An employee rented a four-wheel drive sport utility vehicle for five days. In addition to paying \$90 a day for the rental, the employee did not return the vehicle with a full tank of gas and was charged an extra \$99 (\$4.40 per gallon). The total cost was \$633. The employee could have rented a mid-size or full-size vehicle for approximately \$339.
- Employees rented sports utility vehicles in three instances when a less expensive vehicle could have been rented. Rental cost for these vehicles ranged from \$60 to \$99 per day. Total cost to Lottery for these three instances was \$729. Rental of less expensive vehicles would have cost approximately \$570.

We recommend that Lottery management:

- Ensure that employees use alternative cost-effective transportation (e.g., shuttles and taxis) when available.

- Further define its policy to include the type and size of rental vehicles to be used.

Agency's Response:

Lottery management agrees with the audit recommendation. See page 18 for Lottery's response.

Group Travel

Lottery could better use public resources by reducing group travel expenses. Other state agencies are required to follow the Oregon Accounting Manual, which states, "agencies shall limit the number of officers and employees attending the same out-of-state business meeting, and to the extent possible, develop information sharing for reporting and other aspects that have benefits to more than one person and/or agency." Lottery has not addressed group travel in its travel policy and, as a result, may not be experiencing the cost savings it could in this area.

From October 2000 through January 2002, we noted the following seven instances in which Lottery sent four or more employees to the same out-of-state business meetings or conferences; total expenses for these seven trips were \$60,468. Lottery could have reduced costs if it had limited the number of employees traveling. If Lottery had sent just one less employee in each of the following seven instances, it could have reduced travel expenses by approximately \$11,300.

- In January 2002, five employees traveled to New Jersey and Rhode Island. The employees were a project team whose objective was to observe computer systems at two different lotteries in a live environment. While some of the team members had no exposure to the system, others had exposure but wanted to view the most recent version of the system. Total travel expenses for the three-day trip were \$7,404, an average of \$1,481 per employee.

- In October 2001, four Marketing employees traveled to Chicago for a three-day promotional marketing conference. Total travel expenses were \$10,871, an average of \$2,718 per employee.
- In June 2001, four employees flew to Vancouver, British Columbia for one day and then to Olympia, Washington on the second day to discuss training programs with lottery officials at those locations. The itinerary included a list of questions for discussion, such as how often retailers are trained and what types of training materials are used. Total travel costs were \$3,227, an average of \$807 per employee.
- In April 2001, seven employees traveled to Salt Lake City for a one-day trip for a negotiation meeting related to the purchase of video lottery terminals. Three employees continued to Chicago for another one-day meeting where another employee traveling from Portland to Chicago joined them. Total travel expenses were \$9,149, an average of \$1,144 per employee.
- In January 2001, eight employees flew to Bozeman, Montana to review video lottery terminals for potential purchase. Five of the employees stayed for two nights and the other three employees stayed one night. Total travel expenses were \$4,287, an average of \$536 per employee.
- In January 2001, six employees traveled to Boca Raton, Florida over a six-day period to meet with Lottery's video lottery contractor and perform video game software testing. Total travel expenses were \$15,945, an average of \$2,658 per employee.
- In October 2000, five employees traveled to Montreal, Canada for a meeting with Lotto Quebec officials to discuss the potential purchase of video lottery terminals. Total travel expenses

for the two-day trip were \$9,586, an average of \$1,917 per employee.

We recommend that Lottery management develop and implement a policy to limit the number of employees traveling to the same location for the same project, meeting, or conference.

Agency's Response:

Lottery management disagrees with the audit recommendation. See page 18 for Lottery's response.

Lodging and Meal Expenses

Another area in which Lottery should reevaluate and reduce travel expenses is the area of lodging and meal expenses. Lottery has set its own travel policy, which requires that employees be reimbursed for "actual and reasonable" expenses for out-of-state business travel. Lottery policy specifies, "a reasonable expense is one that is common and necessary to conduct the business of the Lottery, at a cost that is not excessive, lavish, or extravagant, as determined by Lottery management and this policy." The policy also cites the Internal Revenue Service's explanation of lavish or extravagant expenses, which includes, "an expense is not considered lavish or extravagant if it is reasonable based on the facts and circumstances. Expenses will not be disallowed merely because they are more than a fixed amount or take place at deluxe restaurants, hotels, nightclubs, or resorts."

We reviewed 50 out-of-state employee business trips. We used the federal per diem rates for lodging and meals, which other state agencies are required to follow, as a benchmark for reasonable rates with which to compare Lottery's travel expenses. We excluded instances when an employee stayed at the same facility where the conference or meeting was held; in these cases, the expenses were considered to be

reasonable even if the federal per diem rate was exceeded.

In 15 instances, Lottery's reimbursement to employees for out-of-state trips exceeded the federal per diem allowances for lodging and meal expenses for a total of \$4,387.

For example, four employees stayed six nights in Boca Raton, Florida. Their reimbursements for lodging and meals averaged \$222 per day, whereas the federal per diem was \$151 per day. Other lodging facilities located nearby offered accommodations that had wheelchair accessibility and were within the federal per diem rate. Actual expenses for the six days exceeded federal per diem rates by a total of \$1,695. When asked why the employees had stayed at the particular hotel, a Lottery travel coordinator stated that Lottery employees stayed there before and liked it.

We recommend that Lottery management adopt a policy that limits out-of-state meal and lodging expenses to a per diem amount.

Agency's Response:

Lottery management disagrees with the audit recommendation. See page 19 for Lottery's response.

Personal Vehicle Mileage Reimbursement

During calendar year 2001, Lottery maintained four fleet vehicles that were available for Lottery employees' use for local travel while on official business. When Lottery-owned vehicles are unavailable, employees can request vehicles from the State Motor Pool, which is located next door to Lottery's headquarters. Lottery Vehicle Policy and Procedures Manual states that employees are to use Lottery vehicles for business travel unless using a personal vehicle is more practical due to cost, efficiency, work, or other requirements.

From December 2000 through March 2002, Lottery could have saved a total of \$1,561 had it not paid for personal mileage reimbursements as a Lottery owned or state motor pool vehicle was available. In the 21 instances identified for five employees, the trips originated and ended in Salem, the employees' official workstation. In addition, in these instances, Lottery's supporting documentation did not indicate that use of a personal vehicle was necessary for efficiency or work requirements.

We recommend that Lottery management ensure that employees use Lottery-owned vehicles when available for local business travel.

Agency's Response:

Lottery management disagrees with the audit recommendation. See page 19 for Lottery's response.

Cellular Phone Expenses Could Be Reduced

During calendar year 2001, approximately 220 Lottery employees utilized a Lottery-owned cellular phone to facilitate their job responsibilities. The majority of the phones were assigned to service technicians and sales representatives. We found that Lottery could reduce expenses for cellular phone plans and improve its review process of business call reimbursements.

Cellular Phone Plans

Lottery uses the state's contract with AT&T for its wireless telephone service. Under the contract, three service plans with various monthly minutes are available, depending on users' business needs. According to Lottery's contract administrator, AT&T will perform a free analysis at Lottery's request to determine if more cost-effective service plans are available. In addition, Lottery department managers may identify the need for different service plans

during their regular review of cellular phone invoices.

Lottery's cellular phone expenses have decreased significantly over the past two fiscal years. According to Lottery's contract administrator, the decrease is due, in part, to a change from analog to digital service, and to the use of one regional carrier instead of several providers. We found, however, that Lottery could realize further potential savings.

Although Lottery's contract administrator indicated that Lottery requested AT&T to perform an analysis of service plans every six months, we determined that it was not consistent in its request. An analysis was performed in February 2001, but there was no indication that another analysis was requested until 14 months later. Had an analysis been done in August 2001, six months after the February analysis, we estimated that it could have reduced expenses by about \$2,635 per month, if service plan adjustments had been made and usage remained constant. Our analysis was conservative, as it considered only the monthly minutes used, and thus additional savings may have been recognized had AT&T performed the analysis. Total potential savings to Lottery for the eight-month period from August 2001 to April 2002 was at least \$21,080.

In addition, department managers' monthly reviews of cellular expenses were not effective in identifying needed changes to service plans. For a 12-month period, we found that 32 employees regularly exceeded their service plan monthly minutes, resulting in extra airtime charges, yet no changes to the service plans were made. This situation may be due, in part, to the fact that Lottery's management has not developed guidance for reviewing cellular expenses.

We recommend that Lottery management:

- Ensure that periodic analyses of cellular service plans are performed no less than semi-annually.
- Develop guidelines for reviewing cellular phone invoices to identify opportunities for cost savings.

Agency's Response:

Lottery management agrees with the audit recommendation. See page 20 for Lottery's response.

Reimbursements to Employees for Business Calls Made on Personal Cellular Phones

Lottery does not always follow its policy for reimbursing employees for business calls made on personal cellular phones. In addition, Lottery could strengthen its review process for phone reimbursements.

Lottery allows employees to be either reimbursed for business use on a personal cellular phone, or provided a Lottery-owned cellular phone for business needs. Lottery policy specifies that employees are to be reimbursed for the business use of personally owned phones at specified per-minute rates for local and long-distance calls. Other charges or fees associated with business use are evaluated for reimbursement on a case-by-case basis. The use of personally owned cellular phones for Lottery business is to be kept at a minimum.

Lottery managers and accounting personnel are to review reimbursement requests for sufficient supporting documentation and compliance with applicable Lottery policies.

We reviewed all calendar year 2001 expenses for the nine employees who received reimbursements of business calls placed on personal cellular phones. Lottery did not consistently follow its policy during calendar year 2001. From January through May, in 12

instances Lottery made reimbursements on a percentage basis instead of using the per-minute rates specified in its policy. According to Lottery management, they noticed that the reimbursement practice did not match policy and subsequently stopped using the percentage basis method. Lottery management indicated, however, that they did not seek recovery of these overpayments until April 2002. We also noted other instances in which reimbursements did not comply with policy, including the use of the wrong per-minute rate. As a result, Lottery made overpayments of \$534 to \$713, depending on the split between local and long-distance calls.

Lottery's review process for reimbursements is not always effective. In one instance, an employee submitted the same invoice for reimbursement on two separate occasions. The reimbursement claims were dated one day apart, approved by the same manager, and reimbursed to the employee on the same day. On four occasions employees were reimbursed for more than the actual cost to the employee. In another instance, an employee received reimbursements for what appeared to be personal calls.

We recommend that Lottery management:

- Consistently follow its policy for reimbursement of business calls placed on personal cellular phones and strengthen its review process to prevent incorrect reimbursements.
- Recover overpayments made to employees for reimbursements of cellular phone expenses.

Agency's Response:

Lottery management agrees with the audit recommendation. See page 20 for Lottery's response.

Employee Recognition Program Should Be Reevaluated

Lottery should reevaluate its Employee Recognition Program to reduce the amount of public resources it spends. Lottery has implemented an Employee Recognition Program to acknowledge employees for their dedication and service. Lottery pays for the cost of this program with public funds.

The program has various components including recognizing employees for length of service and retirement. Special recognition awards are given for outstanding achievement and employee-of-the-month designation. Finally, Lottery sends a plant or flowers to an employee or family member for acknowledgment of a birth, death, or serious health condition.

Lottery policy limits certain awards to a maximum amount per employee per year. For example, the special recognition component includes discretionary leave with pay not to exceed 40 hours in a fiscal year, recognition awards not to exceed \$1,200 per employee per fiscal year, and other award items (such as gift certificates, gifts, or Lottery store items) that are limited to less than \$75 per employee, per fiscal year. Awards must be approved by the Human Resources Manager, the appropriate Assistant Director and the Director.

State regulations specify that state purchases must promote or support the operation of an agency. In addition, other agencies are required to follow state policy addressing employee recognition. The policy states that to reward and reinforce desired, demonstrated behavior, achievements and results, appointing authorities may establish and maintain plans that recognize and promote extraordinary employee or team achievements. To satisfy state policy requirements, the recognition

program should include performance criteria and not be based solely on time of service. Lottery's special recognition awards and employee-of-the-month awards include performance criteria. The other components of Lottery's Employee Recognition program, however, such as congratulations for personal events, condolences and farewell celebrations, do not include performance criteria and do not appear to promote or support the operation of Lottery.

We reviewed purchases from one vendor totaling at least \$10,372 for calendar year 2000 and 2001 length-of-service awards. Examples of awards purchased include a \$210 Waterford vase, a \$131 Devlin anniversary clock, and a \$236 ladies bracelet watch. In addition, Lottery purchased 100 Cross pens (provided to employees for five-year awards) for \$3,500, spent approximately \$1,900 on flowers or plants for congratulations and condolences, and spent at least \$800 for farewell and employee-of-the-month celebrations.

Lottery maintains a central list used to track awards, and who received awards. During our review of other administrative expenses, we identified award expenses not included on Lottery's award list, an indication that the central list was incomplete. For example, the list did not include 19 employee recognition awards valued at \$68 to \$75 each, or 140 blankets totaling \$2,427 for department employees attending a retreat. Without a complete central listing of awards, Lottery cannot ensure that the maximum amount limits for award value per employee are not exceeded and cannot properly evaluate the prudence of the program in its entirety.

We recommend that Lottery management:

- Reevaluate its Employee Recognition Program and consider lowering its \$1,200 per

employee threshold for special recognition awards.

- Discontinue its practice of using public funds for retirement and length-of-service awards, condolences and congratulations, and employee-of-the-month and farewell celebrations.
- Implement procedures to accurately account for all awards.

Agency's Response:

Lottery management partially agrees with the audit recommendation. See pages 20-21 for Lottery's response.

Auditor Comment:

We agree with Lottery that it is appropriate to acknowledge employees in certain instances, such as the loss of a loved one. However, we recommend that Lottery discontinue using public funds in those instances described and suggest using voluntary employee contributions.

Community Relations Program Should Be Reevaluated

Lottery should reevaluate its Community Relations Program to determine if expenses are reasonable and necessary to meet Lottery's business purpose, which is to maximize profits for the people of Oregon commensurate with the public good.

Lottery established a Community Relations Program that, according to Lottery management, serves to promote the Lottery by increasing its recognition within the community. According to Lottery management, Lottery budgets approximately \$100,000 each fiscal year for expenses of the program, which include organization sponsorships and scholarships. The primary focus of the program is minority, diverse, and disadvantaged groups.

In calendar year 2001, Lottery incurred approximately \$153,000 in

Community Relations Program expenses. Examples of monies distributed included:

- \$13,000 for sponsorship of the Vanport Football Classic, an event that celebrates Portland State University's beginnings as Vanport College and its ties to the Vanport Community.
- \$19,000 to the Portland State University (PSU) Foundation. Of this amount, \$7,000 was for scholarships, \$9,000 for sponsorship of PSU's Chicano/Latino Studies program, \$2,000 for an event table for 10 at the Simon Benson Awards Dinner, and \$1,000 for an event table for four at a dinner to benefit the Asian Studies Program.
- \$2,500 for a community college foundation fundraising event. As part of the sponsorship, Lottery received four tickets to the event, including dinner.
- \$12,500 for sponsorship of support costs for Oscar Night America 2001, a fundraising event held in Portland for Volunteers of America. As part of the sponsorship, Lottery received two reserved tables with seating for 20.

Lottery was not able to effectively demonstrate how these Community Relations Program expenses meet Lottery's mission. According to Lottery management, they have not performed any studies to determine whether the program increases Lottery revenues.

Furthermore, Lottery's controls over the Community Relations Program did not ensure that the availability of public funds for sponsorships and scholarships were communicated impartially to all Oregon communities. Lottery's method of communicating the availability of program funds is through "word of mouth." In addition, only two employees are involved in the selection process.

The Support Services Assistant Director and his assistant not only established the criteria for the selection of recipients, but perform the final selection of organizations receiving program monies. These factors increase the risk that distributions may be decided subjectively.

We recommend that Lottery management reevaluate the program to determine if it meets Lottery's business purpose and, if so, document how. If it is determined that the program does meet Lottery's business purpose, Lottery's management should improve controls over the program to ensure that the program is available to all qualified recipients and to strengthen the selection process.

Agency's Response:

Lottery management disagrees with the audit recommendation. See page 21 for Lottery's response.

Auditor Comment:

While making contributions to worthwhile organizations is commendable, we still question whether this \$153,000 expenditure is consistent with Lottery's business purpose.

Partial Day Absence Policy Should Be Reevaluated

Lottery should reevaluate its partial-day absence policy. Lottery requires its non-exempt employees to use their accrued leave balances for all absences, but does not require its exempt employees to use their vacation or sick leave balances for partial day absences. During calendar year 2001, approximately 145 Lottery employees were exempt and approximately 270 were non-exempt³. Other state agencies are required to follow the Department of

³ Lottery's policy designates the following positions as exempt from the Fair Labor Standards Act: Executive, Administrative, Professional and Outside Sales. Other Lottery employees are considered non-exempt.

Administrative Services' Human Resource policy, which states that exempt state employees shall use accrued leave for partial-day absences. Lottery is not required to follow that policy, and has established its own policy to designate which of its employees are exempt and not required to use their accrued leave for partial-day absences.

Because of this policy, Lottery's exempt employees may receive benefits that are not available to Lottery's non-exempt employees and other state employees. If an exempt employee working for Lottery becomes sick during a workday, or has a doctor appointment and needs to take off part of the day, the employee receives his or her full salary without a reduction of his or her accrued leave. Partial-day absences for Lottery's non-exempt employees would be covered by their accrued leave, or if they had a zero balance, would have to be taken as leave without pay.

In addition, because Lottery's exempt employees are not required to take sick leave for partial-day absences, these employees can accrue sick leave that non-exempt employees and other state employees would not be able to accrue. Under the state's Public Employee Retirement System, an employee's accrued sick leave can increase his or her retirement benefit under two of three current retirement options available.

We recommend that Lottery management develop and implement a partial-day absence leave policy that ensures Lottery's exempt employees do not receive benefits that are not available to its non-exempt employees and other state employees.

Agency's Response:

Lottery management disagrees with the audit recommendation. See page 22 for Lottery's response.

Auditor Comment:

Because Lottery does not track partial day absences, Lottery does not know what its policy is costing the state.

Objectives, Scope and Methodology

The objective of our audit was to review Lottery's administrative expenses to identify opportunities for the Lottery to reduce costs. Our audit objective included determining whether Lottery's administrative expenses:

- Constituted an economical use of public funds,
- Represented reasonable and necessary expenses of public funds, and
- Adhered to prescribed policies and applicable laws and regulations.

Our review focused on those administrative expenses for which Lottery's management has direct control and did not include expenses directly related to revenue generation, such as retailer commissions. The audit included a review of calendar year 2001 administrative expenses in the following areas: meetings, training, travel, cellular phones, Employee Recognition Program, and Community Relations Program. We also reviewed additional expenses in these areas that came to our attention that were outside the calendar year 2001 period, and reviewed Lottery's practices for leave reporting for partial-day absences.

As part of our audit, we reviewed relevant state and federal laws, rules and regulations. Our work included inquiries of agency personnel, review of agency policies and procedures relating to our objectives, and examination of contracts and supporting documentation for expense transactions. We designed and performed tests and analytical procedures to identify cost savings and to determine whether expenses were reasonable and necessary and complied with applicable policy.

We conducted this audit according to generally accepted auditing standards. Fieldwork was conducted from January through July 2002. We limited our audit to the areas specified.

Oregon State Lottery 's Response

November 5, 2002



It Does Good Things

Cathy Pollino, Director
Secretary of State, Audits Division
255 Capitol Street NE, Suite 500
Salem, OR 97310

Dear Ms. Pollino:

The Oregon Lottery has reviewed the report on Lottery Administrative Expenses issued by Audits Division, and appreciates its efforts. As Audits Division reported, the administrative expense limit of 4% of total annual revenue set by the Commission in FY 2000 is well below the 16% limit set by the Constitution. Lottery management has consistently identified ways to reduce the use of State Lottery funds for administrative expenses and to achieve maximum net revenues for the State. As a result, the Lottery has managed to operate under the 4% limit and has reduced expenses from 5.85% in FY 95 to 3.3% in FY 01 and only 3.19% in FY 02.

In reviewing the Audits Division report, Lottery agrees with some findings and recommendations and disagrees with others. Audits Division did not report any violations of state laws or rules. However, the Lottery will seriously consider all recommendations and implement those that will not negatively impact the business' ability to generate revenue in the short- and long-term.

The Lottery is a marketing and sales organization as well as a state agency. The citizens created the operating structure for Lottery's business when they voted on the Constitutional amendment and enabling statutes. The Lottery has created operating policies that balance state government policies and private sector practices. That structure has worked extremely well. The Lottery has generated over \$3 billion dollars in profits for State programs. Furthermore, the Lottery has made -and will continue to make- calculated investments in employee skills and for staff retention. As a result, staff has done an outstanding job of operating a business that would be ranked as 17th in sales and 2nd in net profits when compared to Oregon's publicly traded companies.

Although we appreciate its efforts, Audits Division chose to focus only on examining certain "administrative expenses" in its audit without considering the revenue-generating nature of our business. The Lottery believes an overall return on investment analysis must be done to determine whether the agency is being managed to maximize profits. When viewing the whole picture of net sales, expenses and profits, it is clear the Lottery is an extremely well-run business. In FY 01, for example, the Lottery achieved net sales of \$582.4 million, had Services & Supplies expenditures of \$11.4 million, and generated \$330.8 million in net proceeds to the State. Very few consumer-based private companies can produce the profit margins achieved by the Lottery.

Since 1995, the Lottery's investments in its employees and other costs of doing business have paid huge dividends for the State. I believe the Lottery's record speaks for itself:

Million \$'s	1995	2002	%
Net Sales	\$465.7	\$597.7	28% increase
Annual Transfers	\$271.3	\$340.6	26% increase
Admin. Expense/Sales %	5.85%	3.19%	
Services & Supplies/Sales %	0.23%	0.14%	

500 Airport Road SE • Salem Oregon 97301-5075 • PO Box 12649 • Salem Oregon 97309-0649

PHONE 503-540-1000 • FAX 503-540-1001 • www.oregonlottery.org ☼

Although we are not perfect and improvements can be made, I believe the big picture is clear: The Lottery's business practices generate huge profits for the State of Oregon. Our continual investment in staff and operations has paid off and will continue to reap dividends for the State. The Lottery has not only enhanced the skills and well-being of its employees but, most importantly, increased Lottery net proceeds for important State programs. We've outlined below our detailed responses to the specific findings and recommendations contained in the report.

"Lottery Meeting Expenses Could Be Reduced."

As a revenue-generating business, the successful operation of this enterprise often requires direct interface between staff from Marketing, Retail Sales, Information Technology and Finance & Accounting as well as with outside vendors and business consultants. Meetings are held day and night and often require participation during -and beyond- normal meal hours. Our primary focus is getting work completed as efficiently as possible and making well thought-out decisions that will generate revenue. In its examination of select meetings and related expenses, Audits Division cites the costs without assessing the offsetting benefits and/or savings. It does not consider the increased productivity as staff work through lunch/breaks or the fewer hourly fees consultants charged to the agency because off-site locations were used.

Meals and Refreshments

Recommendation: "Reduce expenses for non-travel meals and refreshments and develop and implement a policy that limits the instances in which public funds can be used for this purpose."

Lottery Response: The Lottery does have such a policy. Although Audits Division does not acknowledge the existence of a "Non-Travel Policy", it is included within our Travel Policy and does address non-travel meals and refreshments. These policies are consistent with DAS guidelines (OAM 10.40.10.PO: Expenditures-Non-Travel Meals & Refreshments; SCS-30-050; and IOM 107-03-120). Nonetheless, the Lottery has changed the name of the policy and will review its policies & procedures to see if more specific language is needed.

The Lottery has a long-established practice of providing light refreshments at any meeting (on- or off-site) when the Lottery requires employees to either work through break/meal or stay on-premise for break/meal to continue business. This is also the case when the Lottery plans an off-site meeting and there are no alternatives for lunch within a reasonable distance or when employees cannot complete lunch and return to the meeting site within one hour. A lunch may be provided (never more than a light meal in the form of sandwich or a casserole) when meetings go through lunch and employees are required to stay on-premise. Time for lunch is often reduced to 30 minutes. Meetings often continue through meal periods or after a brief break to eat. Agendas are required, as well as specific list of participants. Also, in some instances, the costs of a light lunch or refreshment are included in the room charge.

The Audits Division report provides a total figure of \$8,022 for "catered" meetings. Again, Lottery practice is consistent with DAS policy. Audits Division does not mention that this total covers 26 off-site meetings on subjects such as VLT procurement, Managers Quarterly Business Review, Diversity Training for an average of just over \$300 per meeting. As Audits Division points out in another example, the annual cost of \$2,640 for weekly staff meetings breaks-out to \$66 per meeting for 8-15 attendees, which is reasonable for daylong work sessions involving multiple subjects and many different participants. In response to another example, Lottery believes spending \$17-\$19 on an employee for a lunch to thank them for their outstanding performance and/or personal sacrifices during the successful completion of assigned projects is appropriate and helps motivate staff to continue to perform at peak levels.

Annual Meetings and Retreats

Recommendation: "Significantly decrease expenses for Lottery's annual meetings and retreats."

Lottery Response: Lottery disagrees with the recommendation about its Annual Business Meetings because the costs for FY2001 were a one-time anomaly. The Lottery's Annual Business Meeting practices are consistent with DAS (OAM 10.40.10.PO: Expenditures-Non-Travel Meals & Refreshments; SCS-30-050; and IOM 107-03-120). However, we agree with the one example where Lottery could have saved \$1,720 in travel expenses if the staff team-building meeting for newly merged departments held at the Liberty Inn in Lincoln City had been held in Salem.

The Annual Business Meeting is the one time a year when Lottery staff from across the state gather in Salem to network on business issues and motivate itself for the future sales and marketing efforts. As a Sales & Marketing organization the State depends upon Lottery staff to generate substantial revenue. It is a necessity that Lottery staff meet to share information and ideas, and review goals, objectives and strategies and to learn from those who speak to large private sector companies.

Lottery has significantly reduced Annual Business Meeting expenses from 2001 to 2002 (total costs declined from \$40,000 to \$22,000). The higher costs for 2001 were an anomaly. The speaker for 2001 was chosen from a consortium of well-known speakers accomplished in addressing Fortune 500 companies. The speaker cited by the Audits Division had made a similar presentation six months earlier in Portland to several state agencies and Fortune 500 companies. He charged \$130/person for that speaking engagement whereas Lottery negotiated a dramatically reduced cost of \$56/person for the same presentation.

Costs for the 2002 Annual Business Meeting were approximately \$50 per person for the full day, including a working meal and snack. This cost per person is extremely reasonable for an annual event of this nature. Lastly, the supplies and decorations purchased for Annual Business Meetings were donated to the Governor's Annual Charitable Toy Drive.

Audits Division also cites several examples under Meetings & Retreats where potential savings may exist. In the case of the \$2,503 for catering, this was for an all-day meeting (including agenda items during the lunch hour) involving approximately 125 exempt and non-exempt employees. The meals and refreshment provided at this Support Services all-employee meeting was consistent with DAS policy. Like many other state agencies holding large group meetings, Lottery chose to hold its meeting at the State Fairground facilities to direct Lottery administrative funds to that public body. As noted by Audits Division, State Fairgrounds facilities require use of its catering company when meals are to be provided.

Off-Site Meeting Room Rentals

Recommendation: "Conduct business meetings at Lottery headquarters or at other state agencies that provide meeting sites at no cost."

Lottery Response: The Lottery will continue to conduct off-site meetings as needed to operate as efficiently and cost-effectively as possible. Nevertheless, we will also make an effort to reduce the number of off-site meetings and we will further clarify the criteria and better document why an off-site meeting is scheduled.

(Continued)

The Lottery conducts thousands of business meetings on-site each year. However, we go off site if rooms are not available for use, or if off-site rooms better suit the nature of the meeting or its external participants. Additionally, if the use of off-site rooms will result in overall lower meeting costs or higher productivity, the Lottery will use them to meet its broader business objectives.

According to Lottery's long-established standard, smaller meetings should be held off-site only when uninterrupted focused work time of several hours is needed. Absent scheduling conflicts, most large meetings with fewer than 100 people are held at lottery headquarters. Meetings of over 100 employees are not held in auditorium-style meeting rooms' offered by other state agencies because they don't suit our meeting formats. During the time frame examined in the audit, we were involved in preparing or developing many key projects, such as our Video Lottery Terminal procurements and negotiations. If a vendor is traveling a distance to meet with us, we may schedule a meeting place to optimize the schedules of the parties involved. In some cases, we minimized costs and increased productivity by meeting at a location closer to Portland.

"Training Expenses Could Be Reduced"

Recommendation: "Reduce the average amount spent per employee on training.

Lottery Response: The Lottery disagrees. We operate a very large, technology-based sales and marketing business. Given the ever-evolving nature of the technology and equipment used in our revenue-generating business as well as the competitive marketplace in which we operate, Lottery staff is in need of ongoing training. The Lottery believes that spending an average of \$1,500 to train and develop employees in a technology-based, revenue-generating agency is an investment that pays dividends far beyond the "expense." Even if the Lottery is above the state agency average for training and development expenses, we believe the result is employees with above average skills and profit making potential.

In its report, Audits Division's only provides examples of what nine agencies *expected* to spend on training (a range of \$65 to \$1,375), not what they actually spent. In its review, Lottery found several other agencies with actual training expenses comparable to the Lottery (e.g.: DAS, State Treasurer, Department of Energy, PUC, Legislative Administration, \$1,200- 2,200/employee). The Lottery's training programs and expenditures are achieving (as a percentage of payroll) the Governor's benchmark goals as detailed in the DAS employment development policy.

State government and each of the programs that receive Lottery funds benefits from our objective of continual, high quality, training of Lottery staff. Our programs are important for employee skill development as well as the retention of key employees. The dividends from this investment are that annual State profit has gone from \$746,137 per Lottery employee in 1998 to \$814,908 in 2002. In terms of the bottom line, training investments have helped annual transfers of Net Proceeds increase from \$271.3 million in 1995 to \$340.6 million in 2002, (an increase of 26 percent).

Training Unrelated to Lottery's Mission

Recommendation: "Reevaluate its policy of reimbursing employees for training courses that do not directly support the Lottery's mission."

Lottery Response: The Lottery will once again review its degree program against state and private sector programs and consider imposing some additional limitations regarding certain types of elective classes paid by Lottery.

The goal of the degree program is to assist a few select employees in achieving a diploma that relates to their job duties and to enhance their performance in fulfilling the Lottery's mission. To receive the relevant degree, some elective classes are required and current policy allows all elective classes to be included in the cost reimbursed by the Lottery.

Lottery believes having an educated and skilled workforce is entirely consistent with the Lottery's mission. The Lottery's Educational Assistance Program is structured to encourage employees to enhance their performance of job-related duties by seeking additional training up to, and including, related college degrees. It is a worthwhile investment for the Lottery and the State of Oregon.

Audits Division questions why the Lottery would provide training on Interior Design to a member of its Facilities staff whose job routinely involves space planning and layout design. The manager who authorized the training considered this class to be job-related. Audits Division also questions why Lottery spent \$200 to send an Assistant Director to a local "International Speakers" event on foreign policy. The event speaker's underlying and fundamental subjects were leadership and negotiating conflicts. The Lottery believes senior management will apply those broader insights to the effective operation of the Lottery.

More Economical Rates Available

Recommendation: "Obtain speakers and attain training at more economical rates."

Lottery Response: The Lottery disagrees. When selecting a training provider, the Lottery places its priority on expertise and quality that will provide the best return on investment rather than simply going with the lowest rate available.

It is critical for all Lottery managers and key staff to be well-trained in negotiation skills and conflict resolution due to the scope and complexity of contracts we execute with vendors. In order to more effectively negotiate against skilled representatives from the private sector, the Lottery selected a Harvard-affiliated public program to enhance staff knowledge, skills and abilities. The \$100,000 invested is money well spent because it gave 117 employees more effective negotiation skills to represent and protect the interests of the State of Oregon and the Lottery in multi-million dollar projects and multi-million dollar contract negotiations.

Audits Division suggests we obtain certain high level, technical training thorough the web. First, records provided to Audits Division show only one of the five Cisco Router courses were available on-line in 2001. Regardless, we would never rely on web-based learning to give staff the hands-on, laboratory-based skill training needed to operate the new telecommunications network components that are central to generating all \$8 billion in annual Lottery sales. In our judgment, critical training with all Lottery revenue at stake should not be taken on the Web or from less qualified instructional sources.

“Travel Expenses Could Be Reduced”

Recommendation: “Lottery management should require all Lottery employees to fly by coach unless the difference is paid for from the employee’s personal funds.”

Lottery Response: The Lottery agrees with and has always adhered to this recommendation, ***except in the case of two severely disabled employees.*** Audits Division cites examples where two Lottery employees traveled first class, which may leave the impression that the Lottery is engaged in extravagant travel. This is not the case. The two employees who traveled first class each have serious medical conditions and disabilities. Lottery requires them to take 6-8 hour flights to attend business meetings that are absolutely essential to generating revenue. If the Lottery requires these disabled employees to travel long distances on its behalf, it will accommodate them in the full spirit of the ADA. We believe going beyond the bare minimum standards cited by Audits Division is the right thing to do.

Audits Division provides examples of what it believes are sufficient accommodations for sending employees with severe disabilities to business meetings, and assumes that all travel accommodations for severely disabled persons can be satisfied by flying coach. However, when requesting business-class accommodations, Lottery has learned that not all airlines offer it. In another example, Audits Division states that we could reserve the bulkhead seat. However, on many airplanes the bulkhead is an EXIT row and a passenger cannot be seated in one unless they are able to assist other passengers off the plane in case of an emergency. Clearly, this is not a viable alternative for a person with a serious disability. Furthermore, when one is in transit and travel reservations must be altered, it is unreasonable to assume that bulkhead seating will always be available. The logistics of trying to secure seating to accommodate disabled persons within a 24-hour period is not a viable alternative. The Lottery believes disabled employees should not be subjected to any lack of accommodation when traveling across the country to conduct critical business on its behalf.

Use of Rental Vehicles

Recommendation: “Ensure employees use alternative cost-effective transportation (e.g. shuttles and taxis) when available.”

Recommendation: “Further define its policy to include the type and size of rental vehicles to be used.”

Lottery Response: The Lottery agrees. Audits Division noted several instances where staff used poor judgment when selecting a rental car or choosing to rent one instead of taking a shuttle. The Lottery will review its vehicle rental policies and reinforce to its employees a requirement to find the most economical and practical transportation during business travel.

Group Travel

Recommendation: “Lottery management should develop and implement policy to limit the number of employees traveling to the same location for the same purpose.”

Lottery Response: The Lottery disagrees. It is not only prudent but necessary that all key team members with different responsibilities who are directly involved in multi-million dollar projects be present at critical business meetings. Our hands-on, cross-functional team approach is key to our successful implementation of these huge revenue-generating projects. It is not worth “saving” \$11,300 per year to jeopardize or delay critical projects that generate hundreds of million of dollars for state programs each year.

(Continued)

Of the Group Travel examples cited, four of the seven trips were for major procurements of Video Lottery sales equipment and one was for a new Instant Ticketing System, both of which are needed for generating substantial revenue. The purchase and successful implementation of these fundamental, revenue delivery hardware/software systems involves every facet of the Lottery, and one or two people could not represent all the stakeholders in the project. The implementation of these procurements follows rigid project management methodologies that include key representatives from the organization being present at critical product reviews, contract negotiations, and vendor site visits. Lottery projects are delivered within budget and with a high degree of operational efficiency. These objectives could not have been met by sending one fewer individual on these trips.

The other two trips were for training for a new marketing branding campaign and research on Korean language-based programs for retailer training, both key operational initiatives for the Lottery. The rationale for selecting each individual, the documented operational need and benefit to the State was provided to Audits Division.

Lodging and Meal Expenses

Recommendation: "Lottery should adopt a policy that limits out-of-state meal and lodging expenses to a per diem amount."

Lottery Response: Lottery disagrees. While Audits Division focused on only 15 trips in a total sample of 50, Lottery believes the overall merits of its reimbursement policies should be determined by analyzing all 50 trips covered by the "actual and reasonable" standard. When all lodging and meal transactions for the 50 trips are examined, Lottery exceeded federal per diem rates by less than \$25 per person per day. When other factors are considered, (e.g.: trying to manage and account for travel under a variable federal per diem program), Lottery believes it would spend more ensuring compliance with per diem policies and procedures than the purported "savings" would return. Furthermore, Lottery staff often spends less on meals than they would be entitled to under federal per diem rate. Given the nature of where lottery industry business is often conducted, the federal per diem rates do not always adequately cover the lodging expenses, and exceptions would still be necessary. For these reasons, the Lottery uses "actual and reasonable" reimbursement for out-of-state travel.

Personal Vehicle Mileage Reimbursement

Recommendation: "Lottery management should ensure employees use Lottery-owned vehicles when available for local business travel."

Lottery Response: Lottery disagrees. Lottery's policy regarding use of State vehicles and the reimbursement for personal vehicle mileage is consistent with DAS's Fleet Management Policy Section 3 (10/1/98). Increasing mileage on Lottery pool or state motor pool vehicles would result in buying and maintaining more cars over time. The recommendation is more expensive than reimbursing for personal mileage and will not save money in the long term.

A prior Audit Division report required that Lottery pool vehicle usage be tracked against DAS-computed required utilization numbers (DAS standards are currently minimum usage of 680 miles/month). Accordingly, the Lottery monitors utilization of pool vehicles on a monthly basis. Lottery's average usage of pool vehicles has been at 867 miles/month. The ownership cost of a vehicle alone (not including gas, insurance, maintenance) is very close to the current mileage reimbursement rate. Once administration costs are added, it is not more cost effective to add to the vehicle pool instead of reimbursing personal vehicle miles.

(Continued)

The Audits Division assertion that Lottery vehicles were available in some instances where personal mileage reimbursement was requested does not take into consideration any other circumstances such as timing, logistics, efficiency or personal business issues.

“Cellular Phone Expenses Could Be Reduced”

Over the past four fiscal years, the Lottery has reduced its annual cellular phone expenses by 43% (from \$413,000 in 1999 to \$234,000 in 2002). It will continue its practice of actively finding ways to meet its operational needs while keeping cellular phone expenses to a minimum.

Recommendation: “Ensure periodic analyses of cellular service plans are performed no less than semi-annually.”

Lottery Response: The Lottery agrees, and will schedule a review of cellular service plans every six months. Staff reports the 14-month delay noted in the report was due to higher priority work.

Recommendation: “Develop guidelines for reviewing cellular phone invoices to identify opportunities for cost-savings and to ensure comparability of manager reviews.”

Lottery Response: The Lottery agrees, and will refine its guidelines for management and the plan administrator will review cellular phone invoices to flag situations when employees appear to need different plans.

Reimbursement to Employees for Business Calls Made on Personal Cellular Phones

Recommendation: “Lottery management should consistently follow its policy for reimbursement of business calls placed on personal cellular phones and strengthen its review process to prevent incorrect reimbursements.”

Lottery Response: Lottery agrees and will look for ways to make its reimbursement policy for business calls on personal cellular phones clearer to employees and management.

Recommendation: “Lottery management should recover overpayments made to employees for reimbursements of cellular phone expenses.”

Lottery Response: Lottery agrees. All overpayments have been collected from employees. It should be noted that these overpayments span two years and amounted to approximately \$440 on fiscal year total cell phone expenditures of \$273,000.

“Employee Recognition Program Should Be Reevaluated”

Recommendation: “Reevaluate its Employee Recognition program and consider lowering its \$1,200 per employee threshold for special recognition awards.”

Lottery Response: The Lottery has never spent \$1,200 in special recognition awards on any employee for any reason, even for significant contributions and extraordinary achievement. The purpose and criteria for making this award is consistent with DAS Policy (HRSD-50.040.01). During the last three years, the maximum award was \$500, with only one instance each in 2000, 2001 and 2002. The Lottery has revised its policy to set \$600 as the maximum an employee may receive for special recognition in any one year.

Recommendation: “Discontinue its practice of using public funds for retirement and length-of-service awards, condolences and congratulations, and employee-of-the-month and farewell celebrations.”

Lottery Response: The Lottery disagrees. We believe it is very appropriate to acknowledge through some small token an employee's grief over the loss of a parent or child; and that years of dedicated service should be periodically recognized, especially when an employee retires. This practice is modeled after the private sector and sends a strong message that we deeply care about our employees and wish to retain them.

Recommendation: “Implement procedures to accurately account for all awards.

Lottery Response: The Lottery will continue to accurately account for all awards. In the past, some tracking has been decentralized at the department level. The Lottery will add centralize record keeping for all awards under \$75 in value.

“Community Relations Program Should Be Reevaluated”

Recommendation: “Reevaluate the program to determine if it meets Lottery’s business purpose and, if so, document how.”

Lottery Response: Lottery statutes list “public relations” as an anticipated expenditure within its administrative expense budget. The Lottery Commission implemented its Community Relations program to improve public relations with community groups, particularly those headquartered in the Portland area. Like other large Oregon businesses, Lottery acts as a good corporate citizen by making contributions to important programs that are related to Lottery, especially in the area of education. The program is working well and we are proud to assist with these Afro-American, Chicano/Latino and Asian minority programs.

Audits Division suggests the Lottery should only assist the fund-raising efforts for Afro-American, Chicano/Latino and Asian minority programs if it will maximize profits. Except for improved community relations, the Lottery does not seek anything in return. Our support of these programs is genuine and not driven by a profit motive. The Lottery does receive considerable positive news media coverage for its contributions to these events as well as enhanced understanding within minority communities. As a direct result of our activities, the Lottery has been able to increase participation by these minority communities in our hiring, procurement, and promotional activities. On numerous occasions, the Lottery has received direct feedback from community leaders, including presentation to the Commission, that our efforts have been successful. Before it implemented the Community Relations Program, the Lottery sought advice from the Attorney General’s Office. Its advice is that these are an appropriate expenditure of Lottery dollars as long as the purpose is focused and subject to review by the Lottery Commissioners. Information on the Community Relations Program is included in Lottery’s budget documents and communications with Commissioners occurs at least annually.

Recommendation: “Improve controls over the program to ensure the program is available to all qualified recipients and to strengthen the selection process.”

(Continued)

Lottery Response: Audits Division suggests this program should be operated more like a foundation or charity. However, when we look at how other organizations run similar programs, including charitable foundations, none actively solicit potential recipients in an effort to make contributions. Like other businesses, the Lottery uses a process to selectively identify those activities we believe best meet our community relations purposes. As for the minority student scholarships, the Lottery has never been part of the selection process. Instead, the benefiting organization selects the student(s). The funds awarded to the student are directly deposited into the school account, or into a scholarship foundation associated with a fundraising event that ensures that Lottery dollars are awarded appropriately.

“Partial Day Absence Policy Should Be Reevaluated”

Recommendation: “Lottery management should develop and implement a partial day leave policy that ensures Lottery’s exempt employees do not receive benefits that are not available to its non-exempt employees or other state employees.”

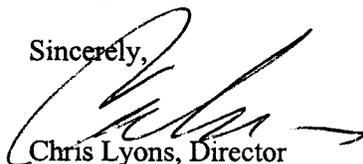
Lottery Response: Lottery policy with regard to partial day absence is allowable under the law and widely used in the private sector. Through the enabling statutes, citizens intended for Lottery employees to be treated more like private sector employees than typical state employees. Because we expect employees to operate a profit making business for the state, the Lottery needs to employ and retain professional business people. Although we are comfortable with current policy, the Lottery will review any options that might still achieve our objectives and evaluate their successful implementation elsewhere in state government and the private sector.

Lottery disagrees that exempt employees are receiving benefits not available to its non-exempt employees. As a matter of fairness, we believe the opposite is true. Non-exempt employees, who must record partial day absences, are also entitled to -and receive- overtime or comp time when they work in excess of 40 hours per week. On the other hand, Exempt employees, who routinely work in excess of 40 hours per week managing this business, are not entitled to additional benefits in the form of overtime or comp time. If our exempt employees worked more traditional workweeks, the recommendation may be more applicable. However, if comp time were paid to exempt employees, it would cost the Lottery between \$600,000 and \$1 million per year.

The Lottery has achieved its success by operating more like a business than a typical state agency. This is what the citizens envisioned when they amended the Constitution and created statutes by a very wide approval margin. To carry out the intent of the people, the Lottery will continue to model its business on the best practices of both state agencies and the private sector. This will result in management decisions that are in the best interest of our business operations.

We believe Lottery employees are the key to our success. To continue to achieve record sales and profits, the Lottery must be able to attract and retain high caliber employees from the private sector in the fields of technology and sales & marketing. Operating more like a conventional government agency instead of a successful revenue-generating business will not further the Lottery’s mission to maximize revenue commensurate with the public good.

Sincerely,



Chris Lyons, Director

This report, which is a public record, is intended to promote the best possible management of public resources. Copies may be obtained by mail at Oregon Audits Division, Public Service Building, Salem, Oregon 97310, by phone at 503-986-2255 and 800-336-8218 (hotline), or internet at Audits.Hotline@state.or.us and <http://www.sos.state.or.us/audits/audithp.htm>

AUDIT ADMINISTRATOR: *Nancy L. Young, CPA, CISA* • AUDIT STAFF: *Diane B. Farris, CPA* • *Ryan Dempster* • *Margaret Wert, CPA*

DEPUTY DIRECTOR: *Mary E. Wenger, CPA*

The courtesies and cooperation extended by the officials and staff of the Oregon State Lottery were commendable and much appreciated.

Auditing to Protect the Public Interest and Improve Oregon Government