



Office of Missouri State Auditor
Nicole Galloway, CPA

Missouri State Lottery Commission



Nicole Galloway, CPA
Missouri State Auditor

CITIZENS SUMMARY

Findings in the audit of the Missouri State Lottery Commission

Travel Expenses

Some Lottery travel costs are not transparent because the primary instant ticket contractor pays some Lottery travel expenses. As a result, these expenses are excluded from travel expenses on the Lottery's financial statements.

In the areas audited, the overall performance of this entity was **Good**.*

*The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

- Excellent:** The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.
- Good:** The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.
- Fair:** The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.
- Poor:** The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

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Missouri State Lottery Commission

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NICOLE GALLOWAY, CPA

Missouri State Auditor

Honorable Eric R. Greitens, Governor
and
Missouri State Lottery Commission
and
May Scheve Reardon, Executive Director
Missouri State Lottery Commission
Jefferson City, Missouri

The State Auditor is required under Section 313.315.1, RSMo, to audit the Missouri State Lottery Commission. The Lottery engaged CliftonLarsonAllen LLP, Certified Public Accountants (CPAs), to audit the Lottery's financial statements for the years ended June 30, 2016 and 2015. To satisfy our statutory obligation and minimize duplication of effort, the State Auditor has used the work of the CPA firm. We reviewed the reports and substantiating working papers of the CPA firm to satisfy ourselves as to the appropriateness of using the reports, and we accept them in partial fulfillment of our duties. We have also audited certain operations of the Lottery in fulfillment of our duties under Section 313.315.1, RSMo. The scope of our audit included, but was not necessarily limited to, the years ended June 30, 2016 and 2015. The additional objectives of our audit were to:

1. Evaluate the Lottery's internal controls over significant management and financial functions.
2. Evaluate the Lottery's compliance with certain legal provisions.
3. Evaluate the economy and efficiency of certain management practices and procedures.

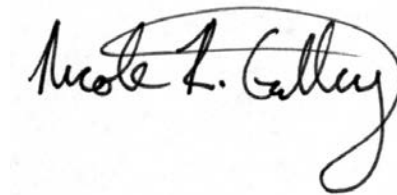
Our methodology included reviewing minutes of meetings, written policies and procedures, financial records, and other pertinent documents; interviewing various personnel of the Lottery, analysis of comparative data obtained from external and/or internal sources; review of contracts that are specific to the auditee's operations and significant within the context of the audit objectives; and testing selected transactions. We obtained an understanding of internal controls that are significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We tested certain of those controls to obtain evidence regarding the effectiveness of their design and operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of applicable contract, grant agreement, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Organization and Statistical Information is presented for informational purposes. This information was obtained from the Lottery's management and was not subjected to the procedures applied in our audit of the Lottery.

For the areas audited, we identified (1) no deficiencies in internal controls, (2) no noncompliance with legal provisions, and (3) the need for improvement in management practices and procedures.

The accompanying Management Advisory Report presents our finding arising from our audit of the Missouri State Lottery Commission.

A handwritten signature in black ink, reading "Nicole R. Galloway". The signature is fluid and cursive, with a large loop at the end of the last name.

Nicole R. Galloway, CPA
State Auditor

The following auditors participated in the preparation of this report:

Director of Audits:	Douglas J. Porting, CPA, CFE
Audit Manager:	Dennis Lockwood, CPA
In-Charge Auditor:	James M. Applegate, MBA
Audit Staff:	Mackenzie J. Wooster
	Dovile Zavistauskaite

Missouri State Lottery Commission

Management Advisory Report

State Auditor's Findings

Travel Expenses

Some Lottery travel costs are not transparent because the primary instant ticket contractor pays some Lottery travel expenses. As a result, these expenses are excluded from travel expenses on the Lottery's financial statements.

The Lottery requires, as part of the contract terms, the primary instant ticket contractor to pay up to \$30,000 per year for Lottery travel expenses including some travel costs of the Executive Director and key employees. Those employees are involved in evaluating and awarding the instant ticket contract and negotiating amendments to that contract. Any unused funds from this amount roll over to the next year.

The Lottery forwarded travel related invoices totaling \$50,891 for payment by the contractor. The costs included \$21,025 for conference fees and \$29,866 for flights, covering costs related to 17 trips during the 2 years ended June 30, 2016. Lottery personnel indicated most of the trips were for interstate conferences, seminars, or meetings not directly related to the contractor. Lottery travel costs should be paid by the Lottery and reported on Lottery financial statements to allow for full disclosure and transparency for costs of Lottery operations.

The Lottery renewed the contract with this vendor in March 2015, extending it until June 30, 2017. However, Lottery officials did not amend it to eliminate the provision requiring the contractor pay up to \$30,000 for Lottery employee travel expenses.

A similar condition was noted in our prior audit report.

Recommendation

We again recommend the Lottery require travel costs of Lottery personnel be paid by the Lottery and disclosed on the Lottery financial statements.

Auditee's Response

The primary instant ticket contract included a small allocation of dollars for travel related to out-of-state printing plant security visits, press checks and industry educational events. All travel expenses paid by the primary instant ticket contractor during the audit period were either for operational visits to the vendor plant, or out-of-state lottery industry conferences, meetings or seminars that involved all lotteries and lottery vendors. The Lottery agrees with the audit finding and has already amended the instant ticket contract, prior to the audit completion, to forego the \$30,000 annual contractual education allowance for the remainder of the contract term and will not include this requirement in future contracts so that travel costs of Lottery personnel are paid by the Lottery and reflected on Lottery financial statements.

Missouri State Lottery Commission

Organization and Statistical Information

Pursuant to Sections 313.200 to 313.350, RSMo, the Missouri State Lottery Commission (Lottery) was created in June 1985. That action followed voter approval of a lottery amendment to the Missouri Constitution at the November 1984 general election. The Lottery began selling instant game tickets on January 20, 1986. From 1986 to 1993, lottery proceeds less prizes and expenses were transferred to the General Revenue Fund for appropriation by the General Assembly. Effective July 1, 1993, pursuant to a voter approved lottery amendment to Article III, Section 39(b), Missouri Constitution, lottery proceeds are transferred to the Lottery Proceeds Fund for appropriation by the General Assembly for educational purposes.

Section 313.321 RSMo, provides that money received from the sale of lottery tickets shall be divided as follows: A minimum of 45 percent shall be awarded as prizes; administration, advertising, promotion, and retailer compensation costs shall be paid as appropriated by the General Assembly; and the remainder shall be transferred to the Lottery Proceeds Fund to be appropriated solely for public institutions of elementary, secondary, and higher education.

Traditionally, the Lottery has paid out more than the minimum 45 percent of sales as prizes. The pay-out percentage has averaged 61.6 percent from 1986 to 2016. The prize percentage fluctuates each year based on factors such as the type of scratcher tickets sold (each game has a different prize structure) and the timing of payouts related to draw game sales such as the Powerball and Mega Millions games. Lottery officials believe that more people will play if there are more prizes to receive.

Lottery retailers are authorized to redeem prizes up to \$600, or players may claim any prizes in person at any of the Lottery offices. Prizes paid by the Lottery are paid from an imprest checking account, and the account is reimbursed from the Lottery Enterprise Fund (LEF). However, beginning July 1, 2016, the reimbursement to the imprest checking account is made from the new State Lottery Fund (SLF). Prior to July 1, 2016, prizes redeemed by retailers, as well as commissions and incentives due the retailers, were deducted from sales of the retailers in determining the net sales due from retailers to the LEF. Beginning July 1, 2016, the SLF began receiving the net sales due from retailers. Monies are now transferred from the SLF to the LEF for lottery operational costs. The SLF is the primary source for funding lottery prize payments.

Estimated Transfers of Profits

Article III, Section 39(b), of the Missouri Constitution requires Lottery profits be transferred to the Lottery Proceeds Fund to be appropriated solely for public institutions of elementary, secondary and higher education. In September each year, as part of the state budget process, the Lottery develops estimates of the transfer for the subsequent fiscal year in its budget request submitted to the Office of Administration and Governor. For



Missouri State Lottery Commission Organization and Statistical Information

example, the estimate for fiscal year 2016 (which began July 2015) was developed by the Lottery in September 2014. The Lottery's estimates provide a basis from which the Governor incorporates estimates into the budget submitted to the General Assembly for determining appropriations to schools from the Lottery Proceeds Fund.

Estimated and actual transfers for the last 4 fiscal years were as follows:

Estimated and actual transfers

		Year Ended June 30,			
		2016	2015	2014	2013
Lottery estimate	\$	278,723,574	298,563,213	288,563,213	267,172,000
Actual cash transfer		308,993,403	270,701,018	267,324,620	288,804,006
Actual over (under) estimate	\$	30,269,829	(27,862,195)	(21,238,593)	21,632,006
Variance from estimate		10.9%	(9.4%)	(7.3%)	8.2%

According to a Lottery official, fiscal year 2016 was a record year for profits and transfers. In September 2014, the Lottery estimated transfers for fiscal year 2016 using the average of the total actual transfers for the preceding 3 fiscal years rather than assuming continued growth as in estimations for previous years. As a result, the Lottery's estimated transfer for fiscal year 2016 was about \$278.7 million, an amount lower than the Lottery's estimated transfers of the previous 2 fiscal years. However, the fiscal year 2016 budget approved by the General Assembly and signed by the Governor budgeted the transfer for education similar to the previous year's higher estimate of \$299 million. The official indicated the Lottery changed its estimation method to determine the requested transfer amount to a 5 year average of the total actual transfers plus 1 percent, beginning with the fiscal year 2017 budget year. This new methodology yielded an estimated transfer of \$278.8 million for fiscal year 2017 budget.

Commission

A five-member Lottery commission is appointed by the Governor with the advice and consent of the Senate. The commission must meet at least quarterly. The commission has the authority to promulgate rules as it deems necessary and desirable to fully implement the Lottery as mandated by the people in Article III, Missouri Constitution. The commission appoints an executive director to act as secretary of the commission and keep all books and records of the commission. The executive director oversees the commission's operation and administration. At June 30, 2016, May Scheve Reardon served as Executive Director, and members of the commission were:



Missouri State Lottery Commission Organization and Statistical Information

Commissioner	Term Expiration
John R. Twitty, Chairman	September 2017
Paul K. Kincaid	September 2017
Dr. Judene Blackburn	September 2016
Vacant	
Dr. Phyllis Chase ¹	September 2016

¹ Dr. Chase resigned from the Commission on January 16, 2017.

Section 313.125, RSMo, requires appointments to be made within 30 days of the expiration of a term. However, the current practice is for the expired member to serve until reappointed or a new member is appointed.

The Lottery staff is organized into three divisions: Executive; Sales, Marketing, and Communications; and Risk Management. Each division is headed by a director who coordinates activities to meet the commission's objectives. At June 30, 2016, the Missouri State Lottery Commission employed 153 individuals.

Appendix A

Missouri State Lottery Commission
Comparative Statement Of Appropriations And Expenditures

		Year Ended June 30,					
		2016			2015		
		Appropriation Authority	Expenditures	Lapsed Balances	Appropriation Authority	Expenditures	Lapsed Balances
LOTTERY ENTERPRISE FUND							
Lottery prizes	\$	174,075,218	174,075,218	0	153,000,000	139,313,923	13,686,077
Advertising expenses		16,000,000	15,998,981	1,019	16,000,000	12,024,546	3,975,454
Personal service		6,936,517	6,782,747	153,770	6,899,318	6,687,606	211,712
Payment of real property leases, related services, utilities, system furniture, and structural modifications - expense and equipment		505,463	480,401	25,062	477,812	455,745	22,067
Expense and equipment		37,218,992	36,105,792	1,113,200	36,218,992	31,328,200	4,890,792
Total Lottery Enterprise Fund	\$	234,736,190	233,443,139	1,293,051	212,596,122	189,810,020	22,786,102

Appendix B

Missouri State Lottery Commission Comparative Statement of Expenditures (From Appropriations)

	Year Ended June 30,				
	2016	2015	2014	2013	2012
Personal service	\$ 6,782,747	6,687,606	6,614,485	6,438,560	6,513,253
Travel, instate	122,314	115,939	118,879	108,997	119,596
Travel, out-of-state	52,057	40,626	47,158	45,605	37,118
Fuel and utilities	38,184	40,846	41,245	40,632	38,713
Supplies	704,154	628,355	633,931	644,021	641,130
Professional development	130,518	71,648	101,377	92,310	92,601
Communication services and supplies	356,146	312,118	425,961	341,774	588,125
Services:					
Printing and binding	7,829,480	6,713,548	8,208,242	7,175,094	7,052,599
Advertising	13,501,826	10,676,014	14,056,807	10,623,384	7,226,510
Other business	20,832,033	14,723,363	13,738,344	13,367,331	12,083,984
Accounting and auditing	206,380	197,565	196,215	186,167	169,723
Public relations	1,865,127	1,383,764	1,733,761	1,962,670	1,685,677
Other professional	3,053,372	2,526,534	4,974,385	4,927,581	3,268,775
Housekeeping and janitorial	55,291	45,989	50,248	55,849	63,621
Maintenance and repair	732,941	1,065,687	962,948	960,901	813,868
Equipment:					
Computer	1,215,452	462,670	731,754	578,298	929,049
Motorized	136,214	193,868	302,000	248,328	238,383
Office	80,012	58,237	12,774	13,940	17,188
Other equipment	586,657	427,350	831,292	557,417	539,387
Property and improvements	128,242	80,281	126,117	47,158	47,659
Real property rentals and leases	433,910	430,541	436,002	452,494	438,930
Equipment rental and leases	70,734	3,283,405	3,416,216	3,475,958	3,143,991
Lottery prizes	166,709,217	132,259,433	155,959,740	148,365,884	140,468,469
Lottery prizes-merchandise	7,366,001	7,054,490	6,840,850	4,544,343	652,390
Lottery retailer-incentives	175,618	133,223	276,018	207,628	350,466
Lottery retailer incentive - merchandise	181,420	131,518	66,957	24,210	68,477
Agency provided food	10,691	23,006	27,715	20,447	15,590
Miscellaneous expense	82,918	39,516	29,248	58,692	93,246
Refunds	3,483	2,880	5,500	3,960	5,551
Total Expenditures	\$ <u>233,443,139</u>	<u>189,810,020</u>	<u>220,966,169</u>	<u>205,569,633</u>	<u>187,404,069</u>

Missouri State Lottery Commission
 (An Enterprise Fund of the State of Missouri)
Statements of Net Position As of June 30, 2016 and 2015

	2016	2015
Current Assets		
Cash and cash equivalents	\$ 36,047,572	30,710,830
Investments held for grand-prize winners	3,929,370	5,132,384
Accounts receivable, net of allowances for returns	45,624,621	45,717,505
Other assets	413,885	245,638
Total current assets	<u>86,015,448</u>	<u>81,806,357</u>
Noncurrent Assets		
Capital assets		
Capital assets not being depreciated	352,973	352,973
Capital assets being depreciated	14,449,992	15,488,205
Accumulated depreciation	<u>(11,867,423)</u>	<u>(13,477,869)</u>
	2,935,542	2,363,309
Investments held for grand-prize winners	<u>35,461,889</u>	<u>36,376,785</u>
Total noncurrent assets	<u>38,397,431</u>	<u>38,740,094</u>
Total assets	<u>124,412,879</u>	<u>120,546,451</u>
Deferred Outflows		
Deferred Outflows - Contributions made subsequent to measurement date	1,154,280	1,137,217
Deferred Outflows - Difference between expected and actual experience	20,766	31,882
Deferred Outflows - Net difference between projected and actual investment earnings on pension plan investments	<u>853,528</u>	<u>0</u>
Total deferred outflows	<u>2,028,574</u>	<u>1,169,099</u>
Current Liabilities		
Accounts payable	575,165	178,088
Due to Lottery Proceeds Fund	7,757,178	14,840,424
Accrued prize liabilities	68,465,425	57,812,017
Grand-prize winner liabilities	3,936,000	5,136,000
Other accrued liabilities	<u>5,601,052</u>	<u>4,552,112</u>
Total current liabilities	<u>86,334,820</u>	<u>82,518,641</u>
Long-term Liabilities		
Due to Lottery Proceeds Fund	2,695,321	2,022,702
Grand-prize winner liabilities	29,351,004	31,785,624
Net Pension Liability	<u>11,183,713</u>	<u>8,249,598</u>
Total long-term liabilities	<u>43,230,038</u>	<u>42,057,924</u>
Total liabilities	<u>129,564,858</u>	<u>124,576,565</u>
Deferred Inflows		
Deferred Inflows - Difference between projected and actual investment earnings	0	2,385,663
Deferred Inflows - Difference between expected and actual experience	71,914	0
Deferred Inflows - Change in proportion and difference between employee contributions	18,642	0
Deferred Inflows - Changes in assumptions	<u>147,946</u>	<u>0</u>
Total deferred inflows	<u>238,502</u>	<u>2,385,663</u>
Net Position		
Investment in capital assets	2,935,542	2,363,309
Unrestricted	(12,401,704)	(12,197,533)
Restricted for the unrealized gain/loss on investments held for grand-prize winners	<u>6,104,255</u>	<u>4,587,546</u>
Total net position	<u>\$ (3,361,907)</u>	<u>(5,246,678)</u>

Source: Excerpt from the Missouri State Lottery Commission's audited financial statements.

Appendix D

Missouri State Lottery Commission
(An Enterprise Fund of the State of Missouri)
Statements of Revenues, Expenses and Changes In Net Position
For The Years Ended June 30, 2016 and 2015

	2016	2015
Operating Revenues		
Scratchers ticket sales	\$ 835,592,355	743,764,015
Draw Game ticket sales	408,553,199	353,699,652
Pull-Tab ticket sales	71,479,292	29,891,139
Total sales	1,315,624,846	1,127,354,806
Other	203,982	460,531
Total operating revenues	1,315,828,828	1,127,815,337
Operating Expenses		
Scratchers prizes	594,577,964	524,877,348
Draw Game prizes	230,056,120	203,725,703
Pull-Tab prizes	64,227,082	26,825,850
Scratchers retailer commissions and incentives	53,207,871	47,426,846
Draw Game retailer commissions and incentives	23,343,290	20,342,488
Pull-Tab retailer commissions and incentives	1,450,220	630,208
Cost of tickets sold	23,705,430	16,163,284
Depreciation	968,354	1,115,148
Advertising	15,998,981	12,024,546
Wages and benefits	10,008,155	9,525,438
Other general and administrative	7,475,486	10,821,677
Total operating expenses	1,025,018,953	873,478,536
Operating income	290,809,875	254,336,801
Nonoperating Revenues (Expenses)		
Interest income	104,369	77,934
Unclaimed prizes	12,023,258	16,788,784
Gain on sale of capital assets	13,335	49,465
Net increase (decrease) in the fair value of investments held for grand-prize winners	3,018,090	1,342,321
Amortization of grand-prize winner liability	(1,501,380)	(1,644,196)
Transfers to State of Missouri Lottery Proceeds Fund	(302,582,776)	(271,252,985)
Total nonoperating revenues (expenses)	(288,925,104)	(254,638,677)
Changes in net position	1,884,771	(301,876)
Total Net Position, Beginning of Year	(5,246,678)	(4,944,802)
Total Net Position, End of Year	\$ (3,361,907)	(5,246,678)

Source: Excerpt from the Missouri State Lottery Commission's audited financial statements.

Appendix E

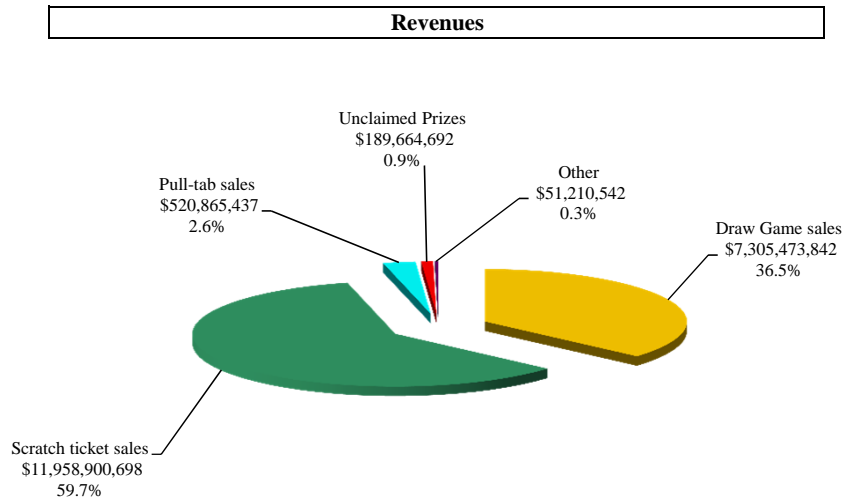
Missouri State Lottery Commission
(An Enterprise Fund of the State of Missouri)
Statements of Cash Flows
For The Years Ended June 30, 2016 and 2015

	2016	2015
Cash Flows From Operating Activities		
Cash received from retailers and others	\$ 1,316,530,385	1,128,680,684
Cash paid for prizes	(871,320,499)	(740,783,809)
Cash paid for retailer commissions	(77,628,337)	(68,475,111)
Cash paid for employee services	(10,069,063)	(9,893,227)
Cash paid for other expenses	(46,895,459)	(39,060,817)
Net cash provided by operating activities	<u>310,617,027</u>	<u>270,467,720</u>
Cash Flows From Noncapital Financing Activities		
Transfers to State of Missouri	<u>(308,993,402)</u>	<u>(270,701,018)</u>
Cash Flows From Capital and Related Financing Activities		
Purchases of capital assets	(1,546,803)	(619,358)
Proceeds from sale of capital assets	19,551	50,110
Net cash used for capital and related financing activities	<u>(1,527,252)</u>	<u>(569,248)</u>
Cash Flows From Investing Activities		
Proceeds from maturity of investments	5,136,000	5,252,000
Interest received	104,369	77,934
Net cash provided by investing activities	<u>5,240,369</u>	<u>5,329,934</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>5,336,742</u>	<u>4,527,388</u>
Cash and Cash Equivalents, Beginning of Year	<u>30,710,830</u>	<u>26,183,442</u>
Cash and Cash Equivalents, End of Year	<u><u>36,047,572</u></u>	<u><u>30,710,830</u></u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	290,809,875	254,336,801
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	968,354	1,115,148
Noncash pension expense adjustment	(72,521)	(368,063)
Unclaimed prizes	12,023,258	16,788,784
Payments to grand-prize winners	(5,136,000)	(5,252,000)
Changes in operating assets and liabilities:		
Decrease in accounts receivable, net	92,884	668,044
(Increase) decrease in other receivables	(55,212)	113,842
(Increase) in prepaid expenses	(113,036)	(19,005)
Increase (decrease) in accounts payable and other accrued liabilities	1,446,017	(24,138)
Increase in accrued prize liabilities	10,653,408	3,108,307
Net cash provided by operating activities	<u><u>310,617,027</u></u>	<u><u>270,467,720</u></u>
Noncash Activities		
Net increase in the fair value of investments held for grand-prize winners	3,018,090	1,342,321
Amortization of grand-prize winner liability	\$ 1,501,380	1,644,196

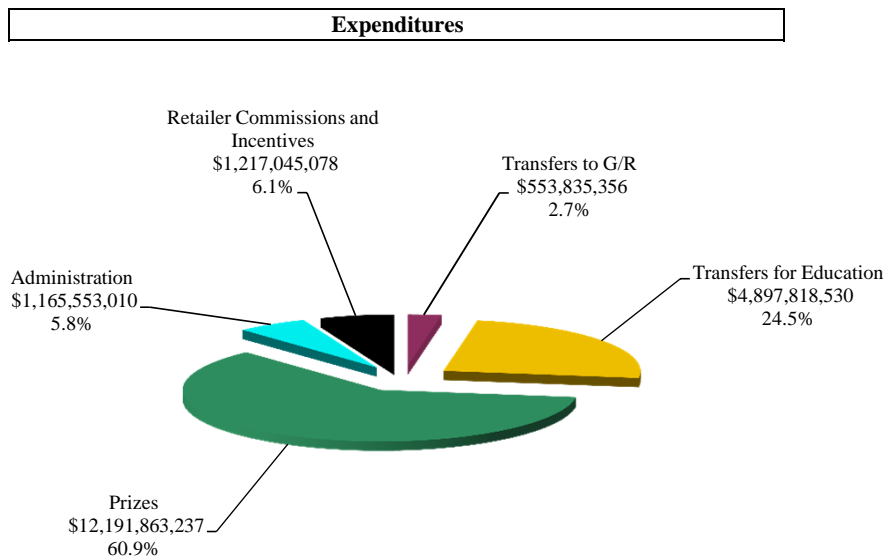
Source: Excerpt from the Missouri State Lottery Commission's audited financial statements.

Appendix F

Missouri State Lottery Commission
Revenue and Expenditure Charts
January 20, 1986 Through June 30, 2016



Total Revenues: \$20,026,115,211

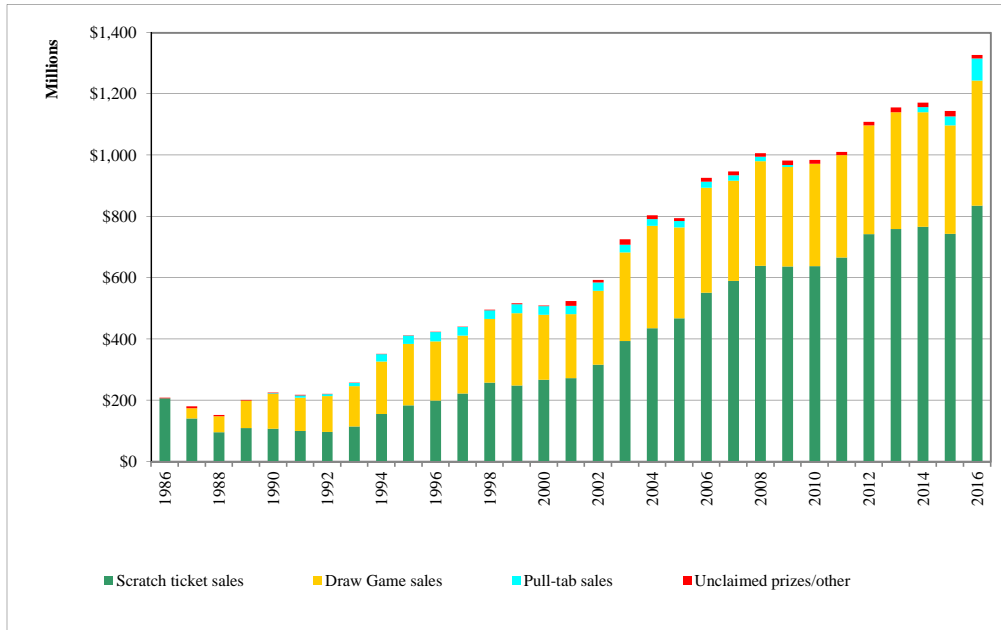


Total Expenditures: \$20,026,115,211

Appendix G

Missouri State Lottery Commission Revenue and Expenditure Charts January 20, 1986 Through June 30, 2016

Revenues



Expenditures

