

SUMMARY

A Review and Follow-Up Report of the South Carolina Education Lottery

INTRODUCTION

State law requires us to conduct a management audit of the South Carolina Education Lottery (SCEL). We reviewed issues relating to administrative expenditures, internal controls for procurement, and the sale and advertisement of lottery tickets. We also determined the status of recommendations that we made in our previous audit of the lottery published in December 2003.

As provided by state law, proceeds from lottery sales must be used to support improvements and enhancements for educational purposes and programs. SCEL receives no appropriations from the General Assembly; rather, funding for the lottery is generated through the sale of lottery tickets.

December 2005



ADMINISTRATIVE EXPENDITURES

In accordance with state law, SCEL's administrative expenditures have not exceeded 15% of its total sales. In FY 04-05, the lottery's actual administrative expenditures were \$109,399,614 which was 11.4% of its total revenue.

LOTTERY SALARIES HIGHER THAN IN OTHER STATE LOTTERIES

State law authorizes the lottery to create its own compensation system. We reviewed the salaries of executives in 18 other state lotteries in FY 04-05 and found that the salaries of South Carolina lottery executives were higher than many comparable officials. As shown below, the executive director in South Carolina was paid more than the directors in 16 of the 18 states that we reviewed. The highest paid deputy director in South Carolina was paid more than the highest paid deputy in 15 states and more than the director in 14 states.

SCEL officials stated that the lottery's ranking in net income per capita (total revenues minus expenses divided by the state's population) warrants high salaries. We found that four of the five states with a higher net income per capita than South Carolina paid considerably less.

SCEL has not established a methodology for compensating its officials based on the actual salaries in lotteries nationwide. A methodology based on *actual* salaries in other state lotteries would help to ensure comparable salaries for comparable work.

In November 2005, the newly-formed North Carolina lottery hired its first executive director at an annual salary of \$235,000 with a \$50,000 incentive if the lottery is started within five months.

LOTTERY SALARIES IN OTHER STATES FY 04-05

STATE	FY 03-04 TOTAL SALES (IN MILLIONS)	DIRECTOR	HIGHEST PAID DEPUTY
New York	\$5,848	\$144,287	\$115,616
Massachusetts	\$4,382	\$120,000	\$104,097
Texas	\$3,488	\$110,000	\$113,568
Florida	\$3,071	\$120,000	\$100,000
California	\$2,974	\$123,255	Vacant
Georgia	\$2,710	*\$225,000	\$195,000
Pennsylvania	\$2,352	\$110,429	\$106,041
New Jersey	\$2,187	\$102,900	\$96,366
Ohio	\$2,155	\$102,000	\$98,700
Michigan	\$1,974	\$113,000	\$106,229
Rhode Island	\$1,481	\$96,768	\$85,067
Maryland	\$1,395	\$132,341	\$96,309
West Virginia	\$1,303	\$75,000	\$80,208
Virginia	\$1,262	\$128,600	\$109,000
SOUTH CAROLINA	\$950	\$196,738	\$166,350
Kentucky	\$725	\$196,700	\$156,453
Tennessee	**\$428	*\$350,000	\$180,000
Louisiana	\$340	\$130,923	\$104,935
New Mexico	\$149	\$177,000	\$105,000
Median	\$1,974	\$123,255	\$105,521

* Georgia's salary does not include a potential incentive of \$100,000;
Tennessee's salary does not include a potential incentive of \$227,500.

** Lottery sales in Tennessee began 1/20/04.

Source: The North American Association of State and Provincial Lotteries and other state lotteries.

ADVERTISING AND SALE OF LOTTERY TICKETS

INADEQUATE COMMUNICATION OF THE ODDS OF WINNING

State law requires the lottery to disclose to its customers the odds of winning. In advertising its games and designing its lottery tickets, the lottery has not adequately communicated the odds of winning. Some advertisements contained no information on the odds of winning. In other advertisements, the lottery communicated the overall odds of winning any prize, including a prize equal to the price of the lottery ticket. The lottery did not communicate the odds of winning a top prize in any of its advertisements or on any of its lottery tickets. In addition, because the lottery has communicated the odds of winning only in writing, it may not be reaching customers with low reading skills.

LOTTERY TICKETS SOLD AFTER ALL TOP PRIZES HAVE BEEN AWARDED

The lottery has repeatedly sold scratch-off lottery tickets after all of the top prizes, printed on the fronts of the tickets, have been claimed. In FY 04-05, the lottery sold \$19.9 million worth of lottery tickets for 16 games after all of the top prizes had been claimed. This total represented 12% of sales for these games. There was an average of nine weeks between the claiming of the final top prize and the last date tickets were permitted to be sold. As a result, some customers may have purchased lottery tickets under the inaccurate impression that they had a chance of winning a top prize. The top prizes for these games ranged from \$1,300 to \$100,000.

NO DATA COLLECTED ON THE SALE OF LOTTERY TICKETS TO MINORS

In its annual analysis of the types of people who buy lottery tickets, the lottery has excluded individuals under the age of 18, who may not legally buy lottery tickets. The lottery is required by state law to hire an independent firm to determine the "age, sex, education, and frequency of participation of players." This law does not instruct the lottery to exclude minors from its analysis. In other states, surveys of minors and undercover studies have found that minors were often able to buy lottery tickets.

PROHIBITION AGAINST ELECTION DAY LOTTERY TICKET SALES

State law requires that "lottery tickets must not be sold on the date of any general or primary election." The effect of this prohibition in calendar year 2004 was a loss of approximately \$1.8 million in lottery sales and \$600,000 in net proceeds available for education. A senior official with the South Carolina Election Commission stated that she did not believe the sale of lottery tickets on election days would negatively affect the election process.

ILLEGAL GAMBLING AT LOTTERY RETAIL OUTLETS

Illegal gambling at some of the lottery's retail outlets has been uncovered by South Carolina law enforcement agencies. We identified 46 lottery retailers who engaged in illegal gambling on their premises in FY 04-05. This illegal competition, mostly in the form of video gambling, may be causing the lottery to lose sales. Businesses are also less likely to pay the required taxes on income from illegal gambling. The lottery's statutory authority to respond to illegal gambling, however, may be limited to cases in which a retailer has been criminally convicted. The Department of Revenue is authorized by state law to administratively suspend or revoke a retailer's beer and wine permit, or impose a fine, for illegal gambling, with or without a criminal conviction. We recommend that the General Assembly amend state law so that the lottery may administratively deny, suspend, or terminate a retailer's lottery contract, or impose a fine, for illegal gambling, with or without a criminal conviction.

FOLLOW-UP

We concluded that the lottery has not implemented three of the nine recommendations that we made in our 2003 audit of the lottery. The lottery has reduced the number of cell phones provided to employees by only 2 (from 86 to 84) and employees with administrative jobs in the central office continue to have cell phones. The lottery has determined that it is more cost-effective to provide state vehicles to some employees but these employees are still allowed to drive their vehicles when conducting lottery business. In addition, the lottery has not conducted internal audits to strengthen controls over its prize payments.

In 2003, we also recommended that the General Assembly consider whether previously appropriated lottery funds have been spent when deciding on future appropriations. The Commission on Higher Education (CHE) had not spent over 80% of the funds appropriated for the teacher grants, the National Guard, and the endowed chairs programs. In this review, we found that CHE still has not spent a majority of funds appropriated for the same programs.

AUDITS BY THE LEGISLATIVE AUDIT COUNCIL CONFORM TO GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS AS SET FORTH BY THE COMPTROLLER GENERAL OF THE UNITED STATES.

FOR MORE INFORMATION

Our full report, including comments from SCEL and this document are published on the Internet at

www.state.sc.us/sclac

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